Tithe an Oireachtais
Houses of the Oireachtas

Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

Michael Walsh

Session 58a (p.m.)

02 September 2015

Strictly Private & Confidential

As indicated on its cover page, the document(s) contained within are confidential unless and until the Joint Committee decides otherwise including where the Joint Committee publishes such document(s). For the avoidance of doubt, "documents" include witness statements in this context. Further to section 37 of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013 ("the Act"), while the documents remain confidential, you must not disclose the document(s) or divulge in any way that you have been given the document(s), other than:

> "(a) with the prior consent in writing of the committee,
>
> (b) to the extent necessary for the purposes of an application to the Court, or in any proceedings of the Part 2 inquiry, or
>
> (c) to his or her legal practitioner."[1]

Serious sanctions apply for breach of this section. In particular, your attention is drawn to section 41(4) of the Act, which makes breach of section 37(1) a criminal offence.

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

STATEMENT OF MICHAEL WALSH
TO THE JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

5 AUGUST 2015

SECTION 1 – STATEMENT OF MICHAEL WALSH

The Joint Committee of Inquiry into the Banking Crisis (the "Inquiry") is, at this stage, well versed in the events which occurred in the lead up to September 2008. The Inquiry has heard from many witnesses with differing expertise in these matters. While my background is in finance and academia, my evidence is primarily focussed on my involvement with Irish Nationwide Building Society (the "Society"), where I served as Non-Executive Chairman. I hope that my submission will help clarify certain matters that have been raised in relation to the Society, some of which I believe are unreasonable and inaccurate and, in some cases, entirely hindsight.

Like, I am sure, every witness who has appeared before the Inquiry, I truly regret the events that led to the banking crisis in Ireland. It is clear, both from the evidence that has been provided to the Inquiry so far, and indeed the systemic nature of the crisis, that none of the financial institutions, none of the Central Bank, the Financial Regulator or the Department of Finance ("the Authorities") and none of the economic bodies fully appreciated the significance of the global credit bubble and the consequential bubbles, particularly in the property and structured credit markets. This was equally true in the US where the two major quasi government agencies in the housing finance sector failed.

I do not dispute that much of the criticism that has been levied at the Irish financial institutions, including the Society, is merited. The Society played its part in the crisis. However, the version of events portrayed by some is not supported by the facts nor my own experience as Non-Executive Chairman. I am concerned that the popular depiction of the Society as being in the poorest financial health of all institutions at the time may hinder the Inquiry and the public understanding of the real issues at play. For example, at no stage did the Society advocate a guarantee for bond holders; because of its liquidity position, the Society was not reliant on new bond issues, so this would not have been important to it.

The Inquiry has called two former executives of the Society - The Managing Director, who built the business over a period of 35 years, and the Finance Director/Company Secretary, who was an executive director for 15 years. These individuals are much better placed to speak to the detail of business of the Society at the relevant time. I can however speak to the Society's model, strategy and board governance.

I have made this statement to the best of my recollection and belief. I believe that the documents that I have submitted to the Inquiry are true and correct. Those documents are not in the public domain.

The INBS Business Model

The Society's business model was different and indeed significantly different to that of other financial institutions. Notwithstanding the evidence submitted to date, however, I believe it to be a more prudent model than that adopted by many of its competitors. I have set out below why I believed the Society's model was sensibly different.

a) *Different in terms of liquidity*

In early September 2008, before a completely, and subsequently admitted, false story was published by Reuters, the Society had cash balances of over €4 billion. This meant that INBS, relative to its size, was not only very liquid and solvent, it was also a net supplier of funds into the wholesale interbank markets. It was the Society's strong liquidity position that enabled it to deal with the run on the Society caused by the false Reuters story without recourse to emergency liquidity or funding. Even after the run, precipitated by the Reuters story, the Society was a net supplier of circa €3 billion to the interbank money markets.

b) *Different in not-competing for unprofitable mortgage business*

Despite being a traditional supplier of mortgages, the Society did not promote 100% interest-only, long duration tracker mortgages to first time buyers and other similar products in an expensive pursuit of market share as was the case with other financial institutions. At many annual shareholder meetings the Society was criticised by some members for not promoting such products but management and the Board deemed this as imprudent and did not follow this path.

If 100%, interest only, long duration tracker mortgages were required to be sold in 2009 in a process similar to NAMA, the discount would have been 60% - similar to the level that applied to the commercial loan books of all of the covered institutions other than BoI where the discount was substantially lower.

c) *Prudent financial model*

As a financial institution serving the commercial property sector, the Society had, I believe, a prudent funding model. Unlike Northern Rock and many of the US Savings and Loans, the Society, where possible, borrowed long and lent short. By focusing its lending on the short pre-development stages, the average duration of outstanding loans was less than thirty months. This left much of the longer duration and more exposed lending (for the development/build/marketing/sale stages) to other banks and financial institutions.

d) *Strong balance sheet – conservative gearing*

The Society had robust and sustained growth in profitability in the 35 years up to 2007 resulting in a strong balance sheet where its Tier 1 capital was entirely permanent capital. In 2008 the Society was operating at gearing levels of less than half its competitors, while at the same time maintaining higher provisions. Equally in the five years to December 31st 2008, it had lower growth in lending volumes than Anglo, Ulster, BOSI and AIB in the combined property and construction and mortgage lending markets.

e) *Stuck to its strengths*

To further preserve the focus of its model the Society did not seek to turn Treasury into a profit centre. Accordingly, the Society did not invest in structured products. The Society's money was placed with Board approved institutions where it could immediately be accessed if required. Prior to the Reuters run, in early September 2008, the Society had sufficient liquidity to meet its bond repayment obligations through to the beginning of 2010. This contrasts with the position of Anglo and ILP[A] which we now know was perilous. The Inquiry has heard that, even without having had to suffer the direct effect of the Reuters run, by late September 2008, both of these institutions were about to run out of funds within the week.

f) *Expertise*

The Society had built up considerable expertise in commercial lending. The Society played to these strengths and had several profitable relationships with developers with a track record of success. This activity was started in 1992 under the supervision of the Central Bank and was authorised by the Building Society Act.

The Society's model was, therefore, carefully considered and it served the Society, and its members, well up until the unprecedented effects of the global financial crisis. The Society failed because its core business was funding property, the area where it believed it had the necessary expertise and the Society did not anticipate the instability in the global markets and its effects on that core business at a sufficiently early stage. The Society did, however, monitor the economic developments and took steps to adapt the business model accordingly.

[A] Testimony by Mr. Cardiff, 18th June, 2015 Volume 2, Nr. 31 at Page 4 "ILP, Irish Life & Permanent, was also nearly out of cash that week and was, in fact, expected to run out of cash that Thursday, give or take a day, exacerbating the systemic impact of the liquidity crisis".

Leadership and Governance - Reversed Engines Before Any Other Institution

The Society was, I believe, the first of all the Irish lending institutions to anticipate and respond to the changed market circumstances in late 2007[B]. As Non-Executive Chairman I believed that the Irish banking system was over exposed and immediate retrenchment was required. On my initiative, the Board decided to minimise lending and build liquidity. The reversal of lending growth and the cautious deleveraging were agreed in December 2007, over 9 months before the State guarantee. After the Board decision and its recognition that the Managing Director, given his client relationships, was well positioned to implement that decision, the first port of call was the Regulatory Authority. I met the Regulator to explain the decisions and rationale to curtail lending, build liquidity and defer the sale of the Society. Clearly the Society avoided publicising this because of the potential impact on the market place. The Regulator was, however, left in no doubt of the Society's deep concern at the threats which were emerging to the banking system in Ireland.

