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Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

John Corrigan

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

Joint Committee of Inquiry into the Banking Crisis

Statement by John Corrigan, former CEO of NTMA

June 2015

INTRODUCTION

I joined the NTMA in June 1991, shortly after its establishment. My initial assignment was as a Director in the Funding & Debt Management Unit. I was assigned responsibility for the National Pensions Reserve Fund on its establishment in 2001. I was appointed Chief Executive in December 2009 and held that position until I retired in early-January this year. Before joining the NTMA, I worked in AIB Investment Managers and in the Department of Finance.

The Committee has asked me to address a number of issues:

(i) the nationalisation of Anglo Irish Bank;
(ii) NAMA;
(iii) the recapitalisation of covered institutions;
(iv) the merger of AIB/EBS and Anglo/INBS and their deposit transfers;
(v) the EU/IMF programme of financial assistance;
(vi) the liquidation of IBRC, the promissory notes refinancing and the relationships with ECB.

I address these issues in this Statement to the extent that I was involved in them and in the context of a time-line from 2007, which is when the NTMA was advised by the Department of Finance of its concerns about the emerging liquidity pressures on the Irish banks, to end-2013 when Ireland exited the EU/IMF financial assistance programme.

BACKGROUND

The NTMA has a number of diverse functions, all of which are clearly defined in legislation. A common theme running through all of its functions, with the exception of the State Claims Agency, is its engagement with capital markets. Its original mission was to fund the Exchequer borrowing requirement and manage the national debt in a cost-effective manner. This mission has been added to by various governments over the years. The additional function most relevant to the banking crisis was the NTMA's role as Manager of the National Pensions Reserve Fund (NPRF) and, as I have said, I was the Director responsible for the Fund up to December 2009. Before its recent transformation into the Ireland Strategic Investment Fund, the NPRF was controlled by the National Pensions Reserve Fund Commission, a body corporate which was independent in how it made its investment decisions. When I was appointed CEO of the NTMA I became an ex-officio member of the Commission. The NPRF's statutory investment policy required that it be invested so as to secure the optimal total financial return provided the level of risk was acceptable to the Commission. The legislation governing the Fund was amended in 2009 in the context of the banking crisis to enable the Minister for Finance to direct the Commission to make investments in Bank of Ireland and Allied Irish Banks. In reporting on the Fund's investment performance, the Commission clearly delineated between the performance of those investments which it had made under its own discretionary powers and the so-called directed investments in Bank of Ireland and Allied Irish Banks. The NTMA had no role in relation to the oversight of the banking system and had no responsibility in relation to the provision of liquidity to the system (we believed the role of lender of last resort fell to the Central Bank/ECB). Between March 2010 and August 2011 certain functions in relation to the State's investments in the covered institutions were delegated to the NTMA and I shall return to this later.

2007/2008

The functioning of the interbank money markets became increasingly problematic through 2007 culminating in the UK in September 2007 in the collapse of Northern Rock, a financial institution which heavily relied on non-retail funding in a way not dissimilar to Anglo Irish Bank. There were sharp falls in 2008 in the share prices of Irish banks with, for example, the share price in Anglo Irish Bank falling by 18 per cent in one day. These falls reflected concerns about the impact of the continuing fall in Irish property prices on the banks' earnings and also the wider international background of non-functioning international money markets. In September 2008 the NTMA was invited to attend with the Department of Finance meetings of the Domestic Standing Group and together with my NTMA colleagues, Brendan McDonagh and Oliver Whelan, depending on which of us was available, I attended meetings of the Group. The deteriorating liquidity position of the Irish banks, in particular Anglo Irish and INBS, was the Group's biggest concern and, on foot of those concerns, the Department of Finance put in hand, as a contingency measure, the drafting of legislation providing for a scheme for bank and building society nationalisation. On 14th September 2008 Lehman Bros filed for bankruptcy. Around that time the Minister for Finance asked the NTMA to retain corporate finance advisors in the area of bank resolution. I was involved in procuring the services of Merrill Lynch in that context. Merrill Lynch subsequently provided advice which formed an input to the deliberations culminating in the Government decision, announced on 30th September 2008, to guarantee the deposits and debt liabilities of six domestic financial institutions (the covered institutions). As the Committee is aware from evidence given by my colleague, Brendan McDonagh, the NTMA was not involved in the deliberations of 29/30th September 2008.

