

# HOUSES OF THE OIREACHTAS

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

### JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

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*Dé Céadaoin, 15 Iúil 2015*

*Wednesday, 15 July 2015*

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The Committee met at 9.30 a.m.

#### MEMBERS PRESENT:

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

DEPUTY CIARÁN LYNCH IN THE CHAIR.

Okay, is that agreed? Agreed. Okay.

*Sitting suspended at 3.12 p.m. and resumed in private session at 4.10 p.m. Sitting suspended at 5.28 p.m. and resumed in public session at 5.46 p.m.*

### **Department of the Taoiseach - Mr. Dermot McCarthy**

**Chairman:** So we now commence our next public hearing with Mr. Dermot McCarthy, former general ... Secretary General, Department of the Taoiseach, and Secretary General to the Government. The Committee of Inquiry into the Banking Crisis is 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? The ... as ... at our session now this evening, we will commence ... or hear from Mr. Dermot McCarthy, former Secretary General at the Department of the Taoiseach and Secretary General to the Government. Dermot McCarthy served in the Department of Industry and Commerce and at the Department of Health, where he rose to the level of assistant secretary general. He was appointed as Secretary to the Government in January 2000 and combined that role with Secretary General at the Department of the Taoiseach in July 2001. He retired in June 2011. Mr. McCarthy, you are very welcome before the committee today.

Before hearing from the witness, I wish to advise the witness that by virtue of section 17(2) (I) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect to their evidence to this committee. If you are directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to so do, you are entitled thereafter only to a qualified privilege in respect of your evidence. You are directed that only evidence connected with the subject matter of these proceedings is to be given. And I would remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry which overlap with the subject matter of the inquiry. The utmost caution should be taken not to prejudice those proceedings. Members of the public are reminded that photography is prohibited in the committee room. To assist the smooth running of the inquiry, we will display certain documents on the screens here in the committee room. For those sitting in the Gallery, these documents will be displayed on the screens to your left and right. And members of the public and journalists are reminded that these are documents and that they are confidential and should not publish any of the documents so displayed.

The witness has been directed to attend this meeting of the Joint Committee of Inquiry into the Banking Crisis. You have been furnished with booklets of core documents. These are before the committee, will be relied upon in questioning and form part of the evidence of the inquiry. So if I can now ask the clerk to administer the oath to Mr. McCarthy please.

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

Mr. Dermot McCarthy, former Secretary General, Department of the Taoiseach, and former Secretary General to the Government.

**Chairman:** Okay, once again, thank you, Mr. McCarthy, and if I can invite you to make your opening statement please.

**Mr. Dermot McCarthy:** Thank you, Chairman. The scale and impact of events which are the subject of this inquiry are such that the work of this committee constitutes an important public service. I wish to support fully the committee in its work by answering your questions

and by furnishing, as I have, a statement regarding 15 lines of inquiry before the committee. I will seek in my answers this evening to assist the committee as much as I can, as I sought to do in my statement, by setting out matters within my direct knowledge as Secretary General to the Government within the constraints of Cabinet confidentiality and acknowledging that many were matters in respect of which I didn't have expertise or responsibility. I will summarise my statement under six headings. In my statement, I indicated that I believed the conclusions of the Nyberg commission of investigation provided a broadly convincing account of the circumstances that led to the crisis. Nyberg describes serious failings by a wide range of actors, including a number of key elements of the public service. He notes that, "Each one is [...] responsible for their own actions and inactions contributing to the accumulation and realisation of risks in financial markets". Everyone who was in a senior position in the public service over the relevant period, including myself, is burdened by these failings, and the deep awareness of their human consequences. With the knowledge and analysis of that period which is now available, like others I am challenged by the question of whether I could have done more to avert the damaging outcomes from the crisis. My regret is tempered only by the belief that I have performed my duties to the best of my ability.

On the regulatory regime, following consideration of the report of an implementation group, the Government approved a proposal to establish a single Financial Regulator within a restructured Central Bank. The proposed arrangements were altered following consultation with the ECB. The Government reviewed the provision for a separate board structure for the Financial Regulator as an important focus for accountability and responsiveness to public and consumer concerns. Following publication of the proposed legislation in 2002, further comments were received from the ECB, as a result of which the Governor's role in relation to the budget and staffing of the regulator was strengthened. The ECB also welcomed the fact that the Financial Regulator would remain a constituent part of the Central Bank.

The annual reports of the Central Bank and the Financial Regulator were submitted for information to the Government. These recorded the significant number of inspections of financial institutions carried out, and regulatory returns examined. The report in respect of 2006 highlighted that international independent reviews of the Financial Regulator's performance contain positive assessments of the regulatory system in Ireland. In its report of 2007, the IMF supported as appropriate the risk-based framework operated by the Financial Regulator in prioritising supervisory resources. The Government decided in 2009 to create a new, integrated regulatory system under the direction of the Governor. The Government was advised that, pending the enactment of new legislation, the boards of the Central Bank and the Financial Regulator had made changes to the operation of the existing legislative framework through improved linkages between banking supervision and financial stability.

On fiscal policy, the budgetary cycle involved the Minister for Finance setting out the broad economic framework within which budgetary decisions should be shaped. This provided a context for the engagement by the Department of Finance with individual Departments to settle their spending Estimates. The Department of Finance's proposals were based on securing financial stability and the productive capacity of the economy, while avoiding inflationary pressures and addressing priority needs. The Department pointed out the potential for reverses, both domestic and international, associated with declining competitiveness, exchange rate movements, increases in commodity prices and the possibility of a downturn in construction activity. The Department recommended the maintenance of a cyclically-adjusted positive general Government balance and containing the growth in current expenditure to the nominal rate of economic growth. From 2003 to 2006, the stability programme reports presented to the Government

identified a gradual and orderly reduction in housing output to a more sustainable level as a significant factor likely to impact on economic performance, partially offset by growth in other components of investment expenditure. In the report for 2006, the potential for economy-wide consequences of construction-specific developments, such as rising interest rates, was noted. The moderation in prices and activity in the property market in 2007 was highlighted. The absence of a sense of impending crisis was reflected by an assessment by the IMF in 2007, which noted that the banking system was well-capitalised and profitable and that stress tests by the Central Bank indicated that even in an extreme scenario, the major lenders had adequate buffers to cover a range of shocks. Economic policy was not formulated by Government in the belief that there was a serious risk to financial sector stability.

The framing of budgetary proposals in Government discussions had regard to the terms of the relevant programme for Government and specific objectives adopted by the Government. The substantial reduction in the debt-to-GNP ratio, substantial budget surpluses, significant annual transfers to the National Pensions Reserve Fund and an ambitious programme of investment in infrastructure to increase productive capacity, with little or no recourse to borrowing, created a sense of confidence with regard to fiscal matters. There wasn't a single view about the conduct of policy or the outlook for the economy. There was of course awareness of contrarian views occasionally expressed in the media regarding the risks of an economic collapse. It was widely considered that this was improbable, while vulnerabilities were nonetheless acknowledged to exist.

Most decision-making requires judging the probabilities of events occurring while striking a balance between competing objectives in the context of Government policy. Collective responsibility requires members of the Government to support decisions once taken. The legitimate exercise of its democratic authority by the Government must be respected by officials. For example, the Department of Finance in its budgetary submissions signalled a preference for a lower rate of expenditure increase than occurred in a number of years. In the years leading up to the crisis the direction of Government policy was not significantly altered in the light of parliamentary scrutiny.

On banking matters, the primary relationship between the banking sector and the Government was through the Minister for Finance and the Department. The banking industry was represented by the Irish Bankers Federation and Financial Services Ireland on general policy matters such as the development of the national payment system. From the establishment of the IFSC, the Department of the Taoiseach chaired the Clearing House Group whose members included representatives from the Departments of Finance and Enterprise and Employment, the Revenue Commissioners, the Financial Regulator, the IDA and, later, Enterprise Ireland.

The Clearing House Group and a range of associated working groups provided a forum for exchange of information and suggestions between different categories of participant in the sector. As its name implies, the group was primarily a vehicle for commercial intelligence gathering in the context of the competition between jurisdictions for investment. The focus of the group was the identification of opportunities and a variety of specialist activities, the marketing of Ireland and the tackling of barriers to growth, such as availability of skilled personnel. The operation of a credible regulatory system was seen as critically important in securing the reputation of the industry and attracting appropriate new entrants. Discussion at the Clearing House Group covered a broad range of public policy. Concerns voiced at times about proposals which were seen as disproportionate, by reference to international practice, were pursued bilaterally with the relevant agency. In published strategies for the future of the sector, industry

representatives expressed their support for a regulatory system which was effective, consistent and efficient.

Turning to the bank guarantee, in the period leading up to 29 September 2008 the Government was briefed on liquidity difficulties in the Irish banking system by the Minister for Finance and increased the deposit guarantee to €100,000 on 20 September. On the evening of Monday, 29 September a meeting attended by the Taoiseach, Minister for Finance and the Attorney General was advised that, unless measures were taken before the financial markets opened on Tuesday morning, irreversible damage could be done to the economy through a banking collapse. The expectation that no Government would allow a bank to fail, especially in the aftermath of the Lehmans example, was reinforced by the potential consequences outlined to the meeting. It was made clear that no European or ECB initiative was in prospect which would address the immediate crisis faced by Ireland. The advice was that the Government had one opportunity to make a decisive intervention, to stabilise liquidity and secure the Irish banking system. It would have no certainty of success but the alternative was certain disaster.

A request to meet from the chairs and chief executives of AIB and Bank of Ireland was agreed. The banks' representatives confirmed the gravity of the funding situation for the Irish banks, with difficulty in getting even short-term funding from the money markets. The negative sentiment towards Ireland was focused on particular institutions, but all were now impacted. They argued that effective action was necessary to reassure the markets. The Taoiseach and the Minister resolved that a broad guarantee would be recommended to the Government. The option of nationalisation of Anglo was considered, but it was concluded that such action could have more negative than positive effects on market confidence. It was also understood that a decision to nationalise Anglo could be taken at a later date, should it be appropriate.

The guarantee would be offered on commercial terms and would provide a framework for any measures required to build market confidence in the Irish banking system. The approval of the Government was given by an incorporeal meeting which was conducted in the early hours of Tuesday, 30 September. A particular concern was that the guarantee might be challenged on European state aid grounds. It was agreed that a formal notification to the European Commission would be made immediately. A full supporting case, including all of the material considered in the discussion, would be detailed in a submission at the earliest opportunity. The European Commission subsequently approved the decision as an appropriate means to remedy a serious disturbance in the Irish economy.

On the programme of assistance, in response to international concerns by mid-2010 about the State's financial position, the Government began the preparation of a medium-term expenditure framework in tandem with the fiscal responsibility framework. It was considered that public confirmations for a recovery plan of the adoption of a comprehensive programme of fiscal reforms and specific measures to achieve the necessary deficit reduction by 2014 would improve market sentiment towards Ireland. The continuing dependence of the Irish banks on ECB liquidity support was evident, as was a market view that further recapitalisation would be necessary. The ECB Council conveyed to the Minister for Finance that the Government should apply for European financial support. Department of Finance officials travelled to Brussels for exploratory discussions on the parameters of a possible programme of assistance if the Government were to decide to apply. The tentative nature of these discussions reflected the Government's concern that the conditionality of any such programme could include unacceptable terms such as changes to the Irish corporation tax regime. On 19 November the President of the ECB wrote to the Taoiseach and to the Minister for Finance stating that ELA could only

be continued if Ireland applied to the Eurogroup for financial support and proceeded with a decisive restructuring and adequate recapitalisation of the Irish banks. The Minister, in consultation with the Governor and the CEO of the NTMA, sought the approval of the Government for a formal request for external assistance, given that the Government could not borrow in the market at current rates and the serious liquidity problems in the Irish banks. Some days later, the national recovery plan was published by the Government - the programme of external assistance was formally announced on 28 November. Imposing haircuts on unguaranteed senior bondholders was raised with the international institutions during discussions on the programme of assistance. The concept was strongly resisted because of their concern about its potential impact on wider financial stability. In March 2011 the agreement of the ECB was sought but declined for the announcement by the Government of a statement of intent to impose burden-sharing on unguaranteed senior bondholders in Irish banking institutions in wind-down.

On changes since the crisis, with regard to the conduct of economic policy the establishment of the Fiscal Advisory Council and the oversight by the European institutions as part of the European semester have brought a greater transparency to Irish fiscal policy. Policy analysis is supported by greater economic expertise within the public service. The national risk assessment framework is a positive development and the legislation to provide for the registration of lobbyists and lobbying activity should also assist in the monitoring of efforts to influence public policy. It is clear, however, that irrespective of any structural or capacity developments that may be implemented, Governments will still be faced with a need to exercise judgment in setting fiscal policy and in assessing the risk to be taken into account in framing budgetary decisions. That concludes my opening statement Chairman and I am happy to answer the committee's questions.

**Chairman:** Thank you very much Mr. McCarthy. If we can begin our questions this afternoon and I will invite Deputy Eoghan Murphy to commence them. Deputy, you have 25 minutes.

**Deputy Eoghan Murphy:** Thank you Chairman and thank you Mr. McCarthy, you are very welcome. In your opening statement on page 11, you state that:

Collective responsibility requires members of the Government to support decisions once taken. The legitimate exercise of its democratic authority by the Government must be respected by officials.

You were Secretary to the Government and Secretary General of the Department of the Taoiseach from 2000 to 2011, so you were at the top of the Civil Service for three different Governments and three different Taoisigh. So in that role, if you could just clarify, can you overrule a Taoiseach or Government or act against a Government's wishes?

**Mr. Dermot McCarthy:** In short, no Deputy. I think there are certain circumstances when one would, like any public official, be required to decline to comply with a direction if it was perceived to be unlawful and there are certain circumstances in relation to the expenditure of resources when one would be entitled to seek a written direction to be copied to the C and AG. But in general terms, overruling Taoiseach or Minister would not arise, I think.

**Deputy Eoghan Murphy:** Did you ever seek such a written direction in relation to the use of financial resources?

**Mr. Dermot McCarthy:** I never had that requirement.

**Deputy Eoghan Murphy:** Okay. And you provide the Taoiseach and the Government with advice. Is it safe to assume that you are across the same information as the Taoiseach is across?

**Mr. Dermot McCarthy:** Not necessarily Deputy. I think in the formulation of policy and the furnishing of advice, the Department of the Taoiseach, through myself, would have provided a core element of information and advice, primarily in relation to the conduct of Government business, in other words, preparation for Cabinet and the management of Cabinet committees and then the particular responsibilities that the Taoiseach would discharge personally. But the Taoiseach would also be in possession of advice from other sources, including his political advisers, his ministerial colleagues outside the Cabinet framework and obviously from other, more direct personal engagements.

**Deputy Eoghan Murphy:** The information coming to the Taoiseach through the apparatus of the Civil Service or the Departments, you would be across the same information coming through that stream?

**Mr. Dermot McCarthy:** In general, but not always.

**Deputy Eoghan Murphy:** Okay. And do you have any role in the formulation of policy?

**Mr. Dermot McCarthy:** Well, there's some aspects of policy where the Taoiseach has a direct personal role, in addition to being the chair of Government, and in those areas, for example, in relation to the conduct of international relations at head of Government level, or the conduct of the social partnership process, when that was under his aegis, then one would be making a direct contribution and giving direct advice. In other areas, it would be largely a matter of co-ordinating material coming from other sources. The Department of the Taoiseach isn't an analytical Department. It doesn't have an extensive policy analysis function. It primarily acts to ensure that information from other Departments and agencies is available and presented in the appropriate way.

**Deputy Eoghan Murphy:** And do you advise on matters of judgment?

**Mr. Dermot McCarthy:** One ... at times. More in relation to process; in other words, where an item is ripe for decision or where further engagement would be desirable.

**Deputy Eoghan Murphy:** And your ultimate responsibility is to whom? As the head of the Civil Service, who's your ultimate responsibility to?

**Mr. Dermot McCarthy:** I wasn't the head of the Civil Service.

**Deputy Eoghan Murphy:** Sorry, well, as Secretary to the Government and Secretary General to the Department of the Taoiseach, who were you responsible to?

**Mr. Dermot McCarthy:** To the Taoiseach.

**Deputy Eoghan Murphy:** To the Taoiseach?

**Mr. Dermot McCarthy:** Yes.

**Deputy Eoghan Murphy:** Okay. And when we talk about the responsibility of Government, can we distinguish between the permanent government and the elected Government?

**Mr. Dermot McCarthy:** Well, the permanent government in the sense of officials in the Civil Service-----

**Deputy Eoghan Murphy:** Yes.

**Mr. Dermot McCarthy:** -----then there's a very clear distinction. They are there to serve the Government of the day, which has the democratic mandate to make decisions. The role of the Civil Service is to advise, support and implement. I think it is very conscious that is its subordinate role in terms of governance.

**Deputy Eoghan Murphy:** So, when we talk about the responsibility of Government, we're talking about the responsibility of the elected Government?

**Mr. Dermot McCarthy:** Yes.

**Deputy Eoghan Murphy:** Okay. On the first page of your opening statement, you say and you stated again, "The conclusions of the Nyberg [report] give a broadly convincing account of the circumstances which led to the crisis." And, on page 7 of the Nyberg report, it says, "The Government actively supported the market over an extended period against the apparently fairly weak but clear opposition of the Department of Finance." Do you agree with this statement from Nyberg?

**Mr. Dermot McCarthy:** I think that's true, particularly in respect of the end of the '90s and the early years of the 2000s.

**Deputy Eoghan Murphy:** Were you aware of this opposition at the time?

**Mr. Dermot McCarthy:** It was expressed, both in terms of formal submissions to the Government from the Department of Finance and the informal discussions that would take place.

