

# 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, 22 Iúil 2015*

*Wednesday, 22 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.

market economy in Germany, where German citizens have access to all of these public services at a level that saves them quite a lot on their basic income. So that's what we were trying to do. We never got the model perfect, you know, and probably we won't at this stage, for obvious reasons, but I think it was a good thing to do and it is the right thing to do and as I indicated in my earlier evidence, I believe that's the way the country should go again in the future.

**Chairman:** Okay, I'm going to bring matters to a conclusion, unless there's any other final comment you like to make by means of closure, Mr. Dunne and Mr. Begg?

**Mr. David Begg:** No, thank you.

**Mr. John Dunne:** No, thank you.

**Chairman:** Okay, thank you. So with that said, I'd like to thank the both of you, Mr. Begg and Mr. Dunne, for your participation today with the inquiry, and your engagement with it. I now formally excuse both witnesses and suspend until our next session, 'til 1.05 p.m. Is that agreed? Agreed.

*Sitting suspended at 12.45 p.m. and resumed at 1.19 p.m.*

### **EBS - Mr. Fergus Murphy**

**Chairman:** We'll return to public session. Is that agreed? And the Committee of Inquiry into the Banking Crisis now resuming in public session and can I ask members and those in the public Gallery to ensure that their mobile devices are switched off? Today we continue our hearings with senior bank executives who had roles during and after the crisis. Our witness this afternoon is Mr. Fergus Murphy, former group chief executive officer at EBS. Fergus Murphy was group chief executive officer at EBS from January 2008 to 2011. He previously held senior positions at ACC Bank and Rabobank. Mr. Murphy is now the director of corporate and institutional banking with the AIB Group. Mr. Murphy, you're very welcome before the committee this afternoon.

**Mr. Fergus Murphy:** Thank you, Chairman.

**Chairman:** Before hearing from the witness, I wish to advise the witness that by virtue of section 17(2)(l) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you're directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you're entitled thereafter only to qualified privilege in respect of your evidence and you're directed that only evidence connected to subject matter of these proceedings is to be given. I would remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry, which overlap with the subject matter of the inquiry. The utmost caution should be taken therefore then 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 documents are confidential and they should not publish any of the documents so displayed. The witness has been directed to attend this meeting of the Joint Committee of Inquiry into the Banking Crisis. You have been furnished with booklets of core

documents. These are before the committee and will be relied upon in questioning and form part of the evidence of the inquiry. So with that said, if I could now ask the clerk to administer the oath to Mr. Murphy please.

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

Mr. Fergus Murphy, former Group Chief Executive Officer, EBS.

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

**Mr. Fergus Murphy:** Thank you Chairman and thank you committee. I would like to say that I'm happy to be here today to answer your questions and hopefully give you my personal perspective, as someone who came back to Ireland from abroad in 2007, commencing in EBS in 2008 and spent four years leading and making the changes necessary to enable EBS to get through the crisis. Chairman, I've submitted a detailed written statement, but if convenient, I'll just take a few minutes now to make some opening remarks. By way of background, I've spent most of my career in international or European banks, including 14 and a half years in Rabobank, working in a variety of roles in treasury and capital markets, corporate banking, general management etc., including head of global treasury for Rabobank International across 44 countries and CEO of Rabobank in Asia. Prior to working for Rabobank, I worked for BNP Paribas for five years and before that, the KBC bank, the Belgian bank. I became CEO of EBS on 14 January 2008, joining the board in February 2008. I'm currently director of corporate and institutional banking at AIB, having held a number of roles on the leadership team and the executive committee of AIB over the last four years, including director of transformation and group services, which is the portfolio responsible for the majority of change management and the restructuring of the group.

On taking up the role in EBS in 2008, I was highly conscious of the sub-prime crisis in the US, as I'd spent some time there in late 2007 in a role that allowed me to view the property industry closely and had developed a growing sense of the challenges confronting that industry in the US. I also, through my Rabobank experience, had a strong recall of the property correction that took place in the Netherlands in the early noughties, when property prices reduced by about 20% causing some stress in the economy. My view at the time, as an interested observer, was that there certainly were challenges ahead in the Irish economy, as it had grown so strongly in the prior decade. Property prices had risen substantially and it was noticeable on coming home how much prices had increased generally. My view at the time was that property prices in Ireland needed to, and probably would correct by about 20%. Something similar to the Dutch experience which, although a difficult correction in their economy, had been manageable. So my sense of the challenges ahead did not drown out my overall positivity, indeed my pride at taking over at the helm of a financial institution in my home country, an organisation with a strong heritage and tradition in Ireland that, like Rabobank, which I'd worked in for so long, was a member organisation. The mutual model in UK and Ireland is very similar to the co-operative banking model in continental Europe both owned by the membership and in existence to serve the membership base. EBS had been a positive force in Irish banking and financial services for decades since its foundation by Alex McCabe and a small group of teachers and trade unionists working together to help each other to buy their family homes in ... from 1935 and I was looking forward to the challenge of leading it through the upcoming challenging period and contributing to its continued modernisation and ultimate growth.

I understood at the time that one of the reasons I'd been selected to lead EBS was my inter-

national background, outside of Ireland banking experience and my capital markets experience. I had been deeply involved in a number of financial crises around the world. For example, I was in Indonesia in 1997 during the worst of the financial crisis in Asia leading a triage team to stabilise the Rabobank balance sheet in Indonesia. That was just shortly before the collapse of the Suharto regime. The EBS chairman, who himself had only taken up the role recently at the time I joined, was a modernising and progressive force and he had been ... he had given me a mandate to bring the organisation forward, look at the operating model and structure in order to create the best possible future for the organisation and its membership. As part of my own due diligence before joining, I did query the EBS exposure to commercial real estate and land and development sectors and was given comfort that although there were some challenges, overall the book was in okay condition.

However, only weeks into my tenure, there were external and internal signs of stress in the local markets. Linking some up ... linking up some of the dots, in terms of my recent and past experience, I commenced a programme of retrenchment and risk containment, which unfortunately would be the dominant activity carried out in EBS during my tenure. For example, I reversed existing plans to create a commercial property subsidiary to enable the growth and the potentially separate funding of the commercial property business, which had envisaged growing the book by circa 50% to 100%, depending upon future market conditions and opportunities. I also initiated a withdrawal from land and development lending within four months of taking office and a withdrawal from commercial property lending within six months of taking office. I addressed the funding and liquidity challenges by accelerating plans to create a covered bond bank, which is a very important structure to enable term funding in the debt capital markets by banks and building societies. We commenced a further balancing of the funding structure and profile of this society by putting a huge focus on the growth of retail deposits. EBS actually grew its retail deposits by circa €2 billion through the crisis, a notable feat when compared with the exodus of retail deposits from other institutions during this period. This particular action helped to stabilise the society and along with the actions on exiting commercial property and land and development finance and other actions, lessened the ultimate amount of capital that the organisation eventually required. I would estimate conservatively that the risk containment activities of that first month period ... first six-month period, resulted in at least €750 million of capital savings for EBS. I reviewed the basic management operating model of the society, which unfortunately wasn't fit for purpose, and I followed up by making essential changes to ensure better governance and separation of duties. For example, there had been no independent CRO function and the risk function reported to the finance director.

Within three months of me joining EBS, Bear Stearns went bust. Within six and a half months of me joining, Lehman's went bust and about a week later, the Irish Government guarantee came in to place. I learned of the CIFS legislation from a quick phone call with my chairman early on the morning of 30 September. Neither I nor EBS had any involvement in the deliberations in the period prior to this on potential guarantees or actions. And I was a little surprised by the decision, when I read about it that morning. EBS had lost some institutional and international funds and deposits and we were concerned with developments but we were certainly not in a fraught position. After the guarantee date, as it is well documented, the Irish economy, property prices and the international backdrop continued to decline through the back-end of 2008 and all of 2009. It was more than apparent that the legacy of the '03-'07 period, whereby EBS, like many other institutions, had built up an unsustainable position in commercial property and land and development finance, a large buy-to-let exposure and built a liability structure that proved fragile, was having a profound effect. However, it is interesting to note that in early 2010, the international backdrop started to improve and it was felt that after PCAR

2010, the worst was over and international markets were recovering. Most Irish commentators, including the Governor of the Central Bank and the Minister for Finance, publicly observed that the worst of the crisis was over, something I was also positive about. However, the commencement of the Greek crisis put paid to that and Ireland found itself again at the centre of a rapidly deteriorating international and local environment. Those days were extremely challenging, as liquidity, credit quality, capital adequacy and economic confidence continued to decline, leading to the troika bailout.

I ensured we at EBS worked cohesively with all Government and other stakeholders to stabilise the system and EBS. I approached every meeting with the starting point that whatever was best for the sovereign was probably the best for EBS, acknowledging that EBS, although an important financial institution with a strong market share in a number of areas and a brand that was less damaged than most financial institutions, was not systemically important in the same way as AIB or Bank of Ireland and that therefore, the solution for EBS may be different to the solution for one of the pillar banks. As CEO, I was going to ensure that the mindset in EBS was open to any practical solution or proposal, including demutualisation, takeover of the society, etc. It was easier for me to have that frame of mind, in that I could be objective on past performance and strategy, in that I wasn't part of it.

Throughout the period, I continued to lead significant improvements in governance and operational controls in EBS, continued to lend sensibly into the residential housing marketplace and improved ... and more conservatively lent and, as mentioned earlier, grew the deposit base. A quick example of the sensible and risk-focused approach is reflected in the volume of residential lending conducted in my time in EBS. This lending was covered 1.7 times by retail deposits, ensuring a secure and locked down conservative approach. Throughout the crisis, I estimate that I spent about 60% of my time on strategic work around working out the long-term future of EBS, onshore merger-takeover, offshore merger-takeover, demutualisation, privatisation, acquisition by private equity etc. We worked on a number of parallel projects all at the one time. All of this worked culminated with a preferred bidder being selected in February 2012 after 11 months of detailed due diligence and engagement. This transaction was terminated on 28 March 2011 and EBS was informed that it was being merged into AIB on 30 March 2011. The success of that merger is, I think, evident in the positive restructuring, stabilisation and return to profitability of the enlarged group over the last four years.

I believe the Irish banks are well on the road to a full recovery. Huge lessons have been learnt within the banking sector and within the regulatory system. Indeed, lessons have been learnt right across the economic and political landscape. I hope my testimony today can add additional insight into your understanding of the crisis, Chairman.

**Chairman:** Thank you very much, Mr. Murphy. And if I can invite our first member today for questioning. Senator D'Arcy, you've 25 minutes.

**Senator Michael D'Arcy:** Thank you, Chairman. Mr. Murphy, you're very welcome.

**Mr. Fergus Murphy:** Thank you, Senator.

**Senator Michael D'Arcy:** You have considerable international experience and experience, indeed, in financial crises in other jurisdictions. Could I ask your opinion in relation to the market's view from late 2007 that the reason the Irish banks' share price was collapsing and, indeed, the liquidity crisis for the Irish banks and the Irish financial institutions was worse here than in others ... the Morgan Kelly view was because the markets understood that the balance sheets

and the loans, in particular, to the commercial real estate sector were so poor that that was the real issue instead of the liquidity crisis as a result of Lehman's? Could I ask your opinion, Mr. Murphy, in relation to which was the deciding factor?

