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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉIREACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 9 Meán Fómhair 2015

Wednesday, 9 September 2015

The Committee met at 9.30 a.m.

MEMBERS PRESENT:

Deputy Pearse Doherty,	Senator Sean D. Barrett,
Deputy Joe Higgins,	Senator Michael D'Arcy,
Deputy Michael McGrath,	Senator Marc MacSharry,
Deputy Eoghan Murphy,	Senator Susan O'Keeffe.
Deputy Kieran O'Donnell,	
Deputy John Paul Phelan,	

DEPUTY CIARÁN LYNCH IN THE CHAIR.

Department of Finance - Professor Alan Ahearne

Chairman: Okay, with that said, we'll commence with session two, is that agreed? Agreed ... with our public hearing with Mr. Alan Ahearne, former special adviser to the late Minister for Finance, Brian Lenihan, TD. The Committee of Inquiry into the Banking Crisis is now resuming in public session. Can I ask members and those in the public Gallery to ensure that their mobile devices are switched off? We continue our hearings today with Mr. Alan Ahearne, former special adviser to the late Minister for Finance, Brian Lenihan, TD. Alan Ahearne is a professor and head of economics at the National University of Ireland, Galway. He was a special adviser to the late Minister for Finance, Brian Lenihan, from March 2009 to March 2011. He advised the Minister on economic, budgetary and financial policy in responding to the economic and financial crisis and played an advisory role in relation to the national recovery plan and the creation of NAMA.

Mr. Ahearne, you are very welcome before the committee today.

Professor Alan Ahearne: Thank you, Chair.

Chairman: Before hearing from the witness, I wish to advise the witness that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you're directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you're entitled thereafter only to a qualified privilege in respect of your evidence. You're directed that only evidence connected with the subject matter of these proceedings is to be given.

I would remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry which overlap with the subject matter of the inquiry. The utmost caution should be taken not to prejudice those proceedings. Members of the public are reminded that photography is prohibited in the committee room. To assist the smooth running of the inquiry we will display certain documents on the screens here in the committee room. For those sitting in the Gallery, these documents will be displayed on the screens to your left and right. Members of the public and journalists are reminded that these documents are confidential and they should not publish any of the documents so displayed.

The witness has been directed to attend this meeting of the Joint Committee of Inquiry into the Banking Crisis and I will now ask the clerk to administer the oath to Mr. Ahearne.

The following witness was sworn in by the Clerk to the Committee:

Professor Alan Ahearne, former Special Adviser to the Minister for Finance, Brian Lenihan, TD.

Chairman: Once again, Mr. Ahearne, I welcome you before the committee this afternoon and if I can ask you to make your opening remarks to the committee, please.

Professor Alan Ahearne: Thank you, Mr. Chairman. As you mentioned, Mr. Chairman, I served as special adviser to the late Minister for Finance, Brian Lenihan, from March 2009 to March 2011. In this role, I advised the Minister on economic, budgetary and financial policy in responding to the economic and financial crisis. Among other things, I played an advisory role in relation to three budgets during the period, the national recovery plan, the creation of the National Asset Management Agency, NAMA, and other measures to address the financial crisis.

The three budgets during this period involved €15 billion of fiscal adjustments at an annual rate. These adjustments were aimed at reducing the Government's huge structural deficit, thereby restoring order to the public finances. Reducing the structural deficit, by definition, required discretionary measures as the structural deficit would not decline due to a cyclical recovery.

In dealing with the consequences of the bursting of the bubble for the Irish banking system, the Minister's focus was on stable ... on restoring financial stability by restructuring, recapitalising and deleveraging the banking sector. The Minister regarded the two main banks, AIB and Bank of Ireland, as core retail banks that would play important roles in Ireland's economic future. The banks required capital to remain in operation. The banks' capital positions were being eroded by loan losses and, therefore, the banks required recapitalisation. The Minister wanted to minimise the burden on the State of ensuring that AIB and Bank of Ireland were properly capitalised. For that reason, he afforded the banks the opportunity to raise private capital through, for example, rights issues involving shareholders. Ultimately, Bank of Ireland was successful in finding private sector solutions.