**Deputy Eoghan Murphy:** So you were?

**Mr. Dermot McCarthy:** Yes.

**Deputy Eoghan Murphy:** Okay. In every year, bar one, from 2000 to 2008, the budget package agreed by Government was greater than what the Department of Finance was recommending, and were you satisfied with this outcome to the budgetary process in each of those years?

**Mr. Dermot McCarthy:** It wasn't a matter for me, Deputy, to be satisfied. I was there to ensure that the decisions were properly taken and recorded and implemented. In terms of the reasons for that outcome, I think, in terms of the analysis in the Wright report, the factors are well set out as to why that would be, including the belief that the opening position from the Department was that: an opening position.

**Deputy Eoghan Murphy:** Well, did you ever advise or caution against the increases that were being decided upon by Government versus what the Department of Finance was recommending?

**Mr. Dermot McCarthy:** I will certainly have advised about the issues that they felt strongly should be taken into account.

**Deputy Eoghan Murphy:** Advising in support of those, of taking into account those issues, or-----

**Mr. Dermot McCarthy:** That they should be certainly taken into account.



**Deputy Eoghan Murphy:** Okay. But then they weren't taken into account, is that correct?

**Mr. Dermot McCarthy:** Well, I think, Deputy, one would have to say they were taken into account but a judgment was made in the round as to what the appropriate outcome should be-----

**Deputy Eoghan Murphy:** Okay.

**Mr. Dermot McCarthy:** -----and that was the prerogative of the Government.

**Deputy Eoghan Murphy:** Okay. Were you ever concerned that irresponsible budgetary decisions were being taken because of a looming election?

**Mr. Dermot McCarthy:** I think one would have to be conscious that the timing of an election was in the minds of members of the Government. I don't believe that one would necessarily conclude that the decisions specifically were irresponsible.

**Deputy Eoghan Murphy:** Okay. How do you explain the reversal in spending in 2002, following the general election? So, at the beginning of the year, for the first six months, spending was 22% higher, year-on-year, but, by the end of the year, it was only 14% higher and, after the election, a memo was sent by the then Minister for Finance to the Departments requesting that they cut back on expenditure.

**Mr. Dermot McCarthy:** From memory, Deputy, I believe there was also a change in broad economic conditions at that time, including, if I recall, exchange rate movements, which would have had a bearing on the performance of the economy, so I'm not sure it would be safe to conclude that any change was purely a function of the electoral outcome.

**Deputy Eoghan Murphy:** Okay. How do you explain the increase in spending in the budget for 2008, given that tax receipts in 2007 were short by €2 billion?

**Mr. Dermot McCarthy:** Well, as I recall, the advice that came in respect of the outlook for economic growth was that it would still be significant, somewhat below full potential because of the expected decline in construction sector, but it was still, if I remember correctly, targeting a modest outcome in terms of the government balance.

**Deputy Eoghan Murphy:** Okay. I think revenues contracted another 14% in 2008, and all of the spending increases for 2008 were reversed in the budget for 2009.

**Mr. Dermot McCarthy:** That's certainly true, but through the course of 2008, the pace of decline in tax revenue, in particular, was very rapid and striking and the forecast in, as I recall, May, was less than half of the assessment provided to the Government in September.

**Deputy Eoghan Murphy:** So given the €2 billion shortfall in 2007, this continuing shortfall in tax revenues wasn't anticipated into 2008 in drafting the budget?

**Mr. Dermot McCarthy:** I don't believe it was.

**Deputy Eoghan Murphy:** Okay. Were you ever concerned that the Government was not using fiscal policy appropriately to manage the economy following the adoption of the euro?

**Mr. Dermot McCarthy:** I think that there was a concern about the need to ensure that the fiscal policy was appropriate, given the impact of the adoption of the euro, and that there should be, on a cyclically adjusted basis, a degree of headroom to provide for any reversal that might

arise. The amount of that headroom as recommended in the June or July annual submissions by the Department of Finance was pretty modest and in most years was, in fact, achieved. So one would, perhaps, assess, in retrospect, that the degree of countervailing force, if you like, to be provided by fiscal policy wasn't sufficiently understood.

**Deputy Eoghan Murphy:** Okay. What was your response to the European Council censure in February 2001 which said that they had "repeatedly urged the Irish authorities to ensure economic stability by means of fiscal policy, and it regretted that this advice was not reflected in the budget for 2001 despite developments in 2000 indicating an increasing extent of overheating"?

**Mr. Dermot McCarthy:** I think there were two strands of reaction to that Deputy. On the one hand there was, I think, acceptance that there was a case to be made in respect of the performance of fiscal policy, but there was also a sense of dissatisfaction that the terms of the censure was not either proportionate or equitable having regard to the performance of other member states.

**Deputy Eoghan Murphy:** Let's leave that part of it aside for a moment. But the actual concern it was expressing about the management of fiscal policy. Brian Cowen said in his appearance before the committee - and this is using fiscal policy to counter for economic stability given that we didn't have monetary policy in our control anymore: "Such conditions do not appear to have received adequate attention over the period 2000 to 2006." Do you agree with that?

**Mr. Dermot McCarthy:** I think in the light of circumstances as they evolved, yes. But I think it's important to say that, as I understand it, the estimate or calculation of the cyclically adjusted balance, certainly in advance, in respect of the Irish economy, is not an easy task. And in the core documents provided, there's reference to the extent of the recalculation by the IMF over the period of the seven months as to what the actual cyclical balance had been, in retrospect, never mind in prospect.

**Deputy Eoghan Murphy:** But if we accept what Brian Cowen said to the inquiry, does that mean that the European Council censure in February 2001 was not given sufficient attention?

**Mr. Dermot McCarthy:** I think it was given attention in the sense that the formulation of budgetary strategy as recommended to Government by Finance did emphasise the importance of securing fiscal sustainability, having regard to the risk that were in prospect, so I think it was acknowledged but, perhaps, not sufficiently.

**Deputy Eoghan Murphy:** And yet, despite this, Mr. Wright concluded that Ireland failed the test of prudent fiscal management. Do you agree with that?

**Mr. Dermot McCarthy:** Yes.

**Deputy Eoghan Murphy:** Did you ever feel that the budgetary process was overwhelmed by the programme for Government or the social partnership process?

**Mr. Dermot McCarthy:** Mr. Wright made that observation or reached that conclusion in a particular context which was that the process was overwhelmed. In other words, that the way in which the budget was formulated, progressed, debated and adopted didn't allow sufficient time for all of the relevant factors to be taken into account and the pressure for expenditure arising from the programme for Government and the pay terms which were established in the public

service through social partnership weren't sufficiently tested. And, in that respect, I think he's probably right.

**Deputy Eoghan Murphy:** Okay. You were a member of the McDowell group on the establishment of a single regulatory authority for the financial services sector. Why was your proposal for the new structure, the one that was favoured by Government ... Charlie McCreevy called it the McCarthy compromise?

**Mr. Dermot McCarthy:** So I noticed. I can't say why it was favoured by Government but I suspect it might have been for the reasons that it seemed to me to be a possible way forward, as a member of the committee. I should say that I was representing the Department nominally because the Department had an IFSC responsibility. At that time, I had no involvement with the IFSC, so mine was a watching brief. And in the discussion, it seemed to me that the desire to have a focus for accountability and engagement through a board, a statutory board, which would be accountable to the Oireachtas, was important but the ... equally, it was important to have a clear, direct oversight from a financial stability point of view from the Central Bank functions. And, therefore, it seemed to me that a process which had a focus for accountability and operational autonomy but overseen by a stability framework made sense, and I suspect it did to the members of the Government as well.

**Deputy Eoghan Murphy:** Did the alterations requested by the ECB, did they have a material impact on the quality of our regulation?

**Mr. Dermot McCarthy:** Arguably, they improved it from the point of view of ensuring that there was, at least, the potential for financial stability to provide the guiding framework for the operation of supervision and regulation.

**Deputy Eoghan Murphy:** Okay. In October 2009, in an interview in the *Financial Times*, Bertie Ahern was reported as stating that the decision to create a new Financial Regulator was one of the main reasons for the collapse of the Irish banking sector. Do you agree with this?

**Mr. Dermot McCarthy:** No.

**Deputy Eoghan Murphy:** Do you take responsibility for the regulation ... the model of regulation that was adopted?

**Mr. Dermot McCarthy:** No.

**Deputy Eoghan Murphy:** Okay. If we could move forward then, please, to 2008, into the crisis period and, actually, if we can go to the evidence book, Vol. 2, page 15. This is ... it'll appear on your screen if you don't have the book in front of you. This is bullet points for Cabinet on 28 September 2008. You see it in front of you there on the screen.

**Mr. Dermot McCarthy:** Yes.

**Chairman:** Yes, it's fine. Here we go.

**Deputy Eoghan Murphy:** Thank you. Were the Cabinet aware that a blanket guarantee was a possible option following the meeting of the Cabinet on the Sunday?

**Chairman:** That's a more inclusive blanket guarantee, Deputy, yes?

**Deputy Eoghan Murphy:** That's right, yes.

## NEXUS PHASE

**Mr. Dermot McCarthy:** In answering, Deputy, I have to be conscious of the requirements of Cabinet confidentiality. But I can say very emphatically that there was no decision in respect of any banking matter taken at that meeting.

**Chairman:** We know the decision wasn't made until the Tuesday evening or the Monday evening, but it's the formula or the shape in which the guarantee was taken on, Mr. McCarthy.

**Deputy Eoghan Murphy:** Just to clarify, at no point in those bullet points, while it does use the word "guarantee" ... it's "Legislate to guarantee/take control of more troubled institution(s)." But there's no reference to a system-wide guarantee.

**Mr. Dermot McCarthy:** It's difficult to answer your question adequately, Deputy, without indicating what the Minister said, which I'm not in a position to do.

**Deputy Eoghan Murphy:** Okay.

**Mr. Dermot McCarthy:** But what I can say is that the meeting which was, obviously, about another matter, budgetary preparation, was briefed at ... towards its conclusion, by the Minister on the general situation in relation to banking difficulties and the general state of preparations to engage with them.

**Deputy Eoghan Murphy:** Okay.

**Chairman:** Can I just ask what was ... maybe to assist you in answering that, Mr. McCarthy ... is that we completely understand the confines of Cabinet confidentiality and so forth. But in the interim period between the one Cabinet meeting and the other Cabinet meeting, discussions, correspondence, other modalities may have been in play. And in respect of Deputy Murphy's question with regard to the overall shape of an overall inclusive guarantee, was that in that space at that time?

**Mr. Dermot McCarthy:** To help the committee as much as I can, Chairman, there was no decision and there was no orientation or mandate in respect of an approach arising from that Government meeting.

**Chairman:** Okay. Thank you. Back to yourself.

**Deputy Eoghan Murphy:** Thank you, Chair. Did the Cabinet Ministers know, upon leaving that Sunday Cabinet meeting, that something would be happening the next day?

**Mr. Dermot McCarthy:** Again, stretching helpfulness, I think, to the very limit, no.

**Deputy Eoghan Murphy:** Okay.

**Mr. Dermot McCarthy:** But equally, Deputy, I think it would be fair to say that they wouldn't have been surprised that something did arise.

**Deputy Eoghan Murphy:** Okay. Thank you for that. Let's go then to the meeting on the 29th. Did you know prior to going to the meeting that a decision on Anglo would be taken that night?

**Mr. Dermot McCarthy:** No.

**Deputy Eoghan Murphy:** At what time did you reach the meeting and at what point in the discussions?

**Mr. Dermot McCarthy:** I think I was notified that there would be such a meeting earlier in the afternoon and I arrived at it, I think, some short time before 7 p.m. So I can't say for sure when the meeting started but I suspect 6.15 p.m., 6.30 p.m., something like that.

**Deputy Eoghan Murphy:** At this point had the possibility of a system-wide guarantee been put on the table by anyone?

**Mr. Dermot McCarthy:** Well, obviously I can't say what was said before I entered the room but the discussion was, at that point, certainly dealing with the nature of the problem; in other words, what had happened during the day, the outflow of funds and so on.

**Deputy Eoghan Murphy:** Okay. Brian Cowen was chairing the meeting, we've heard in evidence. What was your role at the meeting?

**Mr. Dermot McCarthy:** Well, my expectation in joining the meeting was that this was a briefing meeting. In other words, in the same spirit as a meeting which I had accompanied the Taoiseach to on the previous Friday, I think, in the Department of Finance. So my expectation was that this was a briefing in anticipation of the scheduled Government meeting the following morning. So my demeanour, if you like, my expectation in arriving was that this would be a matter of hearing a briefing and to prepare what might be put to Government.

**Deputy Eoghan Murphy:** Do you have an official minute or note of the meeting?

**Mr. Dermot McCarthy:** No, other than, obviously, the record of the decision which was my primary responsibility, as it emerged.

**Deputy Eoghan Murphy:** We know that bankers who were in the building on the night drafted contemporaneous notes of their ... what they recall had happened either the next day or in the following days. Did you draft any such note?

**Mr. Dermot McCarthy:** I didn't, Deputy. Perhaps ... just to explain, my primary responsibility as Secretary to the Government was what was the Government's action and what was required of it and, therefore, the conduct of the incorporeal meeting, which ... the minutes of that, obviously, were presented subsequently to Government for signing an adaption as usual. What transpired the following day, of course, was that there was a series of parliamentary engagements where the reasons for the decision were outlined by the Taoiseach and the Minister for Finance and there was extensive briefing and speech material prepared in ... mainly in the Department of Finance for that. It had already been decided the previous night that the notification and submission to the European Commission on the state aid issue would be done immediately and that all of the material which was considered during the course of the night would be reflected in that. And I saw, within hours, material which suggested to me that that process was, indeed, under way and would be comprehensive. So I didn't make a record of my own in regard to the night.

**Deputy Eoghan Murphy:** The meeting happened in the Department of the Taoiseach. Who's responsible for the meeting room, the papers left over on the table, drafts of press statements, drafts of guarantees that might have been present in the room?

**Mr. Dermot McCarthy:** In general, Deputy, where a meeting takes place in that context it's part of the Taoiseach's private office, so his private office staff, as a matter of routine, would take up and generally destroy any documents that would be left behind by those who were at the meeting.

**Deputy Eoghan Murphy:** Did you see any documents being destroyed after the meeting?

**Mr. Dermot McCarthy:** No.

**Deputy Eoghan Murphy:** Do you feel, as the Secretary General to the Taoiseach and the Secretary to the Government, that the Taoiseach was lacking in advice from any quarter during the course of the evening?

**Mr. Dermot McCarthy:** Not lacking in advice, Deputy, he was presented I think with a very stark picture which built on briefings which had been provided over previous days. He had assessments which were based on judgment, in the context of a very fevered international environment, and presented with the necessity to make a rapid decision, which could only be a judgment call, there was no analytical route to the right answer.

**Deputy Eoghan Murphy:** Did you know that officials from the NTMA were outside of the meeting room?

**Mr. Dermot McCarthy:** Not until late in the, in the evening when I learned they were consulted by Kevin Cardiff in relation to some specific aspects of the text of the guarantee.

**Deputy Eoghan Murphy:** You said you thought you were attending a briefing ahead of a Cabinet meeting the next day, and Dr. Michael Somers, when he was before us ... gave the following evidence:

I don't know why, if its true, that the two main Irish banks were prepared to pony up €5 billion each, for whatever period, provided they got a State guarantee, I don't know why that wasn't followed. If that is ... and that ... I've been told that that's what the scene was. Now, how that changed from five or six in the evening to guaranteeing everything that moved by three or four o'clock in the morning, I don't know. And, as I say, I think its a bad idea taking important decisions in the middle of the night.

So, how do we go from the possibility or from possibly guaranteeing €10 million, €10 billion to keep Anglo open until the weekend, to guaranteeing absolutely everything in the Irish banking system?

**Mr. Dermot McCarthy:** Well, in, in terms of the options which were considered, the idea of providing liquidity support for Anglo for a short period, was certainly considered. And it was considered also in the, in the context of the formulation of the guarantee strategy itself, that in other words, there mightn't be an immediate beneficial impact of sufficient scale such that they would still need liquidity support. But it was in the context of the scale of the outflows, which was reported, and very much on the explicit advice of the Governor and the Financial Regulator that in, in taking a step which mightn't be effective, there was a real risk that one would be removing the possibility of taking a second step that would be effective. In other words, there was one shot.

**Deputy Eoghan Murphy:** You, you, you believe that there was only one shot, that you couldn't have just guaranteed the liquidity of Anglo to at least get you through to the next day?

**Mr. Dermot McCarthy:** In, in the light of the advices and the discussion ... I hope that's not me, it is me, my apologies Chairman. I was sure I had ... I will ... indeed, apologies, Chair. I think in light of the advices which were presented and the discussion, there would have been strong concern that if one moved to buy a day or two, that that was money that would be burnt,

in the context of the immediate issue but also that the prospect then of taking effective, decisive action would be diminished. So it wasn't seen as a viable alternative.

**Deputy Eoghan Murphy:** At any point did you advise against an incorporeal Cabinet meeting, and push for a full Cabinet decision in person?

**Mr. Dermot McCarthy:** No.

**Deputy Eoghan Murphy:** Okay. At any point did you advise against the decision itself?

**Mr. Dermot McCarthy:** No, I don't think my advice was actually sought in the final run because, in a sense, this was a situation where the expert opinion of the key statutory authorities was what was relevant. But it seemed to me to be a reasonable decision.

**Deputy Eoghan Murphy:** Okay. Are you satisfied now in hindsight that the expert opinion of the different State authorities was in the room at the time, given that we know that the NTMA was not present?

