Tithe an Oireachtais
Houses of the Oireachtas

Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

Denis Donovan

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

Statement of Denis Donovan

1 **Culture**

B1c - Prior to and within the period of time examined by the Banking inquiry there were a number of prominent episodes suggesting problems with the internal culture of individual credit institutions in Ireland (DIRT, rogue trader, Forex and other issues). Please discuss your own views on why such events happened and whether the internal culture of the institutions played a role?

Can you comment on the culture in your organisation during this time:

- **were ethics and values defined?**
- **were written policies in place?**
- **where they were in place were these polices practiced by the MD, Directors and senior management?**
- **were they included in personal objectives for all personnel to adhere to?**

Why such events happened?

- I can only comment on my own organisation
- I do not believe that there was a cultural problem in Bank of Ireland
- In my experience, when left to their own devices, staff in BOI tried to do the right thing.

Ethics and Values defined?

- Yes they were and promulgated throughout the organisation. I recall lengthy senior management meetings on the topic.

Written policies in place?

- Yes. I recall that laminated cards were given to every member of staff in the group.

Practiced by the MD, Directors and Senior Management?

- Yes, I believe they were.

Included in personal objectives for all personnel?

- Yes.

2 **B1e - Corporate Entertainment**

Given that your bank was actively involved in the sponsorship of major sporting events, please detail:

(a) Any instances that you are aware of where your bank entertained property developers or bank customers who had large loan exposures (i.e. greater than €10m)?

(b) Any instances that staff in your bank were entertained by property developers or bank customers (who had large loan exposures)?

(c) What do you feel is an appropriate allowable entertainment value receivable by staff before it must be declared

The Bank was actively involved in sponsorship, particularly in sports at a national level and local sponsorships at Branch level.

A. Entertainment/Hospitality by Bank

- The Bank entertained major borrowers at breakfasts, lunches, dinners, rugby matches, golf outings, concerts, etc. Many property developers would have attended such events.

B. Entertainment/Hospitality by Customers

- I can't remember any notable instances of such activity.

C. Allowable entertainment value

- The Bank had written procedures on this issue, including appropriate approval processes. Meals, refreshments, accommodation or travel of reasonable value could only be accepted on the basis that the expense would be deemed to be an appropriate business expense if it were charged to the Group.

3 Corporate Entertainment

Are you satisfied that your Bank's Corporate Hospitality / Entertainment / Marketing expenditure relating to clients, contacts in the property sector and/or organisations, to include politicians, was appropriate and in line with your Group policies on gifts, sponsorship, invitations and inducements?

I am satisfied that the Bank's Corporate Hospitality/Entertainment/Marketing Expenditure was appropriate, in line with our policies in the area and the subject of regular scrutiny.

4 B3a - Loans to Deposits Ratio (LDR)

Loan/Deposit Ratio (LDR) is now targeting 120% - 100% and lower.

Why was this not a target during the 2004-2008 period when it reached highs of over 170% across a number of the Irish Banks?

During that period, the Bank's LDR was not out of line with international peers. I took comfort from the substantial amount of residential mortgages in our book in both Ireland and the UK. The residential mortgage securitisation market was very well developed and highly liquid. Excluding the residential mortgage books and allowing for appropriate haircuts on our mortgage collateral, the Bank's adjusted LDR during the period in question would have been approximately 100 to 110%. I did not foresee, nor do I believe did anyone else foresee, the complete collapse of mortgage securitisation markets specifically and/or wholesale markets generally.

Do you think the level of LDR in your institution was appropriate?

I thought so at the time although clearly, with hindsight, it was not given subsequent events. We were particularly exposed in the U.K. where we had acquired Bristol & West Building Society who had a mortgage book funded partly in the wholesale markets, including securitisations. The problem was exacerbated by the subsequent disposal of the retail deposit book of Bristol & West.

5 B3b - Liquidity

In evidence to this committee a number of witnesses have stated that the Guarantee was needed due to Liquidity issues faced by a number of institutions. What is your view on this and what stress testing had been put in place at your institution to ensure such an event would not happen?

