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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉIREACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 29 Iúil 2015

Wednesday, 29 July 2015

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.

ports, from Honohan and the other people that have ... Watson and so on, but also that I think it will hopefully improve the economic management of the country. And, I suppose, if there's any message, it is that we all need to be more questioning than perhaps we were, particularly when there's a national consensus. I think that is a time for parliamentarians, particularly members of Government, to get behind that and to be more questioning and that's something I think that we overlooked in ... during the period that we're talking about, during the run-in to the recession.

Chairman: Thank you very much, Ms Harney. Mr. Gormley?

Mr. John Gormley: I would just like to add one thing. I think reference was made, at a previous hearing, to Paul Gallagher, the Attorney General-----

Chairman: Yes.

Deputy Michael McGrath: -----and the Green Party attitude, there was reference made in Dan Boyle's book. Now, I can understand why it is that political parties would feel that the AG's office is a block; it's quite natural. You know, the AG's office goes through things line-by-line and says, "You'll have to go back." And it prolongs the legislative process. But from my own point of view, I hold Paul Gallagher in very high regard. He was of enormous assistance to me. He worked extremely hard. He's dedicated to public service. He helped me particularly on the issue I was dealing with, which was the incinerator. I was at the time ... I was told at the time that if I didn't deal with this properly and work on it and take it step-by-step in a very measured and legislative way, that they could pursue me personally. This is the ... and Paul Gallagher helped me out and I'm very grateful to him for that and I just want to put that on the record.

And finally I want to say, Chairman, I think this is an important committee. It's important that your report is very thorough, that you go through every single thing. I don't think, to be quite honest with you, that even with the best will in the world, and putting in all of these measures, that you will avoid in the future another bust. It is part of the cycle. But you can, I hope, mitigate those circumstances and ensure that, in future, we don't come down with such a thud.

Chairman: Okay, with that said, thank you very much, Mr. Gormley and Ms Harney, for your closing comments. In doing so, I'd like to thank the both of you for your participation today and for your engagement with the inquiry. In thanking you again, to now formally excuse you and to suspend the meeting until 6.45 p.m.

Sitting suspended at 6.23 p.m. and resumed at 6.57 p.m.

EBS - Ms Fidelma Clarke

Chairman: With the committee's permission, I'll go back into public session, is that agreed? Agreed. And we now move on to our fourth and final session of public hearings today with Ms Fidelma Clarke, former chief risk officer with EBS. And just from the outset, apologies for-----

Ms Fidelma Clarke: Not at all.

Chairman: -----delaying you today, Ms Clarke, and we'll get proceedings under way as quickly as we can now.

Ms Fidelma Clarke: Thank you.

Chairman: So, therefore, the Committee of Inquiry into the Banking Crisis is now resuming in public session and can I ask members and those in the public Gallery to ensure that their mobile devices are switched off. This evening we continue our hearings with senior figures from the EBS and I welcome to the meeting Ms Fidelma Clarke, former chief risk officer at EBS. Fidelma Clarke was chief risk officer of EBS Building Society from 2009 to 2012. Prior to this, she was company secretary and held a number of roles in the society in risk, credit policy and customer service. She joined AIB in December 2011 and is currently head of risk analytics, reporting to the group chief risk officer. In 2012, Fidelma was appointed as non-executive director of EBS Limited. Ms Clarke, once more, you're very welcome before the committee this evening.

Ms Fidelma Clarke: Thank you very much.

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 are directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you are entitled thereafter only to a qualified privilege in respect of your evidence. You are directed that only evidence connected with the subject matter of these proceedings is to be given. I would remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry which overlap with the subject matter of the inquiry. Therefore, the utmost caution should be taken not to prejudice those proceedings. 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, will be relied upon in questioning and form part of the evidence of the inquiry. So if I can now ask the Clerk to administer the oath to Ms. Clarke please.

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

Ms Fidelma Clarke, former Chief Risk Officer, EBS.

Chairman: So, once again, welcome before the committee this evening, Ms Clarke, and if I can invite you to make your opening comments please.

Ms Fidelma Clarke: Thank you. I have been asked to provide a witness statement in relation to my role as chief risk officer and company secretary of EBS Building Society. As you've said, Chairman, I was appointed chief risk officer in January 2009, reporting the to CEO, Fergus Murphy. From that time, I also had a dotted reporting line to the chairman of the board risk committee. I had been appointed company secretary in July 2008 and resigned from that position in June 2009 to concentrate on the demands of the chief risk officer role. Given the hour, I thought what might be most beneficial for the committee would be for me to drive some of the key themes from the written statement that I have submitted and, with the benefit of some time for reflection, some of the lessons learned.

The route cause of EBS's financial difficulties were set out in its restructuring plan submission to the EU Commission in May 2010, comprehensively covered by Professor Nyberg and have been discussed by this committee earlier today and also last week. These were: a decision to step up lending to the land and development sector at the height of the Irish property boom and insufficient management oversight of this lending; strong growth in EBS's residential loan book in response to competitive pressures; the fact that EBS was a moderately-capitalised business albeit, within regulatory requirements; and an over-reliance on wholesale funding. The board of EBS took the decision to enter into land and development sector in 2002 and to step up this lending in 2005. Controls put in place to mitigate risk weren't sufficient in the face of the timing of the decision and the scale of the financial crisis which ensued.

The growth in residential mortgage lending over the period 2000 to 2008 is a reflection of the strategy of the board of the society to retain EBS's mutual status and remain a relevant mortgage provider in Ireland. This necessitated moving with the market. Numerous changes to credit policy were approved, which allowed customers borrow more than they had in the past. At each stage, the options were clearly documented and considered by the executive and the board before approval. Increased risk appetite, as set out in the society's policies, was supported by a strong economic climate, improved demographics, higher income and lower tax levels - all of which improved loan affordability. Loan exposure was limited with mortgage indemnity insurance. Significant investments in underwriting systems, models and management reporting were made. The long-established management controls in place, including centralised underwriting, loan affordability assessment, mortgage indemnity insurance and independent property valuations, were insufficient to withstand the scale of the economic downturn and the significant correction in house prices.

In terms of its capital position, EBS operated within regulatory capital requirements throughout the pre-crisis years. But its tier 1 capital ratio of 7.9% at the end of 2008 was inadequate to absorb the unprecedented level of provision losses arising from the crisis. The PCAR II and PLAR exercises in Q1 2011 resulted in a required tier 1 capital ratio of 22.5%. Finally, in relation to the liabilities side of the balance sheet, the reliance on cheaper wholesale funds of all credit institutions has, I believe, been extensively commented on. Between 1999 and 2007, EBS's loan book grew by 300%, while deposits grew by 170%. Similar to other institutions, the gaps that ... had been funded through wholesale funding and international corporate deposits. As we now know, this was an unsustainable model and new regulatory requirements in relation to loan-to-deposit, liquidity coverage and net stable funding ratios are in place to prevent a recurrence of this situation. Accountability for these failings was demonstrated to members in the stepping down of the chairman of the board and the finance director early in 2009.

In terms of the risk management of the society, Professor Nyberg expressed the view that the risk management system in EBS was not adequately resourced and seems to have lacked influence within the bank. Looking back, and with the benefit of hindsight, I agree with him, although I do not believe that this of itself contributed significantly to the overall outcome for EBS. The risk team was established in 2002, comprising three people. It's responsibilities were set by the chief risk officer. These included establishing and providing input to a credit risk committee, an operation risk committee and a capital committee over the period 2003 to 2006, documenting the society's risk governance framework, developing a risk assessment process for each function, ensuring that all of the organisation's risk policies were documented, developing an enterprise risk report for the chief risk officer with inputs from across the society on key risk trends and risk positions, delivering the Basel II programme, which included the new requirement for capital assessment, the ICAP process, an internal capital adequacy assessment process, modelling and reporting on requirements - a significant undertaking between 2004 and 2008 - also developing loan-loss provision models to meet aspects of the new international financial reporting standards and building and submitting new regulatory reports on liquidity, asset quality, large exposures and impairments.

The credit risk committee was chaired by the chief risk officer and comprised representatives from the business areas, credit underwriting, the distribution channels, and risk. Its role was to monitor risk trends and review proposed changes to policy in line with the society's approved strategies for onward recommendation to the executive and board. The risk team was not involved in strategy formulation, approval or implementation in terms of day-to-day business operations, nor was it involved in the credit approval process. This was managed by the commercial business and residential underwriting and from 2005, a commercial underwriting unit. There was a senior management credit approval committee, called the loan advances committee, made up of business, credit and senior management, and separately, a subject which the committee has touched on earlier today, a board credit approval committee, comprising non-executive directors and members of the executive.