In the case of Anglo, the priority was to deleverage and de-risk the bank without damaging the rest of the banking system. The Minister had an open mind as to whether a small good bank could be carved out of Anglo, as proposed by the bank's management. Anglo had been included in the blanket bank guarantee and, therefore, the Government had to recapitalise Anglo to avoid a call by creditors on the guarantee. Moreover, Anglo required injections of capital to retain its banking licence and thereby maintain access to Central Bank funding.

In relation to the cost to the State of recapitalising the banks, the upfront costs were large by international standards. The Minister was confident that the State would recoup some of these outlays and wanted to spread the cost of the crisis over as long a period of time as possible. It's worth noting that although the cost of recapitalising Anglo and INBS added markedly to measured Government debt - about €35 billion - the way in which Anglo was recapitalised meant that the burden of servicing this debt is relatively low because the debt is largely held within the State sector, is long-term and can currently be financed in the market at a very low rate.

On the issue of right-sizing the banks, NAMA was established by the Government to help deleverage and de-risk the Irish banking ... the Irish banks. Asset management companies like NAMA have been used in many countries over recent decades during financial crisis to facilitate bank restructuring and to manage and dispose of troubled assets. Regarding the overall effectiveness of NAMA, in my testimony before this committee on 4 March last, I noted the assessment of NAMA in an independent study of the agency. On page 2, the study states, "First, the establishment of the bad asset agency, NAMA, serves as an international example of [the] successful management of bad assets." On page 24, the study states:

> The establishment of NAMA was instrumental in the successful management of the Irish banking crisis. It allowed the banks to recognise fully the losses on these loans, and thus removed an important source of uncertainty for the banks. Next, the government set only overall targets for NAMA in [the] resolution of the bad assets. The relative freedom in running down the bad loan portfolio allowed NAMA to realise a relative good price for its assets disposals.

Also on the same page, the study draws a key policy lesson for other countries:

> Ireland followed international best practice by setting up NAMA, [an] asset management agency to run down the bad assets of the Irish banks. Releasing bad assets from bank

balance sheets is instrumental in the path [of the] recovery.

I share the study's view that the establishment of NAMA played a critical role in restoring financial stability in Ireland. I would note, however, that an asset management agency is not and cannot be expected to be a magic bullet to solve a banking crisis. No single policy measure on its own can do that. NAMA has been part of a set of policies that, together, have helped to restore order to the Irish banking system and contributed to the recovery in the Irish economy.

Notwithstanding the efforts to restore international investor confidence in Ireland and its banks, during the second half of 2010 the cost to the State of borrowing on international markets rose to unsustainable levels. Around the same time, funding in debt markets for the Irish banks dried up and the banks experienced large outflows of deposits, especially corporate deposits. These outflows replaced by borrowings from the euro system. The ECB and the Central Bank of Ireland provided invaluable liquidity assistance to the Irish banking system during the crisis. I believe, however, that the ECB in 2010-2011 underestimated the systemic nature of the crisis in the euro area. The ECB was overly anxious in the latter part of 2010 to reduce the amount of emergency loans that the euro system had extended to the Irish banking system. There are also question marks about the ECB's communications with markets about individual member states. With no access to markets at affordable rates, the Irish Government was forced to borrow from the official sector. The EU-IMF-ECB programme of assistance provided the State with funds that were needed to finance the budget deficit and provide a functioning banking system.

Finally, Mr. Chairman, the large gains in international competitiveness recorded by the Irish economies ... Irish economy over the 2009-2010 period went a long way to creating conditions in the economy for key sectors of our economy to grow, gain market share and expand employment. Without these gains in competitiveness, the Irish economy would not be registering the fast growth rates that we see today. Thank you, Mr. Chairman. That concludes my prepared remarks.

Chairman: Excellent. Thank you very much, Mr. Ahearne, and if I can now invite Deputy McGrath to open the questions, please. Deputy, you've 25 minutes.