I waited month after month for the necessary overarching leadership from the Central Bank and the Regulator. Instead of leadership, I saw a lot of micro action including Regulatory correspondence and even a seemingly inappropriate increase in the Society's reserve ratio in March 2008.[C] While the Society had decided to effectively cease lending and build liquidity, I was convinced that Regulatory leadership was required to ensure broader action across all financial institutions. That leadership never came. At a meeting in early May 2008 with the Financial Regulator, and his senior staff, I used the opportunity to present, both orally and in writing, my recommendations for what I thought needed to be done to save the Irish financial system. With that paper, I set out the actions the Society was taking on its own behalf but more importantly, and in addition to other recommendations, set out the following as my key message:-

- *"Leadership is required from the Financial Regulator/Central Bank. Because of the differing competitive positions between the institutions no consensus will be achieved without the leadership of the Financial Regulator/Central Bank.*
- *In the absence of intervention, problems are inevitable as the Irish growth story has been funded by the capital markets and these are no longer available to meet redemptions. The sooner the intervention the lower the cost."*

[B] The Society made this decision in late 2007 notwithstanding that the Central Bank was forecasting GDP Growth of 3.5% for 2008 and the Department of Finance was forecasting 3.5% GDP Growth for 2009. These forecasts proved to be hugely incorrect. In fact GDP fell by 2.20% in 2008 and fell by 6.40% in 2009. Even in April 2008 the Central Bank was forecasting GDP Growth in 2008 and 2009 of 2.4% and 3.6% respectively. For 2009 the Central Bank was forecasting 6.00% unemployment and 45,000 house completions; the actual unemployment rate for that year proved to be 12.20% and house completions were 26,420.

[C] This is incorrectly reported in Nyberg report (P. 64 Note 101) as having occurred the previous year. (See also note M)

To this day I cannot understand why the Authorities did not intervene in the markets before the financial crisis broke months later. The Inquiry has heard that that the Authorities were working on contingency plans but did not activate those plans until the crisis broke and it was then too late. Indeed, I was surprised to hear evidence from a senior Department of Finance witness that the Department appears to have welcomed the immediate crisis caused by the false Reuters story as it gave them the impetus necessary to begin to take action.[D]

The fact that the Society had started the necessary deleveraging towards the end of 2007 was acknowledged publicly after my departure by the new Board, including the Department of Finance appointed directors, in May 2009, when the new Board noted:-

> *"The Society is pursuing a strategy which began at the end of 2007, predating the market collapse, of reducing the proportion of its assets relating to the commercial property sector."*[E]

Lost opportunity

I believe that the Society acted responsibly by taking that decision in December 2007[B]. It is a matter of deep regret for the Society, and very much more importantly for the Irish taxpayer, that it is now apparent that the Central Bank and Regulatory Authorities, despite having what sounds like serious misgivings as to the stability and sustainability of the Irish banking system as early as 2006[F], failed to effectively bring those concerns to the attention of the Irish financial institutions that it was tasked with overseeing. If the Society had been made aware of these concerns at that stage, it would have changed direction at least a year earlier than it did and I believe that, given the short duration of the Society's loan book, the ability to avoid any new lending and its high level of liquidity, the Society could then have traded its way out of subsequent difficulties and come through without recourse to the taxpayer. No doubt other Irish institutions would have taken similar measures had they been fully aware of those concerns which were at variance with the growth being publicly forecast by the Central Bank and the Department of Finance at that time.

When I agreed to become Non-Executive Chairman in 2001, my brief was to help the Board of the Society oversee a trade sale of its business under proposed new legislation supported by the Central Bank, the Department of Finance and the Department of the Environment

[D] Testimony by Mr. Cardiff, 18th June, 2015 Volume 2, Nr. 31 at Page 13
[E] Chairman's Statement to the Society's AGM on 12th May 2009
[F] Honohan Report P88 Par 6.27 reports that the analysis for the Roundtable Discussions in late 2006 showed that, assuming a non performing asset ratio of 5% and a 75% loss given default, nine out of twelve institutions, representing 88 per cent of total banking sector assets, fell below the regulatory minimum capital. Honohan P10, Par 1.15 "The language of successive FSRs was too reassuring throughout, even as late as November 2007, and did little to induce the banks – or the public and policy makers – to adjust their behaviour to avoid the threats that lay ahead".

which was to be introduced the following year. This was something which, based on my prior analysis[G], I saw as fundamental to the Society's future development. It is a matter of enormous frustration, disappointment and regret that successive legislative delays combined with the unwillingness of the Central Bank to exercise its power under Section 102(4) of the 1989 Building Society Act[H], prevented the planned sale of the Society to an overseas institution long before 2007. This would have delivered a return to its members and ensured that the Society had the benefit of the backing of a larger institution when the crisis hit and probably eliminated the risk to the Irish taxpayer.

Whereas I appreciate that the planned sale of the Society is not the focus of this Committee, it is clear that, if the sale had been allowed proceed in a timely fashion, the value destruction and cost imposed on Irish tax payers could have been avoided and a return delivered to the Society's members. Unlike the financial crisis, there was no shortage of foresight and from 2001 full agreement with the Authorities that a sale should take place and the fact that it did not points to the enormous cost of inaction by policymakers and regulators alike (Appendix 4).

My role in the Society[I]

As noted above, I agreed with the Board and the Central Bank to become Non-Executive Chairman in 2001 to help the Board oversee a trade sale under the proposed new legislation planned for 2002. Annually from 2001, this legislation was promised and not delivered. Having failed to deliver the legislation, the Central Bank and subsequently the Financial Regulator repeatedly required me to stay in situ until a trade sale could be achieved.

I believe it was my background in finance which led to my appointment as Non-Executive Chairman of the Society in 2001, with the particular task of overseeing a trade sale of the Society. In 1982 I became Professor of Finance in University College Dublin. From there I joined NCB Group in 1986. In my capacity as head of Corporate Finance for NCB, I was heavily involved in all aspects of mergers, acquisitions, disposals and flotations. Arising out of that role, in July 1993, I developed a paper for the Board of the Society on its future options in which I identified the need for it to be part of a larger institution and the logic of a trade sale (Appendix 2).

As Non-Executive Chairman, I was always fully independent of management. I never took any loans from the Society. I never claimed any expenses. I was not dependent on the

---

[G] Appendix 2

[H] The Central Bank under Section 102(4) of the Building Societies Act, 1989 had the right to authorise the full sale of the Society "if it considers it necessary to do so in the interests of depositors." In the absence of the Central Bank/Financial Regulator using this power or legislative change there was a mandatory five year delay from the time the Central Bank allowed a Society to convert to a normal company before a Society could be sold to another institution.

[I] Summary CVs for each of the directors are set out in Appendix 7 remuneration I received, which was always set at a discount to the other remaining building society and over 40% below the levels subsequently recommended by CIROC[J]. Equally, neither I nor any other non-executive director had any expectation of gain from a sale of the Society, other than the same amount that would have gone to each share-deposit account holder and each borrower[K]. Neither was I part of the social circle of either the management or the other non-executive directors.

At all stages, as Non-Executive Chairman, I maintained close contact on behalf of the Board with the Central Bank and Financial Regulator. All major decisions by the Board were agreed with them. It was at their request that I prepared a paper for the Department of Finance setting out the options for the Society in September 2008. This was, I believe, a belated recognition of the validity of my earlier calls for action based on the Society's concerns and its decision to cease lending in December 2007 and culminating in my recommendations to the Financial Regulator in May 2008. When I resigned in February 2009, having got Board agreement on a new management team, the Minister for Finance, Mr. Lenihan, intervened to ask me to reconsider my resignation.

The Society and the Central Bank / Financial Regulator[L]

During my time as Non-Executive Chairman, the Board took all issues raised by the Central Bank / Financial Regulator (CB/FR) very seriously and I, and other directors, maintained close contact with the CB/FR and sought to continually enhance management systems. All correspondence from the CB/FR addressed to me as Non-Executive Chairman got full Board attention and where appropriate the Board took additional inputs from its external experts/advisers.

Despite what is now often inferred – the CB/FR had absolute power under the 1989 Building Societies Act to remove any director/executive in a Building Society. (This was a power they did not have in the banks.) Yet, whereas Michael Fingleton has been criticised by many, at no stage did the CB/FR ever suggest to me as Non-Executive Chairman that they wanted him removed; on the contrary, in my view, they saw him as effective and key to the proposed trade sale.

[J] Covered Institutions Remuneration Oversight Committee

[K] Under the Society's Rules all directors were required to hold a share deposit account.