This committee has heard there have been many regulatory developments in the area of corporate governance and risk management as a response to the financial crisis. Risk management is not confined to risk specialist or control functions. Current corporate governance for financial institutions is set out on a three-lines-of-defence model. Business units are the first line of defence and are primarily responsible for managing risks on a day-to-day basis, taking into account the institution's risk tolerance and appetite, and in line with its policies, procedures and controls. The second line of defence is a risk management function, which is independent of operations and management. Its role is to challenge decisions that affect the institution's exposure to risk and to provide comprehensive and understandable information on risks, enabling the board to understand the institution's overall risk profile. The third line of defence is an internal audit function, which assesses the adequacy of the operations of the other two lines. Today, good governance requires that a chief risk officer should be an independent senior executive with distinct responsibility for this job.

In EBS these standards commenced with my appointment as a dedicated chief risk officer and member of the executive team in 2009. From 2009, I presented a detailed risk report to the board each month with an independent assessment of the level of risk being run in various key areas and the actions management were taking to mitigate risks. The number of board risk committee meetings increased and I met regularly with the chairman of the committee to discuss the risk position and outlook for the organisation. The board credit approval committee was disbanded and board training programmes were extended. We developed a risk appetite statement setting out the board's limit of risk appetite in each area and monitored and reported on adherence to this risk appetite statement on a monthly basis.

A number of actions were taken to mitigate, where possible, the extent of the downturn in the Irish economy and property market on the society's balance sheet and to manage the business on a day-to-day basis through the global credit crunch. Lending criteria were tightened. We brought in external, experienced credit resources to advise us on how to manage our business through a downturn. The credit function was reconfigured to manage distressed assets and those at risk of becoming distressed. From the first quarter of 2009, we conducted quarterly reviews of at-risk and impaired cases which informed provision estimates. We commissioned an external firm to review potential mortgage debt solutions in place internationally and we presented the findings of this review to the Oireachtas committee in 2009.

We completed a number of control enhancement programmes. These included enhancements to commercial property documentation and security and deeds management. It ensured that no legal discounts were applied by NAMA, nor capital add-ons applied by the regulator, as a result of missing or incomplete data or documentation. And, of course, throughout the period 2009 to 2011, we monitored funding and liquidity positions very closely and took all actions available to us to avert the risk of a run on deposits and to make contingency plans for that eventuality or possibility.

Some concluding remarks, if I may? The crisis and its aftermath have been debilitating in terms of Irish people's financial health. I fully acknowledge my share of responsibility, together with all who worked in EBS in the pre-crisis period, for that failure, however unintended. From 2009, I worked to the best of my ability with the executive team of EBS, overseen by the board, to minimise, where we could, its impact on customers, on EBS and on the economy. And I am sorry that we could not do more.

Concerns of a housing bubble at the start of the 2000s dissipated in the face of sustained economic growth and the apparent levels of increased wealth, reinforced by positive commentary from external bodies and commentators. The system misjudged both the probability of an economic and property market collapse occurring, and its impact in terms of loan losses when compounded by an international credit crunch - a one-in-100-year event. It has taken more than six years to fully realise the impact of the deterioration in asset quality which concluded with the publication of the European Central Bank's comprehensive assessment results in October of last year.

In the past, policy followed strategy. Risk appetite and risk capacity are now considerations which feed into banks' strategy-setting processes. Limits of risk appetite, in pursuit of the agreed strategy, are set out in banks' risk appetite statements. Regulatory mandated recovery plans ensure that early warning indicators inform banks where action is needed to prevent bank failure.

Excessive competition must be curbed where it threatens the stability and soundness of the banking system, a concept at the heart of conduct risk considerations. And I think the recent example of the loan-to-value cap for first-time buyers is a welcome development in this regard.

Finally, it may sound self-evident to state that banks are, at the end of the day, credit institutions. There needs to be sufficient credit expertise and credit risk evaluation at each level of the organisation, from the boardroom to the bank branches. Thank you very much.

Chairman: Thank you, Ms Clarke, thank you. We will commence questioning and in doing so I'll invite Senator Barrett.

Senator Sean D. Barrett: Thank you, Chairman, and I echo with the Chairman's welcome to you here this evening. Just in your own address to us, that you sent in in the core documents you said the traditional conservative approach to lending in EBS unravelled in the period 2000 to 2007. Would you like to expand on that?

Ms Fidelma Clarke: Yes, I mean, I don't think I'll be saying anything that other people who've attended the committee haven't said. Competitive pressures put institutions in a place where they made decisions to extend their credit criteria in a way they hadn't prior to that. It was informed by enormously strong economic growth from the mid-'90s, affordability was very substantially improved with the reduction in tax rates and the low interest rate environment. Also, there were a number of households where there were two incomes rather than one income as women returned to work, given the demarginalisation of the tax rates. So decisions were made very much informed by a very positive economic environment and a view that that positive economic environment would be sustained. We now know, with the benefit, of course, of hindsight, that that wasn't the case and the soft landing that people spoke about for many years in the early 2000s became a very, very hard landing at the end of the day.

Senator Sean D. Barrett: There's two examples of the unravelling that you described. Book 1 at page 143 and book 1 at page 147. The first one refers to loan approvals of €54.7 million sought for noon the following day, increasing the connected exposure to €88.7 million, and the second one is a 24-hour turnaround for approval for €23.96 million. It's hard to imagine anything further from the model of a group of teachers assisting each other with their house expenses. So, what was going on at that time?

Ms Fidelma Clarke: Well, I suppose, as I've said, I was part of a risk function. I wasn't part of the executive and I wasn't involved in the loan approval process but, clearly, what happened was that the society made a decision to step up its lending to land and development sector. To support the approval of larger loans, it had established a board credit approval committee in 2003 and I think, probably not unlike any other institution, it had a process in place whereby loans were approved within a certain period of time, generally 24 hours. It was one of the issues that the chairman of the board risk committee raised with me when I became chief risk officer, that he had felt that non-executive directors shouldn't actually be involved in credit decisions. And we made the decision, reasonably quickly, to close the board credit approval committee.

Senator Sean D. Barrett: Okay. I see, on page 4 of your document to us, "Having recognised that it could not survive in its current form, EBS was [doing the things you just described]". Mr. Murphy did present to us that it could've survived and that building societies of the traditional kind have survived in the United Kingdom, for example. Did we throw out the wrong kind of organisation?

Ms Fidelma Clarke: It ... it would be nice to believe that the EBS of the 1990s, where I cut my teeth ... I joined it in 1991, I was doing a master's with Trinity and I wanted to find out the difference between an annuity and an endowment mortgage so I joined it for six months and I stayed there for a very long time thereafter. I think it would be nice to believe that that society model could have been sustained. My own personal belief is the availability of credit and the very intensive competition in the market from the early 2000s meant that had EBS decided to retain its 1990s model, if I can call it that - the one I was familiar with - I'm not sure that any board would have - and I am speculating, so let me say that - I'm not sure that any board would have voluntarily taken itself out of the market that it felt was its business to be in and that was providing mortgages to homeowners, traditionally teachers, guards and PAYE workers.

Senator Sean D. Barrett: Because wouldn't the cost base have been much lower, almost, as you say, a financial introductory service of new teachers to existing teachers and guards and so on? I mean, we have some executive pay of €700,000 a year, somebody getting €1.87 million departure money and so on. I mean, did the EBS lose the run of itself in that ... in the model it was adopting compared to its traditional one?

Ms Fidelma Clarke: Well, it was a different model but it was operating in a very, very different time. I've seen the numbers in relation to remuneration. I saw them probably the first time that you did. Not everyone was being paid anything like the levels that you're seeing there so I wouldn't say that it was ubiquitous across EBS or anything like it. And, clearly, they related, in the main, to members of the executive rather than people who were at middle management or lower management.

Senator Sean D. Barrett: The movement to wholesale funding away from deposits, was that regarded as a risk from what you've found looking at how the society was evolving?

Ms Fidelma Clarke: Yes. I suppose, I mean, I had the benefit ... or not the benefit but certainly the position of looking backwards when I became CRO in 2009 at what had happened before. We did a lot of backward review in preparing our submission to the ... for the restructuring plan. So it is clear - again, with the benefit of hindsight - that the availability of credit and the ... on one side, and the demand for ... availability of wholesale funding ... and the demand for credit, on the other side, coincided and all financial institutions moved away from purely funding their balance sheet with ... their lending with deposits. I suppose in a ... in the environment in which Ireland was operating, there wouldn't have been sufficient savings to fuel the type of growth that we saw in the 2000s.

Senator Sean D. Barrett: Then, just arising also, the ... November 2008, the treasury department looked for an increase in the lending lines to the other covered banks in order to invest in their unsecured debt. Was that, sort of, the green jersey agenda that was spoken of at the time?

Ms Fidelma Clarke: Forgive me, I just didn't hear which document you're referring to.

Senator Sean D. Barrett: No, let me repeat that. It's November 2008, the treasury department looked for an increase in the lending lines to the other covered banks, in order to invest in their unsecured debt and to have them reciprocate. Was that the green jersey, kind of, agenda? That is in Vol. 2, page 105.

Ms Fidelma Clarke: Yes, and an item that I believe arose earlier today and also last week.

Senator Sean D. Barrett: Yes.

