Tithe an Oireachtais
Houses of the Oireachtas

# Joint Committee of Inquiry into the Banking Crisis

## Witness Statement of

## Brian Cowen

## 02 July 2015

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[1] *See s.37 of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013*

**STATEMENT OF BRIAN COWEN**
**An Taoiseach, 2008-2011**

I was An Taoiseach from 7 May 2008 until 9 March 2011. In submitting this statement, I am adhering to the format outlined by the Inquiry and address each of the themes and lines of inquiry as contained in the Direction issued. My replies are as follows:

## I. Effectiveness of ECOFIN and the Domestic Standing Group (DSG) (Central Bank, Financial Regulator and Department of Finance)

### *C1a. Inter-departmental contact and the Memorandum of Understanding (MOU) with other EU states on the issue of banking.*

1. The work undertaken by the DSG intensified throughout 2008 and remained steadfastly on issues relating to liquidity issues. The view was that Irish banks had sufficient absorption capacity to meet any issues that may arise.

2. In September the work of DSG accelerated given the impact of what was happening internationally with the banking system for instance the bail out of Fannie Mae and Freddie Mac by the Federal Reserve and also the collapse of Lehman Brothers on 15 September caused what has been described as an earthquake on the global money markets.

3. In Ireland the focus of the work of the DSG became concentrated on Irish Nationwide Building Society (INBS) as a result of a negative news report that emanated from Reuters in early September.

4. The DSG started to retain external advisors in the areas of corporate finance and accountancy expertise. Up to then, the DSG was relying on the Financial Regulator's office in respect of any specific financial institution.

5. Member States in the euro area were becoming preoccupied with problems arising in their own jurisdictions and were focusing on devising national stabilisation measures.

6. Ireland participated in the newly created Financial Crisis Cell which was not established at EU level until October 2008. Its purpose was to enable a Member State facing significant financial instability to share information in confidence with all relevant institutions and Member States. The establishment of the Cell was a significant first, albeit belated, step in strengthening financial stability contingency planning arrangements in the EU.

7. A clear gap in the system was that there was no EU competence for the ECB regarding overall responsibility for supervision of the euro area financial institutions.

8. There was clearly no proper assessments for understanding the possible cross border effects that faltering international lending institutions would have on the banking system across the euro area. These issues were only addressed over time at the EU level after the crisis had hit and their absence at a critical time represented a serious policy failure.

9. The cross border principles contained in the 2008 MOU were not activated at the relevant time because of the delay in implementation by Member States.

10. Under the French Presidency of the EU, President Sarkozy moved the policy response to Heads of State and Government level in the first instance. ECOFIN took the lead after the meeting held on 3 October when an EU policy response was initiated.

11. ECOFIN and the EuroGroup were the fora for conducting management of the financial crisis at EU level. Its effectiveness was tempered by the length of time it took for a consensus to emerge in some critical policy areas regarding EU competence in supervision of the banking system and other regulatory areas.

12. During 2009, and following the introduction of the bank guarantee, there was a huge amount of legislative and administrative work undertaken by the Government including the establishment of National Asset Management Agency (NAMA), the appointment of a new Financial Regulator and Central Bank Governor, new procedures and a more intrusive, interventionist model of regulation was put in place.

13. This required an extraordinary level of cooperation between the regulatory authorities, the Department of Finance and the Attorney General's office. Despite the work pressures involved, I believe that the various Government departments and agencies worked well together.

14. The new Central Bank Reform Act 2010 was another milestone and reintegrated the regulatory role into the Central Bank with a view to strengthening supervision at a national level.

15. Following my departure from the Department of Finance in May 2008, I had no direct involvement in ECOFIN matters.

***C2b. Role of advisors in analysing the crisis (to include crisis management options)***

16. The National Treasury Management Agency (NTMA) was involved in the work of the DSG as deemed appropriate. The Attorney General's office was involved in assisting with the preparation of contingency legislation. The NTMA also facilitated the appointment of external advisors in September 2008.

17. It is noted that Goldman Sachs did some work for the Financial Regulator in relation to INBS in September 2008.

18. Merrill Lynch was retained when it was felt that corporate finance experience was needed to assist in assessing the emerging situation.

19. Analysis up to this point was based on information from and conversations with PwC regarding Anglo and Goldman Sachs regarding INBS. The initial focus by Merrill Lynch had been on Anglo and INBS but this soon expanded to include all six Irish banks encompassing Irish Life & Permanent, EBS Building Society, Allied Irish Banks and Bank of Ireland.

20. The Merrill Lynch draft preliminary analysis presented a number of options and the main elements of each option were considered.

21. On 28 September, Merrill Lynch presented a memo containing more information and an in-depth analysis. This memo stated that liquidity issues aside, all of the Irish banks were profitable and well capitalised. However, liquidity for some banks could run out in days rather than weeks.

22. The memo highlighted the need for the Government to preserve the stability of the Irish financial system as a whole and to safeguard the interests of bank customers to avoid widespread panic.

23. Arthur Cox was retained to provide legal to the Attorney General.

24. PwC was engaged to review the loan books and the capital position of the six Irish banks covered by the guarantee. The PwC report stated under a number of stress test situations that all of the Irish financial institutions which they reviewed would have sufficient capital to meet the regulatory requirements up to 2011.

25. This analysis was hopelessly optimistic and certainly did not envisage the crisis to develop the way that it subsequently did.

***C2c. The liquidity versus solvency debate***

26. The DSG continued its work after I became Taoiseach throughout the summer months.

27. The principal focus remained on the restriction of liquidity to the Irish financial institutions. Contingency planning in relation to legislation related primarily to bringing an individual lending institution under state protection i.e. nationalisation. At no stage did its work embrace the possibility of a systemic risk to the whole banking system.

28. Things escalated in September when first of all there were rumours about INBS. These receded somewhat when the new Deposit Guarantee Scheme was announced. This provided reassurance to many small scale depositors which formed a large part of the INBS deposit base. External advisors were employed to supplement the work that already had been done up to this point.

29. Lehman Brothers filed for bankruptcy on 15 September. The impact of that meant that money markets which provide cash to the banks to conduct day-to-day business started seizing up.

30. On the night of 29 September 2008, it was reported to the meeting that Anglo would need support the next day and Irish Life & Permanent would need it by the end of the week.

31. In the opinion of the Governor of the Central Bank of Ireland we had a system wide banking crisis in Ireland and the view was that the failure of a bank of systemic importance would have catastrophic effects on the Irish banking system and on the wider economy.

32. Getting liquidity back into the Irish financial system was absolutely critical if we were to avoid increasingly illiquid banks from drifting into insolvency.

33. On the night of the guarantee being issued, the Financial Regulator certified that the six main financial institutions in Ireland were solvent.

34. The guarantee did stop the outflows from the Irish banking system and indeed reversed it for a period so that money came back into the system enabling the lending institutions to continue to operate.

## II. Appropriateness and effectiveness of the Department of Finance actions during crisis

### *C3a. Appraisal of the conditions prior to increasing the Deposit Guarantee Scheme*

35. It was evident that confidence was fragile amongst individual depositors and this lack of confidence rapidly spread to all the lending institutions. Reports of people withdrawing their money from Irish lending institutions became amplified through media commentary and there was a general disquiet at what was happening at home and abroad.

36. A silent run by depositors had begun on all Irish banks.

37. It was felt as a first step that ordinary individual depositors needed to be reassured. In response to this worrying development, the Government decided, after consultation with the relevant authorities to increase the existing deposit guarantee scheme from €20,000 to €100,000 and to increase cover from 90% to 100%.

38. This appeared to have the desired effect in reassuring people about the safety of their deposits up to €100,000. The number of depositors covered was numerically large although wholesale deposits were of significantly greater value.