**Chairman:** Final question now, Deputy.

**Mr. Dermot McCarthy:** Well, I think in, in all of the circumstances, it would have been preferable if the senior personnel from the NTMA were available and present but their views were known and, indeed, voiced in terms of the discussion by Kevin Cardiff in particular.

**Deputy Eoghan Murphy:** But, then from your recollection-----

**Chairman:** Final question now, Deputy.

**Deputy Eoghan Murphy:** From your recollection, what were those views, as expressed by Mr. Cardiff, as to the view of the NTMA on the solvency of Anglo Irish Bank and on the knowledge of the Financial Regulator as to what was happening in the various financial institutions?

**Mr. Dermot McCarthy:** I'm not sure that there was any view conveyed in respect of the solvency of Anglo Irish, but there was certainly an NTMA view that nationalisation would be desirable.

**Deputy Eoghan Murphy:** And in relation to the knowledge of the Financial Regulator and whether or not you could trust the information that they had, if they had all the information that was needed to make that decision?

**Mr. Dermot McCarthy:** I think that the ... I'm not sure that I recall any view in respect of the regulator being expressed either vicariously or directly by NTMA.

**Deputy Eoghan Murphy:** Okay, thank you and just-----

**Chairman:** Okay, right we are moving on. Senator Marc MacSharry.

**Senator Marc MacSharry:** Thanks very much. And thanks very much, Mr. McCarthy, and sorry to have you here so late. Can I ask you, in the lead-up to the decision on the guarantee did you consult with any parties outside your Department such as the Central Bank, the NTMA, members of the IFSC clearing house, on the options that might be available to Government?

**Mr. Dermot McCarthy:** No.

**Senator Marc MacSharry:** In terms of Mr. Trichet, did Minister Lenihan advise you of

any telephone conversations he ever had with Mr. Trichet, in particular regarding the burning of bondholders or burden-sharing? And, if so, can you advise on the contents of any discussions around that?

**Mr. Dermot McCarthy:** So ... not just in respect of the period of the guarantee?

**Senator Marc MacSharry:** Well ... anything that you might think is pertinent, but certainly that.

**Mr. Dermot McCarthy:** Okay, well, I don't recall the Minister saying anything in respect of communication directly from president Trichet on the night of the guarantee, put it that way, but there was a report from the Governor on his conversations with the ECB. Subsequently, particularly in the evolution of the banking strategy and then later again in the run-up to the bailout decision, certainly the Minister would have had a number of conversations with president Trichet, obviously, routinely in the ECOFIN context, and he would frequently have reported those, both formally to Government and more informally.

**Senator Marc MacSharry:** We might talk about the bailout period later but in terms of the guarantee itself, is it your understanding that there were clear communications perhaps, rather than phone calls as you've said? And did they always manifest themselves through the Governor? And thirdly, when the Governor spoke about such issues was it always understood to be the case that if the Governor spoke this was Jean-Claude Trichet's position?

**Mr. Dermot McCarthy:** Well, I think if the Governor was purporting to reflect the view of the ECB, then, clearly, that would have been the case and, certainly, in the course of the meeting on 29 September, he was very explicitly reflecting what he had heard from President Trichet. The Governor, obviously, is a member of the ECB council so would normally be expected to reflect the position of the ECB in any event in terms of ECB functions. But I think the Governor would always have made it clear if he was purporting to represent the view of the president, as such.

**Senator Marc MacSharry:** Kevin Cardiff, in his witness statement, said that the National Recovery Plan 2011-2014 was finalised in time to be the main influence on major parts of the programme of assistance, and that the troika partners were happy to accept the four-year plan that had been developed in Ireland and to build on it. Can you elaborate on the substantive differences, if any, between the troika's position in the negotiations and the provisions within the national recovery plan?

**Mr. Dermot McCarthy:** Well, I suppose the primary difference between the two is that the recovery plan, as published, didn't deal with banking matters in detail. It was primarily a fiscal framework for achieving the 3% deficit by 2014 with a strong set of commitments and messages about growth and jobs strategy, which, of course, were critically important in terms of debt sustainability. So that was the primary difference.

On the fiscal adjustments and the pace of the adjustment to achieve the required deficit, I don't think there were any significant differences, Senator. Obviously, in the memorandum of understanding, some of the content of the national recovery plan was expressed in a more granular way in terms of timescales and deadlines and so on.

**Senator Marc MacSharry:** In your statement, you said that the European Commission and the ECB, excuse me, favoured a front-loading of adjustment within an overall adjustment of at least €15 billion by 2014. Were they specific ... to where, you know, on the fiscal plan - you



said the fiscal plan was the difference, rather, that didn't include the banking side - and were they specific on where there needed to be cuts? Mr. Cowen, when in, in his own evidence in questioning, we asked him and he said that there was flexibility. Was there flexibility or was there... were they prescribing measures or were they just interested in the bottom line?

**Mr. Dermot McCarthy:** Their primary focus, I think, was on the bottom line. In other words, the pace of the adjustment. And there was certainly a view that the initial phase of this multi-annual plan should be as ambitious as possible and there was discussion about figures of €7 billion, €8 billion, €9 billion, as opposed to the €6 billion which was ultimately adopted. On the specific measures, in the course of consultation ... and I think Kevin Cardiff's evidence was correctly specific about this, that the text of the plan wasn't shared with the international institutions, to my knowledge, but there was certainly discussion about issues which might be addressed, some of a general structural kind, obviously the broadening of the tax base as part of the adjustment. They were also, I think, very emphatic about the need for labour market adjustments and, in particular, the reduction in the national minimum wage.

**Senator Marc MacSharry:** Just ... when you said there that the text of the plan wasn't shared with the international institutions, who was it shared with, if it wasn't shared with them? Was that not-----

**Mr. Dermot McCarthy:** Sorry, Senator, just to be clear, the text was in draft being worked on by officials from a number of Departments. Elements of it had been submitted to Government. In fact, I think, perhaps in three instalments, the text was considered formally by the Government. So while that process was under way within the Irish system, the text wasn't shared with the international parties. That happened, I think, in the couple of days coming up to publication, which, from memory, was, I think, 24 November.

**Senator Marc MacSharry:** So as yourselves, in conjunction with the line Ministers, prepared a plan independently, you weren't liaising with anybody of the three institutions who ultimately were the troika, is that the case?

**Mr. Dermot McCarthy:** In parallel with the internal preparations, obviously there were discussions going on which started, I think, in October, as I recall, when the normal consultation with the Commission would be happening as part of the general, I suppose, liaison and oversight arrangements at that time. And that developed then into the precautionary discussions that Kevin referred to on foot of the pressure to engage in a programme of assistance. So during that process, things which would appear ultimately in the recovery plan were certainly being discussed in substance with the Commission and IMF people but they weren't party to the drafting, shall we say.

**Senator Marc MacSharry:** Okay, so just to summarise it - you correct me now if I'm wrong, because I don't want in any way to be seen as being judgmental - you were, kind of, making suggestions through the back channels, that, you know, "Would this work or would that work?", and they were giving their reaction to that. Is that-----

**Mr. Dermot McCarthy:** Well, I think the substantive issues had been flagged in discussion for some time, so I don't think it was a matter of seeing would an item run. It was ... and I have to say, I wasn't party to and the Department of the Taoiseach wasn't party to those engagements-----

**Senator Marc MacSharry:** Sure, yes.

**Mr. Dermot McCarthy:** -----but, as I understand it, if you like, the substantive policy issues were the subject of discussion before they were finalised by Government.

**Senator Marc MacSharry:** And, again - sorry to make you repeat yourself now - you said earlier that the partnership was an issue that they did want to, kind of, visit. And did you say the minimum wage or what was the second one?

**Mr. Dermot McCarthy:** I don't think I mentioned partnership-----

**Senator Marc MacSharry:** Sorry.

**Mr. Dermot McCarthy:** -----but the national minimum wage was certainly an issue that they felt would be an important structural adjustment that would facilitate jobs growth. That was also a view shared in parts of the Irish system, so it wasn't an imposition.

**Senator Marc MacSharry:** Was it a red line issue? Not for the Irish side now, I'm talking about the institutional side - the three institutions.

**Mr. Dermot McCarthy:** I'm not in a position to say, Senator; I rather doubt it.

**Senator Marc MacSharry:** Would you know was it the IMF or the Commission or the ECB that raised this issue? Or were they all three at one on this issue?

**Mr. Dermot McCarthy:** From memory, I think the reporting by colleagues suggested that it was the Commission who were most convinced of the merits of this approach.

**Senator Marc MacSharry:** And was it their position that the minimum wage should be reduced or increased?

**Mr. Dermot McCarthy:** They weren't for increasing it, Senator, no.

**Senator Marc MacSharry:** They were for reducing it then.

**Mr. Dermot McCarthy:** Reducing it, yes.

**Senator Marc MacSharry:** Okay. And did they prescribe how much or do you know?

**Mr. Dermot McCarthy:** I don't believe so but I couldn't say for sure.

**Senator Marc MacSharry:** Okay. Was there a discussion in the Department that may be we could do 50 cent or €1 or €2 or ... what way did that work? Do you know?

**Mr. Dermot McCarthy:** There was a discussion ... there was a cross-departmental/ministerial discussion about, obviously, the emerging text of the national recovery plan, and the pros and cons of that issue were certainly discussed.

**Senator Marc MacSharry:** Okay. Did you feel that the approach by the Commission to reduce the minimum wage was accepted by our side or the Government's side of the day as opposed to our side? Or was it something that was a bone of contention for the negotiators and ultimately the Minister?

**Mr. Dermot McCarthy:** No, I think it was accepted by our side as an appropriate adjustment.

**Senator Marc MacSharry:** Any other issue? I think you mentioned two when you men-

tioned the minimum wage. Was there another issue that was ... that there was?

**Mr. Dermot McCarthy:** Well, there was a related issue which was the system of employment regulation orders and sectoral wage regulation which-----

**Senator Marc MacSharry:** Just explain to people that might be watching. Is that, for example, if electricians worked that they get so much an hour or bakers or ... and so on like that?

**Mr. Dermot McCarthy:** Yes, the system applied to some designated industries or occupations. In the end, what was provided in the recovery plan was that this system would be reviewed as indeed it was subsequently.

**Senator Marc MacSharry:** Okay. And were they prescribing in any way that these should be reduced or-----

**Mr. Dermot McCarthy:** No, I think they were unenthusiastic about such systems of wage regulation. But there was a strong view in the Irish system that that process, generally-----

**Senator Marc MacSharry:** Could be visited?

**Mr. Dermot McCarthy:** -----should be revisited.

**Senator Marc MacSharry:** Okay. Were there any other issues, just to move off this point then, that you felt through colleagues, I know that you weren't directly involved, were being prescribed in some way as "must be included" issues?

**Mr. Dermot McCarthy:** I don't believe so, Senator. I think there was a strong measure of endorsement, indeed, of the broad approach.

**Senator Marc MacSharry:** So, would you agree then that ... would you agree with Mr. Cowen that there was flexibility on the side of the Irish Government as to how, to use my quote from earlier, "the bottom line" was arrived at?

**Mr. Dermot McCarthy:** Well, I think there was ... the overriding priority, Senator, was to have specificity - what was actually going to be done. That was required initially in the drafting to improve market sentiment that Ireland would be able, in fact, to achieve the targeted deficit reduction. As things evolved, it was also necessary to be specific so that the terms of the programme of assistance would be equally clear. So that was the overriding concern. So there was flexibility within that framework but there was also a strong analytical base for choosing the things which were specified in terms of structural change, both on the revenue raising and the expenditure reduction side.

**Senator Marc MacSharry:** Were the ECB active in these negotiations ... this portion of the negotiations or were they more focused on the banking side of things?

**Mr. Dermot McCarthy:** Again, because I wasn't directly involved, Senator, I wouldn't like to mislead you with a guess but I know that they were particularly concerned, obviously, about the banking issues.

**Senator Marc MacSharry:** Okay. In Mr. Trichet's letter of 19 November 2010, he said and I quote, "If you don't do this, your banks will lose access to ECB and even national central bank support with disastrous consequences for your country." Do you have any insights, perhaps, from the Department of Foreign Affairs' colleagues or bank contacts on why this letter

was sent, given that it would appear from evidence, the bailout process had at least formally commenced in the months leading up to November 2010?

**Mr. Dermot McCarthy:** Just to say, Senator, I don't recall the text of the letter being quite in that form but that was certainly the message. I think it's ... it is a puzzle. As you say, the process of, at least, preparatory engagement was well under way and I can only assume that it reflected the sense of anxiety on the part of the ECB about both the extent of their exposure to the Irish banking system, but also the broader euro situation where the fragility, the spreads *vis-à-vis* peripheral member states and so on were creating a very worrying outlook. And I think the need to, in a sense, close off this particular source of instability was probably a very high issue of concern. I've no greater insight than that.

**Senator Marc MacSharry:** Just for the record, Chair, I have quoted verbatim from the committee document as opposed to ... I haven't paraphrased in any way. So if it's incorrect, it's incorrect here from me. So, then when we got the banking side of the bailout or of the agreement, was there ... whereas the Commission had been prescriptive only in part on two issues and suggested that you could usefully look at the minimum wage issue and the service agreements issue, did the ECB take a similar benign approach to the banking side and allow you to make the suggestions or was it a case that as, "We had the use of a quarter of their loan book", as another witness put it, they were going to call the tune?

**Mr. Dermot McCarthy:** I think they, but not just the ECB, had concerns that this programme should provide a clear basis for rectifying, once and for all, the Irish banking problem, both through the availability of capital and through the restructuring of the system itself. There was, obviously, concern in the Irish side, the Government side, that the cost of taking on capital commitments should be kept to the minimum, and that the degree of capitalisation should provide only enough, and not more than enough, to meet all the, if you like, prudential and objective requirements. Obviously, there was a concern that the degree of capitalisation shouldn't produce negative outcomes, such as, for example, the desire to have a rapid deleveraging of the assets of the Irish banking system, which could produce significant losses and further capital requirements. So, there was certainly tension in the process around that issue and the outcome, as you know, was a combination of a direct and immediate or almost immediate, draw-down and capitalisation. And a contingency provision which would be brought into play following the prudential capital assessment.

**Senator Marc MacSharry:** Ann Nolan testified: "A number of IMF officials were strongly in favour of burning any unguaranteed and unsecured bonds in Anglo." Against that background, are you aware of any preparations for burden-sharing being made, even on a contingency basis, prior to entering negotiations with the troika?

**Mr. Dermot McCarthy:** I believe that those issues were being addressed in the Department of Finance. I can't say that I'm aware of this particular arrangements or preparations that were put in place. But I ... from the ... my recollection of the conversations, there wasn't a suggestion that this mightn't be feasible to do. So I assume whatever issues that were there were being addressed.

**Senator Marc MacSharry:** But would it have been looking at, kind of, legislation or whatever was needed to do this or-----

**Mr. Dermot McCarthy:** I imagine so but, I'm not privy to the-----

**Senator Marc MacSharry:** Okay, so you're not really aware of that?

**Mr. Dermot McCarthy:** No.

**Senator Marc MacSharry:** Okay. You mentioned in your statement that external advice tended to be - I don't know whether "limited" was the word - but it tended to be the Governor of the Central Bank and the CEO of the NTMA'. Isn't that correct?

**Mr. Dermot McCarthy:** Yes.

**Senator Marc MacSharry:** When we had Mr. Somers, the then CEO of the NTMA in here, he painted a scenario where ... I must paraphrase slightly that he spoke of, "We were the ones with the money and that's what they wanted us for." He also spoke of - on the night of the guarantee in question, and Deputy Murphy may have mentioned this - sitting in a room endlessly, for hours, but that this was the norm. And I think he recalled anecdotally an occasion where he was there waiting to be consulted on some issue of the day, as often was the case, and the people came in and said, "Oh, you're here? We're going to lunch, we'll see you after." In your experience should the NTMA have been consulted a lot more on the basis of their market, practical knowledge, on all of these issues?

**Mr. Dermot McCarthy:** Well, maybe to draw a distinction between the period leading up to the guarantee and perhaps immediately around that, I can't but believe, Senator, that the sense of an absence from the process was, was largely a function of the fact that they were abroad on the particular night, so I don't think there was-----

**Senator Marc MacSharry:** But they'd hardly all be abroad, I mean?

**Mr. Dermot McCarthy:** Well, I think the key ... sorry, I don't want to-----

**Senator Marc MacSharry:** Wasn't there about 160 staff or thereabouts?

**Mr. Dermot McCarthy:** But from the point of view of the interface with Government, I suppose the key figures were the chief executive and his deputy.

**Senator Marc MacSharry:** So-----

**Mr. Dermot McCarthy:** Not to diminish the worth of everyone else.

**Senator Marc MacSharry:** No, no, absolutely not, indeed. But was the practice in your term of office that of the 100 to 160, or whatever number of employees it is, that only two liaised with-----

**Mr. Dermot McCarthy:** No, I'm sure-----

**Senator Marc MacSharry:** As in the CEO and ... I don't know what Mr. McDonagh's role was. There was ... there's kind of three main positions there, isn't there?

**Mr. Dermot McCarthy:** Well, clearly Mr. McDonagh was in-----

**Senator Marc MacSharry:** Yes.

**Mr. Dermot McCarthy:** -----fairly regular contact with, and engagement with, the Department of Finance and I think there's evidence before the committee about the extent of that. The point I'm making is that in terms of formal engagements with the Taoiseach and members of

the Government, it would have been the CEO or the deputy.

**Senator Marc MacSharry:** Was there an attitude around Government Departments generally that, “Look, we don’t need those guys, don’t ring them”?