Ms Fidelma Clarke: I think ... and the reference to me is, I suppose, I was sitting at the meeting in my role as company secretary at the time. There is a paper that, I think, follows that board minute, which is from the group treasurer, and sets out the proposal to provide those lines of credit and to increase, therefore, the overall line of exposure to the sovereign. As both Alan Merriman today, I think, and Fergus Murphy said last week, there was, I believe, a view that that would ... that was not a particular risk for the society at that time. They were all for banks and institutions that were covered by the guarantee scheme and I think you'll see in the treasurer's note that what was being proposed were lines of credit that would be fully covered by the guarantee scheme within the terms of the guarantee scheme.

Senator Sean D. Barrett: Also in your ... the paper that you sent us, there's an interesting item as part of the reforms when you came in, "An external firm was appointed to manage abandoned properties." With so many empty houses built during the Celtic tiger era, your experience will be of interest, I think, to me certainly.

Ms Fidelma Clarke: So, this would have been a situation whereby people who had either rented or were living in properties had left. In some instances, it might have been that they emigrated and, therefore, to protect the asset, we appointed a firm to take security, change the locks and make sure that the property was being minded.

Senator Sean D. Barrett: Okay. Could I refer to ... there's a contrast, isn't there, I think, between what was called light-touch regulation but in fact, a fairly substantial level of adverse findings, over a long number of years, by the regulator where EBS is concerned. In Vol. 2, page 175, there is a letter, I think in 2003, pointing out this. And they go right up to 2008, so there seemed to be a period, a long period, where this was a problem. Page 175, I'll come to that one first, if I may. Thank you, Chairman. "The examination" ... and this one is from Dr. O'Reilly, who was the then regulator, it "raises questions about the maintenance of lending standards in your institution. ... a plan of remedial action addressing all of the issues [is due by the] end September".

And he wrote on 31 July:

> We [...] request that the stated residential mortgage lending policy or institution should be reviewed and ratified by your Board at its next meeting. [The] policy should incorporate the guidance on prudent loan assessment given by the Central Bank in July 2001 [...]

So that's, you know, in a sector which has been described as light-touch, that's fairly hands-on, requiring you to do very definite things in regard to prudent lending, for example.

Ms Fidelma Clarke: Yes. So, absolutely, the regulator conducted regular - and continues to - inspections, where they come on-site, they request a number of loan files and they review them in detail, absolutely. And on foot of that, they come up with a number of findings that you'll see through these core documents, that you'll have seen. For those not in financial services they can look, and are, extensive.

In terms of the responses, we have typically found that a number of the individual items can be answered by return so it's not the regulator inspection team doesn't see or can't find a piece of documentation when they're actually on-site. They have always been taken extremely seriously by EBS and I think they're response which I know is a draft version which follows from the letter on page 175, from the then chairman underlines that ... underlines the importance with which the society takes these findings. In this particular instance, I think there is confirmation that the policy was reviewed and ratified by the board in March 2003 and that it did take into account all of the prudent lending guidelines as set out by the regulator.

Senator Sean D. Barrett: And yet as you go on to page 49 of Vol. 1, and this brings us to 2007 I think, yes it is. Where there's a very strong letter from Yvonne Madden of the Financial Regulator to Mr. McGovern, and by my count there are 85 adverse findings and 93 recommendations and, you know, around page 63 there's ... 63 and 64, there's just adverse finding on top of adverse finding - no evidence of assessment, no evidence of intention to rent a room-----

Ms Fidelma Clarke: True.

Senator Sean D. Barrett: -----no evidence of assessment, no details to explain the increase, no verification of income. So, the fact that this was four years after the 2003 letter, was the society lax in responding to the regulator? What was going on? Because this ... that, and another one in 2008 that ... there's a very high level of adverse finding from the regulator and a very high level of recommendations, going over about a five-year period.

Ms Fidelma Clarke: Certainly, the society took, as I said, the findings very seriously. There ... in terms of the individual findings for individual cases, as I think I've mentioned and others have mentioned, in general they were able to be dealt with by return in terms of reviewing the loan files and providing an update on each case or a piece of documentation that maybe the inspectors, when they were on-site, couldn't find.

The operations of the society were of course continuously reviewed by both its internal audit function and the external auditors. And because EBS was involved in securitisation programmes and establishing covered bond banks, one of the, I suppose, ancillary benefits for a financial organisation at the time was that in order for loans to qualify and in order for any institution to be able to issue a bond, independent inspectors would come in and review substantially large numbers of cases. And the ... if you didn't hit a 99% or 98% tolerance rate in relation to what documentation should be on file and what was available, you wouldn't qualify in order to issue a bond. So, I don't believe that these documents represent an organisation that had very poor controls but I do believe that it was a valuable exercise on each occasion. The Central Bank, as I said, continues to do these types of inspections and banks do take them very seriously.

Senator Sean D. Barrett: Could I look at page 95 in that volume, if I may? This was, I think, in the early days of diversification. It's a board minute of 31 May 2002 and there were approaches on that page - "Go for Broke" or "Toe in the Water". And when you turn over, the commercial property market, which was what they were going into, the document itself says "Annualised [...] returns over the period 1990 to date (peaked at 38.2% in 1998, now down to just below zero)". And when you go to year-to-date performance, the third item is, "Activity in the investment property area is down on last year (not surprising in view of the negative returns)". So were the signs not there that diversifying away from a business which they're very good at, going into areas with returns below zero or negative returns, as on the ... page 96 there?

Ms Fidelma Clarke: Yes. Unfortunately, I can't give you any witness information in relation to that. It dates to a time long before my appointment to either the executive team or the review. I have seen this document in the booklet of documents. I think, though, going back to where commercial property lending started in EBS, based on what I have seen in the society's records, it commenced in the early 1990s as a result of a change in building societies legislation. And, at that time, EBS had a four or five ex-ICC members as senior executives, including the chief executive, who would have taken a decision to enter slowly into the commercial property sector and to limit the amount of lending to the commercial property sector to, I believe, 15% of the overall balance sheet. I don't believe that percentage was ever exceeded. And based on what I have seen, the intent was to create some form of diversification of risk because as a primary building society in Ireland, you had a very high level of concentration risk. All of your assets were relating to residential property in one jurisdiction, which is one of the reasons that EBS, from ... actually from the 1970s, had put mortgage indemnity insurance in place. And in the early 2000s when other institutions had other forms of types of insurance, including ... or moved away from mortgage indemnity insurance, and at a time where customers no longer wanted to pay for the bond that would need to be put in place, EBS took the decision to continue to put that insurance in place itself and to pay for it.

Senator Sean D. Barrett: On page 126 - thank you - on that volume-----

Ms Fidelma Clarke: No problem.

Senator Sean D. Barrett: -----there's the plan ... the "**Key Business Drivers Behind the Plan**" ... "Tracker mortgages will account for an increasing proportion of business - rising from 5% today to 60% by 2008." Did they misunderstand the nature of tracker mortgages, given what we now know?

Ms Fidelma Clarke: It's ... with the benefit of hindsight, tracker mortgages were clearly a product that produced a very, very low return and didn't really include a risk premium. I think no one would argue with that with the benefit of hindsight. Again, unfortunately, I wasn't a member of the executive and wasn't involved in this strategy review or presentation or discussion. Certainly, when they were first introduced and, again, in an increasingly competitive environment, they ... I believe that people felt that the risk was lower because they typically were provided to customers with very ... or at the lower end of the loan-to-value spectrum so that there was some equation of how much risk are we taking in a loan and, therefore, what price should we charge for it? But, clearly, those two things diverged, given the economic environment which ensued. And EBS was involved in tracker mortgages albeit I believe to a substantially lesser extent than other institutions, as per Professor Nyberg's report. I think he quotes EBS having an exposure to tracker mortgages of 20% *vis-à-vis* 50% in some of the other institutions.

Senator Sean D. Barrett: Could I refer to the bonus culture, if I may? Now, that's on page 139 of Vol. 2, and it's also flagged on page 157 of Vol. 2. In 2008, €464,000 was paid in bonuses, albeit on the performance of the previous year, but the society was loss-making in 2008. Was it ever suggested that bonuses should not be paid?

Ms Fidelma Clarke: I'm unable to help you with that unfortunately. I presume and I think what has been confirmed earlier today was that this would have been a matter that would have been reviewed by the remuneration committee at the time. I wasn't a member of either the executive or the board or certainly not the remuneration committee. All I can say is, based on my own experience, people, in the main, were not being paid bonuses of anything like this nature and in fact most salaries, including my own, would have been a fraction of some of the numbers that are on this page.

Senator Sean D. Barrett: The index page for page 157, and thank you for that, in the volume, says the "need for retention bonuses for senior EBS staff - May 2011". But when you get to page 157 it's virtually entirely redacted. Were any bonuses paid?

Ms Fidelma Clarke: No bonuses were paid from the time I was a member of the executive from 2009.