39. As a result of that Government decision, the amount of money covered under the new terms of the Deposit Guarantee Scheme was over €70 billion.

40. This decision when it was announced had the desired effect of providing confidence to depositors in Irish financial institutions who had deposit accounts up to €100,000 in that the Government was standing behind those accounts.

41. It temporarily bolstered confidence in the system generally, though deposits of over €100,000 remained outside the terms of the scheme.

*C3b. Appropriateness of the bank guarantee decision*

**42. I wish to state that what I relay here about what happened on the night of 29/30 September 2008 is, to the best of my recollection, knowledge and belief, a true and accurate account. However I cannot be absolutely certain of the exact chronology of events as they unfolded but I believe that this account provides a substantive recollection of that night's events and the process by which the decision was reached.**

43. The decision to guarantee the banks has to be viewed in the context of what the situation was on that night and what was at stake.

44. Irish banks, as was the case everywhere else, were finding it hard to access cash to meet day-to-day operational requirements. There was huge turbulence not only in the money markets but in the wider stock market which was reinforcing the diminishing confidence within the financial system.

45. We knew over the weekend of 27/28 September that Anglo and Irish Life & Permanent were going to find it hard to get through the following week in terms of having cash to conduct their day-to-day business.

46. At the Government meeting on Sunday 28 September, the Minister for Finance gave an oral presentation to update the Cabinet on the evolving situation. He made them aware of the context in which we were operating in general terms. It is noted that no decision was taken at the Cabinet meeting on that day in relation to this matter. The international banking situation was very volatile and the liquidity position of Irish banks was being seriously affected as a result.

47. At that meeting, the Minister for Finance reiterated the position that the Government was committed to the stability of our financial system. The Government wanted to protect the whole financial system and secure its stability and ensure that all deposits in Irish financial institutions were safe.

48. By Monday 29 September there had been more banking casualties: Hypo Real Estate in Germany, Fortis Bank in Belgium and Bradford & Bingley in the UK.

49. Money continued to leave the system and the rate run increased to such an alarming degree that arrangements were made for a meeting to take place at the Department of An Taoiseach after close of business to review the situation.

50. This took place in the meeting room adjacent to the Taoiseach's personal office. It is worth remembering that over the course of that evening, while I remained in this meeting room some people left the room for the purpose of consultation, information gathering or to undertake some technical work. All major decisions were taken in the Taoiseach's meeting room.

51. From the beginning of the meeting, those in attendance were myself, the Minister for Finance, Brian Lenihan TD, Attorney General, Paul Gallagher SC, Secretary General of the Department of Finance, David Doyle, Assistant Secretary of the Department of Finance, Kevin Cardiff, Governor of the Central Bank, John Hurley, Deputy Governor of the Central Bank, Tony Grimes, Chairman of the Financial Regulator, Jim Farrell, Chief Executive of the Financial Regulator, Patrick Neary and Eugene McCague, from Arthur Cox & Co Solicitors.

52. Secretary General of the Department of An Taoiseach, Dermot McCarthy, joined the meeting after it had started having been delayed performing other duties. I have a recollection that another Department of Finance official, William Beausang, was present for some of the meeting also. The meeting began at 6.15 p.m. approximately. As I was chairing the meeting, I did not take any notes myself.

53. As the meeting began the seriousness of the discussion become clear very quickly.

54. Governor Hurley outlined what had been happening during the course of the day regarding the lending institutions. He referred to a situation which had developed at Anglo where it had lost €2 billion in deposits that day and they expected the rate run to continue the next day.

55. Before Monday, the opinion was that Anglo would have sufficient funds during the course of that week: this was now not going to happen. The issue was going to have to be addressed immediately.

56. Bank shares were down in the stock market and he pointed out that Anglo had run out of cash. He said a very serious situation had developed. Other institutions were also having significant liquidity problems and unless the outflows stopped or reversed, we were heading into very dangerous territory indeed. This had developed into a system-wide crisis.

57. Mr Neary and Mr Farrell, from the Financial Regulator's office, outlined their serious concerns. I recollect that they were of the view that something significant had to be done immediately to stabilise the situation. In that respect, they spoke of the need for the introduction of a guarantee to be considered in view of the serious situation which had developed across the financial system.

58. I recall I asked the Governor what the view of the ECB was and to provide us with an update as to what the ECB's position was. Governor Hurley had been in touch with the President of the ECB, Mr Jean Claude Trichet over the weekend and confirmed to the meeting that there was no euro-wide initiative in the offing and just as other countries had to take decisions on their banks, it was clear that we were on our own, we would have to deal with this at a national level.

59. The position of the ECB (of which Governor Hurley was a member of the Governing Council) was that no bank was to be allowed fail because of the contagion effects that could ensue in the euro area.

60. In other words there could be no "Lehman Brothers" type event in the euro area.

61. Confidence had to be restored as a matter of urgency or else the run rate of outflows could accelerate and leave us with an irretrievable situation.

62. The Governor made the point that we would have one go at addressing this and if it did not work, we may not get a second chance to revisit it as confidence would be gone. Where a first initiative may be deemed inadequate by the market, putting forward a second course of action could then completely undermine our credibility.

63. His outlining of the seriousness of the situation had an immediate impact on all present.

64. The Minister for Finance contributed to the meeting at this point and agreed with the analysis and the up-to-date position given by the Governor. He indicated that he felt part of the solution would be the nationalisation of Anglo.

65. I did not think that nationalisation should be a first course of action and I said so.

66. As I said, my first thoughts in assessing the situation that had been outlined was that I did not find the nationalisation option attractive as a first response. I had a number of reasons for that.

67. First of all, I did not see it as a confidence building measure at that stage given the volatility in the markets. For example, would it create an expectation that other nationalisations were to follow?

68. Secondly, nationalising a bank meant taking all of the assets and liabilities onto the State's books there and then, immediately.

69. The nationalisation option was in effect an open-ended guarantee.

70. The guarantee option looked like a safer option if it was time limited.

71. Given the sentiment in the markets and the state of the banking industry internationally as well as domestically, there was no likelihood of what has subsequently been termed a "temporary" nationalisation. But a temporary guarantee was a possibility.

72. The question I was asking was: how do we get liquidity back into the system and quickly? That was the most important immediate objective. Without doing that successfully, all of the banking system could drift into insolvency because the shortage of cash in the system would mean that day-to-day operations in the banks could not continue within a short space of time.

73. The view was that the banks in Ireland were solvent but illiquid to varying degrees depending on the institution and the best of them, had at most only a few weeks left assuming the deposit outflow rates did not accelerate.

74. The Financial Regulator confirmed to the meeting that all the institutions had sufficient capital and were solvent.

75. Allowing Anglo to fail was simply not an option on the night. It would have implications for the whole system. The costs involved in terms of causing a run on other banks as well would put the whole payments system at risk and cause irreparable damage to the economy as a result of a banking meltdown. It would, in Governor Hurley's words, "set the country back 25 years" as he put it.

76. We were clearly in an unprecedented situation, the dynamics of which were moving very fast. Emergency Liquidity Assistance (ELA) is not designed to address a situation when all of the banks are in trouble. It can work in a specific institution which has liquidity problems once it does not come to public notice. The Northern Rock example proves that in those circumstances the use of ELA can have a more destabilising effect and cause the opposite of what was intended.

77. Putting together an ELA fund from the country's own domestic sources made up of cash balances from the Exchequer and assets from the National Pension Reserve Fund (NPRF) and the Central Bank itself and simply applying that to the liquidity requirements of banks was not going to restore international confidence and get capital flowing back into the banks from external sources.

