Tithe an Oireachtais
Houses of the Oireachtas

Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

John O'Donnell

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

DOCUMENT 1

		Line of Inquiry*	Questions
1	B1c	**Quality of business model setting process**	**Culture** 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? I would first state that I worked in the AIB Capital Markets Division during the period up to late 2005 during which these events took place. Accordingly I am not in a position to specifically comment on the culture of Allfirst or the Republic of Ireland (ROI) Division in which the events took place. It strikes me that they would appear to be unrelated events. The rogue trader incident involved a rogue trader causing significant losses to the bank by hiding unauthorised trading. It occurred in treasury department of the Allfirst, a United States based subsidiary which was not under the control of Group Treasury, operated under its own board and had its own internal audit function. I believe the Promontory Report concluded that it was due to inadequate internal controls although I did not see that report as I was not on the board at the time. I have no reason to disagree with that conclusion. The Forex issues as I understand them related to two separate issues. One involved an incorrect notification of a foreign exchange commission rate to the Financial Regulator. This I understand occurred due to human error. The second issue involved the deliberate overcharging in foreign exchange rates which occurred in the ROI Division in a number of specific branches. I would have seen the report submitted to the Board in June 2006 on this issue and cannot add anything meaningful to the contents of that report. I have no firsthand knowledge of working in that division, or in a group position, at the time of the events. With regards to the DIRT issue, again I have no firsthand knowledge not having worked in the division affected by it, or in a group function, when it occurred. My understanding is that it was an industry wide issue affecting a large number of banks, including state owned banks. For the above reasons I cannot see a common thread linking these issues to cultural issues in AIB. Can you comment on the culture in your organisation during this time: In my view a very strong emphasis was placed on operating to a high level of compliance and ethics. I believe this focus was driven by the episodes referred to above. The Group was very anxious to avoid any further episodes arising. - Were ethics and values defined? Yes – See the Code of Business Ethics For All Employees Of AIB Group issued in January 2004. This was supplemented by the Code of Leadership Behaviours for Senior executives of the AIB Group – "Leading by Example" in October 2004. In 2006 a brief review of the Code was undertaken at AIB's request by the Institute of Business Ethics (IBE) which confirmed that AIB was; "following good practice in training, assessing effectiveness, and reporting on the working, of its ethics policy." E-learning training for staff was introduced and it was required that every staff member complete an online Compliance Driving licence test on an annual basis. - Were written policies in place? Yes-see answer above. In addition the Group had a "Speak Up" policy and an external party, the UK body Public Concern at Work, was appointed, with direct access to the Chairman, to receive complaints where an employee did

			not feel sufficiently confident to raise an issue through line management. - Where they were in place were these polices practiced by the MD, Directors and senior management? To the best of my knowledge they were. - Were they included in personal objectives for all personnel to adhere to? I cannot speak in respect of all personnel but examining my own performance reviews from 2004 to 2007 the issue is covered either in the objective setting or as confirmation point in each year. It is my understanding that this was normal practice and was a requirement of the performance review process.
2	**B1d**	**Adequacy of board oversight over internal controls to ensure risk is properly identified, managed and monitored**	The Promontory/Mazar Report dated Jan 2011 states that; "AIB did not have a suitable corporate structure, it lacked sufficient checks and balances between the business and Risk/Compliance and Internal Audit…" and "Through this period (2005-08), there appears to have been considerable reluctance among senior management to give priority to robust governance and risk practices" As an Executive Director, were you aware of these weaknesses in the governance structure of the bank? No I was not. My impression was that the Bank was very strongly focused on ethics, and regulatory and compliance issues. Board meetings generally spent a very clear majority of its time on such issues. Following an earlier Promontory Report AIB had put in place a three lines of defence system, (management, risk & compliance and audit) which I understood to be recommended best practice. The number of staff in compliance (Group, ROI Division and Capital Markets – excluding overseas) increased from 57 in June 2005 to 139 in June 2008, a 243% increase. Staff numbers in GIA increased from 45 to 91 in the same period, a 202% increase. The number of employees in Risk increased from 160 in June 2005 to 191 in June 2008 an increase of 19%. From 2005 to 2011 the Group Internal Auditor position was always filled by an external hire. Most of the senior staff employed by GIA during this period were, I believe, external hires. An external PWC review of The Group Audit function, presented to the Audit Committee in March 2008, ranked it in the 2nd quartile of PWC's global database of such functions, and was well positioned to move into the top quartile. In a global ratings survey in relation to Corporate Governance, Governance Metrics International ranked AIB 9.5 out of a possible score of 10.00 in 2006. A report by Promontory Financial Group in May 2006 stated, "Allied Irish Banks, plc ("AIB") has come a long way in enhancing its risk management systems and tightening its controls since Promontory first reviewed AIB's risk and control governance in 2002. AIB's management and the Board are justified in taking pride in the overall progress AIB has achieved." The report further stated, "Promontory believes that AIB generally has a conservative appetite for risk, and it does not appear to be engaged to any significant degree in more exotic instruments. Its risk management programmes for market risk and credit risk and its internal audit programme are sound, given AIB's current risk profile."
3	**B1e**	**Appropriateness, management and control of Client Relationship activities**	<u>**Corporate Entertainment**</u> 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)? AIB had a group policy on gifts, benefits and inducements. This policy