Senator Sean D. Barrett: It's strange that that was redacted, I thought it would be the other. But thank you for that. The first offer, I think in 2007, from AIB to buy the EBS, what was the sum that was being considered for that?

Ms Fidelma Clarke: Again, I'm sorry but I won't be able to help you with that. I wasn't a member of the executive of the board and I have no knowledge of it.

Senator Sean D. Barrett: Thank you very much. Thanks, Chairman, and thanks for your assistance.

Chairman: Thank you very much. Senator Michael D'Arcy.

Senator Michael D'Arcy: Thank you, Chairman. Ms Clarke, you're very welcome.

Ms Fidelma Clarke: Thank you very much.

Senator Michael D'Arcy: Why, as a mutual building society, did EBS see it as strategically appropriate to enter the commercial lending market?

Ms Fidelma Clarke: Again, probably a question that could be better answered by the executive or the board in place at the time. As I said, I believe that the reason that the society first got into commercial property lending was to create some form of diversification in relation to risk and also to possibly produce an income stream which was higher than the income stream you'd make from residential mortgages. But, unfortunately, I wasn't in the room and wasn't a member of the decision-making team.

Senator Michael D'Arcy: You weren't a member of the board at the time, no?

Ms Fidelma Clarke: I have only been a member of the board of EBS since 2012 when I was appointed as a group non-executive director of EBS Limited.

Senator Michael D'Arcy: Okay. The level of profits ... sorry, level of profit growth 25% per annum might seem ambitious in a mature market, could you expand upon that please?

Ms Fidelma Clarke: Again, difficult for me to expand upon it. I think it relates to a strategy that was put forward by the commercial business unit. I wasn't involved in the strategy formulation and wasn't in the room when it was being discussed.

Senator Michael D'Arcy: Was there any consideration given to the fact that during this period the other banks in the Irish market were also seeking double-digit growth?

Ms Fidelma Clarke: I'm sorry to provide the same answer. I really would like to be of more help to the committee but I wasn't actually in the room at the time. I became a member of the executive in 2009.

Senator Michael D'Arcy: The EBS increased commercial and development lending in the period from 2003 onwards. Did the board understand exactly what they were getting into at that stage?

Ms Fidelma Clarke: I would be speculating if I-----

Senator Michael D'Arcy: Well, you're allowed speculate.

Ms Fidelma Clarke: Forgive me. If I spoke about the board. I think others have spoken today and last week and I, based on my knowledge, however it has been garnered, I believe the board wanted to preserve EBS as a mutual independent building society. And I think if ... and I have reread the annual report and accounts of EBS over those years and they are informative in relation to what the key areas of focus for the society were. And I suppose I'm really taking my information from there. There was a desire to do what EBS had been established to do. Provide mortgages to teachers, guards, nurses and, in the main, PAYE workers, that was EBS's core business. But through time the pressure on margins as a result of what we now know is absolutely excessive competition meant that EBS was under pressure to be able to create capital. And, I think, as Mr. Merriman has explained well earlier today, without the ability to create capital, it wouldn't have had any credit to make available to mortgage providers. And, therefore, in effect, it didn't have a business model. And I think that influenced its view to look at whether or not it felt that there were other forms of non-core business it could get into, and I suppose, because it had entered commercial property lending in the early 1990s, it possibly felt that it had built up 15 years of experience in that area and, therefore, stepping further along the spectrum in whatever way, as we now know, was decided, was ... was appropriate at the time.

Senator Michael D'Arcy: And do you think they were aware of the, the dangers that were attached to competition in that sector, was very-----

Ms Fidelma Clarke: I think that no one foresaw the extent of the downturn at that stage and had people realised the possibility of a ... I know it's called a one-in-a-100-year event, which we now actually use to inform what's called reverse stress testing in banks, so we come up with situations which will actually break the bank, and look at what would the things that a bank would need to take to prevent that, if possible, from happening. That sort of thinking wasn't in banking, I believe, in the early 2000s. And, again, I believe if people had felt that they were taking a very aggressive or, or dangerous stance that would threaten the viability of what it is they were setting out to preserve, I don't believe they'd have made that decision.

Senator Michael D'Arcy: And were the skillsets ... do you think the skillsets were available within EBS?

Ms Fidelma Clarke: I think there's been a very, very substantial increase in the type of analysis that banks do in a reasonably short space of time. If you remember, Basel II, as it was called, so a new capital requirements directive which ... which effectively gave banks options in terms of their own internal modelling and capital requirements, was to say, if you've got a model internally that you use to make business decisions and you can prove that that model holds through time, we will allow you to hold an appropriate amount of capital for that. Alternatively, if you can't do that, you've to hold a standardised amount of risk. Those models were only beginning to be built in the 2000s ... The risk controls, risk functions, risk thinking, establishment of board risk committees, independence of chief risk officers, board oversight, all of those things changed very, very substantially over the past 15 years.

Senator Michael D'Arcy: Were you surprised when the new CEO, Fergus Murphy, changed the direction when he joined EBS?

Ms Fidelma Clarke: I was not surprised, no. I think, as Mr. Merriman said earlier today, it was becoming evident from the end of 2007 that things were changing, certainly not to the extent of what happened. But with the collapse of Lehman's and a pressure on, on funding and liquidity beginning to be felt, and I think 2007 was the first year where there was an actual negative growth in house prices for the first time, there were signals there that thing were beginning to change and, therefore, it was not a surprise that the society looked at what the future would be and again, with a new chief executive officer in Mr. Murphy, coming to the society from ... not only from externally, but also from another jurisdiction, it would have given him, and did I believe, clear and clean eyes to look at the business model and to determine that it did need to be changed, and changed quickly.

Senator Michael D'Arcy: Okay. Thank you, Chairman.

Chairman: Okay, thank you very much. Deputy Eoghan Murphy.

Deputy Eoghan Murphy: Thank you, Chairman, and thank you, Ms Clarke, you're very welcome.

Ms Fidelma Clarke: Thank you.

Deputy Eoghan Murphy: Now, I'd like to look at Vol. 1 please, of the evidence books, page 41. It's a question, when exactly did you become credit risk officer? Or sorry, chief risk officer?

Ms Fidelma Clarke: I became ... I became chief risk officer on 1 January 2009.

Deputy Eoghan Murphy: 1 January 2009?

Ms Fidelma Clarke: Correct.

Deputy Eoghan Murphy: Not 2007?

Ms Fidelma Clarke: No.

Deputy Eoghan Murphy: Okay. Here we have on ... on page 41 in ... in the volume, board meeting from 1 March 2007, and how concern from the regulator that "Alan Merriman is responsible for both the Commercial business and the Risk function".

Ms Fidelma Clarke: Yes.

Deputy Eoghan Murphy: And we spoke about this with Mr. Merriman at the time, and he said that the person in charge of risk at the time had access to the board and had access to management. That wasn't you then?

Ms Fidelma Clarke: I think he was referring to me as head of risk.

Deputy Eoghan Murphy: As head of risk, okay.

Ms Fidelma Clarke: But my reporting line was to him as chief risk officer, and I think what the regulator was referring to here - and I think it's actually also in your core documents elsewhere - it's the letter from the regulator from 2007. What the regulator was calling out was that in their opinion, at that time, you shouldn't have someone who was responsible for risk who's also responsible for managing a business line within an organisation. And if we come to where we are today in terms of good corporate governance, it's now mandated that this is an independent function, independent of all business and operations.

Deputy Eoghan Murphy: I think Mr. Merriman was saying that his head of risk, excuse me, was ... had access to the board and had access to management, if that person needed it. So is that an accurate reflection of the access you had in terms of decision making or making ... for you to make something aware? Could you bypass him I suppose is the question.

Ms Fidelma Clarke: I would ... I ... no, I don't believe so. I didn't have reason to.

Deputy Eoghan Murphy: Okay.

Ms Fidelma Clarke: Absolutely, but no, I would have, like everyone in middle management I suppose, had occasion to make presentations to the board but I was not a member of the executive nor was I member of the board at that time.

Deputy Eoghan Murphy: Okay and so do you think at the time that the regulator made this ... this was put forward by the regulator to the board, that the regulator was right to make this distinction, that there should be a separation of function?

Ms Fidelma Clarke: I think that corporate governance standards were changing.

Deputy Eoghan Murphy: Okay.

Ms Fidelma Clarke: I do think that they were right. I think, as Mr. Merriman said earlier today, he had a huge number of responsibilities. Thinking today, and we saw it emerging in

2007, but thinking today is it is beneficial for a bank to have someone who's independent of the business, to be able to challenge without any possible conflict, decisions that might be made.

Deputy Eoghan Murphy: So how quick was the EBS to react to these concerns then? Was it two years until your appointment that the ... this separation was made?

Ms Fidelma Clarke: So, no, one step was done in the meantime. So the first step that was done was that the commercial property business that was reporting to Mr. Merriman was changed to report to a different executive director in 2007 or early 2008.

Deputy Eoghan Murphy: Okay.