Deputy Michael McGrath: Yes. Thank you, Chair. Mr. Ahearne, you're very welcome this afternoon. Can I start by referring to your reference on page 4 of your witness statement that the late Minister Brian Lenihan had decided in autumn 2010 to wind down Anglo? So can I ask, what advice, if any, did you give to the Minister at that time to support the decision because, in parallel with that, the then management of the bank were actively lobbying to have a good bank-bad bank split and to try to carve out a new business from what remained of Anglo? So what was your advice at the time?

Professor Alan Ahearne: I guess for ... for all the time that I served in the role as adviser, I was sceptical that a good bank could be carved out of ... out of Anglo. I felt that its ... its business model - which was large exposure or large lending to commercial property - that that would no longer be ... be viable. The management had talked about a new sort of a small business bank but I was sceptical about that. I think the Minister was open-minded on it. I never recall him being enthusiastic about this proposal. The proposal to carve out a small bank came from the management. The Minister felt that ... the argument was put to him that this carved-out small new business bank ... it might be worth something and therefore it might save the State a few billion in terms of the net costs of the banking system. So that obviously got his attention. He was aware that ... that we were going to need more competition in the banking system, so the idea of another bank being there was somewhat helpful. So any interactions I had with him, he was open-minded on it, but I never remember him being convinced one way or the other. So he wanted to give it ... this proposal a shot. It was being sent over to the European Commission for approval and back. I was seeing all these ... this documentation and I think what happened, as we got into September ... August and September, is that the European Commission had gone very cold on this plan and the Minister felt that it just ... just wasn't going to work.

Deputy Michael McGrath: And in your view, what would have been the consequences of going for the other option of trying to carve out a good bank from Anglo? And what would've been the ... the operational factors in that decision?

Professor Alan Ahearne: Well, the bank would've needed some capital but, again, if you thought that there was some value to be ... to come out of it, then there was an argument for giving you the capital ... the couple of billion of capital. I guess the issue was the reputational damage to this bank - whether it would ... it had a ... it would've had a franchise at all. The management felt that it could, that they could get something new out of it. They'd even come up with a new name, "An Banc Nua", but I just didn't see ... it would be the old Anglo, and I couldn't see how it could play a role. Also, banking is about expertise and lending experiences. The expertise that they would have had would largely have been in lending to commercial ... in often the case, highly speculative properties so I just didn't see how this would ... how this would fly.

Deputy Michael McGrath: Sure. And when the decision was announced then in early September 2010 to separate it into a funding bank as such and a recovery bank, what was the anticipated timeline for the overall wind down of Anglo was it going to 2020 at that stage, was that the plan?

Professor Alan Ahearne: I think, I mean, we would have been in and out by ... but I think it was certainly over a long period of time, it was eight to ten years. The problem with ... it had a large amount of assets, loans. It's ... if you try to sell loans, deleverage very quickly, you have to take big haircuts on those loans, if you can find a buyer at all. And if you're taking big haircuts you're adding to the losses so the Minister was conscious that in deleveraging, particularly in an environment with very little appetite for Irish assets, you would have to be very careful and do it over a long period of time.

Deputy Michael McGrath: So a short-term liquidation was not considered as a viable option at that time?

Professor Alan Ahearne: No, that would have been viewed as too costly in the environment at the time. The point of having the funding back was, while Anglo did have ... did have some funds, it had some deposits, it did have ... it was able to raise funds ... and the Irish banking system as a whole needed funding, private funding. So the plan was to try ... how can you keep funding in the system, that funding that they had access to, without having a bank that can lend, and that was the argument for that particular split.

Deputy Michael McGrath: Okay, if I can take you to November 2010 and the negotiations with the troika for the bailout. Ann Nolan of the Department of Finance stated in her witness statement to this committee that IMF officials were strongly in favour of burning any unguaranteed and unsecured bonds in Anglo. This was opposed by the EU and ECB officials. In the event, she said the matter was considered at a more senior level in the IMF, and you have said this as well, as a result of US Treasury veto the IMF came down against any such action. Can you elaborate on what happened at that time and was it a live issue being considered in the build up to and during the negotiations ... the burning of the unsecured senior bondholders in Anglo?