[L] In an academic paper delivered in 1987, I advocated a new streamlined regulatory system under the control of the Central Bank. At that stage, the regulatory environment was very fragmented with different regulators for banking, insurance, building societies etc. I believed that many of the problems in the Irish market prior to that date related to the lack of co-ordination as between the insurance and the banking regulators. The subsequent separation of the monetary and regulatory functions ran counter to my belief in consolidation.

At no stage after 2004 did the CB/FR seek to take any meaningful action in relation to lending or lending related issues.[M] Contrary to some of the evidence that has been given to this Inquiry the CB/FR was far from toothless and where it had an issue, it was my experience that it had no hesitation in using its powers, albeit not always, in my view, in a sensible fashion. One such instance is when the CB/FR approved a reduction in the Society's deposit ratio in June 2007 which would have facilitated substantial lending growth, had the Society not subsequently decided on its own initiative to curtail lending. This approval by the CB/FR is perplexing, given what we now know about the CB/FR concerns about the stability of the Irish banks in 2006[F]. Furthermore, the CB/FR now claim they had concerns in relation to the Society and its management. If these concerns were genuine, this approval by the CB/FR was irresponsible in the extreme, as it gave the opposite impression.

A further example of the CB/FR's attitude to using its power arose in March 2006. Following the resignation of Dr. Power and the co-option of Mr. Brophy, who had been pre-approved by the CB/FR, to the Board, the CB/FR threatened to remove the Society's licence if the Society did not hold an election for a non-executive position on the Board. This threat was not made in relation to a prudential issue but to facilitate a particular non-executive Board candidate. I believed then and now that such a threat was irresponsible. However this action by the CB/FR clearly illustrates that the CB/FR was aware of the extent of its powers and that they were willing to exercise them, albeit in this case completely inappropriately[N].

The Central Bank/Financial Regulator had extensive legal supervisory powers and as is evident from the above threat it was fully prepared to use them. Through their expert inspection teams they had direct access to and detailed knowledge of the inner workings of the Society and indeed each institution. If the CB/FR had material concerns about the Society, it seems clear, based on actions described above, that they would have and could have taken action; they did not.

Contemporaneous Assessment and External Advisors

The Society used top external advisors. KPMG and its predecessor organisations audited the Society and produced multiple reports for the Society on lending and other matters over thirty years. In 2001, in anticipation of the trade sale the Society started utilising the legal services of McCann FitzGerald. Goldman Sachs was the lead advisor on the trade sale and other issues. KPMG completed its detailed Vendor Due Diligence review of the Society in June 2007. There was no suggestion at that time of the Society being other than a very

[M] In December 2007 the Society informed the Regulator it had decided to cease lending and build liquidity. The following March, i.e. March 2008, the Regulator notified the Society of an increase in its reserve ratio. (See also note C)

[N] The CB/FR was fully aware and had the legal advice from Senior Counsel that there was no requirement for an election and that its threatened action was an abuse of power.

valuable asset. But for the global liquidity crisis, the Society would have been sold in late 2007, probably at a valuation of between €1.5billion and €2billion, based on the Goldman Sachs benchmarks. Indeed as late as October 2007 Goldman Sachs circulated a completion timetable for the sale and in November 2007 McCann FitzGerald circulated the proposed sale and purchase agreement.

Hindsight Assessment and Policy Response

With the benefit of hindsight, I believe that the difficulties which the Society subsequently encountered and the associated losses arose from a combination of factors:-

a) Bubble of cheap credit: a global bubble of cheap credit occurred and flowed into many of the international markets with a never ending search for yield. Much of this credit bubble flowed into property and structured products. Despite being virtually impossible to evaluate, many of these structured products were AAA rated. In the US markets much of the property related, and indeed other lending, was bundled into these structured products and sold to other institutions globally. In Ireland and the UK, however, much of the property, SME, and other lending risk was retained on the Balance Sheet of the originating institution;

b) Hyper competition: progressively from 2004 onward larger financial institutions piled into the market in which the Society had operated since 1992 (i.e. the provision of acquisition finance to the property development market). This increase in available funding led to the creation of a bubble in this market sector. The regulatory authorities globally failed to control this situation;

c) Markets freezing: the assessment and awareness of risk by the markets began to increase in the second half of 2007 initially in relation to off balance sheet structures. The renewed focus on risk ultimately led to a complete freezing of the global interbank market as participants were unable to assess the true value of many structured products and, in the case of Ireland, of the on balance sheet loans of the institutions. This banking risk also spilled into the insurance market e.g. AIG, as many of the risks had been insured against;

d) Inability to refinance: the resulting drying up of liquidity in the international inter-bank markets (Lehman Brothers, Bear Stearns) meant that banks could not source adequate funding and therefore the Society's customers found it increasingly difficult to refinance their short term loans from the Society with other lenders as had traditionally been the case. It was the recognition of these issues that had led to the Board's decision in December 2007 to curtail lending, which I had discussed with the Regulator and my warning to the Regulator in May 2008 of the need to take a leadership role.

e) The property bubble bursts: the sudden lack of liquidity caused the bursting of the property bubble that had developed in Ireland and elsewhere and a continuing and ultimately significant fall in value of the properties which secured the property and residential loans in each institution;

f) Excess pressure: It is clear now that, as the commercial property market became increasingly heated, the requirement of the Society's customers for quick decisions led both to some unwise lending decisions by the Society and also apparently to some lapses in adhering to guidelines and procedures laid down by the Board in relation to the processing and approval of loan applications;

g) Concentration of risk in the commercial property sector: because the Society loaned funds to a relatively small number of borrowers many of whom were in the commercial property sector the Society was badly affected by the impact of the factors listed above.

NAMA Transfers

Commercial loans were required by law to be transferred to NAMA at a point in the cycle at which they were at their lowest value and at a price which was substantially below a normal market value. The level of discounts applied crystallised huge losses across all institutions at a time when there was no market.

The table below sets out the discounts applied to each institution as reported in the NAMA Annual Report for the year ended December 31st 2011 as published in June 2012. This table relates to the full transfers, (whereas most of the public commentary at the time was around Tranches 1 and 2 which in the context of the Society only represented 14% in aggregate of the loan book).

NAMA Financial Statements 2011	(Published June 2012)					
	Loan Acquisition by Institution (€ billion)					
	AIB	ANGLO	BOI	EBS	INBS	Total
Loan Balances Transferred	20.4	34.1	9.9	0.9	8.7	74.0
Consideration Paid	9.0	13.4	5.6	0.4	3.4	31.8
Discount	56%	61%	43%	56%	61%	57%

As is evident from the above table, based on the NAMA transfer prices as reported by NAMA, the actual discounts applied for the full transfers of each of the institutions (other than the outlier - Bank of Ireland) were within 5 percentage points of each other.

The level of discount applied to the loans transferred to NAMA was particularly surprising to me, given that:

a) in May 2009 after my departure the Society published its accounts(for the y/e 31/12/2008) showing a write down of less than 5% on the loans rather than the 61% write down at which that Board later transferred them to NAMA.
b) in April 2010 the Society's Government appointed Board stated that they had carried out another detailed analysis of all loans and the associated cash flows and on that basis they had written the €8.7bn non-mortgage loan book down to €5.6bn.
c) however, within a further five months the Board agreed to transfer to NAMA the loans they had valued at €5.6bn in April 2010 for €3.4bn i.e. a further 40% discount.

This unexplained increase in the discount within a few months immediately doubled the required government support for the Society. It is more for the Joint Committee of Inquiry to determine if the level of discounts applied across all institutions has proven to be appropriate but I understand that the Inquiry has heard that some of those loans that were transferred at a discount of circa 60% have been repaid in full.

Liquidity versus Solvency

Following the decision of the Society to cease lending and build liquidity in December 2007, by the end of August 2008 the Society had sufficient liquidity to meet all its bond repayment obligations through the beginning of 2010. Because of the decision in December 2007, the Society was in a strong liquidity position and possibly stronger than all the covered institutions at that time.

There was absolutely no basis for the Board to believe the Society was not solvent prior to the Reuters run in September 2008.