78. The options were narrowing down to a nationalisation plus a guarantee or simply a guarantee of the system itself. The other options referred to by Merrill Lynch which had been discussed were discounted by then. It has to be emphasized no decision was risk free. There was no one good or right option that would guarantee a solution to the problem. It was about trying to pick the 'least worst' option and make sure that if we had only one go at trying to stabilise the situation that it would have every prospect of doing so. Trying to forecast where all of this would go next was extremely difficult to predict.

79. It was strongly stated to us by our own regulatory authorities that this was a liquidity problem and not a solvency problem. At no stage was it contemplated then or indeed until the NAMA valuation of loans emerged, that the funding gap for the banks would reach the levels that it did or that the impairments of loans in the banks would be of the horrific nature or magnitude that came to pass.

80. I was coming to the view that given what was potentially at stake whatever we did would have to have an immediate and dramatic impact in stopping the outflow of funds from banks and indeed reversing the trend if possible.

81. Word came into the meeting that the Chairman and CEO of the two main banks were looking to meet with us. I adjourned the meeting for a short break. During this break, I decided to get an external view.

82. Mr Alan Gray, an economist and a Central Bank board member, was someone whose views I respected. I phoned him and asked him what he thought of a guarantee option being used.

83. Mr Gray emphasized that providing a guarantee would obviously give an advantage to those institutions to whom the guarantee would apply vis-à-vis competitors since they would have the backing of the Irish Government.

84. In that respect, it was important to be mindful how other lending institutions would regard it and he stated that compliance with EU state aid rules would be an important factor to bear in mind. In dealing with that issue, it would also be important to be seen to charge a proper fee for the value of that guarantee to those institutions who got the benefit of it.

85. Mr Gray also stated that if we were considering the introduction of a guarantee of any kind, then it should be strictly time limited. This would assist in arguing that it was proportionate to meet the serious situation that was being dealt with. I thanked him for this advice.

86. During this break from the main meeting, the Minister for Finance and I weighed up the options ourselves in my personal office.

87. We reviewed the discussions from the meeting thus far. He was minded to still go the nationalisation route for Anglo and guarantee the rest of them.

88. I explained my reservations about it and reassured him that nationalisation was something that we could not rule out in the future and would remain an option available to us. I also told him that a time limited guarantee seemed to me preferable than giving an open-ended guarantee which a full nationalisation would entail.

89. I emphasise this point. We were talking the issues through and there was no question of our conversation being in any way adversarial or confrontational with each other. Both of us were deliberating with each other and striving to find the best course of action for the country at this point.

90. The meeting resumed with senior officials in the main meeting room beside my personal office. We were reminded that the bank representatives were waiting in the building and after some time they were called into the meeting.

91. The representatives from the banks confirmed that the position was every bit as bad as the Government believed and immediate action was necessary to address what was happening. We were informed that the money markets had decided that Irish banks were to be avoided.

92. The bank representatives were concerned about INBS as well as Anglo and they wanted to be differentiated from those institutions in that respect.

93. Without stating it openly, it was clear to me that they wanted those two institutions nationalised and a guarantee to be provided for their institutions.

94. What was clear was these two well-established banks were finding it very difficult to get money to keep going. They had enough at their present run rate to get through another couple of weeks.

95. There was certainly no indication from either bank that they felt they were in any way exposed to the extent and level that they believed the other institutions were. They wanted to be treated differently and sought a guarantee. They felt there was an adverse reputational impact being imposed on them as things stood at that time.

96. I did not comment on the presentations made by the banks. We would consider their views but they were not going to be participants in any decisions. They then left the meeting.

97. It was clear that all the banks were running out of cash and depending on the run rate, it could now be days rather than weeks.

98. This reaffirmed my view that something comprehensive would have to be done. I was also under no illusions that they were putting themselves forward as safer bets than other banks and what concerned me was that they were looking for a guarantee for themselves while telling us to take what they saw as problem institutions onto the State books immediately.

99. I recall Mr Kevin Cardiff, Assistant Secretary of the Department of Finance, being asked at some point by the Secretary General, Mr David Doyle to give his view having heard everything. Mr Cardiff was of the view that a nationalisation of Anglo and a guarantee for the rest of the banks was his preference. He accepted it was a judgment call and there was no single right answer to our dilemma.

100. The liquidity problem was the essential initial hurdle that had to be jumped for us to have any chance of getting through the first stage of the crisis. The market was going to react to whatever initiative was put out there: our collective hope was that it would react the right way.

101. I remained of the view that we needed to keep this as simple as possible so nationalisation was not ruled out down the line if such a measure proved necessary as I had explained earlier to the Minister for Finance.

102. The Governor emphasized again that we only had one go at it and we needed to convey a message that was easily understood for it to work and even at that it might still not work. The discussion continued about the nationalisation or guarantee options. I recall too that if we decided we were to go the guarantee option that it would be limited to two years.

103. Eventually I put it to the table that it seemed to me that a full guarantee option provided the best prospects of addressing the urgent liquidity problem and of sending a clear message that Ireland was standing behind the financial system which would be understood by the markets.

104. We hadn't much room to manoeuvre. It would have the benefit of being an impactful measure which could solve the immediate and pressing problem.

105. It is my recollection that I then asked everyone could we run with a guarantee only approach in principle. There was agreement on that. Further details would now have to be worked out.

106. The question arose too that we needed to make some contingency arrangements if the announcement did not work and Anglo needed some support the next day. The bank representatives were brought back into the meeting and the issue of liquidity support for Anglo was raised with them. My recollection is that their response was very cautious and as it was a technical issue and ultimately it was dealt with in discussions in another part of Government buildings afterwards.

107. We went on to discuss then what way a guarantee would be structured. The pricing mechanism and the category of cover were also discussed. When that meeting ended and the bank representatives left it was time for detailed decisions to be taken.

108. In deciding on the senior bondholders it is important to point out that the holders of these type of bonds in Irish financial institutions include the proceeds of Irish pension funds, large credit union deposits as well deposits from religious and charitable trusts. While no one would suggest that those funds should be at risk, in law all holders of bonds of the same category whether foreign or domestic have to be treated the same. In other words you cannot protect some senior bondholders and not others.

109. When considering the case for including existing senior bondholders in a guarantee, we decided that if these bondholders were disadvantaged by not being included, the system would end up relying exclusively on new bondholders to lend their money to the financial institutions with the prospect of driving away existing funders at a time when confidence in lending to those institutions was so low.

110. Later on that night, the question of including junior bondholders (dated subordinated debt) came up. I have a recollection of being in the room with the Governor of the Central Bank at the time when this issue was raised. We decided that given the uncertainty that was in the market, it might be best to include junior bondholders on balance as they were a very small percentage of the total securities that were being covered. We wanted to maintain maximum market access to the Irish financial system.

111. I have made the point before that the great portion of this subordinated debt did not mature during the two years of the guarantee in any event and 80-90% was not paid back because these junior bondholders were excluded from the ELG (Eligible Liabilities Guarantee) after the September 2010 deadline, when the first guarantee had expired. This meant that there were substantial haircuts when it matured for payment after 2010. It represented just 3% of the total liability coverage.

112. At some point I was notified that the TARP proposal had been voted down by the US Congress. I immediately said to myself if there were problems on the money markets today, what will it be like tomorrow?

113. The Attorney General emphasized the need to get together to marshal the arguments for the EU Competition DG to ensure that the guarantee complied with EU state aid rules. The necessity to deal with an extreme disturbance in the economy is allowed under those rules. We obviously had to meet the criteria. There was also work to be done to prepare for the Dáil the next day.

114. I do recall there was a drafting process regarding the wording for the guarantee decision itself and arrangements had to be made for the announcement and publication of the decision before the markets opened the next morning. At one stage in this drafting process, Mr Cardiff voiced his concerns to me that the draft wording which the banks had given him was too vague. I told him to make sure that only what we had decided on would be included and to tie that down to his own satisfaction.