Professor Alan Ahearne: It was a live issue. I mean, I had many conversations with the Minister during the summer of 2010 on the issue of senior bonds, particularly in Anglo because ... now there was no intention of doing anything while the guarantee was in place but the guarantee was going to run out in end-September. And then some bonds in Anglo and some of the other banks would there ... were therefore going to be exposed, they would no longer be guaranteed. So we talked about what could be done with those banks and whether there was room, scope for bail-in or burning those bonds as people say.

I mean, initially I think the Minister wasn't particularly enthusiastic, he saw lots of problems with that and there were problems, market problems, legal problems, and he saw all those. But as time went on during the summer he sort of came to the position, came around to the position that in principle this would be a good idea. I mean, at one stage I remember, maybe in August or September, he even came up with some numbers. He was talking about senior unguaranteed bonds after the guarantee had gone, those bondholders taking a haircut as he put it of 50%. I mean, I remember a conversation when he begun with the line "The bondholders are going to have to take a haircut." He had numbers – 50% for the Anglo, he had smaller haircuts for AIB, 20% or something like that, and then with Bank of Ireland at one stage he mentioned maybe 5% then he said, "Then it's probably not worth doing it." So we'd exclude that bank. So the focus was really on Anglo. INBS didn't have many bonds but that was probably thrown in there as well.

I went to the Washington DC with him, because you mention the IMF, in early October and I met with a couple of IMF officials, I think one of whom you're meeting tomorrow. And they brought up ... we had some discussion with the Irish and they brought up, they said "Is the Minister aware that there's about €4 billion of Anglo bonds that are now unguaranteed, senior non-guaranteed?" I said he is aware of that and he was aware of that. They said "It's a lot of money", and I said "He's aware of that." So it was clear from the short discussion I had with them at that stage that they had spotted this and they had these concerns.

Deputy Michael McGrath: That was October, is it?

Professor Alan Ahearne: That was in early October of 2010 that they were in their line of sight. It was also in the Minister's line of sight. I use the word, mistakenly, "in principle" because it wasn't that he gave an order at some stage, you know, on 30 September after the guarantee "Okay, let's burn them." It wasn't that but he, in principle, if the opportunity arose, if it could be done, he did want a haircut of these bonds. He was very concerned about the market reaction, how that would spill over into the sovereign debt market. He was getting strong advice from the NTMA that announcing that there was going to be a burning of senior bonds would have a very negative effect on the sovereign's access and it would push up interest rates for the Irish Government. He wanted to avoid that, but of course that argument became moot when we got into a situation where Ireland was going to borrow from the official sector and that's why that opened up that opportunity.

Deputy Michael McGrath: So what happened then during the negotiations themselves? The IMF on the ground here in Dublin during the negotiations was still supportive. Why did it not happen?

Professor Alan Ahearne: I mean, the Minister was pushing for, I think right up until – get my dates right – certainly the week of say 22 November – there was still a lot of work being done by the Minister and I think by officials on how we could do this. A lot of it was legal work because there were big legal issues involved. Later that week, or maybe the weekend, I was speaking with the Minister and he said there'd been a conference call, I think ... I understood it was a G7 conference call, but it may not have been, but it obviously involved sort of people at that level, and that it had been decided that the burning of bondholders had been vetoed. ECB was against it. That was relayed to me. The European Commission sided with the ECB and as the Minister put it, although the IMF staff themselves individually, and from earlier on had viewed this as a good idea, the organisation, at the executive level, took a decision not to do it and, therefore, ultimately the troika's position on this was that there'd be no programme would be available if this route was taken.

Deputy Michael McGrath: And did it come down to that net point in the end that if Ireland had insisted on burning senior unguaranteed bondholders there would not have been a programme, there would not have been financial assistance?