**Mr. Fergus Murphy:** Okay, it's a very good question and if I could take a few minutes, Senator, thank you, to answer that one. I think the commencement of the crisis, ultimately, had its origins in the international landscape. What was happening globally ... and I'll probably simplify the illustration just to keep it as tight as I can, but ... and it's often talked about in the context of the US and China, but it's not just the US and China, it's the East and the West, but I'll just talk about the US and China for a moment. We were in a long boom, it was thought, that could be a 30-year boom, because of the improvements in technology and the productivity of the western world. The US was importing a huge amount of Chinese goods. Okay, it's not just China and the US, but, as I say, just take that example. They were paying for those goods in dollars. They were very large consumers. The Chinese took those dollars and they churned them back into the western world, for example, buying significant amounts of US treasuries. One country had a deficit, one country had a surplus; one country was an importer, one country was an exporter. And there was a virtuous symbiotic relationship between the East and the West in terms ... and I use, again, the US and China, maybe unfairly, just as the best example, where deficits in the West were being funded by, often, moneys coming in from the East.

Now, Ireland then was a little beta stock and, literally, at the epicentre of this either geographically or economically, and when I say a beta stock, I mean, you know, a stock or a country that moves disproportionately up or down to a certain event. We had had an enterprise economy and a virtuous economy up to 2003. Then we started, obviously, investing too much in property and property became a too large contributor to our GDP. We were buying and selling property to each other and thinking we were adding real value. So when this influx of liquidity across the world churning around was taking place we received, and our financial institutions received, more of that liquidity than we should have and it meant that Irish banks were able to go to the wholesale markets in a way that they never were before. For example, in 1998, the EBS balance sheet was 100% funded by retail deposits. When I took over in 2008, it was 26% funded by retail deposits. So what had happened in the interim was the effect of what I was just describing.

So you have this ... you had both push and pull factors. You had this global activity taking place, which meant that, for example, in the US, because there was so much liquidity, banks were able, and financial institutions and asset managers, in general, to structure poorly put together assets, because there was so much liquidity sloshing around and investors wanting to invest that liquidity, that they wanted some kind of a yield. So you had the formation of the sub-prime crisis in the US, with badly-structured assets soaking in the liquidity. Similarly in Ireland, the liquidity got soaked into the property marketplace in a similar way as it did in the US in the sub-prime mortgage marketplace. And so, a combination of the two yielded, unfortunately, the environment that we entered into and the shock and cliff-like environment that took place soon thereafter. But, in my view, the origins of the crisis was the global activity. We were badly prepared and badly set up for it, because of what happened in Ireland and the policies and practices, the way the banks had been run, the way, probably, the economy had been run. But the origin was the international piece, and then we were a beta stock, if I could use that analogy. When economists and experts were looking around the world for the likely red hotspots in terms of where this might happen first and what the effect could be, we did, unfortunately, stand out like a sore thumb.

**Senator Michael D’Arcy:** So do you disagree with Mr. Nyberg who said that the crisis was primarily homegrown?

**Mr. Fergus Murphy:** I think that, ultimately, we built our economy. So we put ... so I don’t disagree with him. I think the backdrop was as described. We set up-----

**Senator Michael D’Arcy:** I think you have disagreed with him.

**Chairman:** Let the witness answer himself.

**Mr. Fergus Murphy:** Well, if I could ... Thank you. Senator. If I could just finish that, I, hopefully, will-----

**Senator Michael D’Arcy:** Thanks.

**Mr. Fergus Murphy:** -----square that off for you. The backdrop was set internationally. We are responsible for our own economies. So I believe Mr. Nyberg is right because if you take, for example, the Canadian economy, it was also an international economy and it didn’t let happen locally what happened in Ireland, but the crisis and the effect and the scale of the crisis in Ireland, wouldn’t have been to the magnitude it was and it eventuated had there not been that international piece. We are responsible for our economy. I would agree with Mr. Nyberg that the crisis, as it eventuated in Ireland versus the way the crisis eventuated, for example, in Canada or Australia, is absolutely our fault.

**Senator Michael D’Arcy:** On the night of the guarantee, Mr. Murphy, please, what was your assessment of the liquidity versus solvency of the society that you were CEO of at that stage?

**Mr. Fergus Murphy:** So on the 28-29 September, the liquidity and funding position of EBS was quite stable and, you know, there were ... we had seen some exit of large ticket international customer deposits-----

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

**Mr. Fergus Murphy:** Yes.

**Senator Michael D’Arcy:** Corporate.

**Mr. Fergus Murphy:** Normally talked to and called non-bank financial institution, so asset managers, insurance companies, etc. These are, again, typically out of the UK. But in terms of the stickiness of our retail deposit base in Ireland and our Irish corporate deposit base-----

**Chairman:** Can you just explain what stickiness means, Mr. Murphy?

**Mr. Fergus Murphy:** Sorry, I beg your pardon, Chairman ... in that the deposits were stable and steady and that there wasn’t much volatility in them.

**Chairman:** Sure, thank you.

**Mr. Fergus Murphy:** Apologies, Chairman. So our Irish corporate deposits and, more importantly, our Irish retail deposits were very stable. So that augured quite well.

In terms of the solvency of the organisation, the capital requirements and whether we had enough capital, at that point in time, Irish property prices had reduced by less than 10% from

memory, and so, therefore, in my view, at that point in time, the solvency of the organisation was solid.

**Senator Michael D’Arcy:** Can I ask, Mr. Murphy ... it was reported that you were of the view that a five-year guarantee should have been put in place. Is that report correct?

**Mr. Fergus Murphy:** I think that, on balance, my view was that a five-year guarantee would give more line of sight for the banks and my own preference would have been for a five-year guarantee, which, ultimately, took place. The CIFS guarantee was for two years and then the ELG guarantee, which, obviously, succeeded it, was for five years. The only reason I say that is that the majority of guarantees that were put in place across Europe - and, of course, there were many, as you know, it wasn’t just Ireland that was having problems - typically, were three or five-year guarantees so they tended to be a longer guarantee than the original CIFS guarantee. I don’t think, whether the CIFS guarantee was two year, three year, four year or five year had any fundamental effect on the developments thereafter. But I think, you know, what we put in second time round, a five-year guarantee, allowed more line of sight for the banks to issue in the financial markets because typically banks will issue a three or five year or longer period, rather than a two-year one. So that would be the only reason I would feel that, you know, a five-year guarantee was probably more effective in terms of its efficiency in the marketplace.

**Chairman:** Did you actually make that recommendation, or was that just a view you had?

**Mr. Fergus Murphy:** It was a view I had and I believe, Chairman, it’s a view I would have imparted to the Department of Finance or to the banking unit in NAMA. In a normal way, as in, in a general conversation with them. We would have had, you know, many conversations with them, clearly, weekly, monthly and it is ... it would have been a discussion with them at a point in time.

**Chairman:** Thank you.

**Senator Michael D’Arcy:** Do you think that influenced the decision to extend the CIFS legislation into the ELG?

**Mr. Fergus Murphy:** I have no idea. I have no idea, Senator, I’m sure they were taking input from many people and I have absolutely no idea of whether it would have or not.

**Senator Michael D’Arcy:** But you did espouse that view to the Department of Finance-----

**Mr. Fergus Murphy:** I would have mentioned to them, as I say, in ... as part of an agenda that might have covered 15 or 16 things on a particular month that would have been one point that would have been made.

**Senator Michael D’Arcy:** In November ‘08 the treasury department looked for an increase in the lending lines to the other covered institutions in order to invest in their unsecured debt and to have them reciprocate. This was the green jersey. To what extent, in your view, did your board consider as appropriate to participate in the green jersey thought process?

**Mr. Fergus Murphy:** Well I don’t agree with the term “green jersey”. It’s not one that EBS used, or I had in our vernacular. I think that in terms of lending to other financial institutions in Ireland, small quantum, I think up to €200 million per bank. Now, I say that in the context of international debt markets where the numbers are typically very, very large. In the context of the Irish banks at that point in time being under a two-year guarantee, it was legitimate to



increase our limit to the Irish banks for the period ... within the guarantee period to ensure that liquidity in the local domestic market was reasonable. So it would have been looked at and implemented in that context so that no exposures outside the guarantee period, the CIFS guarantee period, and working to ensure that liquidity in the local marketplace was reasonable.

**Senator Michael D’Arcy:** Can I ask you, Mr. Murphy, if you were aware that the NTMA were unwilling to place deposits into some Irish financial institutions?

**Mr. Fergus Murphy:** I wasn’t aware of that. I’ve read about that both recently and in the past but I wasn’t aware that they were unwilling to put money into certain institutions.

**Senator Michael D’Arcy:** In April 2011 the Government decided to sell your society to AIB for €1. Did you agree with this move and did your board have any alternatives beyond the €1 sale?

**Mr. Fergus Murphy:** In terms of me agreeing with the sale, I believe there were a number of viable, legitimate and credible scenarios that EBS could have gone down and one of them most definitely was a sale or on-shore merger, which is obviously what eventuated with AIB. So at the point of hearing that I felt that was a credible way forward and I think all of the actions and behaviours and values that were espoused at that point in time in terms of working with the AIB team would have reflected that. In terms of the board in general there were, as I say, a number of options that were worked through as I mentioned, actually, in my opening statement. And they were worked through for a multi-year period ... periods. You know, I would have led discussions locally and internationally with various financial institutions or private equity firms and all of them possibly could have been a transaction or could have been successful. It’s very, very hard to say definitively because, of course, it’s a hypothetical scenario. But there was interest across the board in EBS and it is good to see, for example, that PTSB, another one of the smaller institutions during that timeframe, during that time period, has come through and has recently been successful in getting some equity internationally. So there is a marketplace out there, there’s always different options, permutations and combinations, Senator. I think the option that EBS went down was a secure and solid one and has, as I say, over the last three, three and a half years we’d be ... we would feel good that the work that’s been done in EBS and AIB is coming through and building a viable institution. There may have been other options that may have also been viable.

**Senator Michael D’Arcy:** Can I ask you Mr. Murphy, you spent a lot of time with Rabo, a AAA-rated institution considered conservative and solid? The EBS, from your opening statement, changed its business model. From previous evidence from other institutions, they changed their business model at a similar time, around ‘01, ‘02. And in that period, I don’t know the exact number for EBS but AIB, Bank of Ireland and Anglo were trading at about 30% year on year increase for eight years. We had Professor Bill Black - it’s been a while since he’s been quoted here - he would have considered that reckless, a reckless increase. Can I ask you opinion in relation to those levels of increase for a financial institution?

**Mr. Fergus Murphy:** Those levels of compound growth on an annual basis are too high and clearly what happened, I think, kind of shows that. That’s why I would be a very positive advocate for macro-prudential regulation where the regulator, on a top-down basis, from a top-down basis, looks at the marketplace and puts some principles in place that lock down the shape and direction of where the industry goes. At the point in time of that growth period, Senator, had we had macro-prudential regulation of the nature, of the type that the regulator brought in at the back end of last year around mortgage lending, it would have been helpful in terms of

cooling down the economy and cooling down the banking system in general. So those kind of compound growth numbers are too high and would have struck me as such now and at that time.

**Senator Michael D’Arcy:** On page 3 of your opening statement, your full written opening statement, you itemise 11 actions. Those are pretty substantial actions, Mr. Murphy. Was that another change in the business model of EBS?

**Mr. Fergus Murphy:** I think that from coming in and ... early into the role, it was obvious to me that the business model had to change, had to change substantially. And so those 11 points you refer to, Senator, are in the main describing - they’re certainly not exclusive, because obviously with a 5,000 word submission - but they give a flavour for the type of changes that were made which changed the business model.

**Senator Michael D’Arcy:** Can I just ask about those 11, are they 60%, 70% of the alterations, 80% or would they-----

**Mr. Fergus Murphy:** I would have been trying to summarise-----

**Senator Michael D’Arcy:** As best.

**Mr. Fergus Murphy:** -----as best I could the totality, so they must represent, I would believe, you know, 80% of the activity. But, as I say, they’re not exclusive and behind each one of those, of course, there would have been-----

**Senator Michael D’Arcy:** Are other actions.

**Mr. Fergus Murphy:** There would be a lot of other actions and there would be a story behind them all. But you’re giving the flavour for, I’d like to think, action-oriented, hitting the ground running, changing the business model, bringing it to a more conservative risk-mitigated, command-and-control, frankly, and contain-and-control environment, which again, unfortunately, was the way the role eventuated.