Ms Fidelma Clarke: But, as I've said in my own statement to you earlier, it was only in 2009 that we created a fully independent, dedicated, chief risk officer role in EBS.

Deputy Eoghan Murphy: Okay, thank you. Just moving on in the same book, up to page 109, this is the minutes of a board nominations committee meeting on 19 February 2009. On page 109 and turning over to page 110, and we have about two people who were invited not to reapply for re-election to the board. And just to comment on that in relation to Mr. Merriman, who was one of them, the minutes talk about accountability and about the perception of accountability. So in relation to Mr. Merriman, which was this in your view?

Ms Fidelma Clarke: It's a difficult question to ask me. As Mr. Merriman said, and I think as was well articulated in the 2008 accounts of EBS, the then chairman who had been chairman for two years set out that, given that the society was reporting losses for the first time, the society felt it needed to demonstrate accountability to its members and it wanted to do that both at board level and also at executive level. And as Mr. Merriman said earlier himself, he felt he was probably the right person from an executive level. Is any one person responsible for the decisions of the society? I don't believe so. The decisions and the risk decisions of the society and indeed any bank, are a collective responsibility, in my opinion, of the board and also of the full executive team.

Deputy Eoghan Murphy: Was it a mistake to let Mr. Merriman go?

Ms Fidelma Clarke: I'm not sure I'm qualified to talk about that not having been a member of either the executive or the board at the time. I know ... I heard Ms Tinney earlier say that she felt that his skills would have been useful to the society and certainly we heard from, I think, Mr. Merriman today to say that his preference would have been to stay. I think the overriding consideration was as a mutual, EBS wanted to demonstrate accountability to members first and foremost and it took the decision to put that consideration above other considerations.

Deputy Eoghan Murphy: Okay. And then, just that same meeting, the CEO of Haven, the subsidiary, was also invited not to stand for a second term, because essentially the business had failed?

Ms Fidelma Clarke: That is correct.

Deputy Eoghan Murphy: Can I just ask you about that then, why would the CEO of Haven take responsibility in that regard for a board decision to establish the subsidiary and it then to fail?

Ms Fidelma Clarke: I'm sorry, I don't quite understand your question, forgive me.

Deputy Eoghan Murphy: The question is: the CEO of Haven was invited not to stand because the business had failed, essentially, and there was no role for the CEO on the board any more. But the decision to set up Haven was a decision by the board.

Ms Fidelma Clarke: Well, every decision was a decision of the board. So I think this decision, in relation to whether or not to reappoint someone to the overall board, was taken in the context that, having launched a broker business and having then had to shut it down, that there was no requirement to have an additional executive director on the board of EBS from that time.

Deputy Eoghan Murphy: Okay. And just in relation to the joint venture that was meant to be happening, with Britannia Building Society, when did that cease to be a possibility?

Ms Fidelma Clarke: I'm not 100% sure of the time. But I think, from memory, it probably was the end of 2007 or in and around there.

Deputy Eoghan Murphy: So why did the EBS decide to continue with that venture? They decided to go into the idea that it would be split 50-50 with Britannia. Britannia pulls out because of the worries that they have-----

Ms Fidelma Clarke: Of course.

Deputy Eoghan Murphy: -----with the Irish market, yet the EBS continues with it.

Ms Fidelma Clarke: So the EBS at that stage had built up a broker-sourced book and also it had spent and invested a significant amount of money in building third-party servicing arrangements so that ... in order to service the book. And it did that based on, again, what I've read from the records, and what I was involved in from a risk perspective in reviewing, it did that in order to create a business that potentially could be sold at a later date. And, therefore, having arm's length third-party servicing would be a benefit to the model. Having invested in all of that, it was decided to continue with a view, in the future potentially, to having other options and potentially, selling it on, if appropriate, at some future date.

Deputy Eoghan Murphy: And what happened to Haven then?

Ms Fidelma Clarke: What happened to Haven was ... I think someone described it well at one time was, it was a good idea at the wrong time. And so the society made decisions on the basis of, it had very little credit to make available, that if it was making any credit available from 2008 and 2009, it was going to make it available to home owners and people who desired to home, own homes, in Ireland and to its core membership. So it ceased to provide credit to Haven. But the capability was held and actually AIB Bank now is using that capability in terms of its own broader business model, so Haven has ... effectively survived.

Deputy Eoghan Murphy: Right. And was there ever a cost put on the society for setting up Haven?

Ms Fidelma Clarke: I know there was a mention of a cost earlier on, there certainly was, but forgive me I won't be able to quote the number to you now.

Deputy Eoghan Murphy: Okay, that's fine, we can find it ourselves.

Ms Fidelma Clarke: Apologies.

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

Chairman: Thank you very much. Deputy Michael McGrath.

Deputy Michael McGrath: Yes, thank you, Chair, good evening, Ms Clarke. Can I just start by asking you to clarify your role before you became chief risk officer in January 2009.

Ms Fidelma Clarke: Before that, I had two roles. So I was appointed company secretary in July 2008, I had been deputy company secretary for a year prior to that. Separate to that, I was head of risk, responsible for, as I've mentioned earlier, producing enterprise risk reports for the organisation, supporting its risk committees, reviewing the risk disclosures of the society, helping conduct risk assessments-----

Deputy Michael McGrath: Okay. That was head of risk since when?

Ms Fidelma Clarke: I think that title came some time in 2004 or 2005.

Deputy Michael McGrath: Okay. Because I've been just looking at the EBS annual reports and I'm utterly confused, I have to say. For example, 2005, you are ... let me find it here now ... you're listed under "Executive Forum". No, sorry, maybe go back to 2005. So you're under "Management and Head of Risk" in the 2005 report. The 2006 report has you under "Management" again and it just says "Risk". And then, 2007. "Executive Forum - Credit and Risk". Can you just clarify was there a change from '05, '06, '07?

Ms Fidelma Clarke: Of course. There was a change from '05-'06, so the executive forum was, I suppose, a management body that sat underneath the executive. So you had the board of EBS, we had the executive team and then you had, effectively, a senior management group and that's what the executive forum is. My responsibilities changed quite substantially over the period 2003-2008-----

Deputy Michael McGrath: Can we just stick with the structure for a moment? So you have the board of the building society. Beneath that, you had, was it group management board or executive team? Which is it?

Ms Fidelma Clarke: It was an executive team.

Deputy Michael McGrath: Executive team.

Ms Fidelma Clarke: It was called the management board.

Deputy Michael McGrath: Management board, yes.

Ms Fidelma Clarke: It was called that but that's what it was ... it was the executives.

Deputy Michael McGrath: That was what you would regard as the executive team.

Ms Fidelma Clarke: Exactly.

Deputy Michael McGrath: With the various ... a number of the directors. So, in 2006, for example, the chief executive, the director of operations in IT, director of people communications, finance director, director of membership business and so forth; so maybe six or eight people on the management or executive board.

Ms Fidelma Clarke: Correct. Some of whom are-----

Deputy Michael McGrath: And you only joined that in January 2009?

Ms Fidelma Clarke: That's right.

Deputy Michael McGrath: Okay. So then, in 2007, you're described as "Credit and Risk". So when did you get a role in terms of credit and what was that role?

Ms Fidelma Clarke: So, in 2006, the reporting line for the credit approval team was changed to me but I had no role, as I said earlier - and forgive me if I wasn't clear on the subject - I had no role in credit approval.

Deputy Michael McGrath: Okay. So can you just be specific and tell us what role you did have? You said a credit approval team reported to you from 2006?

Ms Fidelma Clarke: From a management perspective, exactly.

Deputy Michael McGrath: From a management perspective?

Ms Fidelma Clarke: Correct.

Deputy Michael McGrath: Okay. But that role for you didn't involve any input into lending decisions?

Ms Fidelma Clarke: None whatsoever.

Deputy Michael McGrath: And did you become head of credit then at any stage?

Ms Fidelma Clarke: I never was involved in any credit decision in the society, no.

Deputy Michael McGrath: But did you have a title of "Head of Credit"?

Ms Fidelma Clarke: The title "Head of Credit and Risk" stemmed from the fact that the management reporting line for the underwriting team was changed to me in 2006.

Deputy Michael McGrath: Okay. So the committee which Ms Tinney referred to earlier on - the credit committee, as such - which she says met once, to her knowledge, from mid-2005 to April 2007. Did you sit on that committee? Did that committee report to you?

Ms Fidelma Clarke: No.

Deputy Michael McGrath: No?

Ms Fidelma Clarke: I'd no role whatsoever in the credit approval authority process from credit assessment, credit reporting, from submission to a management review committee, which we had a loan advances committee, or to the board, so none whatsoever.

Deputy Michael McGrath: Okay. So when you were assigned some credit functions, during 2006? And that's why it's reflected in the '07 annual report. What exactly were those functions in credit? You said it was from a management perspective.

Ms Fidelma Clarke: Yes. So the underwriting team reported to me from a management perspective ... so performance reviews and discussions and things like that; purely management.

Deputy Michael McGrath: Who did you report to?

