Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

David Went

Session 60a

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

DAVID WENT STATEMENT JULY 2015

(1) This statement is made by me in response to the direction issued by the Joint Committee on June 24, 2015.

(2) CAREER HISTORY

I was educated at Trinity College Dublin (BA (Mod) Legal Science/LLB and Kings Inn Dublin. I was called to the Bar in 1970.

1970	Citibank Dublin - Graduate Trainee
1971-74	Citibank Dublin – Corporate Lending Officer to General Manager Corporate Bank (1974)
1975-76	Citibank Jeddah, Saudi Arabia – General Manager
1976	Ulster Investment Bank, Dublin – Director Banking
1982	Ulster Investment Bank, Dublin – Chief Executive
1984	Ulster Bank Group – Director
1987	Ulster Bank Group, Belfast – Chief Executive
1994	Coutts Group, London – Chief Executive
1998	Irish Life Assurance plc, Dublin – Managing Director
2000	Irish Life & Permanent plc – Group Chief Executive
May 2007	Retired

(3) GENERAL

As I retired in May, 2007, when the Annual Report for 2006 was presented, I believe my statement should focus, where appropriate, on the state of affairs at 31 December 2006, which reflected the events of the preceding years.

(4) B1A – COMPOSITION, SKILLS AND EXPERIENCE OF THE BOARD AND BOARD MEMBERS

The merger of Irish Life Assurance plc ("Irish Life") and Irish Permanent plc ("Irish Permanent") in April 1999 was, for legal reasons associated with the demutualisation of Irish Permanent Building Society in 1994, effected by the purchase of Irish Life (a substantially larger and more profitable entity) by Irish Permanent. Irish Permanent changed its name to Irish Life & Permanent plc, became the holding company for the new corporate group as well as a licensed bank and the merged board became not just the board of the bank but the group board of the enlarged entity. Having been Managing Director of Irish Life since 1998, I became Group Chief Executive of IL&P in 2000. The Chief Executive of the bank became an executive director on the group board reporting directly to me as Group CEO.

The initial board composition of Irish Life & Permanent plc reflected the membership of the predecessor boards and it was recognised that this would require adjustment over a 2-3 year period replacing retiring members with people of suitable skills and experience. A non-executive nominations committee was charged with recruiting (subject to full board approval) candidates to meet the desired composition. Over the years to 2006 the committee regularly

reviewed the composition, increasingly with external assistance, and directors were appointed with a wide range of skills and experience – including audit, actuarial, legal, banking and general business management at very senior levels. Because of the relatively concentrated nature of the Irish financial services market, recruitment of individuals with banking experience was uncommon, nor was it usual for candidates to be sought from the UK. There was always a majority of independent non-executive directors and despite what might now be considered as defects in recruitment composition, my view at the time was that we had a suitably skilled, inquisitive and challenging board, fully capable to supervise the business and to populate audit, remuneration and nomination committees in a fully effective manner. Board evaluation of performance was carried out regularly with external assistance.

(5) B1C – QUALITY OF THE BUSINESS MODEL SETTING PROCESS

I joined Irish Life Assurance as Managing Director – Designate on 1 January 1998. Following a strategic review of the Business the Board concluded that the acquisition of a banking customer base to create a true bancassurer was a strategic imperative and discussions were initiated with Irish Permanent plc, Ireland's largest mortgage lender and demutualised building society, which led to the merger to form IL&P in 1999. The opportunity arose to acquire the Trustee Savings Bank in 2001, and this was deemed attractive as it increased customer numbers, had a substantial deposit base and permitted IL&P to become a real participant in the current account market regarded as a core product for bancassurers.

Strategic planning was carried out through a series of Strategic Plans, usually over three year periods, covering a SWOT analysis, review of the economic and competitive environment, potential acquisitions, cost challenges etc. Coupled with these plans was a detailed annual budget focussed on the operational implementation of the agreed strategy. Discussion of both strategic plans and annual budgets had, as a major component, consideration of the capital strength of both Group and bank, bearing in mind the overriding objective of maintaining at all times a buffer over minimum regulatory requirements. The Board was fully involved in the review and debate on the strategic options facing the Group and external expertise was used better to inform the process.