**Senator Michael D’Arcy:** Could I ask, Mr. Murphy, in terms of push back - it’s a term that we’ve become used to here - was there push back from your board, or were you specifically hired to ensure that these actions could be put in place?

**Mr. Fergus Murphy:** I think that the chairman of the board, who would have led my appointment and hiring, was forward-looking and he was looking to do the right things and modernise, continue to modernise the society-----

**Senator Michael D’Arcy:** And your chairman was?

**Mr. Fergus Murphy:** Mr. Mark Moran. He asked me to come into the organisation and to look at it from the perspective of somebody coming from outside of Irish banking, coming from outside of Irish retail banking, and also from the perspective of somebody actually coming back from abroad. So, he gave me a very strong mandate to look at the totality of the organisation and decide what was the best way forward. They had had problems in 2007, in terms of cohesion of strategy and of board, and my role was to come in with outside experience and to try to pull it all together again into the most cohesive strategy and team that was possible.

**Senator Michael D’Arcy:** Can I ask you in terms of one individual within an organisation or financial institution, can one individual have that much authority to do an about face in terms of the direction that an institution had previously been going in?

**Mr. Fergus Murphy:** I think, Senator, you set the tone from the top. You can't do it yourself, clearly. You need lots of very good people working with you who are completely committed to the vision and to the mission, who are up for the change and who are performing and clearly I relied on lots of very good people who I have to say, and it would be wrong if I didn't say, brought an awful lot of discretionary effort to bear through the crisis in working through it as best they could to fulfil the objectives of the society. That's what you would expect, that's what they're paid for, but I do feel I should say that. So, I'm setting the tone from the top, I'm setting the new strategy, I'm relaying the risk appetite - what we're willing to do in the future, what we're not willing to do. I'm making those big changes in terms of direction, and those levers. The execution then clearly of the activities in a granular way through the society - it's not as big as a Bank of Ireland or AIB but it's still a large organisation - is taking place through the teams and through the executive team and the senior management and I think, though, I was able to bring a perspective to bear, which clearly shows a significant change in direction from almost hitting the ground, and I would feel good about that and I would feel that was what my role was about.

**Senator Michael D'Arcy:** Mr. Murphy, on page six, half way down your opening statement you say on the third bullet point on the second number of bullet points:

**Pursued strategy of managing down commercial book:** To aid this process, I employed a number of commercial property lending professionals, closed regional lending offices and improved controls by consolidating operations into a more centralised operation.

Could you just expand upon that, and I want to give you a little bit of background? Mr. Dan McLaughlin, former, or senior, economist with Bank of Ireland, stated clearly that it was the CRE sector that crashed the banks and had the impact that it did upon the Irish economy. Could you just outline what had happened prior to, or how the operation worked prior to you centralising the operation?

**Mr. Fergus Murphy:** Certainly. Commercial property real estate financing was entered into, from my recall, in 2001 in EBS and then they entered into-----

**Senator Michael D'Arcy:** Sorry just be.... how much was in commercial lending prior to that? Did the EBS start from zero?

**Mr. Fergus Murphy:** They started from zero and they would have built a portfolio of commercial real estate and land and development finance to the level of €1.7 billion through the period from '01 through to '07. The society felt that they were under a lot of pressure and that their backs were to the wall in terms of the ability of the organisation to sustain itself, were they still relevant. There was huge compound growth, to our earlier conversation in relation to Irish banking. You also had one of the other building societies, the only other building society, probably a bit of a beta stock on what the banks were doing in terms of growth.

**Senator Michael D'Arcy:** Not an alpha stock?

**Mr. Fergus Murphy:** Therefore, the society which was trying to stick to its heritage, which was that of lending money sensibly to people, to members, particularly who are at the beginning of getting on the property life ... of their property life cycle, the property ladder. But they felt that they weren't building enough capital, they weren't making enough revenue to sustain themselves. They weren't able to fund themselves as cheaply as the banks. They weren't accessing the markets as easily and, therefore, they felt they needed new profit pools to subsidise,

I think is the word, the underlying business that I just spoke about, which was virtuous and, you know, had a multi-decade successful pattern for them. So by entering into commercial property, they believed this would give them fresh revenues that they could use to build their underlying business. The business ... in fairness to the society, there were limits, there were controls, there was risk management - it turned out it wasn't adequate. But the society kept, to my recall, the commercial property balance sheet to 15% of the total balance sheet and they kept the land and development balance sheet to 3% of the overall balance sheet. But between the two, they still became €1.7 billion of business that unfortunately because the society entered into this marketplace later than the other players with smaller scale ... unfortunately, they at times tended to do business in secondary and tertiary locations, with secondary and tertiary developers and commercial property investors, so they weren't probably getting the better business, maybe none of the business was good, I don't know, but they weren't getting the better business. So that meant that when ... the discussion we were having earlier on again ... when the Grim Reaper came around and when the global and international and local situation became cliff-like, that portfolio started to perform very, very poorly.

**Senator Michael D'Arcy:** But can I ask in terms of ... you say it was ... you consolidate operations into more centralised operation.

**Mr. Fergus Murphy:** Yes.

**Senator Michael D'Arcy:** Were there loans being approved regionally, or smaller amounts being made available to less senior directors? Can I ... I suppose what I'm trying to scope is ... it's quite simple to understand what a centralised operation is, perhaps in one venue with a number of individuals, but where did you come from to get to there?

**Mr. Fergus Murphy:** Okay. So there ... Senator, there were a number of regional offices where commercial property would have been lent from. Now, again, in fairness to the society, before my time they ... underwriting would have been centralised and the approval of property would have been a centralised function, centralised credit committee, etc. However, there would have been origination in relationship management teams regionally. So the point I'm making there is that I'm closing down those regional teams, okay. That was done in March 2008 and then in June or early July 2008, I'm closing down commercial property completely in terms of saying, "We're not doing any more". Therefore, the commercial property origination in relationship management teams clearly weren't needed regionally anymore and the one that was there in Dublin, which covered Dublin and surrounding counties, etc. and some of the larger ticket business, almost overnight became an asset recovery unit and an asset management unit because the focus again was control, was minimised risk, was "How do we get our money back?" and that meant a bespoke strategy from each large commercial property transaction and that's what I'm talking to in that, Senator.

**Chairman:** One supplementary and I will bring you back in again.

**Senator Michael D'Arcy:** To be clear, Mr. Murphy, you said there was no chief risk officer. How could €1.7 billion worth of a loan book have been increased from zero without a chief risk officer?

**Mr. Fergus Murphy:** Right. There was a head of credit-----

**Senator Michael D'Arcy:** No, I understand that, but most institutions would-----

**Chairman:** Allow the witness to respond.

**Senator Michael D’Arcy:** Sorry.

**Mr. Fergus Murphy:** No, absolutely, I ... there was a head of credit and the risk officer reported into the finance director which, from a governance point of view, is not ... today would not be an acceptable scenario, okay, and that’s why I changed that. So there wasn’t an independent CRO, chief risk officer, but there was a credit department, there was a head of credit, there was an approval process with authorities, there was a group credit committee etc. So, in fairness, deals were going through a process. It was a flawed process but it was ... they were going through a process. I appointed an independent CRO, which means that person now is on the leadership team, or the executive committee, of the institution. They hadn’t been before that. There was a head of credit reporting through the finance director. By having an independent CRO at the leadership team of the bank, who’s reporting into me, but also probably more importantly, reporting into the board risk committee chair, a non-executive director. You now have risk at the centre of the organisation in terms of strategy implementation, tactics, tone from the top - you have a much more transparent organisational structure and the ability to manage things in a more effective way. One of the findings from the crisis I think that all the reports would talk to is the fact that risk, at times, didn’t have that voice, wasn’t at the centre of the organisation in terms of culture and behaviours and clearly, one of the things I was looking to do was to commence that.

**Chairman:** Thank you very much Senator, I will bring you back in the wrap-up. Senator D’Arcy was also talking to you earlier with regard to liquidity and solvency issues and if I could just get this rounded off before I bring in Senator Barrett, I may ask you Mr. Murphy: did the EBS have any discussions with any other bank, Central Bank or Department of Finance in relation to liquidity issues or solvency of any particular bank in the weeks and days before the night of the guarantee and what was your ... what is your assessment of the liquidity and solvency of the society on the night of the guarantee in September 2008?

**Mr. Fergus Murphy:** Chairman, we didn’t have - I nor anyone in EBS - didn’t have any discussions with the Central Bank in the days or weeks before the guarantee was put in place in relation to the liquidity funding or capital of any other institution.

**Chairman:** Sure.

**Mr. Fergus Murphy:** Obviously there was noise in ... in the system and, and there were rumours but there were no discussions between I, or us and the Central Bank in relation to that. In terms of the society itself, on the night of the guarantee or during that period, as mentioned briefly earlier on to the Senator, we had lost some international customer deposits, corporate deposits as they call them, non-bank financial institution deposits, but our local, retail and corporate deposits were stable. And therefore, although I was, you know, acutely aware of what was going on in the marketplace and we had significant concerns for the future in terms of what could happen next, at that point in time EBS was doing okay.

**Chairman:** Okay thank you. Senator Barrett.

**Senator Sean D. Barrett:** Thank you Chairman and welcome Mr. Murphy.

**Mr. Fergus Murphy:** Senator.

**Senator Sean D. Barrett:** Are you the sole chief executive in Irish banks to survive the cull of bosses after the State guarantee?

**Mr. Fergus Murphy:** I don't think so Senator.

**Senator Sean D. Barrett:** I think Senator Ross, as he was, I think gives you that title in any case.

**Mr. Fergus Murphy:** I beg your pardon, he's right actually. I'm sorry, I was thinking of somebody who started as a CEO after the Government guarantee. Senator I, I stand to be corrected. I, I think he ... I think he's right.

**Senator Sean D. Barrett:** And on the night of the guarantee you were in Donegal or coming back, is that correct?

**Mr. Fergus Murphy:** That's correct, on the night of 29 September 2008, I was leading a small team of ... of the executives in EBS to what we had called a town hall meeting with members in Donegal.

**Senator Sean D. Barrett:** And did your company have any role in the bank guarantee?

**Mr. Fergus Murphy:** No, no.

**Senator Sean D. Barrett:** Maybe that's why you've survived. Sorry I shouldn't keep making ... you say "By the time I joined EBS-----"

**Mr. Fergus Murphy:** Senator could I say, I think this "surviving", I think probably one survived because one hadn't been in the country or managing a bank during the period, as Professor Honohan has said of '03 -'07, when the crisis prevention years were there and when the bubble blew up, I think that's probably why one survived.

**Senator Sean D. Barrett:** You've expressed concern to Senator D'Arcy about the speed of the growth in credit. Do you have any idea what - indeed of 25% and 30% per annum in the lead-in to our troubles - do you have any idea what should be the correct rate of growth of credit in our kind of economy?

**Mr. Fergus Murphy:** Senator I think that ... that's a very good question and if I look at the organisation I came from I ... I would say ... as in, sorry, a Dutch organisation that I worked for, I would say 10% is a ... a good number. Now, that is a very, very general comment I am making because clearly it depends on the economy at a point in time, it depends on the cyclicity of the economy. But you have asked the question in the context of our economy which is an enterprise economy, a foreign direct investment economy. It is an export-led economy. In general I would say that the maximum growth for a bank's balance sheet should be 10% in that scenario but more likely it should probably match GDP.

**Senator Sean D. Barrett:** Thank you. Now, you say in your statement, on page 11, "By the time I joined EBS [and that's January 2008] the damage had been done and could not be corrected in the short term." Could you describe that damaged bank that you've joined?