While the Guarantee Scheme helped the covered institutions, in particular Anglo Irish, attract funding through the interbank market and retail deposits, at least in the near term, the share prices of the quoted banks continued to perform poorly signalling continuing market concerns about their profitability and possible requirements for fresh capital. In a statement issued on 30th November 2008 the Minister for Finance said that in certain circumstances it would be appropriate for the State, through the National Pensions Reserve Fund or otherwise, to consider supplementing privately sourced additional capital for the covered institutions. This statement was issued following a detailed report on each of the covered institutions by PwC on behalf of the Financial Regulator. The Minister's statement said that the content of the PwC reports were commercially sensitive and could not be disclosed. It further said that the reports concluded that even in certain stress scenarios, the capital levels in the financial institutions would remain within the regulatory requirement in the period to 2011.

On Saturday 13th December 2008, with my colleague Brendan McDonagh, I attended a day long meeting in the Department of Finance where the question of bank recapitalisation was considered. We pressed strongly at that meeting for the nationalisation of Anglo Irish, arguing that the potential represented by the State's purchase of preference shares in Anglo Irish Bank (the preferred option of the Department of Finance) for letting its subordinated debt holders off the hook was in itself a compelling argument for nationalisation, which was also the approach recommended by Merrill Lynch. In the event the view that Anglo should be recapitalised rather than nationalised prevailed. A Government announcement on 21st December 2008 on recapitalisation said that there would be an initial State investment of €1.5 billion in Anglo through preference shares with a fixed annual dividend of 10 per cent. The announcement also said that agreement had been reached with Bank of Ireland and Allied Irish Banks that each would issue €2 billion of preference shares to the State with a fixed annual dividend of 8 per cent. At the request of the Minister for Finance, I was heavily involved in the discussions with Bank of Ireland and AIB leading up to that announcement. At the outset of those discussions the banks resisted the suggestion that they needed fresh capital and, in particular, the provision of capital by the State.

2009

The proposed recapitalisation of Anglo was abandoned with a statement by the Minister for Finance on 15th January 2009 that it would be taken into public ownership citing "a weakening in its funding position and unacceptable practices". In the meantime, there were ongoing discussions with Bank of Ireland and AIB on how their €2 billion capital injections could be achieved. Against an international backdrop of banks generally increasing their Core Tier One capital, it was agreed in discussions, which I chaired, that the State would provide €3.5 billion Core Tier One capital for each bank through preference shares. It was the view of the NTMA that, given its bigger balance sheet, AIB was likely to require more capital than Bank of Ireland but AIB stuck to its view that its problem was no bigger than Bank of Ireland and that it would only recommend to its shareholders a deal based on its quantum of additional capital being the same as Bank of Ireland's. The Minister for Finance decided that the €7 billion of capital was to be provided by the NPRF. To do so required an amendment to the NPRF legislation enabling the Minister to give directions to the National Pensions Reserve Fund Commission to make the investments.

The NTMA engaged PwC and Arthur Cox to undertake due diligence on the two banks. To help us oversee this exercise and to underline its integrity we retained Sir Andrew Large, a former deputy governor of the Bank of England, as a "trusted advisor" in relation to the terms of reference of the due diligence exercise, the conduct of the process itself and the judgements to be made in the light of the final results. In response to a request from the Minister for Finance the due diligence exercise was tasked with forming a judgement with respect to the probability of each bank's Core Tier One Capital being above the regulatory minimum at end-2011 and with identifying matters or issues which might reasonably be considered of a "red flag" nature. The National Pensions Reserve Fund Commission reported in March 2009 to the Minister on its due diligence exercise on Bank of Ireland. The due diligence results indicated that there was a reasonable prospect that, allowing for the proposed capital injection of €3.5 billion by way of preference shares, the bank's Core Tier One Capital would be above the then current regulatory minimum 4 per cent at end 2011. The National Pensions Reserve Fund Commission reported to the Minister on AIB in May 2009. The results painted a doubtful picture about whether the bank would be above its regulatory capital minimum of 4 per cent at end 2011. The Minister directed that both capital injections be proceeded with and the NTMA, on behalf of the NPRF, executed on them. The Minister subsequently entered into a Memorandum of Understanding with the National Pensions Reserve Fund Commission (acting through the NTMA as its Manager) requiring it to submit reports to him on Bank of Ireland and AIB at six-monthly intervals.