As a result, IL&P developed a very clear "Ireland First" strategy aimed at becoming a leading provider of personal financial services in Ireland. The Group exited virtually all its wide range of external investments, and by the end of 2006 consisted, with the exception of a relatively small centralised mortgage provider (CHL) in the UK, primarily on the provision of Irish house mortgages (both owner occupier and buy to let), together with a significant car finance business, and a commercial lending business focussed on financing investment properties, generally fully let on long leases.

We did not become involved in large ticket development/speculative property lending nor lending on raw land, nor were we involved to any significant extent in the SME market due to a combination of restrained risk appetite and skill deficits in respect of these types of lending.
The adopted strategy won market acceptance at the time, and appeared logical focussing on lower risk widely spread portfolios of lending in a home market where we had operated successfully for many years and had substantial market presence while exiting a number of overseas investments that were high risk and sub-scale in order to invest capital in Ireland that appeared to offer substantial opportunities. However, clearly we did not anticipate the savage downturn, particularly in house prices and employment and the damage it would do to the

chosen business model, especially when combined with the complete breakdown of liquidity options.

(6) B1D – ADEQUACY OF BOARD OVERSIGHT OVER INTERNAL CONTROLS TO ENSURE RISK IS PROPERLY IDENTIFIED, MANAGED AND MONITORED

Board oversight over internal controls was comprehensive and primarily conducted by regular reports to the Board. In some instances, reports (such as Internal Audit Annual Reports, Compliance Reports, Risk Register) were reviewed in detail by the Audit Committee, consisting of non-executive directors, prior to submission to the Board and further review and discussion there. The reports included:

Internal Audit Report	Half-Yearly
Compliance Report	Half-Yearly
Group Lending Exposures – facilities over €6.35 million and exceptions to Group policy over €3.2 million	Every Board
Group Lending Exposure – exceptions to Group policy over €3.2 million	Immediate with inclusion in regular report above together with exceptions to Group Treasury Credit Policy
Group Treasury Credit and Liquidity Policy	Half Yearly
Reports on PTSB Finance	Annually
Group Credit Report, including Mortgage Arrears	Half Yearly
Risk Management Returns	Half-Yearly

Every meeting considered a very detailed Chief Executive's Report covering the performance of all business units of the Group together with the latest available financial information. In addition, the Board, following detailed review by the Audit Committee, reviewed annual audit management letters and auditor's control reports in respect of half yearly accounts. All of the reports were the subject of detailed discussion at the Board and in the event of directors requiring further information on any topic that would be provided.

(7) B2A – APPROPRIATENESS OF PROPERTY-RELATED LENDING STRATEGIES AND RISK APPETITE

Lending strategy was focussed around house mortgages (both for residential purposes and investment) which accounted for the bulk of the loan portfolio (88%). In addition about 5.5% of total lending was accounted for by commercial loans for the purchase of investment property generally with the benefit of a long term lease. There was no lending for speculative land banking or development activities. The objective was to build up a portfolio primarily consisting of a substantial number of relatively low ticket residential loans – giving a wide

spread of borrowers and locations with conservative loan to value ratios (average 71% at inception in 2006). However, in the event the extent of the decline in residential property prices did not protect the portfolio on the downside.

(8) B2B – APPROPRIATENESS OF CREDIT POLICIES, DELEGATED AUTHORITIES AND EXCEPTION MANAGEMENT

Credit policies were reviewed regularly and changes required approval of the Board. LTV ratios were overall seen as reasonable averaging 71% at inception for residential home loans although First Time Buyer LTVs reached 87% in 2006 following the introduction of 100% mortgages in 2005. In addition, borrowers were tested for repayment capacity, including a stressed 2% interest test. Similar policies were applied to Residential Investment Property loans, with both LTV and rental cover ratios for interest payments. Commercial loans policies primarily consisted of LTV ratios to a maximum of 75% - 80% with regular use of fixed rate loans for 5/7 years to ensure suitable cover for interest payments. Instalment credit loans (mainly for new cars under manufacturer's supported schemes) were automatically credit scored using an externally prepared scorecard, with suitable controls over exception approvals.