**Mr. Fergus Murphy:** Senator the, the ... number of things there, assets and liabilities, so on the liabilities side of the balance sheet EBS, like other institutions, had become too dependent on wholesale and international funding. Again, just as I summarised quickly earlier on, in 1998 100% of the liability base of EBS was retail deposits. Retail deposits, typically, will stay with an organisation unless there's a significant issue with the organisation. That lack of stability in the liability base was a fundamental issue and that is similar to every other institution in Ireland and many abroad and it talks to the discussion we were having on ... having earlier on

with Senator D'Arcy in terms of what was happening internationally. On the asset side of the balance sheet, again EBS had built that €1.7 billion of land and development and commercial property financing, which was too much for an organisation its size. It also had a commercial buy-to-let portfolio of about €500 million or so on top of that. It had entered into the tracker mortgage marketplace, in fairness not to the extent of some other institutions, it had a buy-to-let business and profile. And so therefore the riskiness and the growth of the asset side of the balance sheet and the riskiness of it in the context of its components, was not suitable to a building society which should, at its very heart and ethos, be very conservative, prudential, given the fact that a building society, for example, can't raise capital in the same way as a bank can in the international markets and also the heritage and ethos and ownership. Being owned by members, you have a very special responsibility to stewardship the organisation in a conservative way.

**Senator Sean D. Barrett:** Were there oversight problems? And I refer you to core document Vol. 2, on page 127, the task force Medusa, was, was that part of your correction when you took over?

**Mr. Fergus Murphy:** In fairness Senator, that activity was commencing or had commenced on my commencement with the organisation and this was a very granular root and cause review of the problems that had emerged with a number of fraudulent or potentially fraudulent scenarios involving various solicitors. To my recall there was 34 priorities or improvements suggested in this report so that it couldn't happen again in the society, in the context of improving internal controls and that's what that is referring to. The, the Medusa report and project is probably ... it probably reflects an organisation that is growing too quickly, that isn't able to keep up with the growth in terms of its internal controls and approach. And in that regard, it's probably useful in an illustrative ... in terms of the overall story one is telling.

**Senator Sean D. Barrett:** And in the same volume, there's a very long letter from Yvonne Madden, the Financial Regulator, from pages 37 onwards, which shows, shall we say, a wide range of administrative reforms needed. Just looking at pages 43 to 45, you see items like "no evidence" of what the borrowers did, "not clear" what the purpose, "no evidence", "not clear", "not legible", "not legible". It looks like you inherited a pretty dysfunctional organisation going through that. "Not certified", "not clear", "not reviewed", "not legible", "not independently certified", it just goes on and on through those pages. How did you try to deal with the problems that Ms Madden had drawn to your attention there?

**Mr. Fergus Murphy:** Senator, again this would be illustrative of, yes, the environment that one was dealing with. So in summary, how, how one tried to deal with it was, first of all the tone from the top; getting everyone to understand what the new regime was about, what our risk appetite was about; ensuring that we built an independent risk function, with a reporting line directly into me and into the chair of the board audit ... board risk committee; getting the right person into that role as CRO - and we got an excellent person into that role who did great work in the subsequent years as we worked through the crisis; bringing some expertise into the organisation by bringing new people in who were experts in, for example, commercial property or in risk management; ensuring that the board's training and induction was stronger through thematic learning and education; increasing the frequency of meetings and making sure that the meetings that you were having and the forums that you were putting in place were more granular and allowed for a risk approach in terms of working through this crisis. In terms of managing risk, the biggest risks first. And just becoming much more prioritised, and much more accurate about what the organisation was doing.

**Senator Sean D. Barrett:** That letter is dated to you on 3 March 2008, and I make it there

are 65 recommendations. So was the era of light-touch regulations over? And you were doing reform but you were also ... I think the regulator had certainly been into the business and gone through it with a fine comb at that stage.

**Mr. Fergus Murphy:** Yes, I think that the era of regulation was changing. I think the regulation around Europe and around the world was becoming more risk-based, which is something that is welcome, rather than principles-based. And, again, Senator, I would agree with you that a letter like this starts to show that evolution from a principles-based regulation to a risk-based regulation approach.

**Senator Sean D. Barrett:** How do you analyse 100% mortgages?

**Mr. Fergus Murphy:** One hundred per cent LTV mortgages?

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

**Mr. Fergus Murphy:** In EBS ... again, in fairness to them, before my time, EBS had mortgage indemnity insurance in place. That means that, with an international insurance company, EBS was insuring its book, so that the first loss on the book up to a particular attachment point, and I'll explain that in a moment, is taken by the insurance company. So, for example, if the attachment point is 85% LTV, loan-to-value, then the first 15% loss is for the account of the insurance company. In principle, that was the approach by the society. And that was an effort by the society to protect its capital and to protect its members. When EBS was talking about 100% mortgages, in the same way as other banks were, they, at least, were apportioning this insurance, or they had this insurance against those mortgages. But in terms of looking at 100% mortgages, No. 1, I wouldn't agree with them, and I did away with them, and in the second half of 2008 LTVs, loan-to-values, and debt service coverage ratios, called DSCRs, and NDIs, net disposable income ratios, were all commenced and started to be moved down. And during my tenure there were nine formal changes to the credit policy of the organisation, which reflects the credit appetite, and each of those nine formal changes brought the credit appetite more conservative, and tightened the appetite. Interestingly, Senator, if I might say, during the period before I joined, for the six years before I joined, there were 13 changes to the credit appetite, or to the credit policy, and they were all increasing the credit appetite and loosening standards. In terms of 100% LTV mortgages, given that I don't agree with them, but given that they were in place, the most important point in evaluating them is the affordability of the customer in relation to the loan they're drawing down.

**Senator Sean D. Barrett:** What was Haven Mortgages? Was that a company you had to shut down?

**Mr. Fergus Murphy:** Haven Mortgages was incorporated, if I recall, in either November of December 2007, just before I started, and Haven Mortgages was a subsidiary of EBS and that subsidiary ... the objective of that subsidiary was to do all of the intermediary, or broker business, for the organisation. The broker market in Ireland was growing, it was becoming a larger part of the total market, it was an important channel for the Irish banks and building societies. In the UK, for example, which we often follow in these trends, over 50% of the mortgage market was being originated from brokers. In EBS, they hadn't been involved in the broker marketplace because they wanted to work directly with members, customers who become members on putting a deposit in place with the organisation. Because they were losing market share, they decided they had to get into the broker market in a more aggressive way, and through a different brand and through a different subsidiary, they felt they could do that, and at the same time,



protect the underlying member business in the EBS society itself.

**Senator Sean D. Barrett:** Irish Nationwide wanted to take over EBS in November 2008. How did you respond to that?

**Mr. Fergus Murphy:** I responded by entering into discussions with their chairman and their CEO, and doing some mutual basic due diligence of each other's portfolios. My sense on that was that, other things being equal, *ceteris paribus*, which ultimately they weren't, it would be good if the country could maintain a mutual in the financial services domain. In that regard, I would have clearly seen EBS as being the leader of that potential mutual, or arrangement. It became fairly clear very quickly in those generic discussions, that the balance sheet of INBS was not in a state that one could recommend to one's board or one's members that there would be a co-joining of the two societies.

**Senator Sean D. Barrett:** Was that subject to commercial confidentiality, or did you, for instance, feel like informing the Government that ... what you'd found when you looked at Irish Nationwide-----

**Mr. Fergus Murphy:** I think we were co-travelling, Senator, in that regard, in that the Department or the NTMA, depending on which it was at the time - I'm sorry, my memory - would have been understanding the developments, and I think they would have known more about the INBS balance sheet, actually, than myself.

**Senator Sean D. Barrett:** Is there a difficulty in regulating this sector if a bank, or the old building societies, lends both to the developer and then, subsequently, to the people who buy those houses, or is that a practice which you'd have opinions on?

**Mr. Fergus Murphy:** I think it's possible for both to happen, you know. I think in a marketplace or in a bank, for example, if you're lending to property developers, if you've got a commercial property unit, first of all, it needs to be staffed with really good people who understand property very, very well and have a long tradition and experience in property. Lending to a property development company, I'd rather call it than a property developer, because I think in most societies and economies you're lending to a company ... we had a property-developer culture rather than a property-development company culture, maybe, but if you're lending to a property development company, it's a very different kind of lend to the more granular lending to a borrower who's buying a house and their mortgage might be €200,000, €300,000, €400,000. And so, I think, in a bank, these activities would be very segregated. There would be no real connection between the two, and I think you actually can do both responsibly.

**Senator Sean D. Barrett:** How do you address the problem of short-term borrowing for long-term lending in the housing market, in general?

**Mr. Fergus Murphy:** I suppose since the time of the Medicis in Italy and the formation of what we might call modern banking-----

**Chairman:** I'm sorry to see you going back so far, we'll stick with the periods already. That's maybe bit outside our terms of our reference, but we'll go there - go on.

**Mr. Fergus Murphy:** I'm glad I brought something to bear.

**Chairman:** The Medici.

**Mr. Fergus Murphy:** So banking has been about the disintermediation, and the intermedia-

tion, even, between borrowers and savers. And so banks legitimately run some of that intermediation; sometimes they call it “curve risk”. It needs to be managed very, very carefully in terms of interest rate risk, and in terms of, even more importantly, funding and liquidity risk. And that’s why ... or one of the main reasons why the Irish banks and banks elsewhere came to the situation they came, because they didn’t, and they couldn’t, manage their funding and their liquidity.

So it needs to be managed, Senator, in a very conservative way. There needs to be very strict limits around, maximum tenors and maturities. There needs to be strict discipline and rules around the make-up of the liability base, the components of it, making sure that the organisation has a good mix of liabilities, and that the duration of the liabilities of the organisation matches, inasmuch as it can, the asset duration. It’s not possible to match them directly and typically, assets will have a longer duration than liabilities. But if an organisation has proper rules around their asset liability, management and their committee, you can manage that intermediation in the marketplace sensibly. Unfortunately, what happened in Irish banking was that, clearly, it wasn’t managed sensibly at that point in time.

**Senator Sean D. Barrett:** In your international context, what did the Canadians do that we might have emulated with some benefit to ourselves?

**Mr. Fergus Murphy:** First thing that they have is that they traditionally, over a multi-decade period, would have lower loan-to-values in their mortgage lending - No. 1. No. 2, they didn’t allow themselves the concentration risk issues that emerged in Irish banking, particularly around property, and property lending. No. 3, they didn’t allow their banks to grow by, as the Chairman mentioned, up to 30% per annum, over a multi-year basis. No. 4, they would have had stronger regulation, and regulation that would have been a little bit more proactive. I refer there again to macro-prudential regulation. No. 5, in their marketplace and I’m not sure if this is a stronger point I’m going to make, but they would have had mortgage indemnity insurance on their mortgage books, more as a normal scenario, whereas in EBS it was ... we were a bit of an outlier having that. There are probably five things and, I mean, sixth maybe, Senator, but you’d know this better than I, their economy didn’t grow as fast as ours did in the ten years before the crisis. You know, we grew so fast, we grew too quickly.

**Senator Sean D. Barrett:** Well, that’s most interesting and useful, thanks. Now, you’re a 10% growth person-----

**Mr. Fergus Murphy:** Or lower in terms of GDP growth.

**Senator Sean D. Barrett:** Or lower. Now, the oversight such as all those points that Ms Yvonne Madden and you were working on in relation to internal procedures. Do you think that we’ve got a better oversight of credit within the financial sector now than we had in the lead-in to the crisis?

**Mr. Fergus Murphy:** I do, Senator. I think that there has been a transformational change in the organisational structures of the banks. I can only talk to two institutions here but I would expect, and believe, it’s the same elsewhere.