**Mr. Dermot McCarthy:** I don’t believe so. I mean, I think it’s not a secret that there were issues about the ... in the relationship between the Department of Finance and the NTMA, as there always are between-----

**Senator Marc MacSharry:** Yes.

**Mr. Dermot McCarthy:** -----distinct organisations in the same sort of field.

**Senator Marc MacSharry:** But, with the benefit of hindsight, in practice, would this have meant that, to our detriment perhaps, we didn’t consult some of the other 157 staff if the main three were outside of the country?

**Mr. Dermot McCarthy:** No, I don’t believe that’s the case, Senator. The, the CEO and others were present at briefings with the Taoiseach in the days before the guarantee. There was a very good relationship between Dr. Somers and Taoisigh directly. The NTMA was regarded across the system, and I believe in the Department of Finance in particular, as a very expert body, and its views were both sought and respected. So I wouldn’t draw any inference from the particular conjunction, no.

**Senator Marc MacSharry:** So would you not agree with Mr. Somers’s evidence that they were, kind of left, in rooms more than consulted? And I’m paraphrasing somewhat, I don’t wish to lead.

**Mr. Dermot McCarthy:** I, obviously, accept that that’s what Dr. Somers said, but being left waiting, dare I say, is not entirely unknown in public service, so I wouldn’t regard it as-----

**Chairman:** As you can testify this afternoon, Mr. McCarthy.

**Mr. Dermot McCarthy:** Quite so.

**Senator Marc MacSharry:** Absolutely, and can I say it’s largely because of me, so I apologise. Just two other questions and I’ll finish up, if I can. I’ve asked this to a lot of the secretaries of Departments that were in: can you outline if there were any requests from political outside bodies or otherwise, for reductions in expenditure or increases in taxation between 2000 and 2011? Other than from people like the IMF. I mean, I’m talking civil society, politicians, interest groups, unions.

**Mr. Dermot McCarthy:** I can’t recall too many requests to have budgets cut, though there were cases where people sought independent sources of revenue through charging of one kind or another, with a ring fencing attached.

**Senator Marc MacSharry:** Give us an example of that, if you would, because you are the first to answer in the affirmative, of all your colleagues.

**Mr. Dermot McCarthy:** Well, I find it hard to recall specifics, but things like the introduction, or the increasing in charges for services, passports-----

**Senator Marc MacSharry:** Like plastic bag charge, for example, is that what you mean?

**Mr. Dermot McCarthy:** Not particularly, but charges for passports, that sort of thing-----

**Senator Marc MacSharry:** Who would have been looking for an increased charge for that, for example?

**Mr. Dermot McCarthy:** The agencies that would expect to keep the proceeds of the increased charge.

**Senator Marc MacSharry:** Who?

**Mr. Dermot McCarthy:** Well, a Department or an agency-----

**Senator Marc MacSharry:** Oh, but sure, they're State, like. I'm mean I ... I mean I'm talking about inside ... outside the State.

**Mr. Dermot McCarthy:** Oh outside, no.

**Senator Marc MacSharry:** All right, okay. Very finally then, there was some allegations made by the senior economist of the Central Bank that he had difficulty in getting his points across from time to time, on the basis that he felt that there were political and property interests on the board of the Central Bank. In your entire career, can you outline for us if, at any time, you felt there was an undue political property or business interest with the leg of the Governor of the Central Bank, the regulator or, indeed, Government?

**Mr. Dermot McCarthy:** I have absolutely no basis for, for believing that, Senator, from anything that I observed.

**Chairman:** Okay. Thank you. Mr. McCarthy, I'll just deal with one or two issues and propose we might take a little bit of a break then. Mr. McCarthy, on ... Kevin Cardiff stated in testimony that a one-page draft guarantee document was produced on the night, this is the night of the guarantee, and it was copied and was circulated. So, I'll just bring up ... it's coming up there, Mr. Cardiff's statement, you'll see it there as the paragraph ... at the lower side of the page, it says, "In fact, the decision/press release went through, probably, a dozen drafts, each one mostly only a little different to the previous, before it was finalised." When this was discussed further with Mr. Cardiff, when he was before the inquiry, there was an engagement between Deputy Doherty and Mr. Cardiff which ... the transcript would read, Deputy Doherty speaking says, "Okay and the 12 drafts of the statement that you mentioned in your opening statement that were created, were any of them circulated or were they saved on your computer, or were they just ... was it an open file that kept continued to be edited?" and so on, to which Mr. Cardiff replied:

It was probably an open file. I was sitting at the computer of a guy called Joe Lennon who was one of the Taoiseach's advisers simply because his room happened to be next door. I think Joe or someone else was going in and out. I might have been in and out myself but that it was an iterative process.

Deputy Doherty then said "So none of those documents were ... none of those drafts were circulated at any time to the meeting ... any of [those] drafts?" To which Mr. Cardiff says: "Oh, no, they were all circulated at the meeting." So the 12 drafts found themselves in the room at every given stage. Do you know who produced this draft document right from the get-go and did you receive a copy and what eventually was done with the copy circulated?

**Mr. Dermot McCarthy:** Yes, Chairman, I think the origin of that was ... has to have been

the draft which William Beausang referred to in his evidence, which he had received, I think via David Doyle, from an original draft in the Central Bank, and I ... I've seen that in material which was sent to me yesterday. I wasn't aware, until the evidence of William Beausang, that there was a draft generated in the Central Bank. There was a draft on, on the night, which was produced. But, it was produced, as I understood, from within the room, so to speak, or from Kevin, Kevin Cardiff's drafting. It did go through a number of iterations in discussion-----

**Chairman:** But who put the first draft of the 12 manifestations of that draft onto the table, Mr. McCarthy?

**Mr. Dermot McCarthy:** I believe, for, like, to the best of my recollection, it would have been presented on the table by, by Kevin Cardiff, I think-----

**Chairman:** Okay.

**Mr. Dermot McCarthy:** -----who also made the subsequent adjustments.

**Chairman:** Okay.

**Mr. Dermot McCarthy:** The various iterations of them - and they did go through ... it did go through a number of iterations - I believe are still available on ... or, at least I would be surprised if they are not still available on the Department of the Taoiseach system.

**Chairman:** Well, that's going to be my final question now, 'cause I'll come around to that, okay? So, can I ask you, can you outline the content of the original version? Was the first version an all-inclusive guarantee?

**Mr. Dermot McCarthy:** I can't recall, Chairman, the detail of the first version, but it did go through a number of iterations and the two, I suppose, substantive changes that arose and persisted. One was in terms of the giving of six months notice for the termination of the guarantee; that was removed. There was another, which I can't immediately recall, but in terms of the spread ... Sorry, the second change was the reference to all institutions being solvent, that warranty by the regulator.

**Chairman:** They are technical aspects of the guarantee or maybe difficulties might arise, it would have to be clarified out and they would be worked back and forth as the draft is evolving over the course of the night. But the substantive part of the statement is whether the banks were going to be included in it or totally included or as not, which I would imagine would be a very significant moment in that draft at whatever stage. So at what stage do you recall that actually being in there?

**Mr. Dermot McCarthy:** My recollection, it was quite late in the meeting before a text of that kind came on the table, much later than ... I think William Beausang referred to 9.20 p.m. or 9.30 p.m. as being when he received this draft. My recollection is that it would have been considerably later than that before there was a text on the table.

**Chairman:** Okay. Coming back to my final question on this - can you explain why it would appear that a copy of this document does not appear to have survived a meeting?

**Mr. Dermot McCarthy:** Well, I may be wrong in this, Chairman, but my recollection is that the various stages of the drafting - certainly the later ones from the time it appeared on the table - would still or should still be in the system because, apart from their drafting, my recollection is that they were e-mailed to the Department of Finance press officer, who would, ultimately, have



been the person issuing it. And I recall, vaguely, seeing documentation which, I think, might have been being put together for the Nyberg commission, which had that material so unless I am misremembering, I think there should be the possibility of recovering at least some of them.

**Chairman:** Have you seen a draft of that document or one of the 12 variations of it since that night?

**Mr. Dermot McCarthy:** Since the night, yes. As I say, before I retired...

**Chairman:** As to how recent have you seen one of those drafts?

**Mr. Dermot McCarthy:** I would say I saw them before I retired.

**Chairman:** Which was when?

**Mr. Dermot McCarthy:** 2011.

**Chairman:** Okay. Was it one draft or a number of drafts that you saw?

**Mr. Dermot McCarthy:** From memory, Chairman, I think there were a number and I think it was in the context of the Department putting together material for Nyberg.

**Chairman:** And on the basis of - bearing in mind it is recollection - where did you see those documents?

**Mr. Dermot McCarthy:** Well, within the Department of the Taoiseach but-----

**Chairman:** The Department of the Taoiseach.

**Mr. Dermot McCarthy:** Yes.

**Chairman:** Okay, right. Thank you.

**Senator Susan O’Keeffe:** Excuse me, Chairman, can I ask for a clarification?

**Chairman:** You can, indeed.

**Senator Susan O’Keeffe:** Mr. McCarthy raised a point about the solvency in the draft and I wonder if you could just seek a further clarification because it was raised as one of the drafts.

**Chairman:** Just put it in there and I’ll take it.

**Senator Susan O’Keeffe:** Thank you. Mr. Sheehy said in his evidence that the expression about solvency, about the banks being all solvent, that that would be in the final draft and it was taken out. I am just wondering what your recollection of that particular part of the draft was?

**Mr. Dermot McCarthy:** In an early... I cannot say how early, but in an earlier version of the text, certainly it did refer to the Financial Regulator confirming that all of the institutions were solvent. But I do recall in the discussion that the regulator was uncomfortable with that, not because he didn’t believe it but because in effect a public assertion of that in a Government statement would carry market implications. Now, I saw Mr. Sheehy’s evidence to the committee and I have no doubt there was also a parallel, perhaps, conversation, but I do recall the regulator being unhappy that that would be expressed in that way.

**Senator Susan O’Keeffe:** So it came out.

**Chairman:** Okay. I just want to deal with one issue with regard to the guarantee on a more macro level with you, Mr. McCarthy, before we break. And that's to put the question to you: in your opinion did the duration of the guarantee, which was a two-year duration, create the conditions for the funding cliff that precipitated the bailout?

**Mr. Dermot McCarthy:** It may have done, Chairman, in this sense: that clearly a time-limited guarantee was always going to create an exit issue. Now, that was anticipated quite early on and my recollection is that, in early 2009, the Minister sought the approval of the Government to seek agreement for a variant on the guarantee scheme to allow the issue of longer-term bonds and there was then a new scheme, the eligible liabilities guarantee scheme, which was approved by the Commission much later in 2009. Then there was the question of extending the period from September 2010 and, from recollection, I think it was June, or mid-year, that that approval was received. So, there were attempts to avert that cliff situation emerging but, I think, in practice, it did contribute to the timing, the build-up of those liquidity pressures in the latter part of 2010.

**Chairman:** So, on that basis, just, and just to clarify and summarise it, so what you ... are you proposing that there was some consideration or concern with regard to the appropriateness of the duration and was that being reviewed during that time, prior to its point of expiry - like, for instance, one year in or 18 months in or whatever - that's what you're saying this evening, yes?

**Mr. Dermot McCarthy:** Yes, well it wasn't that the original two-year period was inappropriate but that there would be steps taken to ensure that the exit process would be well planned. But that wasn't, obviously, the sole motivation because the ongoing liquidity challenges and, indeed, the recapitalisation programme-----

**Chairman:** Yes.

**Mr. Dermot McCarthy:** -----required clarity about the funding supports that would be available.

**Chairman:** And also, one year into the process or towards the end of year 1, or on ... coming into the transition then of the first tranche of loans to NAMA were happening at that time, so did the Government consider a review at any point prior to that and then, particularly, prior to the bailout?

**Mr. Dermot McCarthy:** Well, I think the decision to seek a further extension of the period was certainly contributed to by the consequences of the NAMA transfers and the market reaction to them. In particular, the level of the haircut and the period that it took to make the transfer.

**Chairman:** Okay. All right. Thank you, Mr. McCarthy. It's just coming up to about 7.10 p.m. I'm proposing that we break for 20 minutes or just in about that. The other thing, if I can maybe just ask members' permission just to come back maybe about two or three minutes before that, as I just want to review one document, then make a decision on it, and we'll see where we're going from there, okay? Mr. McCarthy, you're excused ... or suspended. So, 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 his evidence or matters that are being discussed before the committee. With that in mind, I now propose to suspend the meeting until 19.30. Is that agreed? And to remind the witness that he's still under oath until we resume. Thank you.

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

*Sitting suspended at 7.09 p.m. The joint committee resumed in private session at 7.30 p.m. and went into public session at 7.55 p.m.*

**Chairman:** We will resume in public session and, in doing so, I'll invite Deputy Pearse Doherty for ten minutes of questions, please.

**Deputy Pearse Doherty:** Go raibh maith agat, a Chathaoirligh, agus fáilte. Can I ask you what contacts, if any, did you have with the ECB, the IMF or the EU Commission on the design of the national recovery plan? And, if there were such contacts, what were the key actions sought by them?

**Mr. Dermot McCarthy:** I actually didn't have any direct contact, Deputy, in the ... those discussions, but I was aware of how they were proceeding from the cross-departmental discussions led by the Department of Finance, who were the main interlocutors.

**Deputy Pearse Doherty:** Okay, and, Mr. Trichet would have been in correspondence with the Minister for Finance and the Taoiseach ... cc'd into the Taoiseach, so you would have received that correspondence, would that be-----

**Mr. Dermot McCarthy:** Yes, I would have been aware of, specifically, the letter of 19 November in 2010.

**Deputy Pearse Doherty:** Okay. You were mentioning to Senator MacSharry in relation to issues that the Commission may have had in relation to the recovery plan. How were you aware of them if you weren't in any discussions with contacts?

**Mr. Dermot McCarthy:** From the reporting by the officials in Finance.

**Deputy Pearse Doherty:** Okay. Ms Kathy Herbert gave evidence to the committee saying that the corporation tax - on foot of a question from Deputy McGrath - was it a red line issue for the Minister and she answered that it was, not just for the Minister but for the Government. Is that your understanding?

**Mr. Dermot McCarthy:** Absolutely. It was the-----

**Deputy Pearse Doherty:** Okay.

**Mr. Dermot McCarthy:** Initially, it was the dominant concern when the question of a possible programme of assistance was mooted-----

**Deputy Pearse Doherty:** And so, when you talk about a red line issue, basically, if there was a push on the corporation tax, was it the position of the Government that they wouldn't have entered into a bailout?

**Mr. Dermot McCarthy:** I can't really speculate on that, Deputy, as to what might have happened in that eventuality, but, the whole purpose of resisting, if you like, the pressure to apply, was designed to prevent a loss of bargaining position in the event that that would be put on the table as a condition. There were grounds for believing that it might, as there were for other issues, like collateralisation, and I think the Government, in my view, rightly, decided that it wouldn't be pressed to confirm that it was applying until it was satisfied that such unacceptable conditions were not going to arise.

**Deputy Pearse Doherty:** But doesn't a red line issue, by definition, mean that you won't

go beyond that point, so, therefore there would be no deal if there was a push on corporation tax? Was that an active consideration, to your knowledge?

**Mr. Dermot McCarthy:** I can't recall that it was ever discussed in those terms, but it was certainly, if you like, the priority in the engagements to ensure that it wouldn't come to that point.

**Deputy Pearse Doherty:** Okay. So, it would be more a priority than a red line issue. Is that what you're telling us?

**Mr. Dermot McCarthy:** It was a priority that could, perhaps, have become a red line.

**Deputy Pearse Doherty:** Okay. And, in relation to cuts to the minimum wage or cuts to those with disabilities that took part in the pension ... or, in the four-year recovery plan, were they red line issues or priorities for the Government, or were the Government eager to pursue those areas?

**Mr. Dermot McCarthy:** I think it's fair to say, Deputy, the Government weren't eager to do any of the expenditure adjustments, or, indeed, the tax raising ones. The question was what would be effective in achieving the outcome which stability required. In the particular case about the national minimum wage, which I mentioned, I do recall that as being referenced as a matter of particular interest from the Commission. It coincided with a view, developing in the Irish system, that, perhaps, this was, indeed, a timely way of stimulating employment growth in, in effect, the low wage, low productivity areas of the economy.

**Deputy Pearse Doherty:** Do you believe now, in hindsight, that that was an appropriate move, to cut the minimum wage by €1?

**Mr. Dermot McCarthy:** I think the Government believed it was the right thing to do. Personally I was not convinced.

**Deputy Pearse Doherty:** Were you convinced at the time?

**Mr. Dermot McCarthy:** No.

**Deputy Pearse Doherty:** Did you argue against it?

**Mr. Dermot McCarthy:** I pointed out some downsides.

**Deputy Pearse Doherty:** Was that a view of just yourself, or was it the Taoiseach's view? Was there support for your view?

**Mr. Dermot McCarthy:** I think there was a period of quite free ranging discussion about pros and cons of different structural adjustments. I would have contributed my point of view as others did theirs and the Government decided.

**Deputy Pearse Doherty:** Okay. Can I ask you just to refer to Vol. 2 of the core booklets on page 18 actually, if we go to that one first. Page 17 and 18 have minutes of the meeting on 30 September 2008 which you were present at, and it talks about different options - nationalisation, guarantee - the minutes are vague, they are Kevin Cardiff's notes. At the end of it on page 18 it says "DMcC [which is yourself I presume] want [very] clear statement of pros and cons of each." Which I presume is the two options that were on the table - nationalisation of Anglo and maybe Nationwide or a system-wide guarantee. Did you ever receive the pros and cons of

each?