Ms Fidelma Clarke: I reported throughout 2005 through to 2009 to Alan Merriman.

Deputy Michael McGrath: To the finance director.

Ms Fidelma Clarke: Who had multiple other responsibilities, absolutely, including risk.

Deputy Michael McGrath: And who else reported to him on credit decisions then? So the credit committee, let's say, which was making the decisions by incorporeal e-mails, it seems, most of the time. But ... so who reported from them? Who did they report to? Did they report to Mr. Merriman?

Ms Fidelma Clarke: No, well, they ultimately did report to Mr. Merriman because some of the credit underwriting team, they reported to me from a management perspective, and I reported to Mr. Merriman. Other people involved in the credit approval process in EBS were commercial lenders and they also reported to Mr. Merriman. But the credit approval process in EBS didn't run along management lines; it ran along a credit approval-----

Deputy Michael McGrath: Okay.

Ms Fidelma Clarke: -----structure.

Deputy Michael McGrath: It's incredibly convoluted.

Ms Fidelma Clarke: It is very difficult to explain to people, absolutely.

Deputy Michael McGrath: Yes, and I am sorry for trying to tease it out.

Ms Fidelma Clarke: No, no, I-----

Deputy Michael McGrath: I am trying to get it clear in my own mind, exactly what your role was and how credit decisions were made and how the chain of accountability-----

Ms Fidelma Clarke: Sure.

Deputy Michael McGrath: -----worked its way up to the executive team and then to the board, so-----

Ms Fidelma Clarke: It might be easiest to think of it as two separate lines.

Deputy Michael McGrath: Yes.

Ms Fidelma Clarke: So there is a credit approval line that has a group of people who are designated as a credit approval forum. The people in a credit approval forum would be senior commercial and credit underwriting individuals.

Deputy Michael McGrath: Right.

Ms Fidelma Clarke: From a credit approval forum, it would move up to a loan advances committee. The loan advances committee was the senior management approval forum within the society and from the loan advances committee, the next level up was the board credit approval authority.

Deputy Michael McGrath: And was there any one person in charge of credit?

Ms Fidelma Clarke: No.

Deputy Michael McGrath: No, okay. So you had the various layers-----

Ms Fidelma Clarke: Exactly.

Deputy Michael McGrath: -----there with committees, and ultimately that fed up to Mr. Merriman from the finance ... as finance director.

Ms Fidelma Clarke: And others. There were other members of the executive who were part of the loan advances committee-----

Deputy Michael McGrath: Okay.

Ms Fidelma Clarke: -----so it didn't run along organisational structural lines. It ran along a management, senior management, board line, but it was wasn't reflected in the organisation's structure.

Deputy Michael McGrath: Okay. So your involvement in risk in 2005 and 2006, that didn't involve any input into the risk assessment of the credit strategy or of loan applications, for example.

Ms Fidelma Clarke: None whatsoever in relation to loan applications.

Deputy Michael McGrath: So what risks were you responsible for assessing?

Ms Fidelma Clarke: So in 2005 and '06, I would have been involved in looking at the Basel II programme for the bank, so I would have led out on that. In 2006, I would have had an increase in responsibility in relation to the treasury middle office-----

Deputy Michael McGrath: Right.

Ms Fidelma Clarke: -----who were substantially involved in liquidity monitoring and reporting, so I would have absorbed that responsibility. I was responsible for implementing an operational risk capability in EBS. I would have been responsible for evaluating the risk governance structure and ensuring that it was well articulated.

Deputy Michael McGrath: Okay.

Ms Fidelma Clarke: I would have been responsible for ensuring that all of the society's risk policies were documented. I would have been a member of the credit risk committee, not an approval committee ... so, sorry, if I confuse you further, but a credit risk committee.

Deputy Michael McGrath: What was the role of the credit risk committee?

Ms Fidelma Clarke: So the role of the credit risk committee was to monitor risk trends and to evaluate proposals for changes to policy within the strategy that the bank had agreed.

Deputy Michael McGrath: Right. And did the credit risk committee have an input into lending decisions?

Ms Fidelma Clarke: No, it was completely independent, so there was a credit approval process which was independent of risk.

Deputy Michael McGrath: Okay. I suppose what I am trying to understand is, you know, when a bank is assessing risk and you have a risk function-----

Ms Fidelma Clarke: Yes.

Deputy Michael McGrath: -----and the various annual reports, you know, do consider the issue of the risk of lending strategy, for example, I'm talking about, across the different banks and what I am trying to understand is how that becomes part, then, of the consideration of lending policy, how that feeds into lending policy and there doesn't seem to be any direct correlation.

Ms Fidelma Clarke: So I think it is true probably of smaller organisations that you have people who wear multiple hats and also you have organisation structures that run along a number of lines that aren't all hierarchical.

Deputy Michael McGrath: Okay. Senator Barrett already asked you about the tracker mortgage interest rate risk-----

Ms Fidelma Clarke: Yes.

Deputy Michael McGrath: -----and I think you addressed that issue, that you weren't on the board, that you had no input into that or assessing the risk from that. Just finally, Ms Clarke, you were with EBS since 1991 you said.

Ms Fidelma Clarke: Yes.

Deputy Michael McGrath: So you experienced EBS as a traditional mortgage lender-----

Ms Fidelma Clarke: Absolutely.

Deputy Michael McGrath: -----as a mutual owned by members and then you were there as it morphed into something entirely different. To what do you attribute that? What are the main causes of that transformation of the model of a building society into, effectively then, a lender to, you know, commercial property and development in land?

Ms Fidelma Clarke: Sure.

Deputy Michael McGrath: What are the main causes, in your view, and how much weight do you attach to the emergence of new entrants to the Irish banking sector and the role that they would have played? Just give us your ... because you've a unique insight, having been there really throughout. What were the main driving factors that led to that change?

Ms Fidelma Clarke: So I'd say two, in summary.

Deputy Michael McGrath: Okay.

Ms Fidelma Clarke: So the first was the availability of credit and wholesale funding. That just pumped money into the economy. And the second one is excessive competition. And probably-----

Deputy Michael McGrath: Led by the Irish banks or led by the foreign banks who came in?

Ms Fidelma Clarke: I think foreign banks entering made Irish banks respond, which in turn put pressure on other Irish players, which led to everyone moving down a certain road.

Deputy Michael McGrath: And the fear was then "We'll be left behind, we have to join the game".

Ms Fidelma Clarke: I think ... I believe the view of the board at the time very much was absolutely ... "Our business, our *raison d'etre*, is to provide money to people in Ireland to buy their home and if everyone else is moving down a road and we don't move with them, we will stop being a relevant provider of mortgages in Ireland."

Deputy Michael McGrath: Thank you.

Ms Fidelma Clarke: Thank you.

Chairman: Thank you very much, Deputy McGrath. I'm going to wrap things up with just a few questions myself, Ms Clarke.

Ms Fidelma Clarke: Of course.

Chairman: And I'll invite just some final questions from leads and so forth. Ms Clarke, Haven, the broker market business of EBS, was a significant change for EBS.

Ms Fidelma Clarke: Yes.

Chairman: And you ... I just reference, in the particular document, the "Broker Market Entry" here ... it's the "Board Update" document. It's in the core documents. Just in reference to that, did the board, in you view, have a sufficient understanding of what it was getting into and what was your view of the impact of this business on EBS later on?

Ms Fidelma Clarke: I'm sorry, I just didn't hear the end of your question.

Chairman: Sorry. Haven, the broker market of EBS, was a significant change for the EBS. And the board was updated in '05 around that. But did the board, in your view, have a sufficient understanding of what it was getting into and what was your view of the impact of this business on EBS later on?

Ms Fidelma Clarke: I can't speak for the board and I wasn't in the board room.

Chairman: Sure.

Ms Fidelma Clarke: The ... I think the driver, based on what I've read and what you have too, was that, I think, by 2005-2006, 40% of all mortgage lending was being done through brokers.

Chairman: Okay.

Ms Fidelma Clarke: So the question was did you want to operate in 60% of a market or 100% of a market. And I think that was the primary driver behind the board's decision to ... to progress with a broker channel.

Chairman: Okay. So Haven ... the Haven model obviously gave you more high street ... high street outlets, a greater footprint across the country. Is that what you're saying, yes?

Ms Fidelma Clarke: It would give you greater access to all of the mortgage lending that was being done. It wouldn't necessarily have given you greater high street presence because, of course, brokers were independent. So-----

Chairman: But a street presence, I'd assume.

Ms Fidelma Clarke: Certainly a street presence-----

Chairman: Sure.

Ms Fidelma Clarke: -----or an office presence anyway. So it certainly ... but, at its heart, it gave ... it gave the society access to 100% of a mortgage market where they, at that time, only had access to 60%.

Chairman: And on the general ... so it became 40% of the ... of your new residential market.

Ms Fidelma Clarke: No. I think ... what I'm referring to is ... I believe by 2006, according to the core documents and the research that must have been done by the business at the time, 40% of mortgage lending was being done through brokers.