After the Reuters run and the Government Guarantee was announced, considerable work was done on behalf of the Department of Finance and the CB/FR to assess the exposures in all institutions. The CB/FR appointed Financial Regulatory staff to each institution. These Financial Regulatory staff were located in the Society's offices and were invited to attend all Board and Committee meetings. The Department of Finance appointed two Public Interest Directors to the Society in late 2008. The Board appointed them to positions on Board Committees where their experience could be capitalised on to greatest effect and provide maximum transparency for them, and in turn for the Department of Finance, into all aspects of the Society. The two very experienced Public Interest Directors were:-

- Adrian Kearns – Mr. Kearns had been a Director of the National Treasury Management Agency and had been joint second in command there to Dr. Somers. Prior to joining the NTMA, Mr. Kearns had been a senior member of the Department of Finance. Given his experience of capital markets Mr. Kearns agreed to take on the Chairmanship of the Asset and Liability Committee. Given Mr. Kearns' position as a key member of the executive board of the NTMA for many years his appointment at that time was especially valuable.

- Rory O'Ferrall – Mr O'Ferrall was a very experienced Chartered Accountant and a senior partner with Deloitte for many years. Mr. O'Ferrall agreed to take on the Chairmanship of the Audit Committee.

In the period September to December 2008, PriceWaterhouseCoopers (PWC) carried out a detailed review of the Society's loan book on behalf of the Department of Finance. PWC assessments were aided by the streetwise valuations of Jones Lang La Salle.

The PWC/JLL report, drafts of which were formally shared with the Society and the Board, showed that under the PWC stress tests the Society was solvent and could trade through its difficulties.

Post My Resignation – Solvency and Going Concern 2009

While I resigned in February 2009, I understand that a Solvency Statement was subsequently required to be signed by the Society in March/April 2009 in connection with a financing by the Society. At that time, all Board meetings were attended by the two Public Interest Directors and the two Financial Regulatory staff members. I understand that the Solvency Statement, confirming the Society's solvency, was duly signed after all appropriate investigations were made and advice received from the Society's auditors (KPMG) and solicitors (McCann Fitzgerald).

I would particularly draw the Committee's attention to Appendix 1 and notably the penultimate paragraph on Page 2. In that Appendix there is a detailed minute of a meeting considering the solvency of the Society on behalf of the Board. The detailed minutes record the involvement of key directors, legal and financial experts. They also reference the Financial Regulator in particular and the Department of Finance. These minutes go to the heart of the Solvency debate and the financial position of the Society well into 2009.

In April 2009, the Society's accounts were audited and they showed surplus assets of nearly €1.2 billion.

On 12th May 2009, the Society released a statement by the Chairman (Mr. Kitchen) for the Annual General Meeting. The Chairman (Mr. Kitchen) made the following comment in relation to the Society's review of the loan book:

> *"The nature of the Society's commercial loan book is that the largest 100 customers represent approximately 60% of the loans and because of this concentration, both the Society and its auditors have been able to go through the provisioning process in a much more specific way than perhaps would be possible in other organisations. Consequently, the Board feel that the provisions made do reflect a conservative*

approach, albeit certain assumptions have to be made in arriving at these figures. I would stress that these provisions do not represent loan write-offs despite what you may read in the press. They are the Society's view of the likelihood of default and an estimate of any potential shortfall in getting our money back. The borrowers, however, remain obligated to repay 100% of the loan."

Armed with this very detailed level of knowledge of the Society, the Department of Finance, the Central Bank, the Financial Regulator, the Public Interest Directors and the Auditors all determined the Society was solvent.

I understand that the Board in advance of signing the accounts in April 2009 got assurance from the Department of Finance that the necessary resources would be available to meet its business plan – which had been approved by the Board, including the Public Interest Directors, and accepted by the Financial Regulator. This Plan effectively continued the change of direction the Board had approved, in late 2007. As Mr. Kitchen noted in May 2009 in his Chairman's statement:

"The Society is pursuing a strategy which began at the end of 2007, predating the market collapse, of reducing the proportion of its assets relating to the commercial property sector."

"As you may have seen in the press this morning, the Society has raised a further €750m by issuing medium term notes under the Government Guarantee and I am pleased to say that we had over 40 European Institutions subscribing for these notes. I think that this demonstrates the Society's ability to raise any necessary funds ......"

"*The deterioration of property markets associated with serious dislocation of international financial markets has produced an extremely challenging environment. Frankly, I do not see any likelihood of improvement in the markets in which we operate in 2009."*

"2009 will be a difficult year and whilst it is impossible to predict an outcome for the year given the uncertainty out there, I would hope that the Society will produce better results than in 2008. Both the Board, management and staff will all be working hard to achieve this."

Against all of the above I cannot understand how, even with the benefit of hindsight, various witnesses have been able to claim, with apparent certainty, that the Society was insolvent in September 2008.

SECTION 2 – SUPPLEMENTARY INFORMATION

B - BANKING

B1 Effectiveness of banks' board governance, client relationships and business models

a. Composition, skills and experience of the board and board subcommittees.

For most of my time on the Board, there were two executive directors, Mr Michael Fingleton and Mr Stan Purcell. When I joined the Board, Mr Fingleton had been the Chief Executive Officer for over twenty years and had built up the Society from very small beginnings. It was clear to me that he had a track record of successful management of the Society up to that point and as such was respected by the Regulatory authorities. Mr Purcell was Finance Director and Company Secretary. The remainder of the Board comprised non-executive directors, including myself. I believe the overall balance of the Society's Board was appropriate for a society of its size.

Brief CVs of non-executive directors are set out in Appendix 7. As will be seen, these were well qualified non-executive directors, and one of them, Dr. Power, was headhunted by the Department of Finance to be the first Chairman of the Financial Ombudsman Council. This role caused Dr. Power's resignation from the Society in 2006. However, it is simply not credible that a member of the Board of the Society would have been appointed to such a key position if the Central Bank, or the Financial Regulator or the Department of Finance had material concerns about the governance of the Society.

The Board was always keen to recruit additional non-executive directors who could add value e.g. in May 2008, with the authorisation of the Financial Regulator, I approached the former Director General of the Central Bank to join the Board but he ultimately decided against it for personal reasons.

Because of the small size of the Board, all of the non-executives were members of the audit and remuneration committees. I chaired the remuneration committee. Dr. Power chaired the audit committee from 2003 to 2006 and Mr. Cooney from 2006 until the Board appointed former Deloitte partner and Public Interest Director, Mr. O'Ferrall, to that role in January 2009. This latter appointment was to maximise the transparency and total co-operation between the Society and the Department of Finance.

In addition the Society had a number of executive committees which operated under terms of reference approved by the Board and were typically chaired by either the Managing Director or the Finance Director.

B1 Effectiveness of banks' board governance, client relationships and business models

c. Quality of the business model setting process.

See Section 1.

B1 Effectiveness of banks' board governance, client relationships and business models

d. Adequacy of board oversight over internal controls to ensure risk is properly identified, managed and monitored.

The Delegation of Authority and Reservation of Powers

The Society was governed by the Building Societies Act, the Rules of Irish Nationwide Building Society (the "Rules") and regulated by the Central Bank of Ireland (the regulatory function transferred to the Financial Regulator from 2003 to 2010).

Under the Rules, the Board of the Society was entitled to delegate any of its powers relating to the business of the Society to committees, senior officials or officials of the Society as it saw fit. It was also entitled to reserve powers to the Board. As is normal, many of the powers were delegated to the executive management.

In 1997, the Central Bank carefully considered the extent of the delegation and recommended that the terms of it be modified so that the Board expressly reserved certain powers to itself. That suggested modification was adopted by the Society in August 1997. The powers reserved to the Board included the acquisition and disposal of material assets and investment, capital projects, the setting of authority levels, and of treasury and risk management policies.