**Mr. Dermot McCarthy:** I didn't and my recollection sparked from that reference is what was I think contributing to there was that in the ... if you like in the explanation of what was decided and in the formulation of the case to the Commission for state aid approval, that we would want to be very clear that the options had been considered and the reasons why this was the appropriate one. So I think that was the context in which I would have made that observation. It sounds like the sort of contribution I would have made in other contexts too.

**Deputy Pearse Doherty:** But you never received the pros and cons.

**Mr. Dermot McCarthy:** I was satisfied that the comprehensive case, if you like, was prepared.

**Deputy Pearse Doherty:** Which side were you on on the debate on the night? We have evidence that certain people in the room argued for a nationalisation. Which side were you on?

**Mr. Dermot McCarthy:** In that discussion and, indeed, in many discussions on banking matters, I had no particular expertise to bring to the table. So I was listening to the debate to, I suppose, assist the Taoiseach in trying to refine what were the net issues. And it seemed to me on the particular issue of nationalisation that the case that this was something which could have a negative as opposed to a positive outcome, was credible. And it was enhanced by the fact that you could move on and nationalise later. But if you made an announcement about nationalisation that wasn't well received, you couldn't undo it. So from a purely prudential practice point of view, it seemed a logical approach to take and in that sense I was happy.

**Deputy Pearse Doherty:** For those that were arguing for the nationalisation, which we understand includes the Finance Minister, what was the rationale behind the arguments for nationalisation? The committee has heard evidence that the issue of solvency was, and this is paraphrasing, but was part of that argument or the loan book of the banks was part of that argument. From your understanding of being present on the night, what was the rationale to nationalise one of the banks instead of guaranteeing it?

**Mr. Dermot McCarthy:** I think the core point was that the business model was not one in which the market had confidence and this was separate from solvency. In fact, there were, as the committee has heard, strong assertions from the regulator that the bank was solvent. But the question was was the negative sentiment towards it creating a negative overspill across the rest of the system. So being seen to engage with that, address it and, in a sense, send a message that restructuring of some kind would occur was, I think, the attraction.

**Deputy Pearse Doherty:** Was there anybody on the night of the guarantee that night, that were raising concerns in relation to losses in the loan book of Nationwide or Anglo Irish Bank or raised issues around potential future solvency of these institutions?

**Mr. Dermot McCarthy:** There was certainly discussion of the potential for losses on their loan books and that this would be in a sense a function of the duration of the environment ... the negative environment. But I don't recall that anyone was of the view that this was inevitably or surely going to lead to insolvency.

**Deputy Pearse Doherty:** Did anybody raise the issue of any banks potentially needing additional capital?

**Mr. Dermot McCarthy:** Not explicitly, but I think there was a strong sense that this measure - this, if you like, pre-emptive measure, as it's been described - would stabilise a situation which wouldn't necessarily be solved as a result; that there was more work to be done.

**Deputy Pearse Doherty:** Okay. And in relation to that night, did you arrange to have minutes taken, as Secretary General of the Department of the Taoiseach, of the meeting?

**Mr. Dermot McCarthy:** Not specifically, Deputy, no. The ... and, I suppose, as others have said, it wasn't a matter of one meeting which-----

**Deputy Pearse Doherty:** Yes, well-----

**Mr. Dermot McCarthy:** -----continued, but in terms of the ... if you like, the main points of the discussion, they were repeated, if you like, from different perspectives and different angles over the course of the evening, so the net points under discussion were actually quite specific and-----

**Deputy Pearse Doherty:** But no minutes?

**Mr. Dermot McCarthy:** No.

**Deputy Pearse Doherty:** Okay. And can you enlighten the committee - without, obviously, breaching Cabinet confidentiality - of the difficulties, or otherwise, of having the Cabinet meeting convened by telephone? And how long did it take? When did it start? How long was the process before all Cabinet members signed off? Were there difficulties or not? Was there a consideration of having a Cabinet meeting, summoning people to Dublin and so on? Can you enlighten us as to how that transpired?

**Mr. Dermot McCarthy:** Well, I think at a certain point when it was clear that a Government decision would be required, and would be taken, it was probably, I would say, approaching 11 o'clock when that was, if you like, unambiguously clear and I think the Taoiseach made the judgment that it wasn't going to be feasible to convene a meeting.

**Chairman:** Final supplementary now, Deputy.

**Deputy Pearse Doherty:** Well, he's not finished.

**Chairman:** Okay. No, when you come in after this, sorry.

**Deputy Pearse Doherty:** Okay.

**Chairman:** Mr. McCarthy, continue and then Deputy Doherty in.

**Deputy Pearse Doherty:** This Cabinet meeting I think may have lasted all night.

**Mr. Dermot McCarthy:** So, my recollection is that I asked a colleague from the Government secretariat to make contact with the private secretaries of the members of the Government, which would be the normal pattern, to put them on notice that they would be called about an incorporeal later in the night and the actual incorporeal was conducted, from memory, between about 1.20 a.m. and 1.50 a.m.

**Deputy Pearse Doherty:** And when did it finish?

**Mr. Dermot McCarthy:** At 1.50 a.m.

**Deputy Pearse Doherty:** At 1.50 a.m. Can I ask you finally, in relation to an e-mail that we see from William Beausang to Brendan McDonagh - we can pull it up on the screen, if you wish, it's DOF03309-001 - this is where it says:

Brendan

We met with [...] SG [which I presume is yourself, Secretary General] this morning and he raised the following issue for us to follow-up with the NTMA.

He said he want [to analyse] from the NTMA to crystallize the issues that might be expected to arise for our sovereign rating in the event that the State provides a guarantee for all the deposits / credits of the domestic banking system or would have to provide substantial funding (e.g. M[errill]L[ynch] analysis suggests this could run up to €100bn?) for institutions [...] into the protection regime and for the banking system [...] generally

First of all, was ... is SG yourself?

**Mr. Dermot McCarthy:** No, I ... I believe it was David Doyle,-----

**Deputy Pearse Doherty:** David Doyle.

**Mr. Dermot McCarthy:** -----Secretary General of Finance.

**Deputy Pearse Doherty:** Okay, that's fine.

**Chairman:** Thank you very much. The next questioner is Senator Susan O'Keeffe. Senator.

**Senator Susan O'Keeffe:** Thank you, Chair. Mr. McCarthy, on page ... sorry, page 4 of your own statement, you say, "The European Commission and the ECB favoured a front loading of adjustment within an overall adjustment of at least €15bn by 2014." Do you recall what rationale they provided for that kind of adjustment in such a short period of time? Do you also recall what the Irish view was and what the IMF view was?

**Mr. Dermot McCarthy:** Well, the rationale was that the ... the need to, if you like, address and correct market concerns about the ... the fiscal situation and to, in a sense, improve the credibility of the sovereign required a bold move, so to speak, in terms of a firm shift in the trajectory to a sustainable balance. So, I think that was their ... their concern. On the Irish side, there was a view that there certainly needed to be credibility about the achievement of the required reduction in the deficit but that that pace of adjustment would cause economic and social dislocation beyond the benefits which it would create. So ... and in the end, there was agreement on a figure of €6 billion, which seemed to be a balanced assessment.

**Senator Susan O'Keeffe:** Okay. If I could take you to 2007, its a document DOF01962. Now, I appreciate this would have been a Department of Finance document, I'm just wondering whether you would have been briefed at that point. This is November 2007, Mr. Ahern would have been Taoiseach, about the funding availability for Irish banks being tight and if the present market conditions persist in 2008, there's an increased risk of liquidity issues arising for Irish banks. So would that information have passed on to you from the Department of Finance in some form or other or?

**Mr. Dermot McCarthy:** Not formally or specifically, but in terms of the, if you like, the normal interchange with Finance, I would certainly have been aware that there was growing

concern about these issues and that Finance, with the Central Bank and the Regulator and indeed the NTMA, were engaging with it.

**Senator Susan O’Keeffe:** Okay. And then again in January, the scoping paper that we’ve heard about, the examining the legal framework for any crisis management operations taking place. Again, this was a Department of Finance document but would you have been notified that that sort of work was in preparation and that a scoping document had been drawn up? When I say you, now, I mean you and the Taoiseach.

**Mr. Dermot McCarthy:** I suspect that the ... certainly the Taoiseach would have been aware of it, I’m not sure that I was ever briefed on it as an exercise, but the fact that there was a domestic standing group functioning was certainly known, well, certainly known to me. But I certainly didn’t see that document at the time or, indeed, until it became available to the committee.

**Senator Susan O’Keeffe:** Okay, but it wasn’t something ... you weren’t unaware, you weren’t in the dark, the Taoiseach wasn’t in the dark about that progress?

**Mr. Dermot McCarthy:** No.

**Senator Susan O’Keeffe:** Okay. So DOF03372, this was part of the briefing document that was given to Mr. Lenihan as he came in as Minister for Finance, this was the document which was marked highly confidential and relates to Seán Quinn and the Quinn Group. Now again, I’m asking whether or not this information here, relating to the Quinn Group, would have been known by the Taoiseach? I appreciate now that he was on the way out as Taoiseach and there was a new Taoiseach coming in but, I’m talking here about Mr. Ahern, whether or not you in your role would have been aware of this information relating to Seán Quinn and the contracts for difference?

**Mr. Dermot McCarthy:** I wasn’t, Senator, at that time and I can’t say whether the Taoiseach was, he never discussed it with me so I ... well, I don’t want to draw any inference from that.

**Senator Susan O’Keeffe:** Okay. So, in ... Mr. Cowen has given evidence that he would have been notified some time in March about the contracts for difference. So, you’re saying you were not aware? You, as Mr. McCarthy, were not aware and you’re not aware whether Mr. Ahern was aware?

**Mr. Dermot McCarthy:** Quite.

**Senator Susan O’Keeffe:** Okay. So when Mr. Cowen then came in as Taoiseach, in May, would you then have become aware or do you recall when you did become aware if, indeed, you did at all, become aware?

**Mr. Dermot McCarthy:** I certainly became aware at some point but I can’t recall specifically, Senator, in it. I’m not sure it was any earlier than when it became a matter of public knowledge.

**Senator Susan O’Keeffe:** Okay.

**Mr. Dermot McCarthy:** Whenever that was.

**Senator Susan O’Keeffe:** Okay. So the whole question surrounding the Financial Regulator and what he knew in relation to what was going on in the Quinn Group, you knew nothing



about that? Okay. Did it come up, the whole issue raised, as you say it became public knowledge at a later point, did it form part of any of the discussions the night of the guarantee?

**Mr. Dermot McCarthy:** I don't recall, Senator, that it did. It might have been mentioned in the context of discussions about the market sentiment towards Anglo, but I can't say that I recall it specifically.

**Senator Susan O'Keeffe:** Okay. You will be aware I think of DOF03290, this would be the Indecon information that Mr. Alan Gray sent to Mr. Cardiff and again I know he ... I think he sent it to a couple of other people, I'm wondering whether you'd had sight of it before it ... at that time, and whether the Taoiseach might have had ... the Taoiseach, Mr. Cowen, might have had sight of it at the time?

**Mr. Dermot McCarthy:** I recall seeing the attachment, the tabular statement, which the Taoiseach certainly did have at some point, because it was from him that I saw it. And it would have been ... I can't recall was it the Friday or the Monday but it was in close proximity to the ... to the decision on the guarantee.

**Senator Susan O'Keeffe:** Would Mr. Gray ever have consulted with you directly, for example, as Secretary General, when he was preparing that document?

**Mr. Dermot McCarthy:** No.

**Senator Susan O'Keeffe:** No. On the night of the guarantee, when Mr. Cowen has given in evidence that he spoke with Mr. Gray on the telephone that night, were you present when that call took place?

**Mr. Dermot McCarthy:** No.

**Senator Susan O'Keeffe:** Were you present when Mr. Lenihan and Mr. Cowen withdrew to have a conversation? They withdrew from the meeting. Were you part of that conversation?

**Mr. Dermot McCarthy:** No.

**Senator Susan O'Keeffe:** You weren't. Okay. On your ... in your own book of documentation, that's DOT 00454, this is a note that was given by Joe Lennon to the Taoiseach, and this refers to, "AIB and Bank of Ireland are requesting an urgent meeting with yourself [meaning the Taoiseach] and the Minister for Finance this evening." First of all, this is hand dated 13/09/08. Is that, in your view, simply an error? You can see it there before you. Because it does look as if it's the night of the guarantee, but I'm just-----

**Mr. Dermot McCarthy:** I'm sure it must be the 30th, Senator, yes.

**Senator Susan O'Keeffe:** Okay. Now, you see that in the note it says, "BOI say they lost €2 billion in wholesale deposits today. AIB are having difficulty in getting cash in the overnight money market." Now, on page 11 of his testimony, Mr. Goggin said ... of Bank of Ireland, "The primary reason we were there was because of the impending Anglo default." So, in this note here, taken by Mr. Lennon and passed-----

**Chairman:** There's phone interference coming from yourself.

**Senator Susan O'Keeffe:** I'm sorry, I just had that reference there.

**Chairman:** Okay.

**Senator Susan O’Keeffe:** -----passed to the Taoiseach, obviously they were saying this. So did this matter of the Bank of Ireland and its wholesale deposits and AIB having difficulty, would that form part of the meeting then?

**Mr. Dermot McCarthy:** When the bank representatives came in, they certainly did reference the extreme difficulty in securing funding on other than very short-term bases. My ... I’m not sure that I recall that they referenced the outflow of deposits but, certainly, the difficulties which they were experiencing as well as, if you like, the implications of the difficulties of others was certainly raised in the discussion.

**Senator Susan O’Keeffe:** And did ... can you recall, did the bankers ... there were four - I think two from each of the main banks. Can you recall whether or not they informed the meeting that they had met and been in touch by phone with Anglo Irish that day and-----

**Mr. Dermot McCarthy:** They did not, no.

**Senator Susan O’Keeffe:** I’m sorry?

**Mr. Dermot McCarthy:** They didn’t, no.

**Senator Susan O’Keeffe:** They didn’t make that information available, okay. And did they ... was there a conversation that took place between them or did they simply come in and lay out their stall and then leave, if you-----

**Mr. Dermot McCarthy:** There was discussion. In fact, there were two and I think possibly three legs, if you like, to the encounter. In the first, they certainly did make, if you like, prepared presentations, if you like, of the situation as they saw it. And they were asked to develop various points, mainly by the Governor, who was engaging, and I think the Taoiseach had asked him to, in a sense, lead the reaction from the official side. And the Taoiseach and Minister, as I recall, said very little in that first phase. There was a second phase in relation to their capacity to provide liquidity support if that was required. In fact, that second phase was the asking of them to consider whether they could and I think the third phase was the response to that as a proposition.

**Chairman:** All right, Senator, I need you to wrap up, now, shortly.

**Senator Susan O’Keeffe:** Okay. Mr. Cardiff has given evidence that it was his view that the Taoiseach, if you like, seemed predisposed at the start of the meeting pretty much to ... towards a guarantee. Now, I know that you missed ... I think you missed the beginning ... the very beginning of the meeting, but I think you did say in evidence here today that you had thought it was a briefing meeting for the Cabinet meeting that was due the next day. So how did it turn into something else altogether? And do you think that the Taoiseach was so predisposed? Thank you, Chair.

**Mr. Dermot McCarthy:** Well, I suppose the first point, Senator, is I said that my assumption, my expectation was that it was a briefing session. I don’t know what was the particular context that led to the calling of the meeting. So it might have been more than that in the Taoiseach’s mind, for example.

**Senator Susan O’Keeffe:** You didn’t know about Joe Lennon’s note.

**Mr. Dermot McCarthy:** No.

**Senator Susan O’Keeffe:** Until you got there.

**Mr. Dermot McCarthy:** Even then I wasn’t aware of it. My recollection is that it was the Minister for Finance indicated that the bank representatives wanted to come in. It may have been already known to the Taoiseach that this was going to happen, but that was the first that I heard of it. In terms of whether the Taoiseach had a predisposition, that wasn’t my sense. I think he was reacting to the strong view from the Governor and the regulator that a firm, decisive intervention was required in the context of something which was now not just system-wide from an Irish point of view, but was rapidly becoming an international financial meltdown. So I think it was in that context that, if you like, his steering of the conversation probably headed in that direction.

**Senator Susan O’Keeffe:** Thank you.

**Chairman:** Deputy Michael McGrath.

**Deputy Michael McGrath:** Thank you, Chair. Mr. McCarthy, you’re very welcome. Can I start by asking you about some evidence given by Kevin Cardiff when he commented that ... on the decision to enter into bailout negotiations in November 2010, he said the communication at ministerial level over the weekend prior to the announcement of the start of negotiations had not been clear enough to prevent them walking into trouble, referring to Ministers Dempsey and Ahern, in particular. So can you please set out what steps, if any, were communicated to you to ensure that there was a harmonised message across Government around this time on the entry into negotiations?

**Mr. Dermot McCarthy:** I don’t recall, Deputy, that I received any particular instructions. In a communications situation like that, the Taoiseach would normally engage directly with the Minister for Finance and then with the Government press secretary and the Finance press officer. I think that there was probably some ... I believe the Ministers concerned did indicate that they had made some efforts to get a steer, so to speak, but I wasn’t privy to that.

**Deputy Michael McGrath:** Okay, that’s fine. You say on page 2 of your witness statement that it was made clear on the night of the guarantee that no European or ECB initiative was in prospect which would address the immediate crisis faced by Ireland. So did Governor Hurley advise those present that he had spoken to Mr. Trichet on that day?