			provided that employees will only accept or provide entertainment or gifts if they are not excessive in value, are consistent with and comply with applicable laws and regulations, and are accepted or given in an open and transparent manner. It also provided that gifts or business entertainment must not be given as a condition of doing business. Each Division and Group Support function were required to establish a limit on the value of gifts or entertainment that require declaration and entry in a register maintained within the business. AIB was a sponsor of a number of major events including sponsoring the Ryder Cup in 2006 and engaged in corporate hospitality at the Ryder Cups in Detroit in 2004 and Kentucky in 2008. ROI Division and AIB had Corporate Boxes in Croke Park and Premium Level Seats. I understand that the GB & NI division had seats in certain soccer stadia but I do not know which ones. AIB Capital Markets organised a corporate entertainment golfing trip to Scotland on an annual basis. (While I do not have details of the attendees they were to my recollection corporate invitees and not property developers.) I am aware that property developers were entertained at the Ryder Cup by ROI Division in Kentucky in 2008. b. Any instances that staff in your bank were entertained by property developers or bank customers (who had large loan exposures)? I am not personally aware of any such instances but there is no reason why such information would come to my attention. What do you feel is an appropriate allowable entertainment value receivable by staff before it must be declared? AIB Group had a policy in relation to such matter. To the best of my recollection the limits in relation to group functions were that over €250 had to be declared and over €500 approved in advance. I believe other division may have had these limits set at other €500 and 1,000 respectively. I had no reason to disagree with those amounts.
4			**<u>Corporate Entertainment</u>** 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 have no reason to believe that they were not. Such corporate hospitality and entertainment is common practice in the financial services sector and other industries.

Reference Appendix A, Themes and Key Lines of Inquiry

		Line of Inquiry*	Questions
5	**B3a**	**Appropriateness of funding sources, mix, maturity profile and cost**	**<u>Loans to Deposits Ratio (LDR)</u>** 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? Do you think the level of LDR in your institution was appropriate? I believed it to be appropriate at the time. AIB had set a target of not exceeding the average LDR of its selected peer group of banks from the FTSE

			300 Eurofirst Index. There was no correlation between the LDR ratio and how a bank performed in the crisis in Ireland. For example Bank of Ireland had a higher LDR ration than AIB but performed better in the crisis. The asset side of the balance sheet drove the relative performances. The banking crisis in Cyprus arose even though the banks were funded almost exclusively by deposits. The LDR also ignores any off balance sheet obligations of an institution. What are important are the mix, reliability and "stickiness" of the funding. In addition to the monitoring LDR target the group had set a hard adjusted /loan deposit ratio. This ratio was to give weight to the maturity profile of funding sources and allow for the inherent liquidity in certain assets.
6	**B3b**	**Analysis of liquidity risks under adverse scenarios**	**<u>Liquidity</u>** 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? The immediate Liquidity issue that led to the guarantee was Anglo Irish Bank being expected to be unable to fund itself on, I believe, the 30th September 2008. I also believe, from evidence given at the Banking Inquiry that it was expected that Irish Life & Permanent would also face difficulties within a relatively short period of time. At that stage AIB were still meeting regulatory liquidity requirements and were in a position to facilitate a request from the Department of Finance with €5bn in liquidity for Anglo Irish Bank but on condition that it be repaid immediately if we were in need of it ourselves. Following the collapse of Northern Rock in September 2007 the availability of wholesale funding in the markets became increasingly difficult. Following the collapse of Washington Mutual and Lehman in September 2008 the situation worsened considerably. AIB prepared stress testing plans in 1999 and 2006. A liquidity stress test was carried out in June 2008. AIB had a Group Liquidity Contingency Plan & Liquidity Stress Testing. This required Group Asset and Liability Management to conduct tests on a quarterly basis and as far as I can recollect this was done. See further comments on our Liquidity Contingency Plan below.
7			**<u>Liquidity & Crisis Planning</u>** What crisis plans did you have in place and what emphasis was placed on Liquidity? It is important to note that one of the functions of the banking system is to carry liquidity risk. There are no 25 or 30 year deposits available in the retail market. Very little funding of such duration is available to banks. Core deposits and credit balances are very short term funding. The banks however carry this duration risk on the assumption that a core level of deposits and funding will always remain with them. They supplement this with various capital instruments, wholesale short term and longer term funding, and access to discount certain types of assets with their central bank. AIB had a liquidity policy that required liquidity ratios in excess of the FR policy and based on criteria more demanding than the regulatory requirements. The regulatory liquidity requirements are meant to provide time in a crisis until other measures can be adopted. The group had a Liquidity Contingency Plan (LCP) as a separate document to the normal liquidity policy. It contains five projected adverse scenarios of progressively declining liquidity, with each scenario defined in terms of a selection of events which identify the move from one scenario to the next. Each scenario is accompanied by a list of likely characteristics and possible management action to be considered. It was recognised that it would be