The Board's policy required that all loans of over €1m had to get approval from the Board, after they had been recommended by the credit committee. The executive then had to put in place the formal offer agreement and complete all necessary diligence before advancing the loan. This level of authority was much lower than was the case in other Irish based banks and the only other remaining building society, EBS. My understanding is that, at that time, management of EBS had authority for loans up to €10 million. In Danske Bank the Irish head of lending had authority up to €15 million. In Ulster Bank only loans above €20 million were notified to the Board. In short, the other financial institutions had delegated much greater authority in absolute and relative terms and given much greater discretion than the Board gave to the Executive of the Society. The full loan approval process as set out by KPMG in their Vendor Due Diligence in June 2007 is attached in Appendix 6.

I do not accept the suggestion that the MD enjoyed complete autonomy and was free from oversight from the Board. This is contradicted by the documentary record and the facts of the matter.

Notwithstanding this level of oversight, it is clear that a non executive Board cannot micro manage the operations of a significant financial institution run on a day to day basis by a full time executive management team. In that context the extent of delegation to the Managing Director, and the reservations to the Board, were in the view of the Board entirely reasonable and were well known to the Central Bank and to KPMG, as the Society's auditors.

The Functioning of the Board

The full Board met at least monthly.

In 2006 there were 16 full Board meetings, in 2007 there were 14 and in 2008 there were 24. At each meeting, the Board reviewed the performance of the Society, considered any correspondence from the Regulator and reviewed the loan proposals in excess of €1m which were presented to it by the Executive.

A Board pack was provided to each member of the Board in advance of all Board meetings. This pack generally contained key financial information including Profit & Loss accounts, Balance Sheets, arrears, and any recent correspondence from the Financial Regulator. Commercial Loan Applications were considered at the meetings having regard to the recommendations of the Credit Committee.

The process for considering and approving loans was fully understood by the Central Bank and subsequently the Financial Regulator. All Board packs and minutes were available to the CB/FR and their specialist inspectors.

The Board required the Society to have an Internal Auditor, a Compliance Manager and a number of Executive Committees to manage key areas within the business including an Asset & Liability Committee, a Credit Committee, a Provisions Committee, an Assurance Providers Committee, and an ICAAP Committee.

Each of these committees had terms of reference and policies as specified by the Board and had strict delegated authorities. An Organisation Chart as set out in the PriceWaterhouseCoopers Report to the Department of Finance is attached at Appendix 5. This chart illustrates that the structure of the Society was standard for an organisation of its size and also shows the reporting channels.

As previously mentioned the Board had two sub-committees – a Remuneration Committee and an Audit Committee. All of the non-executive directors were members of these sub-committees.

The Audit Committee

The Audit Committee met at least four times a year.

Dr. Power took over as Chairman of the Audit Committee in 2003. He held this role until he resigned from the Board in February 2006 when he was succeeded by Mr. Cooney. All of the non-executive directors participated in the Audit Committee up to October 2008. This was to ensure maximum support to the Internal Auditor and Finance Director in progressively improving systems and control. This improvement was acknowledged by KPMG in June 2008 when, at a meeting with the Financial Regulator, at which no one from the Society was present, KPMG inter alia noted in relation to the Society:

- *"All information in one place – nothing overly complex – no treasury*
- *Operates principally in commercial lending – no subprime lending*
- *Controls – key process, much improved upon in the past 6 years, 6 years ago had issue with bank reconciliations, suspense accounts which have been rectified.*
- *Numbers reported in the management accounts – not a risk issue*"

At each meeting the Audit Committee considered circa twelve reports covering areas such as commercial lending, commercial loan administration, savings, anti money laundering, mortgage administration, accounting systems, controls, treasury, IT and compliance.

All audit recommendations made by KPMG as auditors were fully supported by the Audit Committee and the Internal Auditor and the Finance Director/Company Secretary were instructed to have the recommendations implemented.

The Audit Committee met with KPMG, the external auditors, at least twice each year both for the audit plan and for the review of accounts in advance of KPMG signing their Audit Certificate.

Annually the non-executive members of the Audit Committee met with KPMG without any executives present. At no stage in those sessions did KPMG express concerns about either the Executive Directors or the internal audit function. On the contrary, KPMG noted continued improvement in controls.

B2 Effectiveness of banks' credit strategies and risk management

a. Appropriateness of property-related lending strategies and risk appetite.

b. Appropriateness of credit policies, delegated authorities and exception management.

This can only be assessed against the overall description of the model which I have set out earlier.

However, the capital position of building societies differed from the banks and other public entities.

Like all building societies the Society was relatively constrained in its access to capital. The lack of access to the equity markets meant that permanent capital could only be derived from retained profits. Consequently in order to grow the profits and thereby the capital base of the Society, the Society focussed on utilising its capital to maximum effect by recycling capital as fast as possible, by maintaining a low cost base and by maximising the return on any capital utilised.

The loans would typically be provided on a short term basis, with many of them being repayable often within as little as eighteen months. The borrower was expected to enhance the project and then refinance the loans elsewhere with larger institutions.

To optimise the return on capital the Society structured many of its loans with normal market interest charges but with a right to participate in any profits on the subsequent development which would be funded elsewhere. Once the loan was refinanced, the Society had no exposure to any subsequent loss on these developments. In many cases the risk the Society was taking was whether the borrower had the expertise to identify an opportunity where planning could be achieved or improved upon, rather than any longer term development risk which was more appropriate to larger institutions.

The Society's primary focus was on short term lending – in September 2008, the average duration of its loan book was less than thirty months. In contrast up to and including the final bond issue in June 2007, the bonds would typically be for a period of circa five years. Coupled with the lack of reliance on the inter-bank market this gave comfort on the safety of the funding model assuming normal global financial market conditions. Unfortunately the normal global financial market conditions that the Society, and indeed the broader economy, had been familiar with became unrecognisable in 2008 and this contributed to the losses suffered by the Society.

B5 Impact of the remuneration arrangements on bank's risk management

a. Adequacy of the incentive and remuneration arrangements to promote sound risk governance.

The Remuneration Committee from 2002 consisted of all of the non-executive directors. Despite the lack of equity type rewards for the Society's executives, their remuneration was set at levels that were deemed appropriate at the time and not out of line with others.

The primary objective of the Society from the day I became Non-Executive Chairman was a successful sale of the Society to a larger institution. Maximising value in a sale process requires having a business model and organisation which potential buyers of the Society will want. Accordingly, the Board was focussed on enhancing systems in tandem with sustaining profitability.

The objective of a successful sale provided true alignment of interests between the senior executives and the Society's members. Both the members and the employees would have benefited from a successful sale.

Given the repeated promises that the legislation for a trade sale was less than twelve months away, it was not appropriate to create a longer term incentive scheme. An earlier incentive scheme which would have potentially complicated such a sale was set aside by the Board in 2002 and this was accepted by the Managing Director.

Executive Directors were not incentivised by bonuses or the like to generate new loans – the focus was correctly in my view entirely on profit and value creation.

B5 Impact of the remuneration arrangements on bank's risk management

b. Impact of shareholder or lending relationships in promoting independent challenge by the board and/or executives.

I was always fully independent of management and I believe that was equally true for each of the other non-executive directors.

At no stage was I, or the Society, party to any lending decision where I had any involvement. My employer, IIU, had minimal interest or investment in property and had no borrowings from the Society.

Mr. Brophy, who agreed to join the Board in October 2005, had been a senior executive of the Smurfit Group for the previous eleven years. In August 2007, Mr. Brophy was approached to become COO of the Ballymore Group. Ballymore was the largest borrower from the Society. Mr. Brophy took no part in any decision in relation to the Ballymore Group. In December 2007, when I proposed that the Society reverse directions and cease lending, I was fully supported by Mr. Brophy, despite the fact that this might not be in the interest of Ballymore Group.

At no stage did Mr. Cooney or Dr. Power have any relationships which would have impacted in any fashion on their ability to promote independent challenge.

Consequently, none of the non-executive directors had any reason not to challenge any decision or views of management and, as would be expected, issues were raised from time to time by all of the non-executive directors.

Loans were only brought to the Board on the recommendation of the credit committee via the Executive Directors of the Society. At no stage did any non-executive bring or propose a loan directly to the Board for consideration.

R - REGULATORY

R1 Effectiveness of the regulatory, supervisory and governmental regime structure

a. Appropriateness of the regulatory regime[L].