**Mr. Dermot McCarthy:** I’m not sure that it was on that day, it may have been over the weekend, but certainly he indicated that he had spoken to him and that, both from what president Trichet had to say and from his knowledge of the situation, that there was no such prospect.

**Deputy Michael McGrath:** And was a message conveyed that you should stand behind your banks as a country and don’t let any bank fail? Was that message conveyed through the same channel?

**Mr. Dermot McCarthy:** I’m not sure that it was conveyed in as stark a way as that but it was certainly made clear that each member state, each country had to make its own arrangements in respect of their own banking system and that it was the strong view of the ECB that no bank should be allowed fail so-----

**Deputy Michael McGrath:** That was the backdrop?

**Mr. Dermot McCarthy:** Yes.

**Deputy Michael McGrath:** Okay. But was that expressly stated on the night?

**Mr. Dermot McCarthy:** It was-----

**Deputy Michael McGrath:** That was the understood position?

**Mr. Dermot McCarthy:** Absolutely, but I think it may be worth saying, Deputy, that had that not been said, had that not been communicated in such stark terms, it was ... it would have been the view of the Irish authorities themselves that that would not be an advisable or credible risk to take.

**Deputy Michael McGrath:** Okay. And was any consideration given over the course of the evening to making contact with the ECB and making the point to them, “We’re about to make a major decision about our banking system, the scale of which is potentially beyond the capacity of this State and we’re putting it to you, finally, are you prepared to make any intervention to assist?” Was any consideration given to making that call to Frankfurt, even on that very evening?

**Mr. Dermot McCarthy:** I don’t believe so, Deputy. I think there was the view that Frankfurt’s position had been communicated-----

**Deputy Michael McGrath:** Was clear. Okay. Can I just clear up one issue with you? Were you present when the banks, Bank of Ireland and AIB, were informed of the Government decision to go down the guarantee route because we’ve had conflicting evidence from Bank of Ireland and AIB? Bank of Ireland’s evidence was that they certainly knew on the night and left Government Buildings on the clear understanding, having been informed that there would be a guarantee whereas Eugene Sheehy of AIB said he woke up to the news the following morning.

**Mr. Dermot McCarthy:** To the best of my recollection, Deputy, they weren’t informed in any formal way in the meeting room that that was the decision of the Government but there is evidence before the committee, as you know, that there were discussions that at least some people had with people on the official side, so I can’t say that they weren’t to some degree advised or given an intimation, but not, as I recall, in a sense, a formal response to the discussion.

**Deputy Michael McGrath:** Okay, but is it possible that one bank was given one message in a bilateral with an official and another bank was not given the same message and so they’re both correct in what they’re saying? Is that possible?

**Mr. Dermot McCarthy:** I think that’s possible but, given normal practice, I would regard it as very unusual.

**Deputy Michael McGrath:** Okay. You say on page 11 of your witness statement, when you speak about parliamentary scrutiny, that, “As a general observation, it is understandably more likely that parliamentary time and political engagement will arise in respect of specific actions or measures rather than broader policies and options”. Is that your experience of what happened in the time that you were Secretary General to the Government - as an observer of parliamentary scrutiny - that the focus was on, you know, specific issues rather than overall policy direction and major systemic issues?

**Mr. Dermot McCarthy:** I think it would be my, sort of, very broad characterisation of, if you like, the way in which Government was held to account by the Oireachtas that it gathered life, if you like, in terms of specifics, either done or undone, rather than the broader issues. And, for example, given I had a particular association with social partnership, I was always surprised

- and maybe at some level disappointed - that there was never much interest in debating social partnership agreements or NESC strategy reports or whatever, even though, for example, at the Taoiseach's request, I did suggest to the committee on Seanad reform at one point that they might take a particular interest in engaging with NESC and the social partnership process. So it's just a general observation.

**Deputy Michael McGrath:** Okay. So would you say that that represented a failing of Oireachtas scrutiny, that lack of attention maybe on the bigger issues, the bigger questions, as opposed to, you know, maybe local issues or specific Government decisions rather than policy direction. Was it a failing in your view, or not?

**Mr. Dermot McCarthy:** I wouldn't characterise it as a failing, Deputy, but I think one of the difficulties that the Wright report, for example, refers to is that the ... if you like, the market for analytical approaches to policy development wasn't very well developed. And I think Government, of course, should do the right thing, the public service should prepare the right advice. But I think it would have added to the challenge - which Wright concludes was absent - had the Oireachtas been more systematically focused on the analysis of strategy.

**Deputy Michael McGrath:** Okay. Can you recall the issue of subordinated debt being included in the guarantee ... that being discussed on the night?

**Mr. Dermot McCarthy:** Yes ... and-----

**Deputy Michael McGrath:** And who recommended that it should be included ... that dated subordinated debt should be included? Was it the banks, was it on the official side ... the Central Bank?

**Mr. Dermot McCarthy:** My recollection is that the ... both the banks and the official side in effect were of the view that it should be included partly because of the structure of the funding of the banks, and indeed, to a lesser extent the State. But also because of the desire to give a clear, unambiguous, definitive message through the guarantee.

**Deputy Michael McGrath:** Okay. Deputy Doherty questioned you about the issue of corporation tax during the bailout negotiations. Was it specifically put to Ireland, in the lead-up to those negotiations or during those negotiations by a member of the troika, that you should increase our corporation tax rate?

**Mr. Dermot McCarthy:** No, Deputy, I don't believe so but I think the concern, the anxiety was that part of the ... this process, of course, required the agreement of the member states and that it was in the engagement with member states that the risk of such a condition was ... was feared might arise. And that was based on, if you like, the broad environment rather than specific messaging.

**Deputy Michael McGrath:** Okay. Just going back to the issue of the incorporeal Cabinet meeting, can you tell us how that works in the sense that once you get through to a majority of Cabinet members and they agree to the proposal from the Taoiseach and the Minister for Finance, is that it or do you contact everyone? Is everyone's view logged, recorded - how does that work?

**Mr. Dermot McCarthy:** The process, Deputy, is that you try to contact every member of the Government and even if you've got a majority, you keep going to contact everyone-----

**Deputy Michael McGrath:** Okay.

**Mr. Dermot McCarthy:** -----if you can.

**Deputy Michael McGrath:** But decisions, if there is division, would be made on simple majority basis or ... if it came to it? I know it didn't on this occasion but ... did you ever see a vote at Cabinet?

**Mr. Dermot McCarthy:** No.

**Deputy Michael McGrath:** Never?

**Mr. Dermot McCarthy:** No.

**Chairman:** I nearly got distracted there myself as well.

**Deputy Michael McGrath:** Okay, the final one is just on page 3 of Vol. 2. Mr. McCarthy, you were present at this crisis meeting, liquidity crisis meeting, on 25 September as Secretary General to the Government. Do you recall that meeting? Do you recall the reference to what David Doyle said, for example, about potential loss exposures in Anglo and Irish Nationwide, €2 billion after capital in the case of INBS, Anglo could be €8.5 billion and - we're just closing off a line of evidence here; it's been difficult to get to the bottom of this issue - but do you recall it by any chance?

**Mr. Dermot McCarthy:** I recall the meeting and I have some vague recollection of that question being posed and the answers in terms of losses but I can't be confident that it's not a, sort of, recovered memory prompted by sight of the note.

**Deputy Michael McGrath:** Yes. I suppose the context of that question is: was there any suggestion then, or right up to the point where the decision was made to guarantee the banks, that we may have to put capital in behind our decision, that the banks may need additional capital because of loan losses that are coming down the track? Was that ever suggested? Was it ever there in the background to the decision?

**Mr. Dermot McCarthy:** Not specifically, Deputy, but I think there was clearly a realisation that losses on the loan books of, at least, some institutions would probably materialise and that some restructuring and some unwinding of positions would be required and that this would have to be attended to with the stability achieved by the guarantee. I'm not sure that anyone proposed or voiced the view that a specific State recapitalisation would be required but some element of restructuring certainly was envisaged.

**Deputy Michael McGrath:** Thank you.

**Chairman:** Thank you very much. I now invite Senator Michael D'Arcy. Senator.

**Senator Michael D'Arcy:** Mr. McCarthy, you're welcome. Was the guarantee a mistake?

**Mr. Dermot McCarthy:** I don't believe so, Senator, in two respects. In all of the advice and information that was available on the night, I think it was the appropriate response, given the risk assessments that were offered. With the benefit of hindsight, if the knowledge base was what we now know about the vulnerabilities, I don't think we would have got to the night of the guarantee in that way. So, if you like, both in terms of what was presented and what might be a plausible counter-factual, it probably was the right thing.

**Senator Michael D’Arcy:** Can I put it to you that there was a silver bullet attempt in terms of the bank guarantee? And can I put it to you that the deposit guarantee scheme was an increase from €20,000 to €100,000 - a fivefold increase, we were multiple of what other jurisdictions moved up to, you know? I suppose what I’m asking you was, were you and the Executive trying to do too much with one fell swoop?

**Mr. Dermot McCarthy:** The problem, Senator, was that the option of a gradual approach, a more incremental approach, wasn’t there. In a sense, the increment was from a strong guarantee of retail deposits, which worked in the retail market, into a collapse, or what appeared to be a collapse, of the whole interbank funding system internationally. So, in that sense, the need for, if you like, a decisive game changer appeared to be unarguable.

**Senator Michael D’Arcy:** The theory about liquidity was that it was international markets had frozen. The Morgan Kelly thesis was that the markets knew and understood that the Irish loan books were the problem. Which do you subscribe to?

**Mr. Dermot McCarthy:** Well, it’s possible that both were right, clearly, in that there was a problem in the international wholesale market for interbank lending. They were frozen and small countries generally, small banks in small countries, and Ireland, in particular, was at the sharp end of that, so the availability of normal short-term funding had dried up. So that was one issue. The question of whether separately there was a lack of market confidence in the banks as ongoing institutions, I think it is true that there was concern, more than concern at their property exposure in an environment where property-related exposures across the international system were regarded as deeply problematic. Whether that meant that the market was calling it correctly, in so far as that was a market view at that time, I’m not really in a position to say.

**Senator Michael D’Arcy:** Was the NTMA position clearly outlined the night of the guarantee to everybody in the room? The NTMA were outside the door, their views were stronger than most, in relation to guarantee.

**Mr. Dermot McCarthy:** I think that the ... their view, both in relation to the desirability of nationalising Anglo and the impact that an extensive guarantee would have on the cost of sovereign funding, were certainly very clearly conveyed and they were already known, of course, by virtue of the previous engagements the previous week.

**Senator Michael D’Arcy:** But were, was the Taoiseach and Minister for Finance, were they fully informed that the NTMA did not view the guarantee?

**Mr. Dermot McCarthy:** I believe so.

**Senator Michael D’Arcy:** Can I ask, Mr. McCarthy, in terms of the FSR reports from the Central Bank and the Financial Regulator, you quote them on page 7 of your opening statement, section 3.3, or 6.3, did ... were you fully informed, did you read the reports, did you read the appendices, did the Taoiseach read the appendices, and I’m talking about the ‘04, ‘05, ‘06 and ‘07 reports, which were clearly itemising the vulnerabilities and the threats to the financial stability of the Irish economy?

**Mr. Dermot McCarthy:** I didn’t read them, Senator, I’m not sure that I received them. They certainly weren’t submitted to Government directly as I recall. I was aware of their-----

**Senator Michael D’Arcy:** Existence?

**Mr. Dermot McCarthy:** -----core message, no, more than existence, that in a sense the ... if you like, the core message, the central conclusion, was-----

**Senator Michael D’Arcy:** Should you have read them?

**Mr. Dermot McCarthy:** I don’t believe so, Senator. Financial stability wasn’t my responsibility. Lots of important reports are produced and they’re read by the appropriate people, who then formulate policy advice informed by that.

**Senator Michael D’Arcy:** In terms of the financial stability reports, the final report, ‘07, clearly itemised where the public debt, the household debt, had come from ... that’s a line that I pursued, Mr. McCarthy, 71% in 1997, of GDP. In ‘07 the predicted figure was 248% of the GNP, highest in, in Europe; some of the highest in the world. You should have read those reports.

**Mr. Dermot McCarthy:** I don’t agree, Senator. I think it was a matter for the Department of Finance, as the Government Department responsible for the financial system and for advising the Government on economic strategy, to advise, inform Government, and I suppose myself in that process. And I ... there are many things that I might regret but I don’t feel that was something which it was part of my responsibility to do.

**Senator Michael D’Arcy:** Mr. McCarthy, when you were assistant secretary, you were member of the McDowell group on the establishment of the single regulatory authority for the financial services sector. Were you involved in the establishment of the Financial Regulator?

**Mr. Dermot McCarthy:** After the report?

**Senator Michael D’Arcy:** Yes.

**Mr. Dermot McCarthy:** No, Senator, no. That, as I recall, came to Government as a joint proposal from the then Tánaiste and Minister for Finance so, at that point, I had become Secretary to the Government, I think, so I would have been, if you like, on the receiving end of that.

**Senator Michael D’Arcy:** And who was the Tánaiste at that stage? Who was the Tánaiste?

**Mr. Dermot McCarthy:** That was Minister Harney.

**Senator Michael D’Arcy:** Harney. Did you have any role in the selection and appointment of people in the executive positions within ... following the-----

**Mr. Dermot McCarthy:** No.

**Senator Michael D’Arcy:** You didn’t. Okay. Chairman.

**Chairman:** Thank you very much. Deputy Kieran O’Donnell.

**Deputy Kieran O’Donnell:** Mr. McCarthy. On 30 April this year in Kilmainham, Jean-Claude Trichet, the former ECB President, said that Ireland had “total expenditure on compensation of employees in the public sector grew by close to 200% between 1998 and 2008 [ten-year period] compared to the [EU] area figure average of ... 45%” over that period. The social partnership agreements, including benchmarking, played a pivotal role in that respect. Thus when determining the pay terms of social partnership agreements, did external benchmarking with other economies feature as part of the process? If you actually might elaborate and if no, did this give rise to economic risk? And it’s coming, Chairman, the reference ... it’s Vol. 1.



pages 21-34.

**Chairman:** Mr. Trichet's statement?

**Deputy Kieran O'Donnell:** Correct. No, no, it's a basic analysis by the IMF-----

**Chairman:** Sorry. Okay. It's a different document.

**Deputy Kieran O'Donnell:** -----on the social partnership.

**Chairman:** Okay. Thank you.

**Mr. Dermot McCarthy:** Well, Deputy, the evolution of public service pay had those two elements which you cite. The social partnership rounds, if you like, and the benchmarking exercise, at least the first one. On the pay determination, the public service pay agreements were, in a sense, a function of the private sector agreement. The process of wage negotiation under social partnership was, while there was a joint employer representation of IBEC, CIF and Department of Finance and Congress on the other side, in fact, the structure of the agreements were somewhat different but the primary mover, so to speak, was the private sector agreement, which tended to be reflected more or less in identical terms but with different phasing and generally a pay pause relative to the private sector one. The actual levels of the increases were broadly shaped by inflation. It was an inflation-based bargaining process, in essence, certainly after the year 2000, when tax relief wasn't factored in as a-----

**Deputy Kieran O'Donnell:** And did the fact that we went from an economy that was very export-driven to an economy in the ... from around 2003 onwards, which was heavily dependent on property, did it bring about a situation where it gave rise to rapid inflation, consequently had an impact in terms of the wage structure which fed into benchmarking?

**Mr. Dermot McCarthy:** I think there was some element of the inflation profile which derived from that and there was certainly discussion ... the official side would have been anxious that in so far as inflation was explicitly referenced, that it should be the harmonised index of consumer prices, rather than the CPI because that didn't include mortgage-related expenses. That wasn't acceptable to the union side and the employers had to formulate their offers in that context.

**Deputy Kieran O'Donnell:** In hindsight, should that have formed a basis because, obviously, with rampant inflation, it gave rise to the cost of living going up for people so wages had to rise. But in hindsight, if you had it back again would you have done it differently?

**Mr. Dermot McCarthy:** Well, my role in the pay negotiations was to act as a facilitator, rather than a negotiator. And I suspect that the employers tried to achieve the lowest possible outcome in terms of increases and had there been a way of decoupling some of these inflationary pressures from the process, they would certainly have tried it.

**Deputy Kieran O'Donnell:** Can I look to move to just a couple of quick points to clarify the night of the guarantee? Did the banks bring in their own guarantee? Mr. Cardiff was before us ... when he was effectively doing up the ... drafting the press statement for the ... he basically-----

**Chairman:** We will have to keep that general because we don't have the evidence on the screen so-----

NEXUS PHASE

**Deputy Kieran O'Donnell:** The general thing was ... did the banks bring in a guarantee ... their own guarantee on the night?

**Mr. Dermot McCarthy:** My recollection ... excuse me ... recollection is that there was a formula, a definition, if you like-----

**Deputy Kieran O'Donnell:** In writing?

**Mr. Dermot McCarthy:** In writing.

**Deputy Kieran O'Donnell:** Okay, did you get sight of that?

**Mr. Dermot McCarthy:** At the time, I believe I did.

**Deputy Kieran O'Donnell:** Was that copied and circulated to other people at the meeting?

**Mr. Dermot McCarthy:** I believe it was.

**Chairman:** Which institution brought that?

**Deputy Kieran O'Donnell:** Sorry?

**Chairman:** Which institution brought that?

**Deputy Kieran O'Donnell:** Which institution actually brought that?

**Mr. Dermot McCarthy:** That I can't recall, but it ... my recollection is that it had the support of both institutions.

**Deputy Kieran O'Donnell:** Would ... you spoke earlier about ... would they be ... where would those documents ... where would that document now be? Department of Finance or the Department of the Taoiseach? Have you seen it in recent times?