115. Minister Lenihan had at this stage gone home because he had a very busy schedule to fulfil from early the next morning. He told me sometime afterwards that he was not present in the room when the dated subordinated debt issue was decided upon.

116. The decision having been made, an incorporeal Cabinet meeting took place. Ministers were contacted and the decision was confirmed.

117. The minutes of the incorporeal meeting that confirmed the decision were adopted at the Cabinet meeting we held on Tuesday morning, 30 September.

118. I left Government Buildings around 3.30am.

### *C3c. Effectiveness of reviews of banks' loan books and capital adequacy*

119. It is now clear that there were significant weaknesses in the banks' loan books and capital adequacy. In 2008 all financial institutions were performing and meeting the necessary capital adequacy standards as set by the Central Bank and Financial Regulator.

120. The Department of Finance did not have an oversight role in this area at the time. As the crisis evolved, the Department of Finance got centrally involved in the over assessment and analysis of the loan books and capital adequacy of the financial institutions. It is now clear that the relationship between the financial institutions and Financial Regulator was far too trusting.

121. It was only when independent consultants went into the banks and undertook a drill down on not only the loan books but on each and every individual loan that the size and scale in the slide in valuations became apparent.

122. The banks became much more co-operative, transparent and realistic as they realised that they required Government assistance in the form of meeting on-going capital requirements.

## IV. Appropriateness and effectiveness of the domestic policy responses

### *C4a. Decision to nationalise Anglo in 2009 and a review of the alternatives available and/or considered*

123. In the period post guarantee the Department of Finance along with the Central Bank, Financial Regulator and NTMA worked with Anglo and other financial institutions to examine all options to maintain stability and proper functioning of the banking system.

124. Arising from these discussions, in early December 2008, the Government announced its decision to support a recapitalisation programme for financial institutions in Ireland of up to €10 billion.

125. Despite the Government's effort to reassure the market by pledging capital support to the bank, negative market sentiment towards Anglo continued.

126. In December the board of Anglo told the Government that it required help in raising capital. Merrill Lynch and PwC were sent in to advise the Government/Minister on what the next steps should be.

127. Liquidity concerns mounted over the course of December and January: approximately €3 billion in corporate deposits were lost and the liquidity position in the days leading up to nationalisation was extremely fragile.

128. Further credit rating downgrades were imminent which were expected to drive a further €6 billion of outflows in the near future. At that point in time, it was not felt that the use of Central Bank or NTMA options to replace this liquidity would be appropriate. It was decided, following consultation with the Central Bank and Financial Regulator that greater certainty could be provided by taking the bank into State ownership. NTMA and Merrill Lynch were in agreement with the nationalisation.

129. At the time the decision was made, I was in Japan leading a trade mission. I received a phone call from the Minister for Finance stating that it was necessary to proceed with the nationalisation decision immediately.

130. His advisors and the Central Bank and Financial Regulator were in agreement that this was now necessary to protect our banking sector. He confirmed that this was his own view also and I authorised An Tánaiste to call a Government meeting and a memorandum from the Minister for Finance to be put to Government for decision that day.

131. An important factor in the decision to nationalise Anglo was the concern that corporate governance issues could destabilise the bank itself and threaten the stability of the wider financial system.

132. The Government could not allow a situation to develop where the collapse of the bank might have occurred and the Government and the taxpayer would have been faced with the prospect of immediately having to pay out billions of euros to customers who had deposits at the bank.

### *C4b. Establishment, operation and effectiveness of NAMA*

133. Various alternatives were looked at but it emerged that the setting up of an asset management company and taking the impaired loans including property and development loans into one agency would be a better option than having a 'good bank/bad bank' model for each individual bank. It would give a better overview of what the position was particularly for those who had borrowings from several banks so that the overall liability could be more accurately assessed. A valuation method for these loans was agreed with the European Commission.

134. NAMA was established by the Oireachtas to remove systemic risk to the Irish banking system through the acquisition of land and associated loans from participating institutions and to obtain the best achievable return to the State from these acquired loans.

135. The Government had examined a number of ways to deal with risky assets on the balance sheets of Irish banks which were preventing banks from lending into the economy and thereby supporting economic recovery.

136. Dr Peter Bacon had been retained to provide a report on options for resolving property loan impairments and the decision was to establish an asset management agency to ensure that the banks were freed up to lend to the real economy.

137. A steering group was established comprising representatives of the Department of Finance, the Office of the Attorney General and the NTMA to oversee preparatory work for the establishment of NAMA on a statutory basis. However to avoid uncertainty and minimise further deterioration in the banks' loan books, it was important that NAMA be established on an interim basis. This also allowed preparatory work on the necessary legislation to be informed by the initial work of the interim agency. The interim agency was well positioned to help identify technical issues which would have to be addressed in the legislation and to assist in discussions with the EU Commission.

138. The value of the banks' assets had fallen dramatically since September 2008. In all 5 banks participated in the scheme: AIB, Band of Ireland, Anglo, INBS and Permanent TSB. Ultimately NAMA acquired €74 billion of loans for €31.8 billion representing an overall discount of 57%. NAMA paid for the loans through the issue of Government Guaranteed Senior Debt (95% of the cost) and unguaranteed subordinated debt (5%).

139. On September 30, 2010, the Government decided, having consulted with the Central Bank, Financial Regulator, the European Commission and the NAMA board, that where the total exposure of a debtor was below a €20 million threshold in AIB and Bank of Ireland, that the debtor's loans would not be transferred to NAMA. The threshold had previously been set at €5 million. This change was implemented to ensure that NAMA could operate to the highest level of efficiency and effectiveness in the management of its loan portfolio and allow for the completion of all NAMA transfers by year end 2010.

140. It was considered at the time that smaller loans below this threshold would be better managed though the banks' branch networks and through local banking relationships. The decision to raise the threshold from €5 million to €20 million for the transfer of loans from AIB and Bank of Ireland to NAMA reduced the total volume of NAMA eligible loans by €6.6 billion.

141. The scale of the undertaking was enormous and involved the acquisition of over 12,000 loans issued to 780 debtor connections and 60,000 properties. The number of borrowers and the volume of loans made it impracticable for NAMA to value and acquire all loans concurrently, this necessitated making the acquisitions in tranches.

142. Following the acquisition of the loans NAMA engaged either directly or indirectly with all 780 debtors to determine an appropriate strategy to maximise the value of each exposure. NAMA's approach was to engage with borrowers to see whether and to what extent agreement could be reached on how the borrowers would repay their debts.

143. NAMA executed the role of managing and selling the assets under its control, with the primary aim of maximising the best financial return to the State.

144. Under the 2009 Act, NAMA was required to account for its costs in quarterly and annual reports and also had to account to the Public Accounts Committee. Its annual report is audited by the Comptroller and Auditor General.

145. NAMA put huge effort into preparing, bringing to market and completing loan and asset sales processes, which includes some of the largest portfolios to come to market in Europe.

146. To help sustain this interest, NAMA further committed to offering packaged property portfolios with a minimum value of €250 million for sale each quarter in addition to their ongoing disposal activities.

147. NAMA has performed very well considering the size and scale of its remit and has been effective in achieving the aims of what it set out to achieve.

***C4c. Decision to recapitalise Anglo, Allied Irish Banks (AIB), Bank of Ireland (BoI), Educational Building Society (EBS), Permanent TSB (PTSB) and the alternatives available and/or considered.***

148. In the two months which followed the bank guarantee, the Government examined the structure and capital requirements of all the banks. The decision to provide capital to the banks stemmed from ongoing concerns surrounding liquidity and the inability of the banks themselves to raise such capital requirements on the markets.