Professor Alan Ahearne: Yes, I mean, it was ... particularly the ECB's approach was quite strident so there would not have been a programme. And, indeed, I mean, the ECB could have done many other things if Ireland had decided to burn senior bondholders of a bank. They could have said, "This bank is now insolvent, you're burning the bonds therefore we're not going to lend to it anymore." So they could have said the collateral ... this bank is no longer eligible for euro system financing, in which case all the financing would had to have fallen on the State. So there was ... at ... if the troika were against it and the ECB were against it there was no option.

It's also the case, at least we're focusing on the Anglo, the amount of money involved was about €4 billion, from €3.5 billion or €4 billion. Brian Lenihan had in his mind 50% discount so you might say €1.5 billion to €2 billion. It's a lot of money but you've got to balance that against the consequences. The ECB and the European Commission had their arguments and they put them out and there was a recent European Commission paper looking at, assessing the programme – I have it here – and they list eight or nine reasons why they believe at the time Ireland should not have burned the bondholders, and they still think Ireland shouldn't. They said it was in Ireland's best interest not to. So they're making those arguments but the Irish side had a different perspective on it.

Deputy Michael McGrath: And at that time was it only the remaining Anglo bonds that were on the table in, let's say, November 2010, and by coming out of the guarantee at the end of September there was total of about €19.5 billion that were unsecured and were now unguaranteed and Anglo as you say was about €4 billion to €4.5 billion? So throughout October and into November was it distilled down to the question of Anglo bonds or were the other ones not considered?

Professor Alan Ahearne: I think the IMF staff had, at least in their calculations, had produced the sort of numbers you have produced there. They had everything in.

Deputy Michael McGrath: Yes.

Professor Alan Ahearne: But I think when the push came to the shove, I mean, as I described earlier, Bank of Ireland for example, the Minister was very reluctant to discount bonds in there. And I think in *ex post* rightly so because actually when you look at it the bank was able to raise private capital and recapitalise itself through subordinated debt. It's not at all clear that senior bondholders in that particular institution should have been discounted. It's certainly not the ... it's certainly the case that they should not have been ... the losses from Anglo should not have been put onto senior creditors in Bank of Ireland. So I think at one stage they may have had closure and given those sort of more general numbers, but I think in the heel of the hunt it came down to Anglo and INBS, which was much smaller, because those were banks that were going to be wound up and they were in a very ... a different position then. They weren't going to be issuing bonds in the future. It was easier to distinguish them from any other bank in Europe so ultimately it came down to them.

Deputy Michael McGrath: Okay. As you know, Mr. Ahearne, about €15.5 billion in total of losses were imposed on junior bondholders - subordinated bondholders. Much of this was done through liability management exercises where debt holders were asked to voluntarily sell their debt back to the banks at reduced price. Was that seen as being an entirely different issue to the senior bondholders at that time?

Professor Alan Ahearne: It was. I mean, I remember being in conversations - during the summer I think it was or maybe early autumn - in the Attorney General's office with several senior counsel. I am not a lawyer but just listening to the conversation, it was clear that it was much easier to put losses, legally, on subordinated bondholders than on senior bondholders. Subordinated debt, as I understood the conversation, is explicitly subordinated. So after all capital has been wiped out, you can then go to the subordinated debt and put losses on them. But senior bonds are not subordinated to deposits, for example. So, in a liquidation if you liquidated a hotel, you cannot treat the bill that is owed ... money owed to the launderette different from the money that is owed to the meat supplier. They are senior creditors. Unsecured senior creditors all treated equally and that was the position of the senior bonds. They were *pari passu* or equal in the eyes of the law to depositors ... much more difficult game. Now, maybe it can be done but it was clearly a much more complicated operation.

Deputy Michael McGrath: The promissory note structure that was put in place back in 2010, can you explain the logic behind that structure at the time - an overall commitment of over €30 billion, over €3 billion to be paid every year for ten years or so? Can you explain why that structure was put in place and what, in your view, were the advantages of doing it that way from the State's point of view?