On 15th May 2009 the Minister for Finance announced that preparatory work for the establishment and operation of NAMA was underway and the appointment of Brendan

McDonagh as its interim CEO. Following the enactment of enabling legislation in November 2009, NAMA was formally established and its Board appointed in December 2009. As I said already, as CEO of the NTMA I was an ex-officio member of the NAMA Board and in its early days was heavily involved with Brendan McDonagh in recruiting its senior management team. Under the legislation all NAMA employees are technically NTMA employees assigned to NAMA; the NTMA also provides key supports in areas such as IT, Compliance and HR. I believe the decision to set up NAMA was the correct one and, based on the NTMA's engagements with institutional investors and the credit rating agencies, I am strongly of the view that its success played a huge role in Ireland later regaining access to the debt capital markets after it entered the EU/IMF financial assistance programme.

In June 2009 the Minister for Finance invested €3 billion in share capital of Anglo Irish Bank in order to restore the bank's Total Capital Ratio to above the minimum required. The Minister invested a further €1 billion in share capital in Anglo later that year. These investments were made in cash drawn from the Exchequer and the NTMA was not involved in the execution of the transactions. As the Committee will be aware subsequent capital injections were made in the form of Promissory Notes. From the point of view of the NTMA's funding and debt management responsibilities, the use of the Promissory Notes had the advantage that their redemption by the Exchequer was spread out over a twenty year period thereby easing the pressure on the NTMA to access capital markets.

At end 2009 Ireland remained relatively highly rated by the major credit rating agencies, notwithstanding downgrades over the previous 18 months in response to the deterioration in the public finances and the very evident stress in the banking system. Ireland was broadly rated AA or equivalent, but generally with a negative outlook. The NTMA raised €35.4 billion in long term funding in 2009. The money was used to fund the Exchequer deficit of €24.6 billion and to refinance a maturing €5 billion bond, leaving a carryover of more than €5 billion in long-term funding available for 2010. Additional cash balances of €16 billion were carried into 2010 funded by shorter term debt.

2010

In February 2010 the Minister for Finance announced his intention to delegate certain functions in the banking area to the NTMA. This announcement stated that "all of these functions will be carried out on behalf of the Minister, and in close consultation with the Minister and relevant officials in his Department and building on the existing very close co-operation between the two organisations". The initiative to delegate the functions was the Minister's own and was not in response to representations by the NTMA. The actual legal delegation order was made on 11th March 2010. From a policy setting point of view very little changed in reality with the Department maintaining a tight grip on policy issues, albeit with input from the NTMA, among others. However, the Delegation Order brought all of the covered institutions operationally within the remit of the NTMA. Following the making of the Delegation Order the NTMA built up a Banking Unit staffed by experts in banking, bank analysis and corporate finance. (That team was formally seconded to the Department of Finance in August 2011 following an announcement by the new Minister for Finance on the creation of a standalone unit within the Department of Finance to provide oversight of the banking system functions and drawing on the resources of the NTMA to carry out its work.)

In March 2010 the Central Bank announced that banks would be required by year-end to meet a base case target 8 per cent Core Tier One Capital ratio (with 7 per cent equity as the target level). The Central Bank also announced the results of a Prudential Capital Adequacy Review (PCAR) which indicated that both Bank of Ireland and AIB had additional capital requirements. The AIB requirement was further increased in September 2010 based on experience of the actual discount rate/haircut applied by NAMA to loan assets transferred to it. The NTMA Banking Unit was involved in executing on behalf of the NPRF the necessary transactions (which in the case of Bank of Ireland involved private sector capital) to address the capital shortfalls. The Central Bank also identified significant additional capital requirements for Anglo Irish Bank, INBS and EBS which were made good by the State through the issue of Promissory Notes and Special Investment Shares. The extent of the additional capital requirements, and in particular the huge loss announced by Anglo Irish during this period, were major factors in Ireland subsequently having to withdraw from the bond markets.