			possible for the Group to move very rapidly through each scenario in extreme conditions. In is fair to say, however, that the scale, speed and duration of the crisis was not foreseen or provided for. We put in place a variety of instruments to supplement the sources of funding available to the bank. In our ALCO (Asset & Liability Committee) meeting in March 20th 2007 we set out plans to fund €15bn from long term wholesale funding comprising public and private senior debt, US$ Extendibles, US$ Yankee CDs, public and private covered bonds and capital issuances. The intention was to increase longer term funding which is the most stable in a crisis. As the crisis intensified the ALCO unit was also mandated to create securitisation vehicles of assets (including an internal securitisation) which could issue bonds that could be repoed. (Securities that could be sold as a means of raising finance together with an agreement for the seller to buy back the securities at a later date.) Such an internal securitisation was carried out on our UK mortgage book. AIB's liquidity proved quite robust in the crisis. It is my understanding that it was not until September 2010 that AIB required Emergency Liquidity Assistance (ELA); albeit this followed the introduction of the government guarantee scheme. This could be contrasted with HBOS and RBS in the UK who required £62bn in emergency funding by October 2008 according to a statement by Mervyn King, the Governor of the Bank of England. It is my understanding that a number of large European banks also required ELA in 2008 or early 2009.
8			**<u>Wholesale Funding</u>** 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? Our level of wholesale funding was in line with peer banks. As mentioned our loan/deposit ratio was targeted not to exceed the average of a peer group of banks from the FTSE 300 Eurofirst Index. It should be born in mind that long term wholesale funding may be the most reliable and stable funding available in a crisis. It can't be withdrawn without your consent. We were conscious that shorter duration wholesale funding carried greater risk and as mentioned above steps were taken to fund a substantial proportion of it on longer duration. Prior to the crisis I do not believe that our funding profile would have been considered high risk and no rating agency ever advised us that they considered it as such. Standard & Poor's Credit report on AIB in April 2007 referred to AIB's solid liquidity and stated, "The funding profile still compares well with many universal banks..." As far as I can recall no more than 20% of our funding would mature in any one year. The level of risk which emerged in the crisis was, to the best of my knowledge, unprecedented, and accordingly would not have been understood in advance.
9	**B3c**	**Interest rate risk appetite setting and monitoring**	**<u>Interest Rate Risks Appetite</u>** 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 was set out in a Group Interest Rate Risk Policy as approved by the board. The limit was 8.25% of Tier 1 Capital. The limit was based on a value at risk (VAR) limit. This limit was based on a 99% confidence level and a one month holding period. An earnings constraint also applied in that all market risks should not result is losses of more than 1.5% of Tier 1 capital in any one financial year. Capital and Business NIRIL (Net Interest Rate Insensitive Liabilities) were invested over agree timeframes to minimise volatility in earnings as a result of