Professor Alan Ahearne: I mean, assuming that money ... the bank had to be recapitalised, otherwise the guarantee would have been called in and the bank would have lost access to ECB funding. The issue is how do you put a large amount of money in, let's say, €30 billion. One way to do it is to put cash in. I mean that was done through ... AIB and Bank of Ireland were recapitalised with cash from the National Pensions Reserve Fund. There wasn't enough cash. So, the Minister could, in theory, have asked the NTMA to go out and borrow cash, issued Government debt and whatever interest rate prevailed at the time - ten-year money might have been 5% or 6% - borrow that money and put the cash in. A much, much cheaper way of doing it was to, rather than put cash in, to give the bank, Anglo, Government debt and that, whether it was regular Government debt or promissory note, it is all IOUs. Because, that way, Anglo could then go to the Irish Central Bank, present that piece of paper and borrow money on the back of it. That meant essentially that ... so the debt was not being issued into the market. The interest rate that was being paid on the promissory note was being paid to Anglo but Anglo was part of the Irish State as just an internal transaction. Anglo was paying interest to the Irish Central Bank on its borrowings but the Irish Central Bank is part of the State. All this stuff is simply internal. The cost to the Irish State of that recapitalisation was, if you go through it and get down into the weeds, the cost was the cost of funds to the Irish Central Bank borrowing from the Eurosystem and that was extremely low - it is currently zero. So the point was, this allowed Ireland to recapitalise this bank but the burden, the annual burden - the interest rate which is what really matters - was going to be extremely low. And that was the advantage of the promissory note system.

Deputy Michael McGrath: But the State would still have to come up with the cash of €3 billion every year - every March.

Professor Alan Ahearne: So the difficulty with it was ... I mean, people ... when the promissory note was restructured, a lot of people said, "The expensive, high-interest promissory note is being restructured." Well, that's a misunderstanding. The interest rate of the promissory note was irrelevant. The interest rate was being paid to Anglo. It's just one arm of the State to the other. The promissory note was an extremely cheap way of financing it. The problem with it, it was going away, it was going to be replaced every year by €3 billion of money borrowed in the market. So it wasn't that this was an expensive ... it was a really cheap arrangement but in seven or eight years' time it was gone. So, the trick was how could you keep that cheap arrangement in place for as long as possible and that's what the promissory note deal did. The Irish Central Bank currently owns these bonds. The interest paid goes to the Irish Central Bank. Look at the profits the Irish Central Bank is turning over to the Irish State. That's all internal. So this was a very cheap way of financing it.

€30 billion is a huge number but if I told you that you were going to finance €30 billion over 100 years at a zero interest rate, then it's irrelevant, it's for free. So the point is, when you're talking about national debt like that, you have to look at ... it's not just the amount, it's the maturity and the interest cost. And so the key to the way Anglo was being done was to get the cheapest possible finance and you can't get any cheaper than the ECB. It created issues because the ECB then, particularly as the amount increased in the autumn of 2010, were worried that this was monetary financing, essentially that the Irish Government was borrowing at a very cheap interest rate but it was happening through the banking system.

Deputy Michael McGrath: Sure. How did Minister Lenihan react to the letter from Jean-Claude Trichet of 19 November 2010, which really left nothing to the imagination that emergency liquidity assistance would only be maintained if the Irish State applied for a bailout?

Professor Alan Ahearne: I mean, I think it put in writing what had been said already. It wasn't that this was a complete shock. Maybe it was a surprise but what was a surprise was why this was put in writing. But that message that the ECB wanted Ireland in a programme, that the ECB was desperately unhappy with the amount of money it was lending, it wanted its money back, it wanted Anglo, which is the money we're talking about - the €40 billion that had been lent in ELA - it wanted the Government to pay that back by borrowing from somebody, either from the markets or from the troika. So it wanted Ireland to replace extremely cheap money through the promissory note arrangement with expensive money and Brian Lenihan said, "That's completely ridiculous. This is ... How is this going to solve our problem?" I don't remember talking ... explicitly asking him how he reacted to that but it put very starkly the ECB's view on Ireland at the time.