149. In December 2008, the Government announced the first recapitalisation programme for AIB, Bank of Ireland and Anglo. By February 2009, an injection totalling €7 billion was made into AIB and Bank of Ireland. By this stage Anglo had been taken into State ownership.

150. The decision to recapitalise the banks during this period 2008-2011 was also anchored in higher capital adequacy requirements which had been introduced as a result of the banking meltdown.

151. Having initially announced an intention to invest €2 billion in both AIB and BOI in the form of preference shares in December 2008, following a deterioration in the economy and global markets, a Government decision was taken on 11 February 2009 to raise this to €3.5 billion for each of the two main banks. The decision to invest State funds in the form of preference shares was driven by a number of considerations:

(i) The State made it clear it did not want to take control of the banks.
(ii) Other Governments were also supporting their banks using preference shares at the time for much the same reason.
(iii) Preference shares were still considered part of core tier 1 capital which was the key regulatory measure of capital strength at the time.

152. In order to maintain the flow of credit, the recapitalisation schemes included a credit agreement whereby the recapitalised banks were to provide an additional 10% capacity for lending to SMEs and an additional 30% capacity for lending to first time buyers in 2009 with take up to be subject to the demand from viable borrowers.

153. The decision to inject core tier 1 capital into the two largest banks reflected the need to minimise the risk of damage to the real economy as a result of the financial turbulence and by encouraging banks to continue lending to credit worthy borrowers.

154. As part of the recapitalisation package, the Government announced it was looking at other possible measures to enhance the stability of the overall financial system. A guarantee scheme was examined with a view to determining whether it might be revised in ways which would support longer term debt issuance with maturity beyond September 2010. That would bring the Irish scheme in line with schemes in other EU countries where new debt up to 2013 was generally covered.

155. We also announced the intention to examine proposals for the management of risks related to land and property loans of financial institutions which led ultimately to the decision to establish NAMA.

156. The Central Bank's first Capital Asset Review in 2010 effectively forced AIB and Bank of Ireland to raise further capital in 2010. In the case of Bank of Ireland it was able to raise €1.1 billion from debt and equity investors while the Government converted €1.7 billion in its preference shares into equity to support the bank. This left the state with a 35% ordinary shareholding in the bank.

157. It was clear during 2010 that AIB was going to incur larger losses than Bank of Ireland. It was fortunate in having valuable overseas businesses including a minority stake in M&T Bank in the US and a valuable Polish banking franchise, BZWBK. The Department of Finance and European Commission put pressure on AIB to dispose of these businesses to reduce the residual amount required to support their capital ratio.

158. AIB spent much of 2010 preparing and executing these disposals. It was only in December 2010 that the State effectively took control of AIB with the injection of a further €3.7 billion in equity.

159. In terms of Anglo, the first €4 billion of capital required was made in the form of cash injections but as the losses in the bank mounted, the State moved to issue promissory notes which could be adjusted as the capital requirements became known and would also help to conserve the amount of upfront cash required.

160. The promissory note structure was designed to achieve the most efficient outcome for the Exchequer and to spread the repayments over an extended period of years. The slow process in transferring loans to NAMA in tranches played a role in undermining confidence in the banking system and the sovereign in general.

161. Further capital injections were only provided on foot of confirmation from the Governor of the Central Bank to the Minister for Finance confirming the systemic importance of Anglo to the banking system and the need for the proposed capital measures to ensure the financial stability of the bank.

162. The total capital requirements for Anglo and INBS was only known in October 2010 on completion of the Central Bank's assessment of the capital requirements for the restructured bank.

163. Anglo and the Department of Finance with the assistance of advisors determined that the preferred solution for the bank was to explore a 'good bank/bad bank' split. The deterioration in the bank's business made it impossible to deliver a workable structure of that kind. Ultimately the decision was taken in early 2011 to wind down the bank in its entirety.

164. The key consideration for the State throughout was to protect the funding of the bank's loan book. Without it, the bank would have collapsed and the State's liability in the form of the promissory notes would have fallen due immediately.

165. It was only when a long term viable solution for the promissory note was found and the system had more generally stabilised, that the State was in a position to liquidate the bank.

166. As building societies, EBS and Irish Nationwide were in the unique situation of being unable to raise capital from their members nor did they have the ability to raise funds through disposals or other debt buy-backs. The State became their only port of call for new capital.

167. The State's involvement in EBS began with an investment of €100 million in special investment shares (SIS) in 2010 that secured control. This was followed by further investments which had reached €875 million by the end of 2010. The State engaged in a trade-sale process but bids received were rejected as it was not attractive enough for the taxpayer.

168. EBS was deemed to require further capital following the 2011 asset review and following advice from the Central Bank that the society could not survive on its own, the decision was taken by the present Government to merge EBS with AIB in July 2011.

169. The Irish Life and Permanent Group was required to raise €4 billion as a result of the 2011 capital asset review process. There was a deadline of end of July 2011 to raise the capital. They couldn't raise it and the State was forced to take control through a €2.7 billion initial investment which ultimately reached the full €4 billion requirement.

***C4d. Credit Institutions Stabilisation Act (2010) – effectiveness of the actions to merge AIB and EBS, Anglo and INBS and deposit transfers***

170. The 2010 Act was introduced to provide strong powers to resolve the threat to the stability of the financial system generally. The functions and powers provided under the Act were to reorganise the guaranteed domestic credit institutions.

171. The purpose of the bank restructuring measures were to ensure that the banking sector is proportionate to the size and credit needs of the economy. It was to facilitate a very significant reduction in the domestic banking system's reliance on funding from a euro system and the Central Bank of Ireland and put the Irish banking system on a more sustainable funding system platform.

172. The Act is uniquely structured to prevent events of default on banks' financial instruments from arising where restructuring intervention was necessary to achieve the Government's goals. This allowed the restructuring to take place without triggering a right for the holders of senior bonds and derivatives to demand immediate repayment or termination.

173. The subordinated liability mechanism under the Act was at the heart of the State's ability to recover significant sums through the hair-cutting of subordinated bondholders in the solvent relevant institutions, the only time I am aware this has been achieved in any jurisdiction.

174. Following the collapse of the sale process in relation to EBS, it was announced by the present Government on 31 March 2011 that AIB and EBS were to merge as soon as possible on financial stability grounds.

175. A specific plan for the restructuring of both Anglo and INBS in a way that was designed to protect depositors sought to minimise capital losses arising from the work-out of these institutions and strengthen the overall banking system.

176. This restructuring plan was developed and submitted to the European Commission on 31 January 2011. A key part of that plan was to sell the deposits in Anglo and INBS together with their NAMA bonds in a swift and decisive manner. It was considered that the ongoing gradual decrease in deposits in Anglo and INBS was destabilising both institutions and the whole Irish financial system.

177. The continuous increase in Central Bank (both Irish and European) funding also undermined the financial system as a whole. A Transfer Order (TO) and Direction Order (DO) under the Act were necessary to reduce the cessation of business and cross default risk of this transaction.

178. An auction process was conducted by the NTMA in compliance with the EU state aid requirements. Following that process, transfer orders provided for the transfer of the deposits and assets from Anglo and INBS to AIB and ILP respectively.

179. As a result of the transfer, AIB received Anglo deposits (including deposits in Ireland, the UK and the Isle of Man) of approximately €8.5 billion. It purchased senior NAMA bonds of a nominal value of approximately €12.2 billion and the share ownership of Anglo's Isle of Man subsidiary. AIB also made a cash payment of €3.5 billion.

180. IL&P received INBS deposits (including deposits in Ireland, the UK and the Isle of Man) of approximately €3.6 billion. It purchased senior NAMA bonds and other bonds with a nominal value of approximately €3.7 billion in addition to share ownership of INBS' Isle of Man subsidiary. IL&P also made a cash payment.