			changes in interest rates. The quantity of business NIRIL was calculated on a monthly basis and investment decisions as to maturity made by Group ALCO. The measurement and control of interest rate risk was carried out by Global. Treasury. Positions were reported monthly to Group ALCO and to the Board.
10			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? It is not possible for me to comment on the level of understanding of other parties but in general I believe this risk was known and understood albeit historically it had not been significant. An attempt had been made to offer tracker deposits but with, as I understand, limited success and great difficulty in getting duration on the deposits. I recall asking Global Treasury to check availability and pricing for hedging instruments to reduce or eliminate the risk. As far as I can recall this was implemented in respect of sterling mortgages but not euro mortgages. The market in the appropriate swaps for the euro mortgage book was too thin (few participants) and pricing uneconomic.
11	**B3d**	**Appropriateness of investment of liquid assets in government and/or other securities**	**<u>Liquid Assets</u>** 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? Yes, I believe so. AIB had a Group Country Exposure Policy based on AIB's own internal analysis with limits set as a percentage of AIB's tier 1 capital and subject to restrictions based on the country's GDP. I am not aware of any significant mark to market problems in relation to non-Irish government bonds albeit there was significant price volatility. In December 2009, the last year end when I was finance director the net position on non Irish government securities was unrealised gains of €158m. Examining the accounts for 2010 net unrealised losses were €53m in 2010 and net unrealised gains were €246m in 2011. While there may have been difficulties with individual securities the overall position appears satisfactory. I was equally unaware of any liquidity problem in relation to these securities and in any event I would have assumed that, with perhaps minor exceptions, they could have been provided as collateral to the ECB to provide funding.
12	**B3e**	**Capital structure / loss absorption capacity**	**<u>Capital Structure</u>** Banks appear to have set capital target levels higher than the regulatory limits. What was your view on this? Regulatory limits are set on the basis of what the regulator believes is the minimum level of capital that it is prudent for a bank to operate with. A bank has to ensure that it will never breach these limits and accordingly operates with a higher level of capital. In addition rating agencies and investors would have an expectation of higher levels of capital. AIB wanted to continue to be rated as an AA rated bank. To have this rating a higher level of capital was required. Entering the crisis two of the main rating agencies viewed our capital levels as acceptable for such a rating. Was there a markets related expectation to exceed the regulatory levels? Yes – see answer above.

*** Reference Appendix A, Themes and Key Lines of Inquiry**

	Line of Inquiry*		Questions
13	**B6a**	**Effectiveness of internal audit oversight and communication of issues related to governance, property-related lending strategies and risks and funding and liquidity risks**	**<u>Effectiveness of Internal Audit</u>** In relation to my answers to the questions below regarding Internal Audit I would like to advise the committee that Internal Audit did not report to me as regards the preparation or execution of the audit plan for the group, what areas were to be audited or in relation to the content of specific reports. Group Internal Audit was an independent evaluation and appraisal function reporting to the Board through the Audit Committee. It did have a reporting line to me in relation to annual budgeting, remuneration and certain administrative matters. Please detail the criteria used in order to measure the effectiveness of your Key Performance Indicators (KPIs) or annual targets, upon which your annual salary and / or bonus was determined? An extensive set of criteria were set out in my Performance Reviews (PR) over this period of time. I have agreed with Banking Inquiry staff that my Performance Reviews for 2004 and 2005, when I was Head of Investment Banking, are not relevant for the purposes of answering this question. In relation to 2006 and 2007 it was agreed that I should set out the objectives in so far as they relate to Internal Audit. I, or AIB, cannot locate my PRs for 2008 or 2009 but I have no reason to believe, that in so far as they relate to Internal Audit, they would be significantly different. The 2006 PR contains the following reference to GIA among my objectives: "Influence GIA to provide a service, which meets the requirements of all interested parties in the group." My 2007 PR repeats this and adds, "In this regard work to ensure that the new GIA has a smooth transition into the position and that positive relations are developed with his colleagues in the RMC." A further requirement was "Ensure that the group functions under my control: (GFD/GF/Fermat/GroupALM/Inv.Rel./Corp.Dev./ C & B. E. /GIA and Audit) come in in line with budget in 2007 which excluding the provision for AIBCM moving to Bankcentre (€2.2m) and the cost of the new divisional tax specialists located in the divisions (€1m) amounts to a 3% increase in total costs. " They were the only KPIs in my Performance Review relating to Internal Audit. a. Was there any risk or area which Internal Audit felt should have been reviewed but was not included in the Internal Audit annual plan? Not that I was aware of at the time. b. During the period 2004 to 2008 (inclusive), did Internal Audit have staff with sufficient skills and experience to enable them to perform reviews on all risks relating to commercial lending (both customer and sector concentration levels) and funding risks? There was no shortage of staff or skills that I was aware of. As mentioned above GIA staffing was increased from 57 in June 2005 to 139 in June 2008, a 243% increase. The budget for GIA was hugely increased over this time. c. Were these risks reviewed by Internal Audit and if not why not? Yes. GIA prepared a report on Property, Building and Construction in March 2006. They had previously prepared a report on the credit framework in 2005.