**Mr. Dermot McCarthy:** No.

**Deputy Kieran O'Donnell:** Where would it be?

**Mr. Dermot McCarthy:** I can't say, Deputy. I believe what happened was that following that discussion in which the text was produced, there was discussion involving more official-side people who came into the room who hadn't been present for the-----

**Deputy Kieran O'Donnell:** Can I, in the limited time ... what was in that document that was provided by the banks, in your view?

**Mr. Dermot McCarthy:** My recollection is that it was a definition of what would be covered by a guarantee.

**Deputy Kieran O'Donnell:** What was the definition ... what did it include?

**Mr. Dermot McCarthy:** I can't recall with clarity.

**Deputy Kieran O'Donnell:** What do you think it was?

**Mr. Dermot McCarthy:** It was, as I recall, it was a definition of types of deposits and instruments which would be covered.

**Deputy Kieran O'Donnell:** So senior bonds to be included-----

**Mr. Dermot McCarthy:** I believe so.

**Deputy Kieran O'Donnell:** And was it a two-year guarantee?

**Mr. Dermot McCarthy:** Yes.

**Deputy Kieran O'Donnell:** Okay. When the banks left and the draft you spoke about ... the draft going over and back, were the banks present in the room when that ... when it was being revised?

**Mr. Dermot McCarthy:** No.

**Deputy Kieran O'Donnell:** So, Mr. ... I am taking it that Mr. Cardiff did up a draft, he brought it in and out of the room. Did it at the end of the night reflect in substance what the banks had brought in, day one?

**Mr. Dermot McCarthy:** Well, what ... my recollection is that in so far as I could judge it and I am not an expert in banking issues so it didn't necessarily mean a huge amount to me.

**Deputy Kieran O'Donnell:** You are a highly experienced public servant, civil servant.

**Mr. Dermot McCarthy:** But not in banking. But my recollection is that the broad thrust of what they were proposing tallied pretty much with the discussion that had taken place before they came in as to what the scope of a guarantee would be to be effective. I suspect it was more granular and maybe more detailed and as the committee has heard, I think Kevin felt that in that, it went further than-----

**Deputy Kieran O'Donnell:** And Mr. ... the Central Bank's draft that they brought, which was a six-month guarantee, purely on deposits, no mention of bonds of any form, either senior or other, where did that draft ... did you have sight of that draft in the meeting that took place?

**Mr. Dermot McCarthy:** No, Deputy. As I said earlier, I wasn't aware that that, if you like was in gestation and that the first text that I recall seeing of a formula was one which I assumed had originated with Kevin Cardiff but the documents would suggest that he was working from an earlier version which was in effect, the one that William Beausang had been engaged in.

**Deputy Kieran O'Donnell:** Okay, can I Chairman, can I ... is it in order to direct Mr. McCarthy to the e-mail that Pat Farrell would have submitted to him? It was in the book of evidence-----

**Chairman:** Okay-----

**Deputy Kieran O'Donnell:** -----from earlier?

**Chairman:** And I'll just give Mr. McCarthy a bit of leverage on it if he is not wholly familiar with it.

**Mr. Dermot McCarthy:** I'm familiar with it.

**Chairman:** Okay that's grand so.

**Deputy Kieran O'Donnell:** It stated the-----

NEXUS PHASE

**Chairman:** Can you give a reference for that if you have it, please?

**Deputy Kieran O'Donnell:** Yes, Chairman, it's D0T00347001.

**Chairman:** Okay, just give me the-----

**Deputy Kieran O'Donnell:** Page 83 of Vol. 1 in Mr. Farrell's.

**Chairman:** Okay.

**Deputy Kieran O'Donnell:** And effectively it's very simple, it says:

Dermot, we need your support on this - IFSC banking has been completely overlooked. The issue is as relevant to retail banks and has to covered bond banks at IFSC.

From Pat Farrell. That was on 15 October.

I want to direct you to Vol. 1 of your own book of evidence, and it specifically deals with page 95, which is the IFSC Clearing House Group, which was the meeting held exactly the following day, on 16th at 8.30, of which you chaired. And we have a Mr. Deeny, on page 98, speaking about supports for the IFSC. So can you tell me what were the circumstances of Mr. Farrell writing ... sending you that e-mail? What view did the Taoiseach take from that statement? And how did it evolve into the discussion process for the domestic ... for the Clearing House Group discussion meeting the following day?

**Chairman:** Mr. McCarthy?

**Mr. Dermot McCarthy:** Well, the e-mail was received. It was, as you can see, Deputy, it was primarily forwarding to me a copy of, in effect, a submission that the IBF had made to the Department of Finance on this topic. And I did nothing-----

**Deputy Kieran O'Donnell:** I'd say it was more than forwarding now. It says, "...we need your support on this". It's a little bit stronger now than saying-----

**Chairman:** I need you to dial that down a small bit there now, Deputy.

**Deputy Kieran O'Donnell:** Yes. Sorry, yes. If you read it, I would take "...we need your support on this" as being slightly different from saying, "Please find enclosed the e-mail that has just been forwarded to us."

**Mr. Dermot McCarthy:** It had the same effect, Deputy.

**Deputy Kieran O'Donnell:** Right. Just maybe slightly elaborate?

**Mr. Dermot McCarthy:** Well, clearly it had been received by the Department of Finance. They were the appropriate people to assess it. I took no action on it. And I didn't, to my recollection, inform the Taoiseach about it.

**Deputy Kieran O'Donnell:** And did you forward it to the Department of Finance?

**Chairman:** Last question, Deputy.

**Deputy Kieran O'Donnell:** Did you forward it to the Department of Finance?

**Mr. Dermot McCarthy:** I don't believe so. They already had it.

**Deputy Kieran O'Donnell:** So you took a managerial decision that it wasn't in the Taoiseach's domain?

**Mr. Dermot McCarthy:** Absolutely.

**Chairman:** Okay, thank you very much. Senator Sean Barrett.

**Senator Sean D. Barrett:** Thanks very much, and welcome, Mr. McCarthy, at this late hour. Did you send any reply to that request directly to the centre?

**Mr. Dermot McCarthy:** I believe I might have mentioned it to Mr. Farrell the following morning at the meeting that Deputy O'Donnell referred to, that I had received his e-mail.

**Senator Sean D. Barrett:** Yes. And did you know what the cost would have been had you accepted it?

**Mr. Dermot McCarthy:** I was enlightened by you earlier in the afternoon, I think, yes.

**Senator Sean D. Barrett:** Thank you very much. Yes-----

**Chairman:** We're coming up now to the 9 o'clock threshold, and on the TV cameras it says you can say whatever you like, but the rules still apply in the inquiry before and after 9 o'clock. Mr. McCarthy.

**Senator Sean D. Barrett:** Thank you very much. Could I look at Vol. 2 of your own book, Mr. McCarthy, on page 89? What it refers to, Chairman, is a reply to Mr. Trichet in two lines, "I wish to acknowledge receipt of your letter and enclosure of 16 October [2008] which will be brought to the Taoiseach's attention as soon as possible." And the date of that non-response, if you like, or just acknowledgement, is 30 October. And when you turn over the page, Mr. Trichet was making suggestions like the ECB opinion notes that, "I am writing to request that the Irish Government arrange that interbank deposits with a maturity of up to three months be excluded from the liabilities covered under the draft scheme." What was happening? There was such a delay in reply. He was our paymaster and he was making a suggestion which would have saved us money. And we said, "Yeah, we got your letter a fortnight ago." When did we actually reply to Mr. Trichet in that correspondence?

**Mr. Dermot McCarthy:** I believe that the Minister for Finance replied to him. I can't recall the date.

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

**Mr. Dermot McCarthy:** It ... and I ... well, I won't speculate, but I wouldn't be surprised if President Trichet wrote in parallel to the Minister at the same time. The particular concern that he had as I recall-----

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

**Mr. Dermot McCarthy:** -----was the interbank short-term deposits, and that their exclusion-----

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

**Mr. Dermot McCarthy:** -----would have significantly weakened the effectiveness of the guarantee, given the structure of the funding that the Irish banks had. So my recollection is

that the Minister replied to him, giving undertakings to monitor the extent to which that form of funding happened, so that the disturbance of the ECB's management, if you like, of interbank transactions wouldn't occur, which I think was his primary concern, that this was potentially going to distort something which the ECB regarded as a particular priority.

**Senator Sean D. Barrett:** So he did have a reply, reasonably approximate to 16 October.

**Mr. Dermot McCarthy:** That's my recollection.

**Senator Sean D. Barrett:** Okay. Thanks. And, I recall ... I was present when you were chairman of the NESC, did ... the NESC reported, in 2004, on housing. Did it see the bubble happening? And did it see an excess concentration in the total economy on construction?

**Mr. Dermot McCarthy:** My recollection is that it did refer to the degree of concentration. In fact, I believe it cited the financial stability reports that Senator D'Arcy was referring to earlier. It ... as I recall, it did anticipate, as, indeed, did the Department of Finance, that there would be a reduction in the level of housing output. It looked at issues like the potential impact of land hoarding on the price of land and, thereby, the price of houses. It's broad conclusion was that, if you like, the economic rent that was extracted through the capitalisation of reduced interest rates on the price of housing had largely worked out of the system because the ... by that time there was an easing, at least at that time, there was an easing in house prices, and there ... the analysis suggested that, while there had been this very significant output of housing, that there were still very substantial unmet needs, in the greater Dublin area in particular, and for people on low to modest incomes, and they recommended that over time the level of provision of social housing, and a more effective set of supports to the private rented sector, should support housing output as the private demand attenuated. So, I think that was the broad analysis. It wasn't forecasting a collapse, the hard landing, it-----

**Senator Sean D. Barrett:** Okay, thank you. On the incorporeal Cabinet meeting, you've been with us it says here since 2.30 p.m., but I mean, I ... but, I mean, is ringing people, one after the other, at all a substitute for the, kind of, debate that you get around this table, and shouldn't we be careful about incorporeal Cabinet meetings?

**Mr. Dermot McCarthy:** Absolutely, Senator, and they are, on matters of substance, as opposed to formalities, sometimes, things like giving permission to the President to lead the State, might have to be done at short notice, that sort of thing is perfectly effectively done in an incorporeal ... it's not desirable, and, in my experience, is only done when it's unavoidable.

**Senator Sean D. Barrett:** In the ... Vol. 2, on page 131, notes prepared for the visit of the aforementioned Mr. Trichet, it's on page 131, and the briefing, I think that that was for the Taoiseach, it says, "The global financial crisis took hold in August 2007." From my reading of the material, wasn't there an amazing failure to respond between August 2007 and the collapse at the end of September 2008? Were our institutions geared up to meeting this crisis, because you were at the core of so many things, including the NESC, and so-----?

**Mr. Dermot McCarthy:** Well, I think there were a number of failings with ... and, in a sense, a number of people have commented on the unsatisfactory nature of, if you like, the spreading of the blame, so to speak, but, it ... as, as Nyberg, I think, observed, it was of the scale that emerged precisely because there were a set of interlocking failures. On that particular issue, I think there was an orientation to define the problem as a liquidity one, and it was, of course, in origin, a liquidity one, which meant that the concern about the solvency question, the

capital adequacy, the potential exposure on loan books, and so on, wasn't engaged with as early as it arguably should have been.

**Senator Sean D. Barrett:** On the night of the guarantee, should we have combined it with some kind of due diligence, even that the banks which we were rescuing should have left the keys of those banks in the Taoiseach's office because Anglo went from, what, €1.5 billion to €30 billion eventually and wasn't nationalised until late January. NAMA found records ... were totally defective? Did some of them disappear in this interval between being bailed out and eventually we got around to seeing what the total bill was? Would we do all that differently again?

**Mr. Dermot McCarthy:** I think that the reality was that the information which came to light slowly and painfully over some time should have been known to the system well before the guarantee. In the event that ... the scheme of the guarantee, in other words, the particular commitments that covered institutions had to enter into in order to access the guarantee, was quite broad and directive and it gave enhanced powers to the regulator in terms of the conduct of the institution, its funding strategies, as well its loan book ... its management of its loan book. So in a sense the framework for ... not just due diligence but acting on the due diligence was created by the scheme itself. But that was very much a second best to having had that degree of oversight and engagement and knowledge well in advance of the guarantee.

**Senator Sean D. Barrett:** Should we drop the words "constructive ambiguity" and have "quantitative targets" for the efficiency of this sector so we'd know what was going on?

**Mr. Dermot McCarthy:** I think that there was a neglect of relatively basic indicators of performance.

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

**Chairman:** Thank you very much. Deputy John Paul Phelan. Deputy, ten minutes.

**Deputy John Paul Phelan:** Thank you, Chairman. Good night, Mr. McCarthy. It's nearly a 12-hour session you're-----

**Chairman:** We're over the 9 o'clock threshold now. I'll give you a bit of leverage.

**Deputy John Paul Phelan:** I've a few questions. I'll try not to be repetitive, some of them may have been asked already but, firstly, I just ... you wore many hats, I suppose, in your time as Secretary General to the Government and Secretary General to the Department of Taoiseach ... I should say Secretary to the Government and - it's been referred to earlier on - your chairmanship of the NESC and also your role in regard to social partnership. And, therefore, you could be said, I suppose, to have been in a particularly strong position to observe the interconnectedness between different public bodies that led ... or that existed prior to the banking crisis. Against that background, what, if any, follow-up analysis was done internally within the Department of the Taoiseach or, indeed, the NESC on contrarian views on the soft landing theory? We've had different evidence from many witnesses going back to the start of the inquiry, a lot of it outlining that the soft landing rarely if ever materialised in other jurisdictions but there was a belief in this country that it was going to be ... we were going to be a different case, among certain people. Has there ever been any analysis along the lines I'm asking conducted?

**Mr. Dermot McCarthy:** I believe that the NESC, in relatively recent times, has produced a number of studies of what happened in the housing market including, it has to be said, its

own misreading of some aspects of the situation when the housing report was produced in 2004. Why the dots weren't joined up in a sense is, I think, your question, Deputy, and that's something I've tried to reflect on. And part of the answer, I think, lies in issues which were raised before the committee by John FitzGerald and Alan Ahearne, that there was a ... there was a certain segregation of financial stability issues from others and, as Wright observed in his report in the Department of Finance, if you like, a bringing together of the different dimensions of risk weren't ... wasn't effected. It certainly wasn't communicated to the Government. I think we were perhaps distracted by a number of things which were ultimately peripherally important. Like, for example, we had no exposure to the US sub-prime problem, which seemed to be the initial origin of the international financial crisis. The fact that our fiscal outcomes were so impressive and ... and, I mean, at a particular point in the mid-2000s, one of the tasks of the Taoiseach's Department was to organise the orderly management of the international delegations coming to see how the Irish situation was so successful. So there was, I think, ultimately, if you strip it all away, there was a failure of analytical rigour and I don't think that can be laid at the door of the political system.

**Deputy John Paul Phelan:** Going back to the point you were making about the people coming to observe what was happening in Ireland, in 2000, when you became Secretary General to the Government, the Exchequer pay bill was €8.6 billion. By 2008, it had risen to €18.8 billion, an increase of 120%. Now, I know you weren't Secretary General to the Department of Finance but, obviously, you had a role in relation to social partnership and you had an overall role as the person who would have been regarded as the most senior civil servant. Were there any alarm bells ringing for you at that eight-year, 120% increase in the cost of the public service, if you like, in general? And did you raise any of those concerns, if you had ... if you had them?

**Mr. Dermot McCarthy:** Yes, there were concerns, Deputy, in terms of that rate of increase, but it had a number of elements. There was the increase in head count and there had been very significant and deliberate increases in the staffing of a whole variety of services which were regarded as underdeveloped. Then there was the question of the rates of pay, which were, in effect, a function of, as I mentioned earlier, the levels agreed in the private sector and, in a sense, that's as it should be, that the public service should follow rather than lead. In aggregate, the affordability of this and the competitiveness dimension of the overall situation were concerns and there was clearly going to be an adjustment required, which was, in fact, explicitly referenced in the text of the social partnership agreement in 2006, "Towards 2016". And I was interested to see, in the documents sent to me, background papers prepared in the Department of Finance, which I hadn't seen before, regarding the desired outcome of those discussions and I was, I suppose, pleasantly surprised to see that the text of what they desired was actually reflected in the text of the outcome, so they were obviously making their contribution. So, an adjustment to a different path, both in terms of the composition of output and the funding of the State, was flagged, was expected but was, I believe - and I did believe - something which would evolve in a ... not in the teeth of a collapse.

**Deputy John Paul Phelan:** Okay. Can I ask, in relation to again your role as Secretary General to the Department of the Taoiseach, in your time in that period you worked with three different holders of the office. Mr. Cowen was here on two separate occasions and he outlined to the inquiry how he placed ... or I suppose I'm paraphrasing him really now, but he felt that there were people who had responsibilities - such as the Central Bank, the Financial Regulator - and that he let them do their job, I suppose, so to speak, and he relied on the evidence and the information that they gave him. Do you think that there was any substantial difference between



the three holders of the office in your time period, in terms of how they viewed the information that they were getting from those quarters? And I might have a bit of a follow-up on that, but if you could answer that maybe first.

**Chairman:** Please. Thank you very much. Mr. McCarthy.

**Mr. Dermot McCarthy:** I'm not sure my absolute privilege-----

**Chairman:** We might go on the 10 o'clock threshold.

**Deputy John Paul Phelan:** I don't want really specifics, but you ... you-----

**Mr. Dermot McCarthy:** I ... in fact, I worked under five taoisigh in the Department of the Taoiseach and each had a very distinctive style. I'm not sure that the ... that those differences of approach would ultimately have had any great bearing on the sort of input or impact that the authorities would have had because, unfortunately, it doesn't look as though they had the wherewithal to convey the right message.