Delegated authorities were determined on a tiered basis depending on the experience of the holder. The bulk of mortgage loans would require reference to a Central Credit Unit under the supervision of a very experienced retail lender. Loans in excess of the discretion of this unit were referred to a Group Credit Committee consisting of a number of experienced lenders, including the Chief Risk Officer and chaired by the Group Finance Director.

Exceptions to policy were approved on a case by case basis, generally on a "next higher" basis. Reports were made immediately to the Board on loans in excess of €3.2 million exceeding policy and the Board received monthly reports on all loans in excess of €6.35 million and in relation to loans approved as exception to policy, within the delegated discretion system. Similar arrangements applied within CHL, the UK lender.

The stress test required by the Central Bank in 2006 included a house price reduction of approx. 22% over two years, with a modest recovery in year three, together with increased unemployment rising to 9.7% over the three years of the test. While none of the scenarios modelled indicated serious threat to the solvency of the bank, it should be noted that the actual extent of the price declines and rise in unemployment subsequently vastly exceeded those set. However, the most significant defect in these tests, which probably gave a sense of false security to all concerned, lay in the absence of tests involving stress on the funding side. Perhaps this was because of the (now proven to be unfounded) belief in the strength and durability of the sources of funding available to banks in Ireland. There were no specific warning signs and indeed global capital markets had come through many periods of severe stress over the past 20 years and at this time had never appeared so accommodating to reasonably rated borrowers. The bank's credit rating with S&P was considered stable at A+ in December 2007 and indeed the rating was raised in March 2007 by Moodys after a detailed review. It appeared to have a very well spread of funding sources with modest use of securitisation and including substantial available ECB repo facilities. However, the deterioration in sentiment towards Ireland and Irish banks post 2006 demonstrated quite clearly that there is effectively only one counterparty in wholesale markets as Prof. Nyberg perceptively remarked in his report of 2011. Failure to anticipate this truth, in common with

many others, remains, in my view, the single biggest error that was committed in our business plans.

(9) B2C – ANALYSIS OF RISK CONCENTRATION IN THE BASE, THE ADVERSE ECONOMIC SCENARIOS AND THE IMPACT ON CAPITAL STRUCTURE

As previously indicated, the credit portfolio at year end 2006 consisted of Irish residential mortgages (68.5%), UK buy to let mortgages (20%), instalment credit (5.9%) and commercial mortgages (5.6%). This overall portfolio was very widely spread and remained largely unchanged in terms of concentration in the years 2001-2006, underlining the consistency of our strategy as an Ireland First, personal financial services provider. I have previously referred to the results of the 2006 stress test required which appeared satisfactory in terms of a robust response to economic shocks considered severe at that time, but clearly with hindsight absolutely inadequate to model the actual impacts of the recession of 2008-2010.

(10) B5A – ADEQUACY OF THE INCENTIVE AND REMUNERATION ARRANGEMENTS TO PROMOTE SOUND RISK GOVERNANCE

All remuneration arrangements for senior executives, including myself, required the approval of the Remuneration Committee, consisting entirely of non-executive directors. In the case of the senior executives (myself and those reporting directly to me) the package consisted of base salary, bonus opportunity up to 60% of salary, access to the Group share option scheme up to maximum multiples of salary and membership of various Group defined benefit pension schemes. I did not become a member of a defined benefit scheme as I joined Irish Life at age 51 with an anticipated retirement age of 60.

Overall remuneration terms were reviewed regularly with the advice of international remuneration consultants and were intended to provide market median rewards. While at this remove, total reward is substantial, it was not high relative to analogues in the Irish market. However, it is clear that public perception of remuneration in financial services at this time was that it was excessive and it is clear that this perception is reality for financial service executives including myself.