I believe that the global financial system suffered a major liquidity shock of unprecedented proportions. Ireland's banking system, along with many others around the world, faced dramatic liquidity problems in wholesale markets, particularly after the Lehman bankruptcy, and the Group understood that some other domestic institutions may have come under liquidity pressure at that time. BOI had procedures in place, including the invoking of a crisis liquidity committee and a step by step guide to navigate through a liquidity crisis. We had introduced liquidity stress testing in 2007 to identify the potential impact of a range of adverse liquidity shocks but we never envisaged a global systemic crisis such as occurred. The key risk driver identified in the tests was a rating downgrade for the Group. The results of the tests were reported to Group ALCO, GRPC and the Court.

6 B3b - Liquidity & Crisis Planning

What crisis plans did you have in place and what emphasis was placed on Liquidity?

The Group had in place a Contingency Liquidity Plan which was approved by GRPC and dealt specifically with a liquidity event. A summary of the plan was included in the High Level Policy Governing Liquidity and Funding approved by the Court. The plan identified the different stages of a liquidity crisis with roles and responsibilities and required actions defined for each stage. The final phase was a full blown liquidity crisis. I believe that the document provided a useful framework during the financial crisis.

7 Wholesale Funding

Was the level of Wholesale funding in your Institution a concern for you and did you feel the possible risks attached to such funding were clearly understood at both Senior Management and Director level?

The level of Wholesale Funding in BOI was not a concern for me at the time because I believed that our funding structure was appropriate given the availability of deep and liquid Securitisation Markets, the different funding sources/programmes we had and the level of expensive term Wholesale Funding that we had put in place. Our Wholesale Funding Strategy was discussed frequently at Senior Management and Board level. The advantages and disadvantages of different Wholesale Funding strategies and the risks attached were covered and, I believe, understood.

8 B3c - Interest Rate Risks Appetite

What was the Interest Rate Risk appetite of your institution, how was it managed and who monitored the resulting net position?

The interest rate risk appetite of BOI was approved by the Board in the form of VAR limits. These limits were allocated mainly to the Global Markets Business and monitored on a daily basis by the

Credit and Market Risk Functions at Business and Group Level. I received a daily detailed VAR Report as Head of the Capital Markets Division for the 10 years that I held that post.

9 Interest Rate Risks Appetite

The Banking Inquiry has heard evidence and obtained documentation examining the risks that products such as tracker mortgages posed for the credit institutions. Did the senior management and the directors of the bank fully understand these risks and levels of exposure?

At the launch of tracker mortgages, the historical evidence suggested that Central Bank interest rates and money market rates were very strongly correlated as one would expect in a normally functioning market. The divergence that has taken place is a function of abnormal monetary policy in a global crisis. Such an eventuality was not foreseen at the time nor included in the legal documentation for such mortgages which would have allowed Banks to adjust tracker mortgage rates to reflect their actual cost of funding. This risk was not appreciated at the launch of the product.

10 B3d - Liquid Assets

Was appropriate analysis carried out of the risk attaching to non-Irish government bonds, such as other European peripheral countries, which subsequently were not as liquid as originally envisaged and lead to mark-to- market problems?

Our small holdings of peripheral European Government Bonds were intended as part of a prudent diversification strategy for our Liquid Asset Book. I assume that regional banks in those countries also held Irish Government Bonds for similar diversification reasons. The illiquidity that emerged in peripheral bond markets did lead to short term mark-to market problems. However, as by definition, the maturities held in such books were relatively short, a strategy of holding such bonds to maturity recovered the mark downs. At all times these bonds remained eligible for ECB operations.

11 B3e - Capital Structure

Banks appear to have set capital target levels higher than the regulatory limits. What was your view on this?

Was there a markets related expectation to exceed the regulatory levels?

Banks set buffers on capital targets above regulatory limits to avoid the danger of breaching regulatory limits. This was normal and prudent market practice. There was an expectation in capital markets that Banks would maintain such buffers to protect against a breach of prudential limits.

12 C2c - Liquidity and Solvency

On the night of the Guarantee what was your view on the solvency of your institution?

On the night of the Guarantee, I believed that the Bank of Ireland was a solvent institution.