The NTMA's Funding and Debt Management Unit raised €19.9 billion in long term funding in 2010. Funds raised were applied to the Exchequer deficit of €18.7 billion and to refinance maturing bonds. We concentrated a significant portion of our long-term borrowing programme in the earlier part of the year in order to maximise the advantage of the Exchequer for the cost of and demand for Irish sovereign debt which existed at the start of the year. As a result, the NTMA had achieved its borrowing target for 2010 before funding conditions deteriorated markedly during the final quarter of the year and we had to cancel auctions scheduled for October and November. At end- 2010, not least because of Ireland's entry into the EU/IMF Programme of Financial Support, Ireland's credit rating was barely investment grade and indeed one rating agency subsequently marked it down to sub-investment grade. The tone of Eurozone sovereign bond markets was severely damaged in October 2010 when, at an EU summit in Deauville, Chancellor Merkel and President Sarkozy said that holders of Eurozone sovereign debt should be forced to take losses/haircuts as part of any debt restructuring.

I was a member of the team of Irish officials who were directed by the Minister for Finance to enter into discussions with the EU Commission, ECB and IMF in mid-November 2010. At the time there were ongoing substantial losses of corporate and retail deposits by the Irish banks. In response to a request from the Minister for Finance for my views on whether Ireland should apply for an EU/IMF programme for assistance, citing the severe strains on liquidity conditions of the banking system and the risk of a collapse of the system I wrote to him on 21st November 2010 recommending that an application be made. I said that I envisaged that such assistance would provide for a capital strengthening of the banking system and, although likely to be expensive, would also provide sizable funding to the State. I stressed that appropriate liquidity support from the ECB would be a necessary complement to a decision to apply. Unfortunately, such liquidity support was, in my view, only grudgingly provided by the ECB to the extent that their public utterances could have been more supportive in helping restore confidence in the banking system.

On Saturday 27th November 2010, I wrote again to the Minister for Finance, at his request, furnishing comments on the proposed programme of financial assistance with particular reference to its implications for debt sustainability. I said that the €35 billion earmarked in the proposed programme for potential capital injections in the banking system would, if implemented, substantially increase the risk to the sustainability of the national debt. I recommended that, with a view to mitigating the extra burden on the Exchequer represented by such additional borrowing, the question of a formal bail-in should be considered through aggressive liability management/resolution regime with respect to the subordinated debt and senior unguaranteed debt on the balance sheets of the financial institutions concerned. Together with the Secretary General, Department of Finance and the Central Bank Governor, I attended part of the Government meeting held that night (27th November) where consideration was being given whether to accept the proposed terms of the programme of EU/IMF financial assistance to be told by the Minister for Finance that the question of a formal bail-in, which he himself apparently favoured, had been flatly rejected at a meeting earlier that day of the G20 in Korea, a fact which I was not made aware of until then.

2011/2012

As part of the conditions of the EU/IMF financial assistance programme the Central Bank undertook in early 2011 – under the supervision of the ECB – a further PCAR exercise involving the covered institutions. In the context of mitigating the cost to the State of providing further capital support to the banking sector which was expected to arise from that exercise (and for which, as I mentioned above, €35 billion had been earmarked) the NTMA commissioned a study to look at a bail-in/burden sharing scheme involving senior as well as sub-ordinated debt holders in the covered institutions. That scheme identified substantial potential savings, depending on the level of discount/haircut applied. For the scheme to proceed the support of the Troika was critical but once again such support was not forthcoming. Nonetheless, liability management exercises were pursued through 2011 (facilitated by the Credit Institutions Stabilisation Act 2010 – CISA) which helped mitigate the cost to the State of the Central Bank's 2011 PCAR, the results of which were announced on 31st March and which identified an additional capital injection of €24 billion as being needed. During the first quarter of 2011 the NTMA Banking Unit conducted the sale – by auction – of the deposit books of both Anglo Irish Bank and INBS. The sale followed Direction Orders granted by the High Court to the Minister for Finance under CISA legislation to commence the sale process for assets and liabilities (including deposits) and the process of amalgamating the two banks.