Bonus payments for those reporting directly to me were based on individually designed objectives designed to incentivise performance in a relatively small number of personal objectives, including Group profit, business unit profit, market share, cost control, achievement of specific projects, management of risk, reputational risk management. These objectives were agreed with the Remuneration Committee, reviewed at the half year and performance overall agreed at year end, with bonuses agreed based on performance against the objectives. Monthly business reviews were held with these senior executives.

In general terms, I do not believe that the remuneration arrangements led to a culture of excessive risk taking given the checks and balances within the overall credit approval system, including the Group Credit Committee Structure. Bonus payments could be modified downwards in the event of behaviour considered to justify this e.g. compliance type failure.

Separate remuneration arrangements, including performance related pay, applied within the Bank itself, which included agreements with trade unions representing staff members throughout the bank.

(11) B5B – IMPACT OF SHAREHOLDER OR LENDING RELATIONSHIPS IN PROMOTING INDEPENDENT CHALLENGE BY THE BAORD AND/OR EXECUTIVES

IL&P was a publicly quoted company with a very widely spread investor base, including a substantial retail element. As such, we met regularly with institutional shareholders in Ireland, UK, Europe and USA and Canada. These meetings involved exchanges of views on company performance, strategy etc. While on occasion our overall performance was regarded quite unfavourably in comparison to a number of our competitors, particularly in relation to our non-involvement in big ticket property development lending, we did not change our stance on this as we lacked both risk appetite and skills to undertake such business. After each half year tour of shareholders, we reported the feedback to the Board and considered whether we should modify strategy to take account of these views. In general terms however we maintained over this period a very consistent approach to the business in strategic terms.

Because of our business model we did not have lending relationships with borrowers of the nature that, I think, is implied in this line of enquiry.

(12) R1A – APPROPRIATENESS OF THE REGULATORY REGIME
R2B – EFFECTIVENESS AND APPROPRIATENESS OF THE SUPERVISION POLICY AND POWERS

The regulatory regime has been characterised as "principles based" and light touch. However, I would characterise it more as unbalanced with a substantial, relatively well resourced and quite intrusive, self-confident consumer focus contrasting markedly with an under resourced and tentative low key prudential activity. This emphasis on consumer matters seemed to be confirmed by the ex-officio directorship of the Consumer Director of the Regulator in contrast to the Prudential Director. However, it also seemed somewhat strange in that the primary protection required by any consumer is the solvency of the institution.

This misallocation of resources at the outset led to an inability of the supervisor to analyse in a meaningful way the substantial flow of information that banks provided by way of regulatory return such as large exposures. In addition when on-site inspections in any aspect took place (rarely) there was substantial delay in furnishing reports and dealing with a bank's responses to such reports. Responses from the Regulator to the submission of requested responses on particular topics were also very slow, reducing the value of any interaction and led to frustration.

While there was contact between the regulator and IL&P Group at a variety of levels, my personal contact was mainly restricted to twice yearly visits to the Regulator and prudential director to review half year and annual accounts and the information package to be presented. While these meetings were business like and professional, they contrasted markedly with meetings I had experienced elsewhere with other regulators. Certainly my interactions with the Regulator bore no resemblance to the extremely thorough reviews with ratings agencies where significant enquiries were always involved in respect of every aspect of the business.

The Regulator appeared reluctant to use its power of moral suasion that I believe it possessed, preferring to take a very legalistic view of its power. I recall contacting the Regulator regarding the introduction of 100% mortgages which I regarded as an unnecessary and unwelcome

development. It was made clear to me that the Regulator regarded itself as powerless to intervene.

In general it is my view that the Regulator failed to fulfil its prudential function. It is primarily a failure on the part of management and boards of banks that was responsible for the crisis that emerged. However, as with all participants in the creation of the crisis I am sure that different decisions at different times by the Regulator could have reduced the severity of events.

(13) R3B – NATURE AND APPROPRIATENESS OF THE RELATIONSHIP BETWEEN THE CENTRAL BANK (INCLUDING THE FINANCIAL REGULATOR), DEPARTMENT OF FINANCE AND THE BANKING INSTITUTIONS

The Committee has heard from a number of witnesses on the relations between Central Bank (including Regulator), Department of Finance and the banks and as I have no direct knowledge of the relationship between the Central Bank and Department of Finance it is perhaps not appropriate for me to speculate. Any views would originate in the media coverage, including various evidence here.