Deputy Michael McGrath: In the article you contributed to the book on *Brian Lenihan: In Calm and Crisis*, on page 25, you mention that Mr. Lenihan discovered that senior people at the ECB were briefing market sources that the ECB was considering the withdrawal of financial support to Irish banks. So again, this would have been in November 2010. Can you elaborate on that? What was he hearing? What was he referring to there and what impact did this briefing have, which Governor Honohan has acknowledged, when he came before the committee here, did happen?

Professor Alan Ahearne: So in August, I guess, and certainly in September and October, there was a huge amount of international investors or potential investors visited Ireland. These were people involved in pension funds and insurance companies who would be buying ... you would like to be buying Irish Government bonds, who may have done so in the past, potential ... people who would potentially lend to the Irish Government. Now, I met a lot of these people - they were very interested in the Irish economy and developments and stuff like that - and quite a lot of them brought up the point that the ECB appears to be hostile to this lending that it's doing - the ELA that's growing. And I remember somebody, one of them, saying to me - and again this somebody I'm trying to convince that they should lend to the Irish Government at reasonable interest rates - they said, "What are you going to do when the ECB pulls the funding from your banks?" They were talking about the Anglo stuff, in other words, forcing the Irish Government to go to the market to raise €40 billion, which it couldn't possibly do. And I said, "That's not going to happen." And he said, "Well, excuse me, I was in Frankfurt [I think that's what he said] yesterday and I met ECB officials and they told me that's what they are considering, so how do you answer that?" Now some of this was in the papers in the sense that ... I mean, they had, in early October, began to tighten up on liquidity. They had loosened things during the global financial crisis and they had begun to tighten things up - that was public. But it was clear that potential investors, whoever they were talking to, were being told that they want ... they're not happy with this and they're considering doing something about it, which would force the Irish Government on to the market to raise €40 billion.

Deputy Michael McGrath: Okay. Can I raise the issue of NAMA, Mr. Ahearne? And you have addressed it in your witness statement and you are strongly supportive of the NAMA project. But can I put a counter-argument to you, that the NAMA project crystallised immediately losses of €42 billion on the books of the banks, which triggered a massive round of recapitalisation? Subsequently, NAMA sold on the assets at market prices, which were at the lower end of the market, predominantly to US private equity funds or so-called vulture funds, who are now flipping those assets and selling them on for gains. Would it have not have been better to let the banks work their way through the assets at that time?

Professor Alan Ahearne: I mean, crystallisation ... one person's crystallisation is another person's facing up to reality. And what they ... what NAMA forced and the sales forced the banks, the bankers and everybody else to do was face up to the reality of what had happened. I guess if ... let me make a couple of points. One is that the banks would have needed capital to cover those losses in any event, because there was stress tests being done - stress tests done, various PCAR rounds - and, ultimately, there was the comprehensive assessment, which is the stress test done by the ECB. And even if the loans had stayed on the banks - the books of the banks - they ... those stress tests would have seen potential losses in those and, therefore, the banks would have been required to have capital. So, it's not that the removal of the loans caused the banks to need capital, the fact that there was huge losses on those loans, irrespective of whether they stayed on the books or not, meant that the banks needed huge capital in order to cover those losses, in order to-----

Chairman: Final question, Deputy.

Deputy Michael McGrath: Yes, but it meant that those losses had to be fully recognised at the bottom of the market.

Professor Alan Ahearne: Well-----

Deputy Michael McGrath: So, okay, the losses were there *vis-à-vis* the actual value of the assets.

Professor Alan Ahearne: Yes.

Deputy Michael McGrath: But if they had been allowed to work them out over time, as opposed to NAMA doing it, then the outcome may have been different.

Professor Alan Ahearne: Well, look at the aggregate numbers. I mean, if NAMA was about to make or expected to make a profit of €20 billion, or surplus - it's not a profit-making institution - a surplus of €20 billion, then you might have an argument there. You might say, "Well, they clearly underpaid these banks for these assets. Look at the huge profits or surplus they are about to make." And, by the way, most of the arguments at the time were not that the fears, concerns that NAMA was going to underpay, but they would overpay. But my understanding - and you've had NAMA in front of you - is that they more or less expected to break even or that they would make a small surplus. That would suggest to me that they more or less got the pricing right, that the value they paid was the value of the loans and, therefore, what happened is that the banks simply were forced to face up to what was reality.