***C4e. Cost of the crisis and sharing of the impact***

181. The cost of this crisis has been borne by the people of Ireland.

182. The banking crisis exacerbated a serious economic downturn which caused job losses, emigration and a reduction in the standard of living across all sections of society.

183. The Government took every remedial step it could to reduce the gap which opened up between what the Government was spending and what revenues were coming in. This resulted in a painful adjustment across all Government activity after more than a decade of prolonged, sustained growth.

184. These spending cuts and tax increases involved a total adjustment of over €15 billion in the four budgets we introduced, including the 2011 budget. This represented two thirds of the total required adjustment to bring our budget deficit below 3% as required by EU rules.

185. We strove strenuously in the design of the four budgets we produced to spread the adjustment as fairly as possible. The depth of the recession and the measures needed to address it meant that people who were previously out of the tax net came back into it and those who were in it had to pay more.

186. The four year National Recovery Plan we published in November 2010 formed a central plank of the EU/IMF financial assistance programme which has now been successfully implemented resulting in an exit from the Troika programme.

187. Whilst highly unpopular, these measures were absolutely necessary as part of the process of bringing order back to the public finances since 2008 to date.

188. A large part of the unemployment increase was due to the contraction in the construction and related sectors. Consumer spending was well down as people paid down personal debt and increased the overall savings ratio. This had a very detrimental effect on retail businesses throughout the country and a serious unemployment impact there also.

189. The Government has met the growth rates set out in the plan and continued with the necessary structural changes to rebalance the economy.

190. The EU/IMF programme also provided the means and the Credit Institutions Act 2010 provided the legislative basis to implement the necessary restructuring and downsizing of a domestic banking system to a more sustainable model for the future.

191. The ESRI did an analysis of the cumulative impact on household incomes from Budgets 2009 to 2015. It has to be acknowledged that while the highest losses were for the top ten percent of income earners with 15.5% income loss, with the bottom ten percent of income earners estimated to be down almost 13% of their income.

192. The analysis incorporated main changes in direct tax, welfare and public service pay-pensions, carbon tax and VAT, DIRT, specific budget 2014 restrictions of tax reliefs for pensions contributions and medical insurance premia, capital gains tax and water charges.

## V. Appropriateness and effectiveness of international Ireland-specific policy responses

### *C5a. European Union (EU)/International Monetary Fund (IMF)/European Central Bank (ECB) programme of assistance*

193. At the start of 2010, though in deep recession, Ireland, through the NTMA, was able to borrow at rates that were only slightly higher than normal. By the end of April 2010, the budget was fully funded until mid-2011.

194. Around this time Eurostat, the statistical agency of the European Commission, announced that the transactions involving the recapitalisation of Anglo would have to be included in both the measurement of Government budget deficit and debt.

195. Although this was largely a matter of statistical classification with no underlying financial impact, the optics were bad because it pushed up the budget deficit for 2010 as a percentage of GDP to a very high level, albeit on a once-off basis.

196. By April, it was becoming clear that Greece would no longer be able to retain the confidence of market lenders. It had large budget deficits, long standing structural problems and low growth which put its public debt on a clearly unsustainable trajectory.

197. International perceptions were not helped by a consistent pattern of Greece falsifying data it provided to the EU and other international bodies. Greek Government bond yields soared to over 15% and its Government could not borrow any further. Greece applied for external assistance in April 2010.

198. Standard & Poor's, the credit rating agency, gave a very unfavourable rating assessment for Ireland in August 2010 and Irish Government bond yields increased very sharply. At the end of September 2010, the Government announced its intention to withdraw from the markets as a tactical move since we were fully funded until mid-2011.

199. At the end of September higher costs of the bank recapitalisation programme were announced. In mid-October Chancellor Merkel and President Sarkozy declared that a new permanent euro area financial rescue fund to be set up by 2013 would require private sector creditors to accept some debt restructuring.

200. This statement was known as the Deauville Declaration. It was clarified afterwards that the debt restructuring provision would only apply to new debt after 2013. The original statement had caused further market jitters: the damage was done and bond yields jumped further.

201. We had indicated in September 2010 to the EU Commission and the ECB that we were preparing a four year National Recovery Plan to be published in November prior to the budget which would show that we were committed to an adjustment programme that would bring the budget deficit down below 3% by 2014.

202. On 4 October, Minister Lenihan received a letter from the ECB President expressing concern about the situation of Irish banks. On 8 November, EU Commissioner Ollie Rehn visited Dublin. On 11 November the bond yield rose to 8.6% and Governor Honohan suggested that bond yields would fall to more sustainable levels if the planned fiscal adjustment was implemented. On 12 November, the ECB Governing Council decided it could not sustain its large exposure to Irish banks. On the same day, ECB/EU "sources" commenced off-the-record media briefings leading to reports that Ireland would need a bailout and that discussions were underway.

203. On 13 November, there were internal discussions with myself, Minister Lenihan and key officials. We were clear that if discussions were to take place it would be "talks about talks". In other words we made no commitment at that point to formally apply for assistance until we were satisfied what the authorities had in mind and the conditionality attached to it.

204. The off-the-record briefings were clearly trying to create a situation where a formal Irish approach for assistance was being portrayed as a fait accompli by those "informed" sources without prior agreement on conditionality. This was unacceptable to us.

205. We were not against exploring the issues with the EU authorities but neither should they presume or anticipate what decision the Irish Government would make. We wanted to know what they had in mind before we would indicate what position we intended to take. We were looking to explore what possibilities there were before giving our considered view.

206. At the Cabinet meeting on 16 November, the Cabinet was brought up-to-date about the situation that was developing. I did not like the continuous anonymous briefing against Ireland which I saw as an attempt to bounce us into a decision before we had further clarification.

207. At the ECOFIN meeting in Brussels on Tuesday of that week it was included in the Council's published conclusions that an EU delegation with IMF staff joining them for the first time, would travel to Dublin to continue the consultations. I underestimated the impact of the "IMF coming to town" element which immediately sent a message that this was now a done deal rather than a genuine continuation of existing discussions up to then.

208. This perception was further reinforced when the Central Bank Governor gave an interview with RTE from Frankfurt on the morning of the meeting in Dublin by saying while it was a matter for the Government in the first instance, he said he believed that a deal would be done and a loan would be agreed. This development showed the Government in a bad light because of the interpretation given to events that we were keeping what was going on away from people.

209. In fact we were trying to put ourselves in the best position we could, before formally requesting assistance.

210. We wanted to know exactly what we were getting into before we agreed to formally apply for any programme.

211. On 19 November, ECB President Mr Trichet sent a letter to Minister Lenihan threatening withdrawal of ECB funds in the absence of a formal bail out request. This was not well received by us.

212. We knew that providing a fiscal framework under the EU/IMF programme gave us access to funds at a cost cheaper than was available on the markets at that time and into the future.

213. It would provide in that respect funding certainty over a three year period that therefore gave a better prospect to implement the four year plan we had announced. We knew it would be difficult but the plan was robust and rigorous and we were confident that the growth prospects in it were achievable and could complete the journey begun in 2008 to turn the country around.

214. We had a Government meeting on Sunday 21 November and made the decision to request EU/IMF assistance. Based on the progress that had been made in Dublin we decided to formally enter talks.

215. Efforts had been made from time to time to put our corporation tax rate on the agenda which we refused to countenance. We were adamant that our own four year National Recovery Plan which was approved by Government before its detail was shown to the European authorities would form the basis of any programme we would agree.

216. We were determined to meet our responsibilities and build on the three budgets we had already introduced. Though now faced with a funding crisis, by the latter half of 2010 we had halted the severe contraction in the economy of the previous two years. We had greatly improved our competitive position vis-à-vis our EU partners and had seen a return to increased exports year on-year, for the first time since the crisis broke.