As far as IL&P was concerned, we had a business-like and professional relationship with the Regulator. I can recall only a couple of occasions when I would have personally contacted the Regulator on a matter of concern and only one semi social event – an in-house lunch with my Chairman at the offices of the Regulator.

We were members of the Irish Bankers Federation and we tended to prefer interactions on industry issues to be conducted by them. To the best of my knowledge during this period I had no personal contact with the Minister for Finance, the Secretary General of the Department and other senior civil servants unless perhaps at industry gatherings – Institute of Bankers dinners, IBEC etc.

(14) R5D – APPROPRIATENESS OF THE RELATIONSHIPS BETWEEN GOVERNMENT, THE OIREACHTAS, THE BANKING SECTOR AND THE PROPERTY SECTOR

The Committee has heard evidence from a number of witnesses in respect of these matters. I have no direct experience of the nature or appropriateness of these relationships and therefore I do not believe I should speculate on such matters.

CONCLUSION

While I cannot comment on developments post my retirement in May 2007, in preparing for this appearance I have reviewed thoroughly the last accounts for which I was responsible (12/31/06) together with the apparent economic backdrop at the time, in order to explain the subsequent outcomes which contributed to such negative outcomes for staff, customers, shareholders and of course the Irish state and its people, all of which I deeply regret.

While bank margins had declined from 190 basis points to 119 basis points over 2001 - 2006 due to a combination of a very competitive mortgage market, including the introduction from the UK of tracker mortgages, together with an increased use of wholesale funding to fund growth, bank profits

had grown from €91.1 million in 2001 to €202 million (an increase of 111%) while capital remained sound with risk asset ratio at 10.4% comfortably meeting the objective of exceeding regulatory minima.

The two issues which, I believe, best demonstrate the sharp contrast between the time of my leaving and subsequent events are the mortgage quality and liquidity of IL&P on 31 December 2006.

A. MORTGAGE QUALITY –88% OF BOOK ON 31 DECEMBER 2006

New Lending	LTV%
Home Loans:	
First Time Buyers	87
Second Time Buyers	58
Average	71
RIP's Average	68
Equity Release Average	51
Total New Lending	66

Aside from apparently healthy LTV ratios, the arrears position was healthy – since 2002, cases in arrears had halved (from 7.1% to 3.4%) while the number of mortgage accounts had increased by approx. 20%. In addition, despite a sharp slow-down in lending in the latter half of 2006 which had been ascribed to the political confusion in relation to the possible abolition of stamp duty, the strong consensus of economic commentary both domestically and internationally was that despite the rapid expansion of both credit and house prices, the economy was fundamentally sound – the soft landing scenario.

We know now that in the period 2008-2010 the economy, partly from events abroad, encountered its worst recession ever – there was an unprecedented drop in house prices (50% approx.) and rise in unemployment to around 15%, with around 300,000 people losing jobs. Both vastly exceeded levels for which the Regulator had stress tested in 2006. Clearly this was in the nature of the fabled 400 year flood.

B. LIQUIDITY ON 31 DECEMBER 2006

At the end of 2006 the bank appeared to be well funded, with easy access to a variety of apparently liquid capital market sources, long term debt repayments well spread, relatively low use of securitisation, availability of secured repo and ECB eligible collateral together with approx. 30% customer deposits. Moodys rating agency increased the ratings strength to AA3 in early 2007 while S&P maintained a rating of A+ at end 2007.

Events subsequently proved this funding model absolutely inadequate. External events together with negative views on Irish credit portfolios ensured that very rapidly all capital markets were closed to IL&P with the disastrous effects that we now know. The error here

was clearly failing to recognise Peter Nyberg's point that in the capital markets there is only one counterparty and hence if one source closes to a borrower all will close simultaneously.

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DAVID WENT