13 Restructured Facilities

Can you discuss how the facilities made available to large clients between 2006 and 2008 were restructured and, in particular, the use of interest roll-up as a feature? In your view, could potential insolvencies have been recognised at an earlier point in the cycle and could appropriate preventive actions have been taken at that time?

Facilities made available to large clients between 2006 and 2008 were structured to reflect the industry they were in. A large Project Finance Transaction would be structured very differently to a large Leveraged Acquisition Finance or Corporate Banking Transaction. Interest roll-ups were a common feature in Property Development Loans to bridge the period until the property became income producing. I do not believe that the elimination of interest roll-ups would have made a significant difference to the levels of insolvencies witnessed, as they were largely a function of the dramatic collapse in property prices. The availability of a Central Credit Register might have been a helpful preventive measure during that period.

14 C3b - Guarantee

(a) **Were you aware of, or did you participate in, any correspondence between AIB and BOI in relation to the Government Guarantee Scheme?**

I was not aware of and I do not recall participating in any correspondence between AIB and BOI in relation to the Government Guarantee Scheme. I do recall them complaining subsequently, as we did, about the cost of the Guarantee scheme.

(b) **If so, what was agreed or discussed by the two banks?**

See (a) above

(c) **Were you aware of or did you participate in any correspondence or meetings that your bank had with either the Central Bank or Department Of Finance during the day and night of the bank Guarantee? If so please detail.**

I did not participate in any correspondence or meetings with the Central Bank or Department of Finance during the day and night of the Bank Guarantee. I was aware of a meeting between our CEO and the Central Bank that morning. I was also aware of a meeting between our Governor and the Central Bank Governor that day and that our Governor and CEO went to see Department of Finance Officials and members of the Government that night.

15 Guarantee

(a) **In the period leading up to the night of 29th September 2008, was your bank in discussion with any other credit institution in relation to it's own liquidity or the liquidity of other credit institutions, the nationalisation of any credit institution or the proposed Guarantee and if so provide details?**

The only discussion of an identified institution that I recall in the period leading up to the night of 29 September took place on September 7 in the Central Bank of Ireland. We were asked by the Central Bank to engage (together with AIB) with a representative of Irish Nationwide Building Society. We discussed their liquidity situation and came to the view that we could not give them any assistance. I believed that whatever collateral BOI had available to it should be reserved for its own liquidity needs.

I was aware of a meeting on the morning of 29th September between our CEO and the Central Bank where I believe the possibility of our acquiring IL&P was discussed. I was also aware of a meeting on the afternoon of 29th September between our Governor and CEO and the Chairman and CEO of Anglo Irish Bank which I believe discussed their liquidity position.

(b) **On the night of the Guarantee, please detail any knowledge you have of who remained at Head Office and in contact with your CEO between the hours of 9.30pm and 3am?**

There were a lot of people coming and going that night. The only people, other than myself, that I have a clear memory of being in Head Office that night and in contact with our CEO were the CFO and the CEO of the Retail Division.

(c) **In your opinion, was the Guarantee necessary for your bank and if not why not?**

In the circumstances of an imminent default by an Irish financial institution, I believe that the Guarantee was necessary for all Irish financial institutions to provide absolute clarity to markets when they opened the following morning. Bank of Ireland did not seek a guarantee in its own right.

(d) **Did you feel that you were adequately informed about the above issue, did you have an opinion on this issue and were you listened to?**

I gave my views to our CEO and I believe that I was listened to.

16 Guarantee

In your view should Anglo and INBS have been Guaranteed or nationalised at the end of Sept 2008? Please describe any discussion of this issue between your financial institution and other financial institutions?

I do not recall any discussion of Anglo and INBS in the context a guarantee or nationalisation with other financial institutions. I do not believe that a different approach would have altered the subsequent outcome substantially.

Did your institution seek to communicate its position on the Guarantee to the Government? Can you describe any such representations made by your institution to the Government?

I believe that our Governor and CEO did communicate the Bank's position on the Guarantee to the Government that night but, as I was not in attendance, I cannot describe those representations.

Can you describe any discussions between your financial institution and others on the cost of the Guarantee? Can you give your own views on how the costs of the Guarantee were quantified?