217. The IMF and others were now predicting a return to growth for the Irish economy if the programme was implemented.

218. When we tried to see if there could be burden sharing by unguaranteed senior bondholders during the subsequent discussions, the IMF personnel in Dublin were sympathetic but when it was referred to a higher level within the IMF and a discussion took place with some of the larger Member State contributors to the IMF, there was total opposition to it.

219. Mr Timothy Geithner, US Treasury Secretary, was opposed because he claimed it would totally undermine market access for those European countries that were in trouble. We also understand that the ECB were opposed to it for the same reason.

220. Without the EU Commission, ECB and IMF all being in agreement, it was not possible to have the burden sharing issue included in the Programme.

221. It was made clear to us that any attempt by us to burden share with senior burn bondholders would mean no programme for Ireland.

222. The Cabinet adopted the four year National Recovery Plan as policy. The Troika representatives had sought sight of the programme before Cabinet considered and adopted it: there was no question of that happening as far as we were concerned.

223. We had decided on the rate of adjustment over the four years in the best way possible for the country. When the Troika did get it after Cabinet approval, they agreed to adopt it as the central plank of the programme. It was as we believed it to be rigorous and realistic and designed to meet the economic challenges we faced.

224. The EU/IMF programme was finalised and adopted by Government on 27 November 2010 and one additional year was allowed to reach the general 3% deficit threshold.

225. On the banking side, the programme provided for an immediate €10 billion recapitalisation for the banks and they were required to deleverage. With the exception of Bank of Ireland, all financial institutions came into State ownership. Deposits from Anglo and INBS were to be transferred to other banks and put into wind down mode.

226. Regarding the interest rate that would apply, there are two points I would make. The IMF part of the package was based on IMF rules and was a technical issue. In relation to the EU side of the funding programme, we were faced with the fact that we were the first country into this EFSF/EFSM model of funding being provided by the EU and Member States.

227. The ECOFIN Council was anxious not to provide a rate which would make it attractive for countries whose risk premia on their sovereign bonds was so high that the rate available in the EU programme would prove attractive, while at the same time providing it at a rate that was affordable and less than the market price.

228. Minister Lenihan negotiated ably and secured a 5.8% rate of interest with the proviso that if there were subsequent lower rates available, on the basis of equality of treatment, we could avail of them. That subsequently proved to be the case.

## VI. Appropriateness and effectiveness of other EU-wide policy responses

### *C6c. Other – Fiscal Compact Treaty, Sovereign Debt Restructuring Mechanism*

229. In the aftermath of the crisis the European institutions and individual Member States examined the existing fiscal rules and how they could be improved to help limit the possibility of imbalances in the public finances which developed during the 2000s from reoccurring.

230. We began work aimed at introducing a domestic fiscal framework that would establish fiscal rules, multi-annual fiscal planning and performance budgeting for expenditure.

231. This national process got overtaken by the negotiations on the reform and strengthening of the Stability and Growth Pact. As a result of this the domestic fiscal rules were not proceeded with in favour of those that were being devised at EU level so as to ensure there would be no conflict between domestic and EU requirements.

232. The present Government took up this process of negotiations when it took office in March 2011 which culminated in the strengthening and reform of the Stability and Growth Pact.

233. The fiscal compact treaty was acceded to after the passing of a referendum in May 2012 and the present Government effectively transposed Articles of the Fiscal Compact through the passing of the Fiscal Responsibility Act 2012.

***C6d. Role and influence of the ECB***
***C7b. Role of the euro zone and international partners in this decision***

234. Throughout the bank guarantee period September 2008 to September 2010, it is readily recognised that the ECB provided significant liquidity assistance to the Irish banking system enabling it to continue to function with the necessary cash for day-to-day operations which was indispensable to the function of the economy.

235. From the time Greece required external assistance from other Member States in April/May 2010, the interest rates on Irish sovereign debt started to increase significantly and by September 2010, Mr Trichet in the ECB began to articulate concerns to Minister Lenihan regarding the pressure that was coming to bear on our fiscal and banking situation.

236. The Government was committed to developing a four year plan that would set out how Ireland was going to reduce down its structural deficit to three percent by the end of 2014 as an effort to rebuild confidence in the international credit markets about our ability to bring the public finances back into reasonable balance.

237. Although the ECB was very concerned about the large commitment they were continuing to make to the liquidity of our banking system, they wanted restructuring proposals.

238. Throughout the financial crisis there were more frequent meetings taking place both at the level of Council of Ministers and Heads of State and Government level.

239. We were anxious not to have too big a time gap between the announcement of the four year plan and the budget. The European Union, through Commissioner Rehn's office, were anxious to know what we had in mind in terms of the fiscal parameters of the plan.

240. The ECB were liaising very closely with the EU Commission on these matters. I would say that they were more hawkish in terms of the rate of adjustment they felt the markets needed to see in order to restore confidence which had been shaken since the Greek crisis erupted.

241. Minister Lenihan had developed a good relationship with EU Commissioner Rehn and indicated to him that what we had in mind was a €15 billion adjustment with budget 2011 the first instalment of €6 billion. I recall this indication was given in early November.

242. Being funded until June 2011, we felt that maybe a precautionary programme could be discussed with the EU to be available if we needed it.

243. It became very clear to me, very quickly that people were trying to bounce us into a programme in principle. I have no doubt that there were elements within the EU institutions who were providing inspired leaks to the media with that agenda in mind.

244. Subsequently the rumour machine went into overdrive from what were termed generally as euro zone "sources" that suggested we were applying for an EU/IMF programme.

245. The Cabinet meeting on Tuesday 16 November heard from Minister Lenihan on the outcome of the previous two days discussions. He had to go to EuroGroup and ECOFIN meetings that week and on the basis of the progress that was being made he was continuing to engage and report back to Government. The pressure was intense at those meetings.

246. The ECB were at all times pushing for this position of Ireland being in a programme without explicitly confirming that it would continue to support the Irish banking system.

247. I have outlined in my reply at C5a. the role the ECB went on to play regarding the EU/IMF programme of assistance.

248. The ECB role in the negotiations related to the bank restructuring and recapitalisation issues that formed part of the programme.

249. Regarding those aspects of the negotiations, the Irish concern on the recapitalisation front was to ensure that funds borrowed under the programme for that purpose would be sufficient, while at the same time not leading to an overcapitalisation.

250. The ECB were obviously anxious to use the opportunity to facilitate the maximum repayment of funds due to the Central Bank as a result of their strong liquidity support to the Irish system over a sustained period since the crisis began.

## VII. Impact of the crisis on bank creditors

### *C7a. Options for burden sharing during the period 2008-2013*

251. The ELG scheme was introduced in 2009 by the Government to facilitate the issuance of bonds that would attract a guarantee beyond the initial guarantee expiry date of 29 September 2010. Importantly it excluded dated subordinated debt from the guarantee after that date so that burden sharing could take place in respect of that unguaranteed category of debt after that date.

252. Very little of the subordinated debt that was guaranteed for the initial two year period matured within that period. I understand that €5.6 billion was the figure for the burning of those junior bondholders which represented a general write down of over 80%.

253. I understand that almost all the subordinated debt in AIB, Bank of Ireland and Irish Life & Permanent was subject to burden sharing. I believe that IBRC had very small amounts of subordinated debt by early 2011. Any cash required to repurchase bonds involving a discount would have required ELA funding given IBRC's reliance on such funding at the time.

## VIII. Effectiveness of the regulatory, supervisory and governmental regime structure

### *R1b. Effectiveness and appropriateness of the supervision policy and powers*

254. The supervision policy and powers proved ineffective in the context of the failure to properly judge the risk that was building up in the banks and other lending institutions.