At a practical level, from my perspective, there was minimal change in the Regulatory environment in the period I was involved with the Society. In the early days, I had frequent contact with the Governor, Mr. O'Connell and subsequently, Dr. O'Reilly. Dr. O'Reilly would then have been my primary contact up to his retirement in January 2006. Indeed it was in deference to his requests that I continued to stay on as a Non-Executive Chairman of the Society notwithstanding the continuing delays to the anticipated legislation.

R1 Effectiveness of the regulatory, supervisory and governmental regime structure

b. Effectiveness and appropriateness of the supervision policy and powers.

The Regulators/Supervisors had at all stages all necessary powers in relation to Building Societies. They had the ability under the Building Society legislation to remove any director/manager they wished and of course they had the ultimate sanction of removing or imposing a condition on the license. No such sanction was ever imposed in relation to the Society. However, the ultimate sanction was once threatened against the Society albeit, in my view, in inappropriate circumstances as described in Section 1.

Central Bank/Financial Regulator Inspections

The Central Bank and subsequently the Financial Regulator conducted regular detailed inspections of the Society and all other institutions. The Society took these inspections very seriously and co-operated fully with them. In June 2006 the Financial Regulator completed a detailed inspection and shortly following this the Board reviewed an action plan from management to deal with all issues raised during the inspection. Subsequently the CB/FR followed up with their inspection letter. The Regulator had a priority designation for their findings as set out in their inspection letters of High Priority, Medium Priority and Low Priority. At the end of this very thorough process, the Regulator did not designate <u>a single</u> finding as High Priority.

Lending Related Adjustments by the Regulator

In 2004, the Central Bank imposed a higher reserve requirement on the Society due to the changing mix of its business. While the Society would have preferred not to have this formally announced due to a potential adverse reaction from rating agencies, it was in truth appropriate as a lower capital weighting for domestic mortgage assets was the norm.

In March 2008, some months after I had informed the Financial Regulator of the Society's decision to largely cease lending, the Financial Regulator increased the Society's reserve requirement[C]. Given that the Society had already implemented a prudent and significant change in direction the Financial Regulator's action seemed irrelevant and did not seem like a sensible intervention.

Other Regulatory actions

In December 2004, the FR publicly criticised the Society because the FR concluded that, contrary to the provisions of the Building Society legislation, some staff had given ballot papers to customers for the April 2003 AGM without being requested in writing to do so and in some cases without the supporting information.

In October 2008, the Society was, quite rightly in my view, fined due to a staff member citing the Government Guarantee in seeking to generate deposits in the UK at a very sensitive time.

R3 Clarity and effectiveness of the nexus of institutional roles and relationships

b. Nature and appropriateness of the relationship between the Central Bank (including the Financial Regulator), Department of Finance and the banking institutions

My knowledge of the relationships is confined to the Society; I have minimal knowledge of the relationship between the Central Bank, Department of Finance and the banking institutions.

R5 Clarity and effectiveness of the Government and Oireachtas oversight and role

d. Appropriateness of the relationship between Government, the Oireachtas, the banking sector and the property sector.

I have no direct knowledge of these relationships other than to the extent that in the context of the Society, appropriate legislation, although fully supported, was not implemented in 2002 and the Society was misled by Government and/or the Central Bank in each successive year in the period 2001 to 2006 in relation to the imminence of such legislation. Annually, the required legislation was promised: annually it was not delivered to the detriment of the members and ultimately the taxpayer. Set out in Appendix 4 are the key events as they relate to the proposed trade sale of the Society – from 2001 the agreed objective of the Central Bank and the Society.

C - CRISIS RESPONSE

C2 Role and effectiveness of the policy appraisal regime before and during the crisis

c. The liquidity versus solvency debate.

See Section 1 – Statement pages 11 and 12.

C3 Appropriateness and effectiveness of the Department of Finance actions during crisis

b. Appropriateness of the bank guarantee decision.

Neither I nor the Society was involved in the decision by the Government to provide a bank guarantee in September 2008. The Society did however engage with the CB/FR on various occasions in relation to the banking crisis.

In December 2007, due to concerns in relation to global liquidity the Board decided to minimise lending and build liquidity and this was immediately communicated to the CB/FR.

In March 2008, there was a run on Anglo and the Irish market became increasingly unstable.

In May 2008 – being concerned about the lack of action by the CB/FR I prepared a briefing paper which set out the need for action on their part. In this paper to the Financial Regulator I did advocate a better deposit guarantee. This was an issue raised by depositors at the Society's AGM in April. I was informed by the Financial Regulator that this was being looked at.

In September 2008 the Financial Regulator asked me to prepare a paper for the Authorities on the options for the Society, given the run that had resulted from the false Reuters story. In that paper, I again set out a belief that a more extensive deposit guarantee was required.

In the Society's meeting with the Central Bank/Financial Regulator on September 20th 2008, i.e. post Lehman and the effective freezing of the global interbank markets, the Central Bank provided a copy of a statement due for release increasing the deposit guarantee to €100,000. At the meeting I expressed the view that as the crisis had already broken this would be insufficient and I was told that the Society should interpret a subsequent paragraph of the release as an implicit guarantee of all deposits. At no stage did the Society advocate a guarantee for bond holders; because of its liquidity position, the Society was not reliant on new bond issues, and therefore such a guarantee was not relevant to it.

Given the very fraught situation at the time and the fact that immediate action was required, it is perhaps understandable why the blanket guarantee was put in place. However, for the Society, it was unnecessary and in my view, as expressed in writing to the Authorities at the time, a full <u>deposit</u> guarantee would have sufficed.

C4 Appropriateness and effectiveness of the domestic policy responses

c. Decision to recapitalise Anglo, Allied Irish Banks (AIB), Bank of Ireland (BoI), Educational Building Society (EBS), Permanent TSB (PTSB) and the alternatives available and /or considered.

At the time of my resignation it was believed by all involved including the Central Bank, the Financial Regulator and the directors, including the Department of Finance appointed directors, that the Society would be able to trade through its position without a capital injection, though it was clear that, at a minimum, it would require the ongoing benefit of the Guarantee

However, in more general terms, a massive contraction in credit as occurred was inevitably going to drive down prices and any capital injections will have only partially helped to offset that contraction.

In the context of the Society, not having been present, I can only act as a commentator. However, for the taxpayer, the most efficient approach (if allowed by the ECB/Europe) to dealing with the Society would have been some form of conservatorship with deposits being guaranteed or alternative funding being provided during the wind–down phase. As noted this was something the Society had largely commenced itself in late 2007.

Appendix 3

Timeline of Key Events

1987	Michael Walsh ("MW") prepares a study for the Building Societies in advance of their submissions in relation to the 1989 Act. The key focus is the changing structure of the Irish Mortgage Market. (Paper presented at the Dublin Economics Workshop in Kenmare on the future for Building Societies.)
1989	New Building Societies Act 1989 comes into force. Society comes under the supervision of the Central Bank starting January 1990.
1992	The Society, under the supervision of the Central Bank, starts to become involved in housing development in Ireland.
July 1993	MW prepares a paper for the Board of the Society on the need to be part of a larger financial institution to enable it to compete with the much larger entrants which had come into the market from the mid-eighties. (**Appendix 2**)
1994	Under the supervision of the Central Bank, the Society acquires sites for development in the London docklands.
1995	MW joins the Board of the Society as a non-executive Director. MW ensures at all stages that he is independent of management. He never borrows from the Society and has no expectation of a gain from a sale of the Society.
1997	Delegation to the Managing Director is reviewed. The powers reserved to the Board are implemented based on the Central Bank recommendation. Reserved powers include acquisition and disposal of assets that are material, investment, capital projects, authority levels, treasury and risk management policies. All loans above the authority level required Board authorisation, following which the executive had to put in place the formal offer agreement and complete all necessary diligence before advancing the loan.
2000	Half of the Society's business utilises new powers in the 1989 Act – the loan book is equally split between residential and commercial.
May 2001	MW accepts appointment as non-executive Chairman on the understanding that a trade sale was imminent and that the necessary legislation would be passed within twelve months.
2002	• Promised legislative amendment necessary for the trade sale is not delivered. • The Central Bank states to MW and Dr. Con Power that it hopes to have the necessary amendment in the Central Bank Bill 2003 to enable the trade sale. • October – Central Bank (Dr. O'Reilly) states that it expects MW and Dr. Con Power to stay on the Board until a trade sale can be effected.
2003	• Legislative changes again promised but not delivered. The Central Bank is unwilling to use its discretion under Section 102(4). • McCann Fitzgerald is instructed by the Society to assist with the drafting of the necessary legislation.

