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Houses of the Oireachtas

Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

Pat Farrell

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

Witness Statement by Pat Farrell to the Joint Committee of Inquiry into the Banking Crisis

As requested by the Joint Committee of Inquiry into the Banking Crisis (the Joint Committee) I herein provide a witness statement in my capacity as CEO of The Irish Banking Federation (IBF), Federation of International Banks in Ireland (FIBI) (hereafter "IBF") a position I held from January 2004 to June 2013.

I endeavour herein to address the broad themes which the Joint Committee has requested of me in my capacity as CEO of IBF for the relevant period to the extent possible in this capacity.

By way of background IBF was established in 1973 on Ireland's accession to the European Economic Community to represent the Irish banking sector internationally as well as domestically. FIBI was formed following the establishment of the International Financial Services Centre so as to provide a particular focus for the needs of international banks.

My own appointment as CEO of IBF commenced shortly after the establishment of the Irish Financial Services Regulatory Authority (IFSRA).

My responsibility was to assist the Council of the IBF in formulating strategy for the IBF and implementing that strategy. The Council of the IBF typically consisted of either the Group CEO or the Head of the Irish Retail Banking Division of the main Irish banks / domestically focussed international banks and the CEO/Country Managers of several of the internationally owned, internationally focussed banks.

I represented the sector at European level as a member of the Executive Committee of the European Banking Federation (EBF) and I also represented the sector through membership of a number of relevant Irish industry and State sponsored bodies.

I also represented the sector for certain engagements with the media and in engagements with the State and with public representatives. Such engagement took place when common themes existed for the IBF's membership, which themes had been endorsed by the Council of the IBF.

Banking

My tenure covered two quite separate distinct phases.

The first phase was the period 2004 – 2008 which saw a significant increase in the number of financial services companies and banks operating in the domestic Irish consumer banking markets culminating in for example approximately 13 providers of mortgages. This was a period of rapid but, as subsequently proved, unsustainable economic growth with overseas banks entering the market either directly or through acquisition and with the established banks seeking to grow their business and/or responding to this wave of intense competition.

At the same time there was also considerable growth in the number of banks establishing internationally focussed activities to operate from Ireland.

The second phase involved the aftermath of the international and domestic banking crisis from mid-2008. The impact of this crisis and its aftermath on the stakeholders of the IBF's member banks including their customers, shareholders, staff and the taxpayers of their home countries (including Ireland) is well documented.

The aftermath included some of the following outcomes: retrenchment, insolvency, restructuring, nationalisation and exit for a significant number of banks operating in or from Ireland. In some cases this reflected the fact that entire banking group's business model and activities were fatally or fundamentally flawed or a recognition that the business models for their Irish activities were either flawed or could not be maintained as they sought to preserve capital and liquidity and reduce costs. The designs of the Group business models for these banks and of the business models for the Irish activities of these banks had a number of different features and they responded in a number of different ways to the challenges these business models faced. However common business model flaws were under-capitalisation, over dependence on wholesale funding, aggressive pricing and loosening of credit standards coming into the crisis followed by rapid retrenchment to core (often home country) franchises post crisis. The burdens on the Irish taxpayers and on the shareholders of the domestic Irish banks from the flaws in their business models has been the subject of a wide range of reports and investigations, including this Inquiry. Noteworthy has also been the in excess of €50 billion which has been borne by the shareholders/home taxpayers of overseas banks who had to re-capitalise their subsidiaries competing in the domestic Irish market and/or losses they incurred as they retrenched from the Irish market. This retrenchment/exit also caused significant difficulties for Irish consumers as they sought to make alternative banking arrangements away from products/product providers which proved to have been unsustainable and/or customers finding that their loans/mortgages had been sold to entities where the customers had no choice in the matter.

I should also say that as a member of the Executive Committee of EBF, I witnessed similar pre and post crisis features across the European Banking industry to differing degrees of severity.

Given the role of IBF as described above, we were not privy to, and did not have a role in adjudicating on, the funding or liquidity policies, the risk management models, or the composition skills and experience of the boards of individual banks.

Regulatory, Supervisory and Government

My term as CEO of IBF commenced shortly after the formation of IFSRA and I noted early on that the Consumer Director sat on IFSRA's board whilst the Prudential Regulator did not.

In the period up to September 2008 the primary interaction I had with IFSRA was on consumer orientated regulatory matters and initiatives and this was the focus of the agreed strategy of interaction agreed with me by the Council of the IBF for the domestic banks. For example during my tenure the IBF had the responsibility for co-ordinating the implementation of a range of consumer focussed initiatives such as the Dormant Accounts Act , Inter Bank Switching Codes, IBF/Money Advice Bureau Service (MABS) Debt Protocol, promotion of electronic payments, consumer protection codes and the establishment of the Social Finance Foundation (SFF). For the international banks there was considerable focus on taxation related issues and skill shortages in the Irish market. I sought on several occasions to have broader dialogue with the Central Bank on general banking issues but was given the clear message that IFSRA was the primary conduit for engagement. There was also a focus for the IBF on engagement, through the EBF, with the European Integration agenda in terms of payments, consumer protection, and other initiatives to complete the EU Single Market in Financial Services. From time to time we also submitted technical papers prepared by members in response to regulatory consultations both locally and at EU level. To my recollection, business model discussions and general issues of prudential regulation in areas such as capital, liquidity or credit standards were not a notable feature of agenda discussions within the IBF or between IBF and regulatory or other authorities.