Chairman: Okay. That's on the aggregate actual figure.

Ms Fidelma Clarke: In the aggregate. So if you weren't involved in the broker business, you were only operating in 60% of the market.

Chairman: As somebody whose job was to assess risk, did that have the same level of risk as the business and the risk assessments that you were doing or did it create less or more stringent assessment processes of new applicants?

Ms Fidelma Clarke: So it was decided that the credit policy of ... certainly it was the intent, again, based on the documentation here, that the credit policy of the society would effectively be the same for the broker business. But there was one very important distinction and that was that the society was prepared to pay for mortgage indemnity insurance for its core business, but it was not prepared to pay for mortgage indemnity insurance for its broker business. And, therefore, the loan-to-value exposures that it would entertain for broker business were different.

Chairman: Okay. So when the indemnity came through the broker model, did the broker deal with the mortgage insurance indemnities themselves?

Ms Fidelma Clarke: I don't believe brokers put any insurance in place. They wouldn't have needed to. It was the society itself that was putting the insurance in place for everyone who took out a mortgage with it.

Chairman: Just explain that to me. If a person, myself let's say instance, was to walk into EBS, the way the package would be put together is I would have to have the indemnity insurance before you would sign off on my mortgage.

Ms Fidelma Clarke: If it was the 1990s, that would have been the case. In the 2000s that was not the case.

Chairman: I didn't need to get insurance from you.

Ms Fidelma Clarke: You wouldn't have even known that we were insuring your loan necessarily because we did not ask you to pay for the insurance; we paid for the insurance.

Chairman: As part of the product.

Ms Fidelma Clarke: As part of the society's risk-mitigation plan.

Chairman: Yes. If when a mortgage was taken out through EBS through a broker and the broker went to you and said, "Mr. Lynch's, here is his portfolio, his P60 and all the rest of it", how would the indemnity issue be managed then?

Ms Fidelma Clarke: There wouldn't have been one because the offering that the broker would have been have been able to make to you would have been for a lower loan to value where we felt we didn't need to put insurance in place.

Chairman: So there was a difference in the loan to value between what the broker was able to offer and what you were able to offer directly.

Ms Fidelma Clarke: Correct.

Chairman: Okay. So on no occasion did the loan to value equalled what you were giving that brokers were actually presenting.

Ms Fidelma Clarke: No, to the best of my knowledge, no.

Chairman: Okay, all right, thank you.

I just want to move on to some matters relating to the lending period from 2003 onwards and just present a number of documents to you that are in your pack. EBS increased commercial and development lending significantly in the period from 2003 onwards. I'll just go through some of the slides that we have here. The first one here is actually this one that went up. Okay, you see at the top of the screen there, Ms Clarke, "A self assessment process has been completed on commercial property lending and 29 risks were identified, one of which was external. There are 6 risks that are considered high in nature". It then goes through various bullet points. Just noting the first two of them, "Concentration risks on large exposures which could provide a bad debts exposure or large redemptions". And, secondly, "Making losses due to bad lending decisions".

I'll just move on to the next slide, which the 005. What we have here at the end of the page is a whole load of product offering by the society and just how ... and the upper slide ... a demonstration of how the whole mortgage market was moving in 2006.

On to the next slide, which is 006, the highlighted section there is "Change the Stress Test on Interest Rate" and how the current policy, which was a stress test at the standard variable rate in the next column of +2% to move up to a 6% that you were exceeding to maybe be 1% above it.

And the on to... I'll just skip on to another couple of slides. This is from 2005 and it says 100% mortgages move from pilot to permanent solution. EBS are considering a number of options round 100% mortgages at the time. Option 1 is "Increase Price" and that is not considered an option. As you can see this is in red, because consideration as "Market pricing would make it difficult to charge a higher rate for this product. Most lenders are charging between 3.1% and 3.25% for this product", that's some less the standard variable rate. There is 2, "Reduce Cost", which is "Genworth have indicated that they will not reduce pricing for this cover. We may be able to negotiate some reduction base lending to state guaranteed employment sector; not agreed at this juncture."

I just want to stop there for a moment. What was Genworth's problem?

Ms Fidelma Clarke: When you say "problem", it's ... I think that reference is that Genworth had a price for its product and there was no reason for it to want to reduce it.

Chairman: Were Genworth your indemnity company? Were they?

Ms Fidelma Clarke: They were, yes.

Chairman: Indeed. So were ... where were Genworth coming from this? Were they seeing that the product was getting out of control or that they want ... that they had concerns with regard to how much they were now exposed with regard to the risk? Where were Genworth coming from?

Ms Fidelma Clarke: No, they weren't. I think this is a reference to them ... would they have reduced the price for an existing product that they had?

Chairman: Sure.

Ms Fidelma Clarke: And the answer to that was it's unlikely.

Chairman: And did they?

Ms Fidelma Clarke: But in terms of providing insurance for 100% mortgages, they did provide insurance for 100% mortgages-----

Chairman: Yes.

Ms Fidelma Clarke: -----and the society, certainly the risk function, wouldn't have supported a 100% mortgage offering without insurance in place.

Chairman: Yes, okay. Did Genworth's costs go up, down or remain the same?

Ms Fidelma Clarke: ... very substantially.

Chairman: They went up substantially, did they?

Ms Fidelma Clarke: Yes.

Chairman: How much?

Ms Fidelma Clarke: I'm sorry I won't be able to give you a number for that.

Chairman: 10%, 20%? I'm not looking at the sum.

Ms Fidelma Clarke: Well, you see it would depend on what the take-up of the additional-----

Chairman: On 100% mortgages where did Genworth go?

Ms Fidelma Clarke: I'm ... I would be ... I couldn't give you a number.

Chairman: Okay, I won't pin you to a figure but you will say substantially, yes?

Ms Fidelma Clarke: Oh, absolutely.

Chairman: Okay.

Ms Fidelma Clarke: You were buying a higher amount of insurance, if I could just explain it to you for one moment. So at that time, EBS was buying insurance cover for the portion of a loan between 85% and 92% or 80% to 92% if people were borrowing to the maximum of what was allowed of them. What we then did was to say is if we reluctantly are going to offer 100% mortgage, we'll now need to insure from that 85% to 100%, so you're buying a bond for a larger amount of insurance-----

Chairman: Indeed.

Ms Fidelma Clarke: -----so, absolutely, the cost was higher.

Chairman: And given that Genworth were the tendered or the option of insurer that you actually had, they were the only company-----

Ms Fidelma Clarke: They were our insurer.

Chairman: -----you were dealing with. They were your partner in this regard.

Ms Fidelma Clarke: Yes.

Chairman: Did Genworth at any time express concerns with what was coming in through Haven and other brokers in regard to the overall institution?

Ms Fidelma Clarke: They ... well, they would have had no exposure to that because they weren't providing any insurance for that part of the business.

Chairman: Okay, all right. And then I'll just go to the third column, which is "Increased Return (Introduce an Unsecured Deposit Bridging Loan) ... We currently offer a deposit loan through GE Money." What is GE Money, by the way?

Ms Fidelma Clarke: It was just the name of a company.

Chairman: Okay. "We are proposing offering deposit bridging product through EBS, a higher rate to increase return on capital. There are system implications and therefore we expect delivery in Q2 in 2006." That's the recommended option. Was that taken?

Ms Fidelma Clarke: It was, I believe, taken, absolutely.

Chairman: Okay. All right. Can I ask you, Ms Clarke, just on the broader scheme of how the model was developing during then, did the board understand the risks attached to such lending and what could happen should it go wrong?

Ms Fidelma Clarke: I'm sorry, you're asking me, in general, for the period?

Chairman: Yes, in the regard, EBS increased commercial and development lending significantly in the period from 2003 onwards. Did the board understand the risks attached to such lending and what could happen should it go wrong?

Ms Fidelma Clarke: So it's a question that I'm afraid my response will be speculation rather than witness-----

Chairman: Okay.

Ms Fidelma Clarke: -----because I wasn't-----

Chairman: Sure.

Ms Fidelma Clarke: -----at the board meetings where it was discussed. I wasn't a member of the board-----

Chairman: All right, okay.

Ms Fidelma Clarke: -----and nor was I a member of the executive making any recommendations.

Chairman: Were you familiar with any concerns at board level?

Ms Fidelma Clarke: Not at that time, no.

Chairman: At what time? Was there a concern you were aware of, if any?

Ms Fidelma Clarke: Oh, I think from the end of 2007 and the beginning of 2008, of course.

Chairman: You were familiar with board concerns at that time.

Ms Fidelma Clarke: I would have been more familiar with it because, as deputy company secretary from 2007, I would have been in the boardroom.

Chairman: And was that reflected in the overall EBS book or was it inclusive of the subsidiaries in the brokers and all the rest that you were including?

Ms Fidelma Clarke: Yes, the broker business only launched in 2007 if memory serves, so it was closed off pretty quickly in 2009. There's no question, I believe, that there was concerns about commercial property lending, which was reduced in the second half of 2007 and, as the committee is aware, ceased altogether for land and development in March 2008 and then in July 2008 for all commercial property lending.