16 December 2003	Minister for the Environment announces the approval of a package of measures to allow a trade sale with legislation to be published in early 2004.
2004	Central Bank confirms to MW and Dr. Con Power that there is nothing as between the Central Bank and the Society other than normal matters as between a regulator and a regulated entity.
2004	Legislative amendments promised in December 2003 were not delivered.
9 September 2004	• Minister for the Environment writes to the Society stating that the necessary legislation will be finalised by the end of the Autumn 2004. • Legislation was not delivered.
2005	• Despite assurances from the Minister for Finance and the Minister for the Environment, the legislation promised was not delivered. • December – Financial Regulator (Dr. O'Reilly) re-iterates his previous requirement that MW and Con Power stay on the Board until a trade sale can be effected.
February 2006	Dr. Con Power (Chairman of the Audit Committee) resigns from the Board due to a conflict of interest between his role as Deputy Chairman of the Society and his role as First Chairman of the Financial Ombudsman Council. Mr. David Brophy, whose appointment had been approved by the Financial Regulator, is co-opted to the Board to replace Dr. Power.
March 2006	The Regulator threatens to withdraw the Society's licence if the Society does not hold an election for the position of non-executive director to accommodate a named individual.
June to August 2006	The Financial Regulator's candidate actively campaigns to stop the legislation, which the Central Bank, Financial Regulator, the Society and its members all want to facilitate a trade sale.
August 2006	The *Building Society (Amendment) Act 2006* is finally signed, enabling a trade sale.
November 2006	The Society appoints KPMG to conduct Vendor Due Diligence, based on accounts to year end December 2006.
June 2007	• The Vendor Due Diligence to enable a sale of the Society is completed by and signed off by KPMG. • Valuation of the Society is estimated at between €1.5 billion and €2 billion. • Bear Sterns rescue one of their off balance sheet funds.
September 2007	Run on Northern Rock. The Bank of England provides support.
October 2007	Goldman Sachs circulates a timetable for completion of the trade sale of the Society, which envisages the Acquisition Agreement being completed and signed by 17th December 2007.
17 December 2007	• At this stage bank shares are being re-rated downwards and heightened international financial market uncertainties suggest a trade sale is not likely. • On MW's initiative as non-executive Chairman, the Board of Society

	resolves to restrict lending and build liquidity. Board believes the Managing Director is best positioned to execute the new strategy, notwithstanding that under the Society's Rules he would have to step down from the Board on reaching the age of seventy (i.e. the following month)
18 December 2007	• As non-executive Chairman MW met with the Financial Regulator and explained the logic for Society's decision to build liquidity. • Financial Regulator and Board agree that the Managing Director should continue in the role of Chief Executive and attend at Board Meetings. There was subsequent discussion on whether to change/remove the age limitation.
February 2008	Northern Rock is nationalised.
March 2008	• Because of market volatility, following the run on Anglo, the Board resolves not to change the Society's Rules to remove the age limitation for directors. (In November 2008, KPMG recommend that it should be.) • The Chief Executive is only prepared to stay if he receives the same quantum of remuneration as in 2007. • The Federal Reserve Bank provides emergency funding to Bear Sterns. • The Head of the SEC in the US (Christopher Cox) says that the collapse in Bear Sterns is confidence not capital, i.e. it is about liquidity.
May 2008	JP Morgan acquires Bear Sterns.
9 May 2008	Society warns the Financial Regulator orally and in writing of the need for leadership to avoid a crisis in the Irish Market. Society also advocates for an improved deposit guarantee scheme.
5 September 2008	Reuters publishes a completely false story which precipitates a run on the Society. Prior to the run the Society had sufficient liquidity to meet all its bond repayments through the begining of 2010
15 September 2008	At the Financial Regulator's request, MW prepares a paper for the Department of Finance on the options available for the Society.
30 September 2008	*Credit Institutions (Financial Support) Act 2008* becomes law.
December 2008	PricewaterhouseCoopers in conjunction with Jones Lang LaSalle complete detailed reports on the Society on behalf of the Department of Finance, Central Bank and Regulator covering 70% of the Society's loan book. The report shows that the Society can trade through its problems.
January 2009	Public Interest Directors begin attending Society's board meetings. They are: 1) Adrian Kearns – Mr. Kearns had been a Director of the National Treasury Management Agency and had been joint second in command there to Dr. Somers. Prior to joining the NTMA, Mr. Kearns had been a senior member of the Department of Finance. Given his experience of capital markets Mr. Kearns agreed to take on the Chairmanship of the Asset and Liability Committee ("ALCO"). Given Mr. Kearns position as a key member of the executive board of the NTMA for many years his appointment at that time was especially valuable.

	2) Rory O'Ferrall – Mr O'Ferrall was a very experienced Chartered Accountant and a senior partner with Deloitte for many years. Mr. O'Ferrall agreed to take on the Chairmanship of the Audit Committee.
January 2009	• Submission of Business Plan to the Financial Regulator re-iterating plan adopted in December 2007. The Society obtained significant input from Goldman Sachs and KPMG on the plan submission. • The Society reviews the remuneration proposals for the Board and senior management for 2009 with CIROC.. • The CIROC submission and the Business Plan both had substantial input from the Managing Director. • MW raises the question with the Central Bank on how the year end audits are to be handled and receives no response.
23 January 2009	Public Interest Directors, having been approved by the Financial Regulator, are formally appointed to the Board of Society by the Minister for Finance.
February 2009	• MW resigns as non-executive Director and non-executive Chairman of the Society. • Minister for Finance (Mr. Lenihan) asks ex-Minister (Mr. MacSharry) to try to convince MW to reconsider.
March 2009	• Solvency certificate signed by Adrian Kearns, Public Interest Director and former NTMA director. • Mr Kearns takes advice from both KPMG and McCann Fitzgerald.
April 2009	The Board of the Society signed the 2008 Accounts, showing Reserves of nearly €1.2 billion. • KPMG sign the Accounts as independent auditors. • Mr O'Ferrall was Chairman of the Audit Committee. • The Minister confirms that the Society has all the necessary resources to implement its Business Plan.
May 2009	The Chairman confirms to the Annual General Meeting:- • The Society's change of strategy starting in December 2007; • That being conservative, the Society believes a 5% provision on its loan book is required.
December 2009	*NAMA Act* comes into operation on 21 December 2009.
March 2010	Tranche 1 transferred to NAMA – the loans were discounted by 58% (i.e. loans of €670 million transferred, €280 million received).
April 2010	• 2009 Audited Accounts signed. Those accounts record that €8.7billion of loans are to be transferred to NAMA. Those loans are valued by the Board, and confirmed by the auditors, at €5.7billion (i.e. an impairment provision of €3billion, or 34%, is made). • KPMG sign the Accounts as independent auditors. • Mr. O'Ferrall was Chairman of the Audit Committee.
August 2010	Tranche 2 transferred to NAMA on 23 August 2010. Discount of 72%. i.e. loans of nominal value of €590m were transferred to NAMA for €160m.

June 2012	• NAMA 2011 Annual Report shows that the loans of €8.7billion were transferred for a consideration of €3.4billion (i.e. the Society agreed consideration €2.3 billion less than the €5.7billion value it had certified on those same loans less than 9 months earlier. This is an additional 40% reduction in value). • Despite this additional 40% haircut, the Society's aggregate haircut was identical to Anglo's and within 5 percentage points of AIB and EBS.