255. The structure set up under the 2003 legislation which divided the macro and micro prudential responsibilities between the Central Bank and Financial Regulator did not work as well as was intended.

256. The changes made at that time emphasised the consumer protection aspect of regulation at the expense of the prudential responsibility that the Financial Regulator had. The principles based regulation which was the operational policy in line with other regulatory regimes meant that there was a culture built up which assumed that the best risk management practices were in operation within the lending institutions.

257. In essence where governance processes seemed to be in compliance, the outcomes were not examined or analysed sufficiently by the Financial Regulator so as to raise serious questions about how risk was building up in the banking system.

258. In the absence of specific problems being detected at the micro prudential level, with attendant sanctions being enforced on them, the Central Bank at a macro prudential level, took a benign view of the risks and concerns it identified.

259. While the primary responsibility lies with the banks themselves, there is no doubt that a more intrusive and sceptical approach by the regulatory entities could have changed the course of events.

260. There is no doubt that in the aftermath of the crisis, a new culture was adopted regarding the approach of the Financial Regulator and decisive action brought a change in behaviour. The most important reform has been the reintegration of the Financial Regulator office back into the Central Bank as a single organisation and the skills mix has been upgraded so that the institution is now applying the appropriate measure of oversight necessary to meet present circumstances.

## IX. Effectiveness of the supervisory practice (Central Bank, Financial Regulator and Department of Finance)

### *R2c. Adequacy of the assessment and communication of both solvency and liquidity risks in the banking institutions and banking sector*

261. The analysis throughout from the second half of 2007 up to September 2008, including the night of the guarantee, was that we had a banking system that was having serious liquidity problems, worsening over time, particularly after mid-September but which were certified as being solvent as at the 30 September 2008.

262. The assessment of the PwC report was that there was adequate capital in the lending institutions to withstand any impairments until 2011.

263. These proved hopelessly optimistic and when the property market went into freefall in late 2008, continued through 2009 and 2010, the losses accumulated were horrific in the extreme.

264. The prudential capital asset reviews, the pricing of the loans transferred to NAMA and the prudential liquid asset reviews have proven to be far more rigorous exercises precisely because all of the loans have been examined rather than top-down sampling exercises which had taken place before.

265. The improved capital adequacy requirements for the banks and the deleveraging of their loan book has now meant our lending institutions have been reduced to a more sustainable level of operation proportionate to the size of the economy.

266. Assessments of liquidity and solvency risks can now be more accurately predicted as a result of the reform of the risk management practices in the lending institutions themselves and the change of structure and culture in the supervisory authorities.

## X. Clarity and effectiveness of the nexus of institutional roles and relationships

***R3a. Awareness and clarity of roles and accountability amongst the regulatory and supervisory institutions of the state***

***R3b. Nature and appropriateness of the relationship between the Central Bank (including the Financial Regulator), Department of Finance and the banking institutions***

277. I think it is clear that the Central Bank Reform Act 2010 has provided a new and effective structure and brought further clarity to the roles and accountability amongst the regulatory and supervisory institutions of the State learning the lessons that must be learnt as a result of the banking crisis.

278. The 2010 Act has created a single fully integrated Central Bank of Ireland with a more complete remit over prudential regulation and financial stability issues. The Central Bank and Credit Institutions (Resolution) Act 2011 provides the necessary mechanisms to enable the Central Bank to intervene where a credit institution gets into serious difficulty and is in danger of becoming destabilised or otherwise failing.

279. The Central Bank (Supervision and Enforcement) Act 2013 further strengthens the ability of the Central Bank to impose or supervise compliance with regulatory requirements and to undertake timely regulatory interventions.

280. This legislative framework taken together brings the necessary clarity and powers to the regulatory authorities to deal in a timely and proportionate way with failing or destabilised institutions.

281. Regarding the Department of Finance's relationship with the banking institutions, the Department has now entered into Relationship Framework Agreements (FRA) with each bank in which the State has a shareholding. These banks are AIB, Bank of Ireland, PTSB and IBRC.

282. The agreements are structured to ensure that the institutions will operate on a commercial basis and with independence from the Minister for Finance in respect of day-to-day operations.

283. When IBRC went into liquidation in February 2013, the RFA was rendered obsolete. These agreements with banks ensure that the Minister for Finance's relationship with the relevant bank is in line with the best institutional shareholder practices.

## XI. Appropriateness and effective utilisation of the expert advice

***R4a. Appropriateness of the expert advice sought, quality of analysis of the advice and how effectively this advice was used.***

284. It was appropriate that the Department of Finance, through the NTMA, sought and obtained corporate finance advice from Merrill Lynch and Rothschild.

285. Similarly, accounting advice from PwC enabled the system to get collated information more quickly about the banks than might otherwise have been the case.

286. However it is clear that the sampling of property loans did not give as representative a picture as one would expect and whilst this was perhaps the accepted methodology for obtaining a fast or quick assessment, it is clear that the stress testing and assumptions used did not provide a full picture.

287. This was complicated no doubt by the fact that there was no active market for a period which meant that values were notional and worst case scenarios were not accurately ascertained.

288. Merrill Lynch devised an options paper which set out the arguments for and against each option.

289. The unpredictability of market sentiment as things quickly deteriorated meant that there was no one correct solution.

290. The unprecedented nature of the crisis and the speed at which financial institutions were failing, together with the contagion impact on the wider financial system meant an accurate assessment of the situation was difficult.

291. The conventional wisdom regarding capital adequacy proved totally inadequate which accelerated solvency concerns and opened up a funding gap that meant the recapitalisation programme had to be supplemented after the reviews of capital assets were completed.

292. No matter how specialist the advisor, it is particularly difficult to get an accurate picture in a crisis situation from a desk analysis that is primarily reliant on information from existing management.

***R4c. Analysis and consideration of the response to contrarian views (internal and external)***

293. Taking all perspectives into consideration when the present was hard to assess and future developments hard to predict was challenging.

294. All relevant opinions relating to matters that had to be dealt with by the Government were considered before decisions were taken.

295. Views were aired and using best judgment, the decisions deemed necessary and essential to be made were made.

296. The ability to include and assess all points of view on an area of policy has to be balanced against the need for speedy and decisive action in a time of crisis.

## XII. Clarity and effectiveness of the Government and Oireachtas oversight and role

### *R5b. Appropriateness of the advice from the Department of Finance to Government and the use thereof by Government*

297. In relation to economic and budgetary policy from May 2008 to March 2011, the Department of Finance provided much sound advice as to how the gap between expenditure and income must be reconciled over that period. Despite the depth of the recession, they remained focused on moving to close the gap at a rate which reflected the determination of the Government to deal with the mounting crisis while seeking to maintain social cohesion in the face of major retrenchment.

298. Given the workload that had to be undertaken by the Department of Finance during the banking crisis and the required legislative programme of reform, in addition to their existing responsibilities, the Minister for Finance and his officials in conjunction with the Attorney General and his staff, displayed tremendous capacity and commitment to duty that was exemplary.

299. The complexity and range of the work done both at national and EU level in the most difficult circumstances is a record of achievement in which everyone involved can be proud. This is so despite of the fact that we ultimately had to enter into an EU/IMF programme.

***R5c. Analysis of the key drivers for budget policy***

300. The onset of a deep recession and its impact on the public finances were the key drivers for budget policy during our time in Government.

301. Broadening the tax base, creating new sources of revenue and cutting back Government spending were essential features of our budgetary policy.

302. Restructuring the banking industry was also a core objective of public policy.

***R5d. Appropriateness of the relationships between Government, the Oireachtas, the banking sector and the property sector***

303. There was no change in my relationship with these two sectors from the time I was Minister through to my time as An Taoiseach.

**Brian Cowen**
**10 June 2015**