**Deputy John Paul Phelan:** Okay. Others, most notably witnesses that we've had from the ... previously maybe working with the NTMA, expressed concern with regards to the capacity of the regulator, in particular, to do the functions that were delegated to that authority. Did you at any point in time share any of those or have any cause to have concerns about the capacity of the regulator to perform their function? And, in particular, I suppose, I'm asking the question in relation to ... or did you ever get involved in a discussion in relation to the number of staff that would have been doing the prudential regulation of financial institutions?

**Mr. Dermot McCarthy:** I didn't, Deputy; it wasn't something that would have come my way. My main ... in fact, until the period of the crisis, my only engagement with the regulator was in the context of the IFSC, and staff from the regulator would attend meetings with the clearing house group, and I'd have to say my observation in that forum was that they were confident and competent in their interactions. They sometimes came under pressure, which I understand might still be an issue, about things like the timeliness of turnaround of applications for authorisation and clarity about new forms of authorisation and so on, but my observation was that they engaged with those robustly and didn't display anything that would've caused me to doubt their competence at least in those areas that came up for discussion.

**Deputy John Paul Phelan:** Okay. Finally and briefly, we've had evidence particularly, I think, from Mr. Cardiff in relation to not just outside forces, but individuals and groups that came to him and maybe others within government prior in the earlier part of 2008 before the guarantee outlining the possible need for a political guarantee and then maybe a more extensive guarantee. Were you aware of those approaches yourself and did anybody in that time period approach you on those matters?

**Mr. Dermot McCarthy:** No one approached me, that I recall. And my awareness of, if you like, the discussion of potential guarantees would have been certainly no earlier than the beginning of September; in other words, that it was in the ether of that stage.

**Chairman:** Thank you very much, Deputy. I'll just wrap up with a couple of questions, Mr. McCarthy, and then Ill invite the two leads to wrap up as well and any closing comments you may wish to make yourself. I just want to bring a minute up on the screen there just for a moment. It's in your own book of evidence, its DOF01B02. It's a minute of a meeting where there is a discussion with liquidity and insolvency, in particular to Anglo and INBS and so forth.

Are ... there is the Attorney General, Taoiseach and the Secretary General to the Government. Were you present at this meeting that this minute relates to?

**Mr. Dermot McCarthy:** I believe I was, yes. Chairman.

**Chairman:** Maybe if you could just briefly outline as to what the agenda of that meeting was discussing.

**Mr. Dermot McCarthy:** Well, it ... as I recall it was an occasion for the officials who had been engaging with these issues in detail to brief Taoiseach and the Minister for Finance on where, if you like, their analysis was leading. And the short note there, I think, does capture, as I recall, the range of issues that would have been covered in the presentation. It wasn't an occasion when any decision was expected and, certainly as I recall, none was made.

**Chairman:** Right. Given the nature and the seriousness of obviously what was being discussed here, could I put the question to you, Mr. McCarthy, when even approximately - I'm not looking for the specific hour or the specific date, but by approximation - did you become aware that the whole, say, borrowings situation presented a systemic risk? And how was this risk relayed to you, and by whom?

**Mr. Dermot McCarthy:** Well, I would have had an awareness of the liquidity pressures and the fact that there was a degree of mobilisation, if you like, across the financial system by the Central Bank, in particular, to prepare for a further tightening of that. The point where it became a systemic risk as opposed to a problem to be managed, I ... if it was earlier than the beginning of September, it wasn't much earlier, I think, than that.

**Chairman:** You think it was earlier ... approximately, just on a date line, quarter 1, quarter 2, if not even the month.

**Mr. Dermot McCarthy:** Well, no earlier than quarter 2, certainly.

**Chairman:** Of-----

**Mr. Dermot McCarthy:** Of 2008.

**Chairman:** 2008. No later than quarter 2 of 2008, okay.

If I can just deal with one final issue then, Mr. McCarthy. There's a table in your evidence book there, and I just want to bring that up. And the two tables relate ... one is a ... it deals with sectoral lending volumes, in billions, and you can see a, kind of a, significant growth factor there from ... going from '01 into '02 and then a massive escalation ... quite significant escalation where we go from just in about ... I reckon these are millions ... I'm assuming ... in around €50 million in around 2003 up to €250 million in 2007. There's quite a big peak. And there's another table here ... sorry, they're billions actually. I've just been ... they're not millions, they're actually billions. I just wanted to bring up another table there as well for you and that relates to the increases in public services allocations. These are from 2000 to 2008. What we see here is in millions again, but if you remove the commas, I presume ... or go by the commas, they're actually billions. We see, in social welfare, an increase in that period of 160%. That's from €6 billion to over €17 billion; in education, just under €4 billion to €8.5 billion - I'm just giving the approximate figures here now to you; health, of just under €5.5 billion to €15 billion or, actually, over €15 billion; capital investment going from €9 billion up to €9 billion; total expenditure going from just under €26 billion to over €62 billion, an increase of 141%; in terms

of GDP, expenditure of plus 71%. Okay, so in regard to that table, what we see here is a huge increase in public expenditure allocations between 2000 and 2008 at 141% in total, which was precisely double the growth in GDP over the same period. As I then say, when combined with the statistics on the parallel major growth in construction-related lending, were these two sets of figures alone not sufficient warning for Government that a bubble was being created?

**Mr. Dermot McCarthy:** Well, on the expansion in credit, Chairman, clearly, it is a very dramatic increase, but the interpretation of that in terms of risk to financial stability was something which Government would have relied on a Finance assessment to ... to create and they, I suspect, in turn, were taking full account of the financial stability report from the Central Bank, and it ... I think it's a matter of fact from previous reports that the assessment, the tone, and the messaging didn't flag that this was something which threatened financial stability. It created vulnerabilities but not a pending crisis.

On the expenditure increases, they were very significant, but as a result, I suppose, of the strong output, in particular, from the construction sector, their funding was ... appeared to be accommodated in a way which was compatible with a strong fiscal outcome. In reality, the elements of a bubble were building up, but if you like, the distillation of that into a clear analysis and message wasn't received.

**Chairman:** Okay. And putting aside concepts like groupthink, herd instinct, and all the rest, if somebody just arrived to these figures coldly, not taking on the, kind of, media environment or influences or anything, just looked at these figures coldly, should they be giving at least amber signals that there is potentially a problem here?

**Mr. Dermot McCarthy:** I couldn't disagree, Chairman. But the ... in the messaging as received, it was amber and not red.

**Chairman:** Okay, all right. So in your view was Government aware at that time that there was an amber light, to use that parlance?

**Mr. Dermot McCarthy:** I believe so, Chairman. Certainly by, I think, 2006 the ... if you like ... the amber was very visible. It might have been flashing a bit earlier. But the emphasis, if you like, in terms of the risk to economic performance that were highlighted included the potential downturn in the construction side. But also issues like exchange rate movement, commodity prices, the fate of the US economy. By contrast with those issues, this was something under, potentially, some measure of domestic control. What the messaging was understood to be saying was that it was no different, in terms of its risk significance, to those other issues.

**Chairman:** Another part of the messaging at that time, Mr. McCarthy, is that they were preparing for a soft landing or the potential for a soft landing. You'd have been familiar with that messaging as well at the time. In regard to that messaging, are you aware of any evidence, and I'm not talking about commentary that's taken from third parties or external agencies that are not in Government but NGOs, financial institutions, whatever. I'm talking about evidence that was either in the Department of Finance or in the Department of the Taoiseach that supported - and I'm talking about evidence-based support now, as opposed to commentary-based support, that supported a soft landing theory?

**Mr. Dermot McCarthy:** Well I can't say that I'm necessarily familiar with everything that Finance would have done but I certainly would have been familiar with everything that they submitted to the Government. And they would have been advising that an orderly transition to a

lower sustainable output was what was to come. My recollection is that the ESRI medium-term review in 2003 and their *ex-ante* appraisal of the national development plan in 2006 did provide analysis of the housing market that concluded with forecasts of housing demand and output that the soft landing was a credible and likely outcome.

**Chairman:** And that was an external ESRI report, that was not a Department of Finance report?

**Mr. Dermot McCarthy:** Yes.

**Chairman:** Okay, thank you. I'll just now move towards wrapping things up so, with your permission, Mr. McCarthy, and invite Deputy Murphy in to wrap up please.

**Deputy Eoghan Murphy:** Thank you, Chairman, and thank you Mr. McCarthy. Just three brief questions. We had in evidence from Ann Nolan that before nationalisation of Anglo could take place that the bond agreements would have to be analysed and looked at and ... to see what was there. But at the same time the Government was preparing legislation for nationalisation of a bank, more than likely Anglo. So were you preparing for nationalisation of Anglo in the run up to that night of the guarantee, including that night, without having done the due diligence work on the bond agreements in the bank?

**Mr. Dermot McCarthy:** I can't really comment on that, Deputy, because I wouldn't be aware as to whether such analysis had taken place. I don't recall anything on the night being said that implied there was an impediment to moving to nationalisation if that was the decision.

**Deputy Eoghan Murphy:** Okay, thank you. When the new Government attempted on 31 March to ... a second attempt at burden-sharing, there was a phone call between Jean-Claude Trichet and the Taoiseach, is that correct?

**Mr. Dermot McCarthy:** That is correct.

**Deputy Eoghan Murphy:** Who instigated that phone call?

**Mr. Dermot McCarthy:** The Taoiseach as I recall.

**Deputy Eoghan Murphy:** Was there any contact between the Taoiseach in November - the end of November - with the president of the ECB, Jean-Claude Trichet, in relation to burden-sharing at that final moment when a decision was being made whether we'd do it or not?

**Mr. Dermot McCarthy:** I can't be sure, Deputy, but I don't recall it.

**Deputy Eoghan Murphy:** Why wasn't the Department of the Taoiseach leading in the negotiations on the bailout agreement, including burden-sharing, at the time of the bailout negotiations in November 2010?

**Mr. Dermot McCarthy:** Well because the whole, if you like restructuring, both in the banking side and the fiscal side, were the responsibilities of the Minister and Department of Finance. They were the ones through ECOFIN and the normal contacts who would have been engaging with their counterparts in the various institutions. So it was, if you like the appropriate way in which the negotiations would be conducted.

**Deputy Eoghan Murphy:** And yet the Department of the Taoiseach led on the night of the guarantee?

**Mr. Dermot McCarthy:** I don't believe it did Deputy, the Taoiseach led on the night of the guarantee. But the, the input was in respect of the financial assessment and the advice was, the advice from the Department, the Governor and the Financial Regulator, with the NTMA views also relayed, they were all if you like finance entities. The role of the Taoiseach was to lead the process to a conclusion.

**Deputy Eoghan Murphy:** Final question then is, in relation to your time as Secretary to the Government and Secretary General to the Department of the Taoiseach, did you ever have concerns yourself or were concerns ever brought to you by senior management in the Government apparatus about improper influence on Government decision-making or policy formulation from individuals or sectors or industries outside of the State?

**Mr. Dermot McCarthy:** Never improper influence. Influence was certainly applied by those who had it but ... it was, is part of the job of Government to engage with that influence, assess whether it's valid and worthwhile and respond appropriately. So, but the, sort of, improper pressure for whatever reason, I don't believe I experienced it.

**Deputy Eoghan Murphy:** Okay and you never felt there might be an improper association between ... a part of the Government and a particular industry or sector in the State?

**Mr. Dermot McCarthy:** Improper, no.

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

**Chairman:** Thank you very much. Senator MacSharry.

**Senator Marc MacSharry:** Great thanks very much, and finally can I just ask a couple of quick questions? In terms of the percentage rate, 5.8% not being reasonable it said in one of the core documents there rather than bring it back up, and there was a quote where it was estimated that the most comparable rate for eight-year money at the time was 6.02%. Do you believe that Ireland got a good deal?

**Mr. Dermot McCarthy:** In the circumstances at the time, I think it was an appropriate outcome but the circumstances at the time were not good in the sense that the ... I think this was the first time in which, in which the new support mechanisms were being applied and in, in the way in which they were deployed there was as much attention in my view, from what I could observe, on protecting the interest of the contributors, as ensuring the effectiveness with the recipient, so that the interest rate was ... it was reasonable, having regard to the alternative market rates but it was certainly posing a significant sustainability issue. And it was flagged as an area of particular concern, both by the Governor and the CEO of the NTMA, as well as the Department of Finance and it was clear ... that opportunities would have to be sought to bring about a lower rate at the right time.

**Senator Marc MacSharry:** Mr. Cardiff, when he was here, said it was explicit in the memorandum of understanding that the rate would be reduced if and when time allowed. Is that the case?

**Mr. Dermot McCarthy:** From memory, there was certainly provision for the, the rate to be revisited.

**Senator Marc MacSharry:** You mentioned towards the end of your statement, when you were giving some views on, on those issues that have been addressed since and what things may

or may not help and you mentioned the registration of lobbyists, and I had asked you earlier about did you ever feel, as a certain person in the Central Bank had, that there was an undue political or business interest leading Government or influence decision-making and policy in government, and you said no. Would you like to revisit that on the basis of what you said to do with lobbying? I mean do you feel that there was excessive lobbying or did this have an unhealthy input, or why do you feel things are better now or will be better with the registration of lobbyists, if you, if you said earlier that there was no ... you saw nothing in your 11 years?

**Mr. Dermot McCarthy:** Well, if I recall, Senator, the question you asked me was there some ... someone or some interests exercising an improper influence, and that is certainly not my experience.

**Senator Marc MacSharry:** Okay.

**Mr. Dermot McCarthy:** But in terms of lobbying, I mean, at a ... in one sense, lobbying is the essence of public life - engaging and seeking to influence others. I ... my view is that it's healthy to have that as transparent as possible and that the merits of what people are being asked to take on board can be assessed. I don't believe that Government was too vulnerable to lobbying effort. I did believe and do believe that lobbying capacity is not equally distributed around society and one of the strengths of social partnership was that it gave everyone a seat at the lobby table and they had to listen to each other. There are other ways of doing social dialogue, clearly, but all of that is supported, in my view, by a good regime and a realistic regime for monitoring lobbying activity.

**Senator Marc MacSharry:** Okay. Just on the burning of bondholders, can you outline for us what was the difference in response from Europe, from, I presume it'd be, Trichet and the G20, or G8 or whatever it was ... that were influencing the fact that this wasn't going to be accepted? What changed between November and March, if anything, to the position of the EU and the troika and powers that be? Harden, weaken, was it the same?

**Mr. Dermot McCarthy:** My impression, Senator, is that it didn't change.

**Senator Marc MacSharry:** Okay. Did the efforts from the Governments of the day change or were they equally powerful and robust, or not?

**Mr. Dermot McCarthy:** I think there was extensive engagement on both occasions and there was an expectation of a measure of agreement for different reasons on both occasions but, ultimately, on both occasions the answer was "No".

**Senator Marc MacSharry:** Finally, in the establishment ... and commentary on the establishment of the Dáil about this inquiry, the Taoiseach spoke of uncovering what he described as the "axis of collusion" between Fianna Fáil, the banks and developers. What's your own view of a statement like that?

**Mr. Dermot McCarthy:** It's a political statement, Senator, and I've come to appreciate all political statements.

**Senator Marc MacSharry:** But in the context of the inquiry?

**Deputy Michael McGrath:** There's an answer now using all your experience.

**Senator Marc MacSharry:** Would your knowledge - just, it's a very supplementary question - of your 11 years, obviously, in the Department, working under five taoisigh and, indeed,

the benefit of hindsight lead you to believe that such commentary represents fair comment, or not?

**Mr. Dermot McCarthy:** Well, maybe not to comment on the comment but to comment on the substance of the issue-----

**Senator Marc MacSharry:** But I've asked you about the comment, now, in fairness.

**Chairman:** I'll allow Mr. McCarthy to make his own interpretation of it as well. You can ask the question but Mr. McCarthy gets to make the answer.

**Senator Marc MacSharry:** Yes, well I've often heard you direct witnesses to answer the question.

**Chairman:** I have but I don't think we're in a situation here where I'd be giving Mr. McCarthy-----

**Senator Marc MacSharry:** Well, I think it's an important question. I think it's an important question and I would ask you to answer it to the fullest extent possible.

**Mr. Dermot McCarthy:** In so far as, if you like, the substantive dimension is concerned, I didn't form a view or reach a conclusion that the actions or policies of the Government were based on a relationship or a disposition towards sectors or institutions. And I think it will be one of the beneficial outcomes of this committee's work to provide material and reach conclusions that may help the broader public to form a view.

**Senator Marc MacSharry:** Great answer.

**Chairman:** Thank you very much. Have you anything else, Senator?

**Deputy Kieran O'Donnell:** Are you happy with that now?

**Chairman:** If that's bringing us-----

**Deputy Kieran O'Donnell:** Are you happy with that?

**Senator Marc MacSharry:** No, I'm not particularly happy with it. But that's all I'm getting, isn't it?

**Chairman:** Sorry, can we please return to the meeting there? And we'll conclude with Mr. McCarthy. Mr. McCarthy, is there anything by means of further, final, additional comment that you might like to add before I bring proceedings to an end?

**Mr. Dermot McCarthy:** No, thank you, Chairman.

**Chairman:** Okay. With that said, I'd like to thank you again, Mr. McCarthy, for your participation today, and for your very accommodating engagement with the inquiry in regard to scheduling, and to now formally excuse you in that regard. I propose that the meeting is adjourned until 9.30 a.m. on Thursday, 16 July 2015. Is that agreed?

The joint committee adjourned at 9.36 p.m. until 9.30 a.m. on Thursday, 16 July 2015.