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

**Mr. Fergus Murphy:** In terms of the granularity of risk management, in terms of the culture around risk management, again risk being at the centre of the discussion for all strategic and tactical issues, the organisational structure, the reporting, the identification of risk, the mea-

surement of risk, the conversations around risk, the accountability and responsibility around risk, I think we are now at good practice level.

**Senator Sean D. Barrett:** And you mentioned in response to Senator D’Arcy on wholesale funding, you’ve gone from 26% retail, 74% wholesale. What are you at today?

**Mr. Fergus Murphy:** In terms of the combined AIB-EBS balance sheet, about 60% of the balance sheet now comes from retail deposits, current accounts and consumer corporate deposits, about 20% comes from wholesale funding, approximately 10% comes from capital and 10% from other resources. So, the focus, Senator, is very much on retail deposits.

**Senator Sean D. Barrett:** Your first posting was in the ACC. Was that right ... in your early career, that’s where you joined banking?

**Mr. Fergus Murphy:** It wasn’t, Senator. I joined banking in the subsidiary in Ireland of Credit Bank, known at the time as Irish Intercontinental Bank ... Credit Bank, the Belgian bank and, in fact, I had a short tenure in ACC Bank, when I came back to Ireland from Asia in the middle of 2007. ACC Bank was a Rabobank subsidiary, 100% owned by Rabobank. In fact, I had bought ACC Bank for Rabo or I had led the acquisition of ACC Bank for Rabobank in 2001 before I headed off to Asia and so I came back to Ireland as CEO of ACC Bank and the strategy was to build a, what we called, second home market for Rabobank in Europe in Ireland, because we had Rabobank Ireland in the IFSC, which was a fine wholesale financial markets corporate banking structured finance business. I used to be CEO of that in the past. We had ACC Bank, which I had just come in to be CEO of, which is a business bank. We had ... Rabo did have a 38% ownership in a company in the Netherlands called Eureka and Eureka own Friends First or did own Friends First in Ireland, the insurance company. And the idea was to bring all these things together and, also publicly known, attempt to buy EBS, which I, ultimately, became CEO of, because EBS being a mutual is a very similar model to the Rabobank co-operative model in the Netherlands. And try to create an organisation for Rabo in Ireland that would have a mortgage business, a savings business, a corporate banking business, a treasury business and an insurance business and a business banking business and become a real player in Irish financial services at that time. That was the mission I came back to in 2007 from Asia.

**Senator Sean D. Barrett:** What I was trying to get at there is that if you get a banking system that’s obsessed with property, do you need sectoral banks for agriculture and industry side by side?

**Mr. Fergus Murphy:** I think the ACC Bank and the ICC bank were virtuous and did an awful lot of very good work in the Irish economy over a number of decades. At this stage in the development of our economy and financial services, I don’t think you specifically need that kind of a specialist institution. If I look at AIB, for example, and if I look at other banks in the Irish market ... if I look at Rabobank where I came from, they would have very strong sectoral expertise in the sectors they choose to work in. So, for example, Rabobank would be the largest food and agri-bank in the world and they would work from farm gate to food plate with some of the smallest farmers and some of the largest food companies in the world. Similarly, I think, in Ireland AIB and, indeed, Bank of Ireland, would have a very strong focus on agri. They’d have a very strong focus on other sectors like ICT, biotechnology, health care, hotels, restaurants, leisure, etc. So, at this stage, Senator, I don’t think we’d probably need that specialism and it was probably more appropriate in the formative years of the Irish economy back in the ‘50s and the ‘60s.

**Senator Sean D. Barrett:** We've had evidence, finally, that house prices in Ireland have gone from 2.5 times incomes to as high as 12. Has sectoral concentration on property caused part or all of that massive house price increase?

**Mr. Fergus Murphy:** Senator, is this a recent phenomenon you're referring to or-----

**Senator Sean D. Barrett:** Since about 1990, I think, would be ... yes, the figures for that, yes.

**Mr. Fergus Murphy:** So ... well, yes, again as you know very well, the percentage of our GDP that was happening on the back of property development, property investment, became out of sync with global and European norms. And that is again - and I'm sorry to repeat myself and clearly, you're hearing this probably every day and you know it - you know, one of the biggest fundamental pillars upon which the Irish economy crashed and so, you know, your property industry again, similar to your banking industry, should macro speaking be growing similar to your GDP and given the multiple times over GDP property was growing at over a long period in Ireland, you know, it was a huge input factor to our crash and it's a huge lesson for us to learn.

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

**Chairman:** Okay. Thank you very much and I think you've addressed the ... just one outstanding issue but I just want to get one aspect of it. In regard to the Financial Regulator and the Central Bank having been concerned with regard to the level of growth of credit and the oversight of such credit, what was your view of this and what steps did you help the EBS to take to offset these concerns?

**Mr. Fergus Murphy:** Chairman, in terms of the growth of credit?

**Chairman:** Yes.

**Mr. Fergus Murphy:** In the marketplace? Yes. So, for example, in the 2002-2007 period, the residential book in EBS would have grown by 17.4% per annum, not quite the 30 per cents we were talking about earlier on but 17.4% per annum. From 2008-2011, during my tenure in EBS, the residential mortgage book grew by 2% per annum. So you've a substantive change in approach in tone from the top, in risk culture, risk containment and I think that one stat ... I could give many but maybe, Chairman, that one stat might hopefully illustrate the changes that I was looking to direct in terms of growth of balance sheet.

**Chairman:** Okay. Thank you. And in regard to the regulator, what was your understanding of the regulator's observation of that growth of credit at that time?

**Mr. Fergus Murphy:** Sorry, Chairman, in terms of?

**Chairman:** In regard to your observations of the regulator and the significant growth of credit, what was your observations of the regulator's office at that time?

**Mr. Fergus Murphy:** Thank you, Chairman. I don't recall the regulator discussing the macro-prudential point which is what you're talking about there, the actual growth year-on-year. The discussions were many and would have been illustrated probably quite well by the discussion I was having with Senator Barrett around that 3 March 2008 Financial Regulator letter around many small items, but important ones, regarding commercial property and our fitness in terms of the way the operating environment was executing property transactions in the building society. I don't recall but I may be wrong, I don't recall any specific conversations

with them around annual growth.

**Chairman:** Okay. Thank you. Senator Marc McSharry.

**Senator Marc MacSharry:** Thanks very much. Thanks, Mr. Murphy, and welcome. In 2003, Project Nova was instigated, which would have fundamentally changed the business model of EBS, linking it to the larger Rabobank Group and a possible three-way platform of EBS, ACC Bank and Friends First. Was this an indication that the original mutual model of EBS was no longer valid?

**Mr. Fergus Murphy:** I think that it was an indication that the mutual model in EBS was under significant pressure. I think it would have been too early, Senator, to say that it was not valid but, as I mentioned earlier on, it certainly was challenged.

And so, EBS were looking at options in terms of was there another way to preserve the mutual or mutual-like environment and code and heritage and, at the same time, get access to a bigger balance sheet and a more powerful engine, if I may choose that term, which would be coming in from the Rabobank, you know, global, big, Dutch bank which you know is in the top 20 banks in the world.

**Senator Marc MacSharry:** And was that driven by survival or pursuit of market share?

**Mr. Fergus Murphy:** I would ... of course, obviously it's many years before I joined the organisation but my sense of it is that it was driven by survival. More by survival than market share but, Senator, they actually become a similar discussion because it's about relevance. I think the most important point would be about relevance - "Can we ... we can probably survive but can we be relevant? Can we still be a 10% or 15% provider of finance into this market? Can we be relevant in the towns and villages of Ireland?"

**Senator Marc MacSharry:** And just ... I'm conscious about people watching at home and a mutual being owned by all of the people who have money in their accounts there-----

**Mr. Fergus Murphy:** Yes.

**Senator Marc MacSharry:** -----isn't that-----

**Mr. Fergus Murphy:** Yes, that's basically it.

**Senator Marc MacSharry:** That's the model. So, presumably, to maintain a market share in a market where everyone else getting their money from the wholesale market and borrowing short to lend long at low rates and lending out at higher rates, is it the case that a mutual just might not be at the races because there isn't enough members of the mutual to keep ... keep the wheel turning?

**Mr. Fergus Murphy:** That's a scenario, Senator, and if you look at ... if you look at our nearest neighbour, the UK, we have in the UK ... or we don't have, they have many mutuals who are still doing well.

**Senator Marc MacSharry:** Okay.

**Mr. Fergus Murphy:** So in the UK, for example, the Nationwide Building Society, not to be confused with the Irish Nationwide Building Society, is a virtuous, strong, market-share, strong-presence, excellent-reputation retail bank.

**Senator Marc MacSharry:** And is it-----

**Mr. Fergus Murphy:** And so, the point I'm making is that it is possible still for mutuals to survive and for that corporate governance and legal form to thrive. In Europe, the first cousin of mutuality would be the co-operative banks and if I take my old alma mater, Rabobank, it's, I would say, thriving around the world and particularly thriving in the Netherlands. It's just, unfortunately, that our mutuals took wrong decisions. Clearly, if you can run a mutual in the UK, you can run one in Ireland in terms of the proximity, culturally, Anglo-Saxon economies, etc., etc.

**Senator Marc MacSharry:** So let's say Nationwide in England - because you have mentioned them as an example - is it fair to say that while they maintain, you know, a successful business or whatever it is, that their market share, you know, when compared to others that aren't mutual, has dropped?

**Mr. Fergus Murphy:** They were struggling for a while but ... in fact, I'm not obviously an expert on them but my understanding is that they are doing very well again in that it's been a "back to basics". Some of the hype in banking, clearly is gone. Some of the players are no longer in the UK, either, that were there. So Halifax, Bank of Scotland, etc., being mopped up by Lloyds Bank, RBS's challenges. So the Nationwide has seen, I think, a strong resurgence in its activity, in its membership and in its volumes and is probably stronger now in 2015 than it was in 2005.

**Senator Marc MacSharry:** Naturally this ... some of these issues, as you've said, predate your appointment to EBS. But, given your experience in banking ... a lifetime or a career in banking at different levels, if EBS, for whatever reason, had decided to maintain their mutual structure and to lend out money in line with those ... the resources of the members determined, would they be still tipping along there or would they have crashed?

**Mr. Fergus Murphy:** I believe the best comparison there again is the Nationwide in the UK and I would, therefore, suggest - I mean it is hypothetical, but I would suggest - that they would probably still be tipping away and that they would be relevant in Ireland and that they ... the organisation would be as it was - a mutual. Now, I should say, in fairness, that the EBS brand is a very important part of AIB. That the EBS, as a company - as a subsidiary in AIB - is doing well. It was profitable in 2014 and, you know, the future looks strong for it in the context of the business it's doing and the position it has still in Ireland as a community financial services provider.

**Senator Marc MacSharry:** Just again - with your experience in banking these are, kind of, general questions - would the decision of say what was Irish Permanent Building Society to mutualise have influenced, to your mind, the direction that EBS and, indeed, others were seeking to go and the Irish financial services market?

**Mr. Fergus Murphy:** Yes. In fairness, Senator, I think that the EBS culture and the board that I joined ... the base case was they wanted to preserve mutuality and I think that was a virtuous objective and I think there was strong alignment in the board in relation to that. Again, they knew that they had a lot of problems. Again, they knew that the markets were beginning to turn. They had looked to see could they do this composite deal with Rabobank where, again, you're marrying the continental European member-based organisation called a co-operative with the Irish or UK member-based organisation being a mutual. And that, therefore, they wanted to conserve a mutual, excuse me, or a mutual-like organisation in Ireland and that's where the genesis of the discussions with Rabobank in 2003 were coming from. I should say for full ...

for full transparency, I would have been leading those discussions from the Rabobank side at that time.