14			Were there material issues identified during an audit which were reported as outstanding at the end of the year and were not addressed the following year (i.e. were any issues carried forward as outstanding for a number of years)? If yes, how frequently did this occur? Material issues identified by GIA were carried forward as outstanding until they were resolved. Some issues that required significant I.T. investment may well have been carried forward for a number of years but I do not have specific information on these or how frequently they occurred.
15			Did Group Internal Audit review the risks associated with customer concentration levels and short term funding to service long term lending? I believe that GIA did address the management of concentration risk in their Credit Framework audit in 2005. I was not on the Board at that time and accordingly did not receive this paper. I am not aware of their having addressed the issue of short term funding being used to service long term lending but this is a normal banking activity which the liquidity policy is meant to address. As part of the ICAAP report credit concentration risk was reviewed by Group Risk using external KMV (Moody's) models and the result concluded that credit concentration risk was acceptable and that addition capital was not required to support concentration risk under Basle II requirements. In December 2008 GIA did an audit of Risk Management of Concentration Risk. It identified 5 important and 4 minor issues which management agreed to develop action plans to resolve by 31st December 2009. (The relevant ranking scale was: Material/Significant/Important/Minor.) No material or significant issues were identified. In any event December 2008 was post the government guarantee and there would be no intention of permitting this portfolio to increase.
16	**B6b**	**Effectiveness of oversight of prevailing risk culture**	**<u>Risk Culture</u>** Was a review of the risk culture and appetite of the Bank ever carried out by either external consultants or internal audit? If yes what was the outcome and any action taken afterwards? I cannot recall a review specifically addressing risk culture and appetite. As stated above the Promontory Report in 2006 stated that "AIB generally has a conservative appetite for risk, and it does not appear to be engaged to any significant degree in more exotic instruments. Its risk management programmes for market risk and credit risk and its internal audit programme are sound, given AIB's current risk profile." In relation to culture it stated, "AIB's Board and Senior Management are to be commended for incorporating a culture change programme as one of the centrepieces of its risk management reform effort." A report was prepared in November 2006 by GIA. (I note that I am not on the distribution list for that report and I cannot say whether I received it or not.) The first action point on the report appears to be relevant to this question. It states, " Action 1: Group Risk is currently designing and implementing a management process to identify, measure and manage property

			concentrations within the Group." A Group Risk report dated 25th April 2007 concluded that AIB has a significant property concentration that is likely to grow but that extreme stress test would not threaten solvency or the capital position. It recommended specific limits for the portfolio, presumably in response to the GIA report.
17	**B7a**	**Impact of prevailing accounting standards in recognising risks**	**IAS39** a. Was the adoption of the IAS 39 standard discussed at Board meetings? The standard was adopted prior to my appointment to the board so I cannot definitively answer this question. I would suspect it was discussed as my understanding is that the adoption of International Accounting Standards / International Financial Reporting Standards was an EU legal requirement. b. Did the Board fully understand the implications that the adoption of this standard had on the financial statements of the Bank? I believe that to be the case. For example the 2006 accounts show a reduction in the stock of provision by €146m in relation to the transition to IFRS in 2005. Whether they understood the longer term implications of its implementation in the context of a prolonged economic boom followed by an extreme crash is not possible for me to say. c. Did the board seek an accounting specialist to advise on the implications of this standard and explain how this measurement of the Bad Debt Provision differs from the amounts calculated under the previous accounting methodology? I do not know if this was done prior to my appointment to the board in 2006. As the transition year was 2005 it would likely have been prior to this date. To the best of my recollection during the crisis the Audit Committee had an internal presentation made to them on the standard and I believe they also had a presentation made by KPMG. d. If you, or any of the board members, had concerns with the adoption of IAS 39 were these concerns raised with the Regulator / Central Bank? I did have concerns in relation to the standard. I did not agree with it and voiced that opinion openly both at the board and with investors. A discussion was held at the board concerning the possibility of asking the Financial Regulator to issue us with a directive to ignore the standard. It was decided however that this was likely to be futile as it was an EU requirement that from 1 January 2005 International Accounting Standards / International Financial Reporting Standards would apply for the consolidated accounts of EU listed companies. e. Did you feel that the amount thereafter provided for the "Provision for Bad Debts" was adequate and in hindsight do you feel that the amount provided should have been different? I felt that the provisions fully complied with the requirements of IAS39 and in fact were viewed as excessive in that regard. I did not agree with the provisioning methodology required by IAS 39 and would have preferred utilisation on the historic cross cycle provisioning methodology which would have resulted in a higher stock of provisions.