I recall in October discussing the cost of the Guarantee with the Department of Finance. They were largely technical discussions on how the cost would be calculated, etc. I recall making the point that the burden of the cost should not be "democratised" across all Institutions but reflect the relative strength or weakness of individual Institutions as reflected by their rating.

Can you give your own views on the transfer of risk from the credit institutions to the sovereign entailed by the Guarantee? Were representations made by your institution to European parties on how to resolve the crisis? Can you describe such representations?

In a crisis of such magnitude in a small economy, the fate of financial institutions and the sovereign are inextricably linked. Given the sequence of events, the burden on the sovereign was difficult to avoid in my view.

I do not recall any representations to European parties by BOI on how to resolve the crisis.

17 R2b - Financial Roundtable Discussions

The Financial Roundtable meetings were attended by senior management of you bank. Were you an attendee at any stage or were you informed of the roundtable discussions? Were discussions held with you or was any policy/strategy change considered as a response to these meetings?

I did not attend any Financial Roundtable discussions. I may have been briefed in a general way about some of the topics discussed if they were relevant to my area. I do not recall any strategy changes arising from such meetings.

18 Macro-Economics Inputs

Did you include macro-economic considerations in your credit strategy? Did you discuss Financial stability Reports or other macro-economic forecasts with the Banks economics unit or senior management?

BOI included macro-economic considerations in our credit strategy from both our own Economics Unit and external parties, including Financial Stability Reports. All were discussed regularly at Group Risk Policy Committee Meetings.

19 Prudential Policy Implementation

In your opinion was the introduction of new liquidity requirements and reporting standards in 2007 a helpful measure to improve liquidity forecast and liquidity monitoring? If not, why not?

I believe that the new liquidity requirements and reporting standards were an improvement and added to the quality of liquidity forecasting and monitoring. They prompted us to review our contingency plans, stress testing and liquidity management generally.

20 Prudential Policy Implementation

Please provide details of any discussions held with FR staff on the continuous relaxation of credit policies. Could you please describe the outcome of these discussions?

I imagine that discussions about credit policies took place during regular interactions with the Regulator. I believe that our CEO met with the Financial Regulator on the topic of 100% Loan to Value Mortgages. Bank of Ireland was uncomfortable with the launch of that product by some of our competitors.

21 - Communication with the Central Bank/Financial Regulator

R3b - Apart from the provision of reports to the Central Bank/Financial Regulator what other communication did you, or your reporting lines, have with staff at the Central Bank or Financial Regulator?

Prior to the crisis, I had very little contact with the Central Bank or the Financial Regulator. The businesses in my division would have had regular business-as-usual type contacts with the Central Bank and the Financial Regulator.

22

(a) **Did the bank provide any "out of course" insight (i.e. informal) to the Financial Regulator on their credit risk and bond exposures during 2007 and 2008?**

I do not recall any "out of course" insight being provided to the Financial Regulator on BOI's Credit Risk or Bond Exposures during 2007 and 2008. I do recall regular discussions on liquidity, with the conversations becoming more and more frequent as the crisis escalated.

(b) **If so how often would this have occurred?**

See answer to (a) above.

(c) **Who within the financial Regulator was your primary contact, for credit risk and bond exposures?**

I presume that the regulatory team allocated to BOI would have been the main point of contact on BOI's credit risk or bond exposures.

23 - Relationship with Central Bank/Financial Regulator

How would you describe your relationship with the Central Bank/Financial Regulator?

I would describe BOI's relationship with both the Central Bank and the Financial Regulator as professional and business-like.

24 - Relationship with Banking Supervision

During reviews of your loan book, monitoring or governance structures, how would you describe the working relationship with the Banking Supervision teams of the CBI/FR? What was your view of the knowledge and expertise of the banking supervision teams?

Prior to the crisis, I had little interaction with the Banking Supervision team covering BOI. Contact increased as the crisis unfolded. I had the impression that they were under-staffed and had difficulty keeping good people, constantly losing them to more lucrative positions in the Private Sector. I recall suggesting to the Central Bank that secondments from the Private Sector might be a possible solution but it was felt that confidentiality issues would be difficult to overcome. Secondments were common practice in other Central Banks such as the US Federal Reserve Bank.

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