**Senator Marc MacSharry:** Do managers in the EBS branch network have sales targets?

**Mr. Fergus Murphy:** The planning that would have been done in EBS - before my time and during my time - would have been top-down in terms of “We believe we should have 15%, let’s say, 10%, whatever, of the mortgage market; we believe that based on the fact that the economy is going to do A, B and C next year - growth will be whatever”. And those targets ... that group target then would have been, you know, the plan. Targets within the branches wouldn’t have been articulated in a precise way. Clearly, collectively you have to make your plan but there wouldn’t have been tags on people’s foreheads, managers in branches, etc., “This is what you have to make. This is the volume you would have to do”. Now, that’s in the branches, which were owned by EBS. 80% of the EBS network is or was tied to broker agents. These are local entrepreneurs who are in the local community and they are, again, tied, as the description suggests, to EBS in terms of their activity. They are paid on a commission basis for the business they do. That is their employment. That is their *modus operandi*. Now, they do not have any credit approval authority. All credit, during ... in the past years and now, all credit is approved centrally. So, although they are paid on their commission basis, they cannot do business. It has to be approved centrally.

**Senator Marc MacSharry:** I understand. And I noticed all mutuals at different times had these tied agent brokers, okay. Is it fair to say that, really, everybody was moving away from that model - really back to the ‘90s - of the broker tied agent of-----

**Mr. Fergus Murphy:** That they are moving away from it now? Is that-----

**Senator Marc MacSharry:** But going back to the ‘90s, were they not beginning to kind of close off ... yes, brokers could be out there and come to you with proposals but, you know, the Joe Bloggs auctioneer-undertaker-filling station who was also Irish Nationwide or EBS or whatever ... that really from the 90s that was ... they were all moving away from that or, certainly, EBS too or-----

**Mr. Fergus Murphy:** I think, probably overall, that would have been the trend but I ... there would have been examples in other markets like, again Canada and Australia, where actually that ... that model would have continued as it did in EBS.

**Senator Marc MacSharry:** I just want to get to that ... I appreciate they want to make money so they want to lend more but, as you said, they weren’t underwriting, so, in real terms ... weren’t specifically there to dictate what growth or not-----

**Mr. Fergus Murphy:** No-----

**Senator Marc MacSharry:** -----they were making but-----

**Mr. Fergus Murphy:** -----in fairness, no-----

**Senator Marc MacSharry:** But in terms of ... so, just to put it another way, is there no targets for the sales staff within the branch network of EBS? Because there was ... where I’m coming from with this is, all of your colleagues have effectively denied that there was no performance-related targets for the management in all the branch networks all over the country and this is just a bit curious to some of us here and I just want to know had EBS the same model

where people turned up for work, go in there and do the job to the best of your ability but, you know, nobody has a sheet of paper that says the Stillorgan branch needs to lend ... we have expectations in the line of X amount of money on mortgages, or Y amount of money on credit cards, or, you know, whatever the products are, and I just ... because ... there's kind of ... there's the board level of view on this and the management, they're coming in here and talking to us on it. And then there's the anecdotal one, that really the shoe was rarely taken off the throat, in the context of targeting staff.

**Chairman:** Senator. Mr. Murphy?

**Mr. Fergus Murphy:** I think, Senator, that in the branches in EBS, during my time, there would have been soft targets for the branches. In other words, you know, they ... it wasn't their number one - what they call KPI, key performance indicator. But you ... the organisation would divvy up its expected market share based on the analysis it does on the economy, etc. Now, and then you would say, well, we, you know, we should be doing X of that in Limerick, and we should be doing X of that in Leinster, we should be doing Y of that in Connacht based on the demographics, based on the marketplace, based on economic activity. So, to my strong recall, there wouldn't have been strong explicit requirements on a particular branch or a particular individual in a branch to, "You must deliver €15 million," let's say, "in mortgages this year if you want to be eligible for a bonus," or some kind of variable remuneration, etc. But there would have been a top-down expectation, "We're going to do X per cent on X volume in Limerick or in Leinster." So I am sure there would have been discussions between regional managers and branch managers on a constant basis in terms of what volumes were they doing, were they holding market share, were they winning market share, what the bank or the building society up and down the road was doing, across the road, etc., and, you know, were we fit for purpose in terms of our origination and relationship management. But I don't believe there were ... and I think if we weren't, if a branch was not performing, I think there would have ... there probably would have been discussions in terms of the performance of the branch, because at the end of the day, it is a retail financial services outlet. But I don't think, Senator, there were hard criterion around volumes.

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

**Senator Marc MacSharry:** Thank you.

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

**Deputy Kieran O'Donnell:** I welcome, Mr. Murphy. Chairman, can I direct the witness to Vol. 2, two pages, both interrelated, page 157, which effectively is the minutes of a board meeting on 1 April 2011 with EBS, very much around the whole area of merging with AIB? And interrelated with that, I want to refer to page 139, which is EBS top ten bonus payments 2010 through 2008. Chairman, am I at liberty to mention the particular individuals that are mentioned on the schedule on page 139?

**Chairman:** Just a moment there now, let me see.

**Deputy Kieran O'Donnell:** Are they public?

**Chairman:** No, I don't think they are. I ... if you can just address it generally, Deputy, there for a minute and I'll come in and I'll give you a clear direction in a moment. Okay?

**Deputy Kieran O'Donnell:** Okay. Were ... and specifically what I'm referring to is page



157, at the very top of the page, Mr. Murphy, where, “Chairman highlighted that, from a risk perspective, it may be necessary to seek binding commitments from certain critical EBS staff by offering them retention bonuses, etc.” So were retention bonuses paid-----

**Chairman:** I might just assist you there, Deputy, and I’ll stop the clock to do so. I’ve an indication of where you’re going in this. I think where we were with this with other institutions that were in, the names were actually redacted, so to be consistent, I would just ... in that manner, I would advise that you take the-----

**Deputy Kieran O’Donnell:** Even though they’re in the body of the-----

**Chairman:** Yes, but to be consistent with other testimony.

**Deputy Kieran O’Donnell:** Okay, that’s fine.

**Chairman:** You can through the years and the sums, just-----

**Deputy Kieran O’Donnell:** That’s fine.

**Chairman:** Okay.

**Deputy Kieran O’Donnell:** Were retention bonuses paid to EBS staff as part of this process? EBS ... did you personally receive one?

**Mr. Fergus Murphy:** Deputy, no, I can absolutely confirm that, number one, I didn’t receive a retention bonus, and just for full clarity, I wouldn’t have received, nor would I have expected to receive, any bonus during any part of my tenure in EBS, and I can confirm I didn’t. I think that’s a general comment made in a board meeting, and I can confirm to you that no other individual in the organisation would have received or did receive a retention bonus then or at any other point in time during my tenure.

**Deputy Kieran O’Donnell:** And so can I take it that from 2008 on, no member of staff, either from the CEO down, has received a bonus payment in EBS?

**Mr. Fergus Murphy:** Yes.

**Deputy Kieran O’Donnell:** Okay. Can I refer you to page 139, and just looking at the ... just generally - it’s not the total there - but I notice between ‘01 and ‘08 that the level of bonuses paid, the top ten bonuses, there was €8,000 paid in 2001, that went over the years to €11,000 in ‘02, €235,000 in ‘03, it went to nearly €1.5 million in 2004, went down to half a million, €521,000 in ‘05, just short of €900,000 in ‘06, went to €1.5 million in ‘07, and down to €464,000 in 2008. In fact, I know one individual would have received nearly €450,000 of a bonus. How did that culture, within EBS, arise?

**Mr. Fergus Murphy:** I think that financial markets, Deputy, and financial institutions became bloated, and I think that EBS, as a small independent, would have been, in fairness to them, looking at the marketplace, they would have been ensuring that there was a third party consultant working with them in terms of benchmarking their people and their remuneration. However, the results coming from those benchmarking would have told them that the market was moving on, that variable remuneration was an “important part” of the scorecard with your employee, your senior employee, and so it would have evolved, I would imagine, organically, rather than overnight, and you end up where you are in relation to that particular page.

**Deputy Kieran O'Donnell:** Okay. Can I ask you on page 6 of your statement you make reference to that in 2005, EBS went from a situation where they were not in the land and development lending to over a two-year period to go really from zero to €1.7 billion. And the question I want to ask you is: if EBS had not gone into the land and development lending, would EBS have required a bailout from the taxpayer? Would EBS be a stand-alone prudential building society today?

**Mr. Fergus Murphy:** I think it's a very, very good question, Deputy. If we look at the €2.375 billion that was required for EBS in terms of the Government and taxpayer, significant of the moneys are around the land and development and commercial property area. So, for example, specifically €425 million was required with regard to the assets transferred to NAMA, and they would have all have been land and development and commercial property. There was a-----

**Deputy Kieran O'Donnell:** At the time that NAMA arose, what was the level of what I would regard as development loans in EBS at that time?

**Mr. Fergus Murphy:** To my recall, about €550 million.

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

**Mr. Fergus Murphy:** Of land and development, and then commercial property in totality-----

**Deputy Kieran O'Donnell:** So the €1.7 billion you speak about-----

**Mr. Fergus Murphy:** Is the total of the two.

**Deputy Kieran O'Donnell:** Was total of the two, but some of that would have ended up ... so there would have been €1.7 billion of loans available for transfer to NAMA.

**Mr. Fergus Murphy:** And €900 million were transferred over, specifically.

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

**Mr. Fergus Murphy:** And that was the €425 million loss in that regard.

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

**Mr. Fergus Murphy:** Also, EBS under the requirements had to deleverage, like every other institution, and €2.5 billion of commercial and buy-to-let assets were deleveraged and the cost to the organisation of that was €535 million.

**Deputy Kieran O'Donnell:** So we're up at nearly a billion.

**Mr. Fergus Murphy:** A billion.

**Deputy Kieran O'Donnell:** A billion.

**Mr. Fergus Murphy:** Yes, so then there was also extra capital required in general for commercial impairments of €120 million.

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

**Mr. Fergus Murphy:** So now we're ... the ... you know, it's beginning to tick along. And

then also there was a generic general buffer of €300 million required for EBS. Now, if you apply most of that to commercial property again, because the commercial property piece was the most risky-----

**Deputy Kieran O'Donnell:** I suppose the question I have-----

**Mr. Fergus Murphy:** -----you're getting a large number, so, therefore, had there not been commercial property and land and development strategy emanating, originating from 2001 onward, we have more than ... we have probably, if my maths are right there, about 60% straight away of the required financing capital injection into the company dealt with.

**Deputy Kieran O'Donnell:** You would not have been going into NAMA?

**Mr. Fergus Murphy:** Correct.

**Deputy Kieran O'Donnell:** As an organisation. So in your view was the ... two quick questions. Number one; why did EBS enter the market when clearly it was a profitable company, profitable business prior to that? And why did it go in after the land and development business? Did it have the requisite expertise? You spoke already about risk assessment. And do you believe at the time, for the organisation, that it was a ... I suppose a ... bordering on a reckless move as a mutual society?

**Mr. Fergus Murphy:** Right. There's no one word I could describe, Deputy, to ... or adjective or whatever, in terms of, of what it was. I think it's a conflux of various errors and issues and happenstances and poor strategy. So, I wouldn't describe it in ... with any one word. But, again, how did they get into it? They got into it because they felt they were losing relevance and that they had to create new profit pools, revenue pools, that would sustain their capital base and allow them to continue to have market share, particularly in the residential mortgage marketplace, which, in fairness, is a virtuous multi-decade, first-time buyers, second-time buyers, etc.

**Deputy Kieran O'Donnell:** So, I suppose, I have one more question now, I should ask, would EBS be stand-alone today if it hadn't gone into the development side in 2005?

**Mr. Fergus Murphy:** I will try and give you the best answer I can there. Obviously it's hypothetical in that we can't read the future. But, given the structure of the recapitalisation of EBS and the requirements that were, as we've just gone through fairly specifically, that were specifically related or can be correlated very closely to commercial property in land and development, it would ... it would seem to me that there was a very reasonable chance of the organisation making it through, had they not been involved in all of that.