Appendix 4

The Promised Trade Sale - A History - 2001 to 2006

2001

- The State sold ICC, TSB, and ACC by means of trade sales.
- Assurance is given to the Society by the CB that a trade sale of the Society would be facilitated and this was supported by the Central Bank, the Department of Finance and the Department of the Environment

2002

- Contrary to expectations, the relevant provisions permitting a trade sale were not incorporated in the Housing (Miscellaneous Provision) Bill 2002. Apparently, the relevant provision was removed at Cabinet despite the confirmed support from the Central Bank, Department of Finance and Department of the Environment.
- October: Dr Liam O'Reilly, who was responsible for Banking Supervision in the Central Bank stated that he wanted Michael Walsh ("MW") and Con Power to remain on the Board until a trade sale could be achieved, at which point the Nationwide could be sold to a larger financial institution.
- November: Central Bank informs Dr. Power and MW at a meeting that it was seeking to introduce a provision into the 2003 Central Bank Bill to enable the Trade Sale of the Society.

2003

- In a repeat of the previous year the intended clause to facilitate a trade sale of the Society is not included in the Central Bank Bill, despite the support from the Central Bank. Instead the Society was informed that a Government Review Group was being set up with the promise of legislation to facilitate a trade sale in late 2003.
- The Society retains McCann Fitzgerald to help speed up the drafting of legislation. The Central Bank is unwilling to use its discretionary powers under Section 102(4) to facilitate a trade sale.
- October: The Central Bank (Dr. O'Reilly and Mr. Neary) undertakes to MW and Dr. Power, the Vice Chairman, to review with Mr. Cardiff in the Department of Finance when the necessary legislative changes can be implemented to facilitate a trade sale of the Society.
- December 16th: Minister for the Environment announces on behalf of the Government, approval of a package of measures to inter alia allow a trade sale. The legislation is to be published in early 2004.

2004

- January: MW and Dr. Power meet with the Central Bank - Dr. O'Reilly and Mr. Neary. Dr. O'Reilly and Mr. Neary again confirm that in relation to INBS:
    - The Central Bank's major objective was the orderly transfer of INBS to a larger institution.
    - They also saw the Managing Director as being essential to an orderly transfer and did not want anything to happen in the Society which would make a sale more difficult.
- Notwithstanding the Minister's announcement in December 2003, the bona fides of which I accepted, and the subsequent assurances from the Central Bank in January 2004 once again the required legislation is not published.
- July 2004 – The other remaining building society, the EBS, are seeking a change to the drafting of the Bill according to Minister Cullen – The Department of Finance do not want the change. EBS state that they can get legislation passed by the end of July if the Society agrees the change. Otherwise it will be mid September.
- September 9th: The Minister for the Environment writes to the Society stating that the necessary legislation will be finalised by the end of autumn (i.e. end October / November 2004).
- Despite the further undertaking the legislation was not published.

2005

- Despite the written commitment of the Minister for the Environment in September 2004, once again the legislation was not published.
- February 24th: McCann Fitzgerald provide advice on possible alternatives to realise value for the Society's members in the absence of the promised legislative amendment.
- March 15th: the Board expressed concern at the ongoing delay in introducing the legislation.
- April 11th: The Board met with the Minister for the Environment who said he was anxious to deal with the proposed legislation and not in favour of delay but could give no indication on timing. The problem is with other Departments.
- May 10th: The Minister for Finance said he and his Department were in favour of demutualisation.
- May 16th: The Financial Regulator, Dr. O'Reilly, confirms to Dr. Power that he had spoken to Mr. Considine, Secretary General of the Department of Finance, who was fully supportive of getting the legislation put in place. The delay is attributed to the Department of the Environment.

2006

- Discussion and review of the final draft of proposed Building Societies Amendment Bill. McCann Fitzgerald advising.
- June – August: Very active campaign from some members to stop legislation.
- August: legislation to allow a trade sale was signed.
- September: Board decision to await the publication of the 2006 audited accounts before formally going to the market. This enabled the Vendor Due Diligence to be carried out in parallel with the annual audit to meet potential buyers' likely requirements.

- November: Board appoints KPMG to do the Vendor Due Diligence.("VDD")

2007

June 20: KPMG complete Vender Due Diligence

October 22: Goldman Sachs circulate a Completion Timetable for Sale of the Society

November : McCann Fitzgerald circulate a draft acquisition/sale agreement. Goldman start drafting the fairness report for the Board.

December 17: Due to the re-rating of banks and the increasing problems in global financial markets the Board recognises that a sale of the Society is unlikely and :-

- The Board, on MW's initiative, decides to cease lending and build liquidity
- The Board defers announcing the postponement of the sale pending the publication of the 2007 Accounts
- On behalf of the Board MW informs the CB/FR of its decision the next day.

Appendix 7

Non-Executive Directors – Brief CVs

Michael Walsh - I completed undergraduate and master degrees in University College Dublin, and MBA and Ph.D. degrees specialising in finance at the Wharton School, University of Pennsylvania. In 1982 I became Professor of Banking and Finance in University College Dublin. While in UCD I completed reports for NESC and the IDA on developing the Financial sector and advised the then Department of Industry and Energy on infrastructure financing. In 1986 I joined stockbroking firm, NCB Group Limited, as Managing Director of the corporate finance business. Since then I have been a full time executive of companies owned by Mr. Dermot Desmond. As head of corporate finance in NCB I was heavily involved in all aspects of mergers, acquisitions, disposals and flotations. Arising out of that role, in July 1993, I prepared a paper for the Board of the Society on its future options in which I identified the need to be part of a larger institution and the logic of a trade sale. (**Appendix 2**).

Con Power (1999 – 2006) – had a MEconSc degree from University College Dublin and was a qualified Chartered Secretary (FCIS), Chartered Management Accountant (FCMA) and Chartered Certified Accountant (FCCA). In addition to his qualifications Mr. Power had been an Inspector of Taxes, worked within Foras Forbartha and was head of the Economic Policy Directorate of the Confederation of Irish Industry. He was the first Director of Financial Services Ireland and was appointed by the Government as the first Chairman of the National Roads Authority. The Government appointed Dr. Power as the first Chairman of the Financial Ombudsman Council. That appointment reflected well on the Society and its board as clearly it would not have been made if there was any question mark in the mind of the Department of Finance, the Central Bank or the Regulator in relation to the performance or integrity of the Society or its Board.

Terence Cooney (2001 – 2009) had a MEconSc degree from University College Dublin and was a Fellow of the Institute of Chartered Accountants (FCA), a Fellow of the Chartered and Certified Accountants (FCCA). Mr. Cooney had been a Higher Inspector of Taxes. He qualified as a Chartered Accountant with Ernst & Young and subsequently joined PricewaterhouseCoopers, ultimately setting up his own practice in 1992. In 1999 Mr. Cooney published the standard reference book on Irish Taxation which is updated annually ever since. Mr. Cooney is a founder, Fellow and past President of the Institute of Taxation in Ireland and has been an advisor to many businesses during his career.

Mr. David Brophy (2006 – 2009) agreed to join the Board in 2005 as a fourth non-executive director and was co-opted in 2006, following the unexpected resignation of Dr. Power due to a conflict in his role as Chairman of The Financial Ombudsman Council. Having obtained a law degree, he joined the PwC tax practice. He subsequently worked for Citibank in London in the Treasury Division and joined Smurfit Group in 1994. As Group Director Tax and

Corporate Finance for the Smurfit Group, he worked on the take private of the Smurfit Group and its merger with Kappa. Mr. Brophy subsequently (September 2007) became COO of Ballymore Properties.

In June 2008 Mr. Sean Carey was co-opted to the Board. Mr. Carey had over forty years experience in local government and had originally been appointed as Finance Director of Dublin City Council. His final position was Deputy Dublin City Manager. Mr. Carey had a long term background in property and planning and had an intimate knowledge of the Dublin property market having been responsible for much of the development strategy.

In August 2008 Mr. Daniel Kitchen agreed to join the Board and was formally co-opted in October 2008. Mr. Kitchen was a qualified accountant, who had been a senior member of the Investment Bank of Ireland before going on to become Finance Director of Green Property, a quoted Irish property company, and then moving to London to become Finance Director and Deputy Chief Executive of the Heron Group. Mr. Kitchen subsequently became the Chairman of the Society upon my resignation in 2009.