Following the entry into the EU/IMF programme and the announcement in February 2011 by the Minister for Finance to second the NTMA Banking Unit to the Department of Finance, the strategic focus of the NTMA shifted back to what we regarded as one of our core roles – funding and debt management – and the challenge of regaining access to the capital markets so that Ireland would have sufficient funding visibility at end-2013 to exit the programme (assuming the terms of the programme had been generally met). That challenge was made all the more difficult because, in addition to demonstrating that we had enough cash to meet day-to-day Exchequer needs after the end of the programme period, there was an Irish Government bond falling due for repayment in mid-January 2014 in an amount of some €12 billion which we would have to demonstrate to the market was "money good".

Irish sovereign euro denominated bond yields hit record highs in July 2011 when the yield on the 2-year bond reached 22 per cent and that of the benchmark 10-year bond hit 14 per cent implying huge falls in the market values of those bonds. The spiking of Irish bond yields well into double digit figures more or less coincided with Moody's credit rating agency downgrading Ireland to sub-investment grade which meant that a part of Ireland's longstanding investor base – which has credit rating constraints on the bonds in which it can invest – was no longer open to us and a key challenge for the NTMA was to find new investors. We therefore embarked in mid-2011 on a vigorous programme of engagement with over 200 existing and potential institutional investors in Ireland, the UK, the rest of Europe, the US and the Far East. That programme of engagement continued in 2012/2013 through meetings and presentations we aimed to keep investors fully informed of the significant progress made by Ireland in consolidating the public finances, recapitalising and restructuring the banks and regaining competitiveness. The investor relations programme yielded relatively early results when in 2012 we raised €5.2 billion on the market in long term debt, regained regular access to the short term markets and succeeded in reducing the outstandings on the January 2014 bond to €7.6 billion by persuading institutions to swap their holdings of that bond for holdings of a longer-dated bond in an amount of €4.2 billion. A hugely supportive development in 2012 was the statement by the President of the ECB that the ECB was prepared to do "whatever it takes to save the Euro".

2013

There were two further hugely supportive developments in 2013. These were the commitment by the EFSF and the EFSM to extend the maturities on the European portions of our programme loans and the agreement, on the liquidation of IBRC, to replace the promissory notes provided to IBRC with long-dated floating rate sovereign bonds carrying maturities out to 40 years. The combined effect of these two initiatives was to reduce by €40 billion the amount that otherwise would have to be refinanced by Ireland over the next 10 years and to extend the average maturity on Ireland's public debt from 7.5 years to 12.5 years. The NTMA raised €7.5 billion in long term debt in 2013 and reduced the outstandings on the mid-January 2014 bond to €2.7 billion. The Exchequer ended 2013 with sufficient cash and other short-term investments to cover 12-15 months of financing needs, facilitating the exit from the EU/IMF programme without the need for stand-by credit lines.

Conclusion

I believe the NTMA responded positively to the expectation of the Minister for Finance that we work closely with him and his Department in seeking a resolution of the banking crisis. Our involvement brought us into areas which were well outside what were our core functions. This crisis was domestically generated but the complexity of its resolution was added to by the global banking crisis which had seen the collapse or State rescue of household names such as Lehman, AIG, RBS and HBOS and the major dislocation of the international inter-bank markets. The apparent absence of crisis management skills in the ECB (in contrast to the IMF) was, I believe also a complicating factor. Ultimately in Ireland's case the crisis resulted in, among other things, capital markets being closed to us, a body blow that particularly resonated with the NTMA which had a very good relationship with investors. Forming judgements and making decisions to try to come to grips with the crisis was obviously complicated by a lack of reliable information in a hugely volatile environment. Decision making in such circumstances can seem like trying to catch a falling knife. So, for example, it was only on the third attempt – and with the benefit of knowing what the NAMA discounts/haircuts were likely to be – that the banks were adequately capitalised.

I trust that the Committee will find my Statement helpful.

June 2015