As CEO of IBF I was, in late 2004, appointed by the Minister for Finance as a member of the Financial Services Consultative Industry Panel (FSCIP) which was in existence up to June 2010. The role and mandate of the Panel was to act in an advisory capacity to the newly established Irish Financial Services Regulatory Authority. Its role was similar to Panels operating in other jurisdictions such as the Practitioners Panel which operates in the UK under the aegis of the Financial Conduct Authority (FCA). The Panel published five Annual Reports covering the period 2005 to 2009 inclusive. The broad themes of which were as follows:

- A critical focus on the balance struck between the prioritisation and allocation of resources to the conduct of business and the prudential regulation roles of IFSRA
- A request that the regulator deepened its understanding of individual firms' business models given the diversity and complexity of regulated firms operating in Ireland
- Consideration be given to having a designated senior executive focused on IFSC supervision
- With reference to EU legislative and regulatory agendas it proposed the appointment of a dedicated senior executive with responsibility for co ordination of the Irish engagement and response
- It proposed reviews of competition barriers in retail banking
- Called for extensions of provisions of consumer codes to non deposit taking entities operating as mortgage lenders
- Sought the application of regulatory impact assessments to major regulatory and legislative initiatives
- Called for investment in HR and IT support services and review of the associated shared services model then in place between the Central Bank and IFSRA.
- Commented on proposed industry levies and methods of allocation and general commentary on IFSRA's annual budgeting process
- Promotion of benchmarking against best practice regulation in comparable jurisdictions

The Panel in its final Annual Report of 2009 noted *"In 2009 the main focus of the Panel was to ensure a meaningful participation in the debate around the reform of the regulatory structure in Ireland. To that end, we published in July a detailed paper entitled "Structural Reform of Financial Regulation in Ireland". The paper was acknowledged as a significant contribution to the important debate that has now culminated in the Central Bank Reform Bill 2010 which will provide the statutory framework for the reform of Irish financial services regulation. Our paper stressed that the single most important ingredient required for successful reform was the quality of the People appointed to carry out the task. It is fair to say that an excellent beginning was made in the appointment of Central Bank Governor Patrick Honohan and Financial Regulator Matthew Elderfield. The quality of the follow on appointments will be critical to the successful implementation of the far reaching reform proposals. The Financial Regulator presented his proposed strategy to the Panel prior to its public announcement and we were pleased to note that its broad thrust was very much in line with the previously expressed views of the Panel, in particular recognising the critical importance of an appropriate skills mix within the Regulator, an understanding that the regime should be risk based and not "one size fits all", and the importance of a strategic policy unit which would, among other matters, enable Ireland to play a full part in the emerging international developments both at EU level and beyond, which will increasingly determine regulatory direction here in Ireland. The industry is absolutely committed to playing its part in the rebuilding of international and local public confidence in Irish financial regulation and we believe that a good start has been made, but much remains to be done"*

As the crisis unfolded during the second half of 2008 the various members of the IBF became increasingly focussed on their own specific issues and it became apparent that for some of the subsidiaries of international banks the key decisions were being taken outside Ireland. The members of the IBF Council had differing senses of priorities, were reluctant to show their hands for obvious reasons and had differing degrees of mandates to articulate to the IBF as to what they wanted the IBF's mandate to be in engaging with relevant authorities and regulators on solvency and liquidity issues. Engagement with the Central Bank, IFSRA and the State during this time tended to be focussed on issues such as bank support mechanisms for customers including those in mortgage arrears and IBF obligations arising from introduction of the Credit Institutions (Financial Support) Scheme (CIFS).

Crisis Management System and Policy Response

Prior to 29 September 2008 IBF had no mandate from the IBF Council to discuss specific Government liquidity or solvency support initiatives for the sector with the authorities and was not a party to considerations by the authorities on such matters. During 2009 and particularly after the arrivals of Professor Honohan as Governor of the Central Bank of Ireland and Mathew Elderfield as Financial Regulator there was increased evidence of cross stakeholder working groups involving the Department of Finance and the Central Bank of Ireland where IBF was a participant on sector wide issues such as mortgage arrears, access to credit, supporting SMEs in distress, as codes of practice etc were developed and enhanced and I witnessed a high degree of co-operation and interaction.

With regard to the Troika we were used by the Troika as a source of information particularly during 2011 and 2012 and views were solicited on a range of themes including:

- Competition related matters and issues.
- Sectoral initiatives and progress on mortgage arrears resolution. We had a number of discussions regarding judicial process; legislative and regulatory impediments we believed were exacerbating the problem and presenting barriers to resolution.
- Our views regarding proposed reform of the bankruptcy regime and the introduction of a personal insolvency framework.
- Access to credit for SME's and support for firms with a sustainable business who were experiencing financial difficulties

All such interactions with the Troika were either done in conjunction with the Irish authorities or the details of the engagement were shared with the Irish authorities.

Pat Farrell

"Sheemore"

18 Claremont Park

Sandymount

Dublin 4