**Deputy Kieran O'Donnell:** Can I refer you to Vol. 2, page 161, and, Chairman, it's, it's EBS board presentation 26 September - "Government intervention anticipated and unavoidable". And I want to read just one, one paragraph, "Government intervention anticipated and unavoidable; potential scale of intervention is likely to be considerable and could change the Irish banking landscape here fundamentally." That's a note from the minute of a meeting of 26 September 2008 which I expect, Mr. Murphy, you attended?

**Mr. Fergus Murphy:** Yes.

**Deputy Kieran O'Donnell:** And, can you just give me the basis for that statement because that statement was made, basically, three days before the guarantee was put in place?

**Mr. Fergus Murphy:** So, I, I think there, what that reference to is, it is publicly known at

that point in time, and there's an awful lot of noise in the ... in the system around the stability of ... in particular two financial institutions.

**Deputy Kieran O'Donnell:** Anglo and Irish Nationwide.

**Mr. Fergus Murphy:** Yes, and that therefore, one is, in this note is, is reflecting that and saying that it would seem that it's inevitable that there will have to be some kind of intervention.

**Deputy Kieran O'Donnell:** And how long would it have been in the public ether that those two organisations were in ... were in trouble?

**Mr. Fergus Murphy:** Personally, from my point of view, I would say March-April 2008, I would have started to get informal updates, get a sense, in terms of my own perspective, that the growth of the decade before that, particularly ... particularly these two organisations, was strange. I wouldn't have been conclusive in my own view in terms of what was going to happen next. I wish I had a crystal ball. But, that there were ... it was ... it wasn't ... it didn't seem very conventional and that these two organisations, in particular, seemed to be outliers.

**Deputy Kieran O'Donnell:** And, two quick questions. Did you regard either institution as to be systemic to the Irish banking system and did you, as CEO of EBS, in any way approach the Central Bank, Financial Regulator, Department of Finance, Government sources to express your concerns? And, did you see in any way that they could impact on EBS, your own institution, in terms of, of its activities?

**Chairman:** Thank you, Deputy. Mr. Murphy?

**Mr. Fergus Murphy:** Sure. In terms of their, their importance ... their systemic importance, first of all, Deputy, as I mentioned earlier on, I didn't believe EBS had the same systemic importance as, for example, AIB or Bank of Ireland, and would have approached my business with the stakeholders in that regard, which I think was the appropriate and right thing to do. So, similarly, you know, given that I didn't think EBS was systemically important, I also wouldn't have thought that Anglo Irish Bank or INBS were systemic to the system, in the same way that I wouldn't have thought EBS was, because, you have a smaller market share, you were a smaller organisation, you are not a payments bank, a transition payments bank, you're not running ATMs *per se*, you're not doing basic banking, you don't have current accounts. So, based on that kind of approach, I wouldn't have seen them as systemic.

**Deputy Kieran O'Donnell:** And you wouldn't have seen any-----

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

**Deputy Kieran O'Donnell:** You wouldn't have seen any reason why either of those institutions couldn't have been nationalised on the night of the guarantee?

**Mr. Fergus Murphy:** I wasn't competent and still probably wouldn't be competent to say what should have happened to them. I think that's a very long discussion, Deputy, that, that we could have. It's very difficult for me to say exactly what should have happened to them in the environment we were in.

**Chairman:** All right ... and I don't want you speculating because you'll be put on record on speculation as opposed to actual factual basis. Deputy Doherty, please.

**Deputy Pearse Doherty:** Go raibh maith agat agus fáilte. Can I ask you to comment on the

proposed merger with Irish Life and Permanent, the reasons behind it and also the reason why this proposed merger didn't go through? You, you'll see it on ... page-----

**Mr. Fergus Murphy:** 167, I think.

**Deputy Pearse Doherty:** Yes, 167 to 172 on core Vol. 2.

**Mr. Fergus Murphy:** Yes, thank you, Deputy. The ... there were two efforts made to see whether or not Irish Life and Permanent and EBS, and then latterly, when Irish Life and Permanent and PTSB had decoupled, whether PTSB and EBS could merge with each other. This was the, the first effort when, obviously, Irish Life and Permanent was, was one unit. The, the thesis there and the objective there was to see was there a position where we could, again, in Ireland, have a, a third force by aggregating ... merging bank three and bank four, so to speak, and then having a viable organisation that would be not that dissimilar to an AIB or Bank of Ireland. So, that, that was the piece at the time, and we would have gone through work to, to validate that at the time.

**Deputy Pearse Doherty:** And, why didn't it ... why didn't it happen and what period of time are we talking about?

**Mr. Fergus Murphy:** So, I, I think we're referring there and I just might, might check the date, but I think that would have been late 2009. I wonder does the-----

**Deputy Pearse Doherty:** It's not on the book.

**Mr. Fergus Murphy:** It's not, is it not? I, I think that's ... was late 2009, Deputy, and going into early 2010. My memory on why it didn't happen is that I think one of the ... I think the initial PCAR came along, in early 2010, and the quantum of capital that was required into the institutions took over as the focus, rather than a merger of, of institutions.

**Deputy Pearse Doherty:** Okay. And, would you not ... did you not have an indication of what was coming down the line in terms of PCAR or were you still thinking that it would be a lot smaller than what PCAR discovered?

**Mr. Fergus Murphy:** No, I think we would have had a fairly good line of sight on it. But, for example, PCAR ... one of the interesting things about capital in an organisation, in a bank, is, if you say the capital ratio should be 4% and then you can turn around the next day and say it should be 8%, so one of the ... one of the things that PCAR did correctly and rightly was it increased the capital requirements by two, of an institution. So, it's actually very hard to predict that, 'cause you could ... you could say, it could be some other number too. And, subsequently, Deputy, the ... the levels went from 8% to 10.5% etc., so it's very hard, at any point in time, to predict what an exercise might eventuate.

**Deputy Pearse Doherty:** Can you tell me how it was possible for a building society to issue commercial property loans? What was the legislative framework that underpins this type of lending that EBS partook in?

**Mr. Fergus Murphy:** So, in terms of the, again, the origination and genesis of that going back to 2001, because it was a property loan, my recall is that the ... the legal format and framework of the society enabled a property loan. And, because it was property, it was within their ... it was within their mandate.

**Deputy Pearse Doherty:** So, the hotels, which basically ... you could buy a hotel under the

type of ... or, you could fund the purchase of a hotel under the legislation in 2001?

**Mr. Fergus Murphy:** Yes, because the underlying loan was to a property. I think that would have been the key piece. But, I'm just going back now in memory, as obviously, as you know, three or four months into my tenure I was closing it down. So I was more interested in how we don't lend to any property or hotels or anything, rather than how to do it. But, because it was a property loan, I think that's how it qualified.

**Deputy Pearse Doherty:** And, you say when, in 2010, €836 million of property loans originating in just two years, between 2005 and 2007, were transferred to NAMA at an average discount of circa 60%, the resulting capital loss on these loans was very damaging. What was the nature of the €836 million worth of loans that were transferred to NAMA? Was it land, hotels, was it residential housing, what type of loans were they?

**Mr. Fergus Murphy:** The ... sorry, the lion's share, Deputy, I think, off the top of my head maybe €540 million, €550 million - I stand to be corrected - would have been land and development. So, it would have been non-developed activities that could have been a field somewhere. It could have had zoning. It could have had planning. It may not have. But, the lion's share would have been that kind of business plus some of the larger commercial property.

**Deputy Pearse Doherty:** Okay. And this land, was that for housing or was it for commercial?

**Mr. Fergus Murphy:** It could have been both for residential development or for commercial development. In many occasions it probably would have been for residential development, given the location, because often the locations were secondary and tertiary locations, in that it was unlikely to have a commercial activity in those areas.

**Deputy Pearse Doherty:** Okay. And you were mentioning to ... on previous question, the question about ... and we've had evidence to suggest by some witnesses that it was commercial lending that broke the banks. In relation to that statement, do you believe that that is true for EBS or not true?

**Mr. Fergus Murphy:** I think that, to my conversation a few moments ago with the Deputy, I think it is a very large bearing to the EBS story. I can't say it's 100% of it, but it has a ... it's a dominating factor in the context of EBS being ... what happened to EBS. Another important point there, for example, so ... because I can't say it's 100%, is the liquidity and the funding of the balance sheet. There are a number of dynamics all coming together at the one time. One could argue that one item is 30% and something else is 60%, but those two points would be the dominating factors and I would believe that the commercial property piece is the most dominant.

**Deputy Pearse Doherty:** Okay. In relation to the portion of land that was transferred to NAMA, what was the haircut on that type of ... on that product?

**Mr. Fergus Murphy:** The overall haircut was 57%. I can't give you, off the top of my head, the haircut for that sub-piece of land and development versus commercial property, Deputy, apologies, but it was 57% overall to my recall. For some of the land and development it could have been up in the 70s.

**Deputy Pearse Doherty:** Could have been up, okay. Can I ask you, what would have been the effect of a political guarantee on EBS as opposed to a legal guarantee, in your view, in rela-

tion to access to liquidity?

**Mr. Fergus Murphy:** So, more of a letter of comfort, do you mean?

**Deputy Pearse Doherty:** A statement of intent by Government, what many other European governments did?

**Mr. Fergus Murphy:** Yes. I ... generically, again, hypothetical, hard to know, but I believe that the system in Ireland was ... it was more acute. The problems were more acute. We're a small economy. You're not going to be able to do, potentially, what the Germans or the UK or the US can do in terms of protecting their systems. You probably have to be more transparent and you're probably not going to get the benefit of the doubt from the markets given the size of the economy etc. So, probably you have to be more explicit.

**Deputy Pearse Doherty:** What ... how long did the guarantee's effects last? We've heard from again witnesses that they had ... they had disappeared by the end of that year, by December, I think, from a former Taoiseach, or a Minister. Sorry, I'm not sure which one may have said it. But how long did the liquidity ... did the guarantee provide the type of access to liquidity that the banks needed?

**Mr. Fergus Murphy:** The original CIFS legislation coming in in September 2009, definitely gave a shot in the arm to the financial institutions and to EBS, at that point in time, but as I mentioned earlier on, we weren't in a grave state. I was concerned, we weren't in a grave position in September 2008, but there were inflows of deposits in the three to maybe four to five months after that. So the deposit base grew on the back of the guarantee. Thereafter, in 2009, things continued to get worse for the economy and for the banks, for the sovereign, and one would have started to see an outflow of deposits again as the connective ... as the connection to the sovereign became more apparent to international investors and the sovereign itself started to weaken.

**Deputy Pearse Doherty:** So, after about four to five months, your view was that depositors or lenders that would place money with your bank and other banks, began to question the solvency of the State and being able to stand over the guarantee that was given?

**Mr. Fergus Murphy:** Yes. I think the global ... or sorry, the local trend very much shows that during 2009, things got ... were getting worse.

**Deputy Pearse Doherty:** Okay. In Vol. 1 page 49, if you'd just refer to that page, it's an inspection by the regulator into certain aspects of EBS's loan book in 2007, and we know that similar inspections took place across the banking system in January to March 2008. How much knowledge would the Financial Regulator's office have in relation to the loan book of EBS? And would the office have been aware of EBS's exposure to commercial land and development property loans? Would the office have been aware of the funding model of EBS at the time?

**Mr. Fergus Murphy:** Yes. Deputy, I think the answer to all of those is yes. I mean, there were very deep relationships between the regulator and all the financial institutions, including EBS, and by the nature of a letter like this and the earlier letter that I was discussing with Senator Barrett, one can, I think, readily see that there is a strong depth of understanding and a strong depth of investigation in relation to each institution, given the nature of the letters coming through in terms of detailed challenge, and again, appropriately put, in relation to policies, procedures and how the institution can improve itself.