*** Reference Appendix A, Themes and Key Lines of Inquiry**

	Line of Inquiry*		Questions
18	**C2c**	**Liquidity v Solvency Debate**	**Liquidity and Solvency**

			On the night of the Guarantee what was your view on the solvency of your institution? I believed the institution to be solvent. I had no reason to question the solvency of the bank at that time. My understanding is that the decline in property values at that stage was less than 10%. Our stress testing in 2007 had indicated the ability of the bank to withstand, in what was viewed as an extreme scenario, falls of from 30% to 60% (average 36%) in various asset values.
19			**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. In my role as Finance Director I would not be familiar with the credit restructuring of facilities other than a small number that might be considered at the board or, on occasions, the Chairman's committee. It is my understanding that such restructurings would go through the normal credit decision making processes. Interest roll –up is a normal feature of funding property development. The construction of office buildings or houses does not produce a source of income until the property is either sold or let. Interest roll-up in restructuring is a different issue. It is difficult to estimate what the effect of earlier recognition of interest roll-up would have had on the eventual outcome. Clearly where this was occurring, in a restructuring context, then the credit was already experiencing stress and I am not in a position to say what preventative actions could have been taken. The credit exposure would already exist.
20	**C3b**	**Appropriateness of the bank Guarantee decision**	**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 did not participate in any correspondence between AIB and BOI in relation to the Government Guarantee Scheme. I believe there was a phone call on September 29th between Dermot Gleeson and Chairman of AIB and Richard Burrows, Governor of The Bank of Ireland at which they discussed meeting the Government or Minister for Finance that night. At the request of the Department of Finance I believe there was contact between AIB Global Treasury and Bank of Ireland Treasury, to discuss what market requirements or expectations would be in relation to the guarantee and what instruments should be covered but I believe that was after the night of the guarantee. b. If so, what was agreed or discussed by the two banks? Other than as set out above I am not aware of anything. c. Were you aware of or did you participate in any correspondence or meetings that your bank had with either 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 meeting with the Department of Finance or Central Bank during the day or night of the guarantee. We were, on a number of occasions, in contact by phone with Eugene Sheehy and Dermot Gleeson who were present in the Department of Finance. Our conversations with them largely related to our ability to provide Anglo Irish Bank with €5bn in funding the following morning and our requirements as to how that would be guaranteed. To the best of my recollection we also discussed potential terms of a government guarantee including duration, cost and a possible announcement to be made by the government.

21			**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 its own liquidity or the liquidity of other credit institutions, the nationalisation of any credit institution or the proposed Guarantee and if so provide details? Other than the telephone conversation between Dermot Gleeson and Richard Burrows on the afternoon of the 29th September and a meeting which was held on 7th September 2008 in, I think, the Financial Regulator's (FR) Office at the request of the FR, between AIB, Bank of Ireland and FR staff to discuss the liquidity position of Irish Nationwide I am not aware of any other discussions. 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? Colm Doherty (MD AIB Capital Markets) Eamonn Hackett (Group Treasurer) and myself (John O'Donnell). I believe Donal Forde (MD Republic of Ireland Division) may have joined the meeting from time to time. I also believe Nick Treble (Head of Risk) may have been present but I am not certain. c. In your opinion, was the Guarantee necessary for your bank and if not why not? I feel that it was going to be ultimately necessary given the turbulent state of money markets and the shortening duration of our liquidity. I cannot say when it would have become necessary. 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 was adequately informed, I did have an opinion and I was listened to.
22			**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? AIB's position on the night of the guarantee was that INBS and Anglo Irish should be nationalised and the other banks guaranteed. I agreed with that position. I am not aware of any discussions with other financial institutions on the matter other than what may have transpired in the conversation between Dermot Gleeson and Richard Burrows on the 29th September 2009. I was not a party to that discussion so cannot say whether they discussed this issue. 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 the Group CEO and The Chairman communicated AIB's position to the Government on the night of the guarantee. At a Board meeting on Sunday 28th September, Eugene Sheehy, advised the board that he had been advised by the Department of Finance that the government were expected to nationalise Anglo Irish and INBS and to guarantee the other banks so presumably some conversation took place where that was communicated. I am not aware of any other representations made. 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 cannot recall any discussions with other institutions on the cost of the guarantee. On the night of the guarantee I believe that Eugene Sheehy suggested that the cost be based on the same system used for charging for FDIC insurance on deposits in the United States. This proposal was not