Chairman: In terms of the strategy that the concerns were raised that you were hearing about around 2007, was the strategy itself by your observation one driven entirely by competition or was it other factors? This is the strategy to grow.

Ms Fidelma Clarke: I suppose the strategy decisions had been taken long before that, so those strategy decisions had been taken in 2002 and 2005, but certainly from my observations from 2007, mid-2007 on, there was absolutely very clear, considered, evaluation of the environment, changes in the environment and, you know, evaluations as to what could we do to try to mitigate risk and, in particular, I would say if I may-----

Chairman: Sure, yes.

Ms Fidelma Clarke: Those were reflected in decisions to cease land and development lending early-----

Chairman: Okay.

Ms Fidelma Clarke: -----and they were also reflected in the fact that the society set up task forces, and they were called task forces, in August-September 2008, to try to get its hands around and its arms around the potential for distressed assets both on the residential and commercial book.

Chairman: And coming back then to 2003, these are the difficulties in 2007 that arose-----

Ms Fidelma Clarke: Yes.

Chairman: -----but back in 2003 was the strategy driven by competition to engage, like I have demonstrated, some of the advertising that was going on? Was the strategy initially one based upon competition in the market?

Ms Fidelma Clarke: I believe the strategy was to remain a relevant mortgage provider in Ireland and retain the society's mutual status. I believe that was its strategy. I believe it made ... policy changes were made, absolutely, in support of that strategy but at its heart, the strategy of the society was to continue to provide mortgages to people in Ireland and to remain a relevant mortgage provider.

Chairman: Okay, and very, very finally, just with regard to the whole process itself, how aware were you of any skill problems with EBS, who had little previous exposure to commercial lending?

Ms Fidelma Clarke: Well, certainly on the basis that I think one of the recommendations in support of the decision to approve the "Step Up" strategy on land and development in 2005 was the recruitment of people with expertise and experience in land and development lending indicated that those skills were not in the society. I think I have made reference earlier to the fact that in the 1990s, five or six of the executives and most senior people, including the chief executive officer, were ex-ICC people. They had a huge amount of expertise in, in commercial lending. I think one of the lessons learned and, you know, one of the things we can see now looking back is that because Ireland went through 15, 20 years of quite a benign economic climate, the people who'd, you know, cut their teeth in credit by lending and maybe making losses, all of those people had passed through the system by the time, you know, the mid-90s had come and that was reflected very much, I believe, in the fact that when we were trying to get our hands around the extent of this problem in 2008, 2009, 2010, we had to bring people back out of retirement from other organisations to help us or people over from England to help us to help us get our hands around how do we go about managing that.

Chairman: The skillset was gone.

Ms Fidelma Clarke: The skillset, exactly, had been gone.

Chairman: Thank you. I, just, Senator O'Keeffe has just indicated once to me. Just briefly, Senator, and then I am going to bring in the wrap-up.

Senator Susan O'Keeffe: Thank you, Ms Clarke. I appreciate that you have said that you were not involved at all in credit and I just wondered ... Ms Tinney's observations today, the detail she gave about how those final decisions were made, obviously that is not something you knew about.

Ms Fidelma Clarke: I wasn't involved in it at all, no.

Senator Susan O'Keeffe: Exactly. But she does go on, she does talk about the sort of feeding frenzy as the banks - I am quoting - "clambered over one another to get a piece of the action". I am just wondering, given that you were in the society at that time and you were working there for a long time-----

Ms Fidelma Clarke: Absolutely.

Senator Susan O'Keeffe: How would you, how would you describe that? Do you think that that's a fair description of what was going on?

Ms Fidelma Clarke: I think I would and have described it as excessive competition. Absolutely there was excessive competition in the market, which led to downward pressure on the society's core business, which led it to take decisions about what it could do to remain viable, which led it to, I believe, agree to a proposal to step up lending to a land and development sector at a time that, it transpired, was the very height of the market, unknown at the time. That is how I would describe it.

Senator Susan O'Keeffe: And then finally, what, if any, was your relationship with the Financial Regulator's office either in your time as the head of credit operation risk and then as the chief risk officer, because obviously we have heard testimony about the fact that, you know, they had very few people? They had two people, maybe, across two institutions, so do you consider that you would have been adequately regulated or do you think, do you know, that really, in fact, you only ever heard from them on very odd occasions?

Ms Fidelma Clarke: I would have had an ongoing interaction with the Financial Regulator, which would have increased very substantially when I became company secretary and thereafter when I became chief risk officer. So, absolutely, a lot of interaction. But before that ... before that, I suppose, what ... my interaction with them would have been more on the ... where they came in to do an inspection and then seeing what we would ... what we would respond to them on and helping pull that response together. One of the documents we looked at earlier on was decisions in relation to credit policy from 2006 and, actually, at that time we recommended that we share our proposed changes with the regulator and we would have often invited the regulator in or ... at reasonable intervals if we felt there was something that would be of value for them to know. I do believe it was a ... from what I could see, it was, you know, there were small teams in terms of inspection teams. I think in terms of the broader structure of the Financial Regulator from top level through middle level through the inspection teams ... you know, it's hard for me to comment on the upper levels because I would have had no interaction with them.

Senator Susan O'Keeffe: Would you have had an inspection once a year or once every two years or-----

Ms Fidelma Clarke: It ... I believe once every two or three years.

Senator Susan O'Keeffe: Once every-----

Ms Fidelma Clarke: Two or three years.

Senator Susan O'Keeffe: Thank you.

Chairman: Senator Barrett, conclusion?

Senator Sean D. Barrett: Thank you very much. What was the fee for a non-executive director, say, in a recent year?

Ms Fidelma Clarke: I know it will have been reported in the annual report and accounts so that's probably the best place to go for it but it was modest.

Senator Sean D. Barrett: Yes, and how much were the ... what was the audit fee then by comparison?

Ms Fidelma Clarke: I'm ... I wouldn't like to ... I wouldn't like to quote a number because I'm afraid I don't know but we could certainly provide it to you if ... of help.

Senator Sean D. Barrett: Because I'd contrast ... I mean, did the auditors report anything of what we've been discussing in these number of days about the EBS?

Ms Fidelma Clarke: I think Dargan Fitzgerald appeared in front of the committee and commented that, in his opinion, their control environment was reasonable, certainly for the time that he was the auditor. And as I mentioned earlier, had the society's controls been very poor, I believe it would have been picked up by internal audit, by external audit and also by the external firms that came in to evaluate the bank's adherence to its own policies and procedures.

Senator Sean D. Barrett: And yet we saw a company, you know, be sold for a ... €1-----

Ms Fidelma Clarke: Yes.

Senator Sean D. Barrett: -----after all these audits. I'm surprised, as a non-auditor, that they weren't better informed about what was happening to the company when they were auditing the books.

Ms Fidelma Clarke: And, I suppose, they were auditing the production of the accounts and they were auditing the control environment. I think what we're seeing is there were no matters of enormous significance coming through from that. I think you ... there's an extract in one of the booklets from the auditor findings at the end of, I believe, 2006 or 2007. I don't think that's what brought the demise of EBS as an independent organisation.

Senator Sean D. Barrett: In other areas of commercial activity, would auditors draw the attention of a shopkeeper that your newspaper stand's not doing well but you're doing really well on ice cream or do they just add up numbers and head off on their merry way, kind of thing?

Ms Fidelma Clarke: I wouldn't be an expert on the auditing profession outside of the reviews that I've been involved in in banking. Certainly, the auditors that I've dealt with - and I've dealt with almost all of the firms, one way or another, in my time - take a ... take a very rigorous and robust approach to evaluating and signing off on financial institutions' accounts.

Senator Sean D. Barrett: The contrarians. This organisation seems have been particularly anxious to shut down contrarians. We've two case studies in our papers. One was here today and the other ... why was that? Would they not have diversity of ideas, good discussions and so on?

Ms Fidelma Clarke: I can't answer for the board of the society. I'm sorry. I don't think it would be appropriate.

Senator Sean D. Barrett: Thank you very much. Thank you, Chair.

Chairman: Okay, that's fair ... that's fair. I'm going to bring matters to a conclusion. Ms Clarke, if there's anything you'd like to say by means of closing comment or any remark, I'll take that if you wish.

Ms Fidelma Clarke: Given the lateness of the hour, I won't beg your indulgence except to say that I do believe the work of this committee is extremely important and I wish you every success.

Chairman: With that said, Ms Clarke, thank you very much. In doing so, I'd also like to thank you for your participation today. Our apologies for delaying you with our late start and also thank you for your engagement with the inquiry. With that said, I propose that the witness be excused. We will suspend for five minutes. Thank you.

Sitting suspended at 8.30 p.m. The joint committee resumed in private session at 8.41 p.m. and adjourned at 9.11 p.m. until 9.30 a.m. on Thursday, 30 July 2015.