**Deputy Pearse Doherty:** So, like there's stuff in this ... in this review, for example, that no proof of addresses for individuals in terms of mortgages that had been handed out. One individual, two jobs, there was a handwritten P60 and payslip for a second job; "no tax was being deducted from [the] employment", and it "would question the sustainability of the second employment".

There's also other findings, which say that there's ... you aren't stress testing, or you weren't ... the bank wasn't stress testing appropriately but also that the bank details for the last three months, bank account details were not being requested in relation to mortgages at all, so - apart from buy to let - so, is this just something that happened in the previous couple of months before the Financial Regulator did their inspection or was this going on ongoing with an EBS for years prior to that?

**Mr. Fergus Murphy:** I think it's illustrative of what was happening in financial services in Ireland, not just in Ireland, but particularly in Ireland, during a multi-year period, including 2007, Deputy, as to that letter, 29 June 2007. The system wasn't able to keep ... catch up, keep up with the volume. The ... putting it bluntly, it was a, kind of, "stack 'em high, sell them cheap" approach in Irish banking. Because of all of the liquidity that was there in the world, as we spoke earlier on about, and because so much of it was available to Ireland and to Irish financial institutions, for example, the focus was on profit before tax, rather than on return on equity. And so that meant institutions were typically building the balance sheet ... again I'm repeating, I'm sorry ... to the 30% per annum comments made earlier on, and if you keep doing it, it'll keep being virtuous. But then the music stopped. And so the organisation and the operating environment in the organisation, and the control environment in the organisation, and the banking operations, and the things that need to take place, like validating income or making a payment or ensuring affordability, were struggling, creaking at the edges to keep up with the origination machine that was being fuelled by the easy liquidity.

**Deputy Pearse Doherty:** But can I just, finally on this here, like, if you go to page 52, on the top of that page, it's item 4, "The Society's Credit Policy does not require bank statements to be obtained and reviewed in assessing affordability other than in the case of applications relying on surplus rent roll to support Homeloans or [buy to let]." Now, to me, that is just ... like, this is a bank issuing a loan, who's saying to the customer who's getting this money from the bank, "We don't actually need to see any of your bank statements." Like, is this ... was this just creaking at the edge where they decided to change the credit policy to say, "Well that's too much hassle asking them for the bank statements", or was this the policy of EBS forever, since it was established, and the Financial Regulator's only finding this out in 2007 during this review?

**Mr. Fergus Murphy:** I would say, Deputy, to try and be helpful there, that one, I would imagine it wasn't the policy of the society for generations and decades before that, and that they would have had a reputation for being a conservative and prudential and good lender. I would imagine, and I don't have the detail here, that the wording here, "The Society's Credit Policy does not require bank statements", it may be ... and please do bear with me if I'm incorrect in this ... that the Regulator has evidenced where bank statements weren't seen or required or were on file and that the credit policy isn't explicit enough about calling out the requirement for bank statements. If I was betting on this, I would imagine that is the nature of this point 4, on page 54, rather than we ... we, as an organisation, EBS, at the time, as an organisation, has a blanket, you know, disinterest in receiving bank statements from applicants. However ... so, you know, devil in the detail, however, I think substantively a letter like this with so much in it, in terms of things that need improvement or could be done better, does reflect on, I think, probably your



concerns, Deputy, but also the comments I'm making in terms of the system wasn't able to keep up with the origination that was taking place on the back of a property economy.

**Deputy Pearse Doherty:** Okay, thank you.

**Chairman:** Thank you very much. I'll now move to wrapping things up. Senator D'Arcy, three minutes.

**Senator Michael D'Arcy:** Mr. Murphy, Senator Barrett stated you were one of the few who survived the cull and now that you're one of the most senior people in AIB. Are you - and when I say "you" I'm speaking about executive bankers - are you overpaid in this country?

**Mr. Fergus Murphy:** I don't believe so, Senator, but my view will, you know, be a small one there, in that these things need to be benchmarked properly, locally, sector-wise and regionally. So, I believe that there is strong benchmarking that takes place in terms of what is the right amount of remuneration for a person doing a particular job. And so, you know, clearly, I have no influence on my own remuneration and I believe that, with the general improvements that have been made, which we referred to earlier on, in terms of risk governance and how the banks are running ... being run, and what the tone from the top is, I would feel confident that people in the future will get paid transparently, whatever that is, and that it will be properly benchmarked and organised suitably so that the best interests of the society, of the customers and of the bank is maintained.

**Senator Michael D'Arcy:** And who should the two pillar banks be benchmarked against?

**Mr. Fergus Murphy:** I think that-----

**Senator Michael D'Arcy:** There's only two of you.

**Mr. Fergus Murphy:** It's ... you know, I think one should benchmark against other institutions in Ireland, or companies in Ireland in other sectors. And one should benchmark against like-sized banks in other jurisdictions that are probably OECD zone A, western European, or whatever. I think there's probably plenty of exemplars or comparators there for us to use. Now, this is not an area of expertise of mine and I don't, you know, manage this part of the business but I would imagine that would be a reasonable approach.

**Chairman:** Thank you very much. Senator Barrett?

**Senator Sean D. Barrett:** Thank you, Chairman, and thanks again, Mr. Murphy. What criteria should be used in choosing board members for the Central Bank?

**Mr. Fergus Murphy:** I think, Senator, that it's very important to understand the sector. So, you must ... and it's probably a challenge, or a valid criticism of banking in Ireland at a point in time that, possibly, there were directors on banks who didn't have a strong financial background. But I think you need a certain quotient, or a quorum, or a percentage of your board that have a very strong financial background, be it in insurance or be it in banking, because it is a different business to lots of other businesses. If I could for a moment, you know ... if you sell a banking product to a customer, ironically and usually, that product stays on the bank's balance sheet for five, ten, 15 or 20 years. If I sell cheese, or if I sell shoes, or if I sell whatever, once I sell it, it's gone. Now, if it wasn't a good piece of cheese, the customer will come back and say to me, "It wasn't very good" and they may not buy anymore cheese from me again. But it's very different. You sell something to somebody but it stays on your balance sheet, so that's a

different industry with a different rigour around it. It's actually quite a complex industry and, therefore, I believe having financial services background and experience would be very, very important.

However, I think it's also very important to have people on the board of the Central Bank, or any other bank, that can bring a wide perspective outside of banking because one of the challenges and one of the, again, valid criticisms of banking is that we became so insular and so micro around the importance of banking that one could have forgotten what was actually happening in the real economy. And so having people with strong economic background and people with strong governance background and some people with expertise from sectors outside of banking would be the right mix. But the concentration should be on financial services expertise.

**Senator Sean D. Barrett:** Thank you. And the final one: how did auditors of Irish banks miss so much?

**Mr. Fergus Murphy:** I think the auditors were working within their prescribed mandates with regard to accounting standards and I think that we could have a long discussion on accounting standards and how they have evolved and the changes that are taking place now in them to, for example, try to predict more accurately the state and the likely projection of a bank's balance sheet. So, for example, going from incurred loss to expected loss, which IFRS 9 will do in the coming years. But I suppose the auditors and the accountants were working within the strictures that they were in, in terms of the accounting regulations that they had to follow. So, I think that would have probably, Senator, been a large part of it.

**Senator Sean D. Barrett:** Thank you, and thanks, Chairman.

**Chairman:** Thank you very much. I just wish to wrap up with you, Mr. Murphy, please. And maybe a lot of discussion this afternoon was with regard to the past and the, sort of, corrections that were required and so forth. A part of the work of this inquiry is also to look to the future in terms of making recommendations so we don't revisit the errors of the past and the difficulties that come with them and maybe if I could draw you into making some final comments in that regard and if you might particularly talk about measures that would result in behavioural change in financial institutions. Earlier testimony here has, kind of, brought two issues to the fore: the separation of banks and bankers as being two different entities, and the concept, or the discussion earlier, that something like €140 billion has been paid in fines by financial institutions post-crisis, which would indicate that there is still behavioural aspects that are of concern.

**Mr. Fergus Murphy:** Chairman, I think that is a very good point and I think that, again, taking a step back, banks got way ahead of themselves. They became extremely arrogant as a global sector and there's been, again, many lessons learned and many things have gone wrong, locally and internationally - fines of billions of euros being paid by banks around the world for misconduct of various types. They do say - it's a little trite - you know, that culture eats strategy for breakfast. I think it's true though, and if you build the bank around the right behaviours, which takes time, if you inculcate those behaviours steadily and consistently in the organisation, if the leadership of the organisation, starting at the board, are role models and are looking to do the right thing, if they call out good behaviours and they call out bad behaviours consistently - and that is the central mission for the board and for the management - I do believe we can continue to bring financial services, globally and locally, back into a more respectable space. It's going to take multiple years and efforts and attempts, but that's the mission that we are all on now. So, in that context, setting the required standards, having a meritocratic envi-

ronment where people are performance managed in a fair but tough way; ensuring that conduct risk is at the very centre of the discussions again that take place around the top table. Again, it's easier to have those discussions when you've an independent CRO reporting both in to the board and in to the chief executive, conduct risk being the ... ensuring that the bank is doing the right thing by the customer; that they're making every effort to sell them the right kind of product at the right time; that the customer's eligible for that product; and that the customer can afford that product etc., etc.

That concept of conduct risk wasn't there ten years ago. It's a new phenomenon and if we build our bank based on conduct risk and based on having those transparent behaviours, we can bring it back to a good space. There are some countries in the world, like Canada, which we mentioned earlier on, like Australia, like Singapore, where I lived and worked for a number of years, where banking has a better reputation. I'm not saying that it has the very best reputation but a much better reputation than it has here, for example, in Ireland, and understandably after what has happened in Ireland, but I do believe, and I am confident, that with the right culture and the development of that culture, we can bring banking back to be a sustainable, responsible part of the economy, where people who work in banks - decent people, I mean, you know, there are a lot of ... thousands of decent people who work in banks - aren't embarrassed to get into the back of a taxi and say, when the taxi driver asks them, "Where do you work?" they're afraid that ... they don't want to say they work in a bank. We've got to get over that. And culture-----

**Chairman:** You share that with a few professions, I'd say, Mr. Murphy, and maybe you're in proximity to a few of them at the moment.

**Mr. Fergus Murphy:** And culture is at the centre of that. And the culture of an organisation, nine tenths of it is under the waterline. It's like an iceberg: one tenth is over the waterline. So you have to work on that culture very, very hard and for many years because a culture grows over a 40-year period and, you know, it's subtle, whereas a strategy, you can see. It's in a paper, you can measure it, it's in a spreadsheet. So, our task now is to build that culture and it's early days but I would like to say, and I believe it is the case, that in AIB - and I'm sure it's the same in the other institutions - we can see the culture changing, we can see that we are there for the customer. It's not about the bank; it's not about the banker; it's not about the bankers bonus; it's about doing and fulfilling for the customer. And if we do that, we've a chance of respectability for banking again.

**Chairman:** Okay, thank you very much, Mr. Murphy. With that, I'm going to bring matters to a close. I just propose that we just take a very, very short private session after this just to work out the, kind of, sequencing for something to eat and all the rest of it. I've just been on to the canteen services here and I'll just give information to members about that as well. So with that said, I propose that we suspend just a few moments so we can excuse Mr. Murphy, and on doing so, thank you for your participation and for your engagement with the inquiry. And to now formally excuse you. Thank you very much, Mr. Murphy.

**Mr. Fergus Murphy:** Thank you very much, Chairman. Thank you.

*Sitting suspended at 3.22 p.m. and resumed at 4.45 p.m.*

### **Ballymore Group - Mr. Sean Mulryan**

**Chairman:** I now propose that we return to public session is that agreed? Agreed. The