			accepted. I believe that at some stage we were asked what parameters should be involved in determining the cost and we suggested a number of criteria including the size of the institution, its credit rating and whether it was a retail bank or critical to the money transmission system. I do not know how the costs were ultimately determined by the Department of Finance. We were simply advised what it was going to be. I note that criteria are set out on page 36 of the AIB Bank, Draft Restructuring Plan, (provided as part of core documents) but I am not conscious of having been aware of these criteria prior to receipt of that document from the Inquiry. 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? The transfer of the risk was to create a contingent liability on the sovereign. The sovereign would be required to pay if the guaranteed party did not pay. I understand from the AIB Draft Restructuring Plan that no claim was ever made in respect of AIB. I am not aware of any representations by AIB to European parties.

*** Reference Appendix A, Themes and Key Lines of Inquiry**

	Line of Inquiry*		Questions
23	**R2b**	**Nature and effectiveness of the operational implementation of the macro-economic and prudential policy**	**<u>Financial Roundtable Discussions</u>** The Financial Roundtable meetings were attended by senior management of your 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 do not know what the financial roundtable discussions were. I have no knowledge of them.
24			**<u>Macro-Economic Inputs</u>** 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? Yes, macro- economic considerations were provided as part of the business planning cycle on an annual basis to form part of all planning considerations including credit. Internal and external economic forecasts were frequently considered. Unfortunately, with a few exceptions, the overwhelming consensus was for a soft landing.
25			**<u>Prudential Policy Implementation</u>** In your opinion was the introduction of new liquidity requirements and reporting standards in 2007 a helpful measure to improve liquidity forecasting and liquidity monitoring? If not, why not? I believe that it was helpful. It moved from a position of a requirement for a stock of liquid assets to take account of the maturity profile of liabilities and set minimum requirements for 0-8 and 8-31 day time periods with monitoring ratios for periods beyond that. AIB had in any event adopted such an approach in its internal liquidity policy, in line with what was considered best practice, since 2004.
26			**<u>Prudential Policy Implementation</u>** 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 am not aware of any such discussions.
27	**R3b**	**Nature and appropriateness of the relationship between the Central Bank (including the Financial Regulator), Department of Finance and the Banking Institutions**	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? We would have had communications relating to new capital issues and the CEO and I would meet them prior to the release of half yearly and annual results. We would also have had communication with them in relation to our Basle II application. I met them on a number of occasions with the Group CEO during the crisis to discuss liquidity and the crisis generally. I understand that there was ongoing communication between our Group Treasury and FR staff on AIB's liquidity and on the general funding position in the Irish market.
28			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? Not that I am aware of. b. If so how often would this have occurred? See a above. Not applicable. c. Who within the Financial Regulator was your primary contact, for credit risk and bond exposures? I did not have one. I cannot recall having any inter-action with the Financial Regulator on these issues.
29			How would you describe your relationship with the Central Bank / Financial Regulator? The Relationship was professional. As mentioned above I met them on a number of occasions with the Group CEO during the crisis to discuss liquidity and the crisis generally. Other than that my only interactions that I can recall would have been in relation to the Basle II application and publication of results.
30			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? I cannot recall any meetings with the banking supervision teams in relation to reviews of our loan book, monitoring or governance structures. I, together with the Group CEO, met with the Financial Regulator and certain FR staff during the crisis to discuss liquidity and the crisis generally. I also met Financial Regulator staff in relation to our Basle II application. My interactions with them were professional and cordial. I felt the teams were under resourced and had limited expertise but generally attempted to compensate for this by consulting other regulators for advice. Whether this view is correct or not I do not know.

*** Reference Appendix A, Themes and Key Lines of Inquiry**