Chairman: Thank you. Deputy, I will bring you back in again. The next questioner is Deputy Eoghan Murphy. Deputy, 25 minutes.

Deputy Eoghan Murphy: Thank you, Chair, and thank you, Mr. Ahearne. You are welcome back to the committee. I just want to stay with NAMA, if I may, because in your opening statement you suggested it was unfortunate that the details of the final tranche of loans, the transfer to NAMA was not available prior to the PCAR figures being announced, but you also said that the "subsequent upward adjustment made in September 2010 contributed to the weakening of investor confidence in Ireland around this time". So, are you saying that the NAMA process contributed to our need for a national bailout?

Professor Alan Ahearne: No ... I mean, the way you put it there is far too stark. Ideally, the loans would have moved in one go and there would have been a price given and, therefore, the Central Bank, in doing its PCARs in the March of 2010, would have seen that price. And, therefore, a line could have been drawn over how much capital the banks needed for those particular assets. Now, the banks needed more capital for different assets, but at least for those.

The reality is, of course, that there was so many loans and, most importantly, the European Commission had set down rules by how these were ... how these would be priced and transferred, and they involved loan-by-loan transfers and due diligence and so that made for a slower process. So ... now, there were advantages to that in that doing that loan by loan allowed ... meant that the pricing was much more accurate and it allowed the State, through NAMA, to see the full picture. You could imagine in theory where a random sample ... a large random sample of loans is taken, they're priced and then all of the loans transfer at that price. That would be faster, but, of course, it would be more risky because you are only taking a random sample.

Deputy Eoghan Murphy: Was it weighed up in designing the process, this potential for the damage of drip-feeding information into the market about what was transferring across from the banks?

Professor Alan Ahearne: I mean ... I think the most important thing was that the EU Commission rules were out before NAMA was even announced, so they were following that. So, there was no issue of could we ... can it be done in a different way.

Deputy Eoghan Murphy: And the inability to get political consensus. I mean, to what extent did that delay the process and to what extent was that frustrating the efforts of the Minister and the Department?

Professor Alan Ahearne: I mean, I don't think it delayed things. NAMA was announced in April. From scratch, things were ... the legislation was written. I think it was announced. There was draft legislation put into the public domain in June or July and then legislation introduced. There was a Bill in September and it was up and running by later that year. So, given the size of the operation, given the size of the problem, that was fairly speedy. I think it took a lot of the Minister's attention and energy, the debate about it but ... look, this was a big ... this was a big policy decision and so, I think he understood that there was going to be a serious debate about it.

Deputy Eoghan Murphy: In the chapter you contributed on the book on Brian Lenihan, you wrote that Minister Lenihan learned that one of the banks, AIB, was covertly briefing against NAMA. At what level was this happening and what did those briefings involve? And were you aware of other banks doing this?

Professor Alan Ahearne: That was reported back to him, that some stuff was appearing in papers ... I can't ... what it were, but some stories about NAMA's going to bankrupt the country and this sort of stuff. I think he had a ... the press office had done some work to see where this had come from and he was informed that they believed, or somebody believed, that it had come from AIB, presumably from senior people there.

Deputy Eoghan Murphy: Was it the view of the Minister or the Department that the banks were actively trying to delay NAMA or interfere with its establishment?

Professor Alan Ahearne: That ... I think the view was that particular bank, which had big problems at that stage - much of it was still under the carpet - that that particular bank would prefer not to face up to the reality that they had made huge loans - speculative property loans - and there was going to be huge losses on it. So, I think he recognised that, yes, there was going to be opposition from certain bankers to the facing up of reality, but he was determined that people were going to face reality. He knew full well - I mean, I had discussed this with him - that the international evidence was that if you try to hide it, the costs don't go away, particularly the cost to ... the public cost, the cost to public finances or ... and to the citizens. They accumulate over time. It doesn't get any better, it gets worse and you have to face up to the problem, and he was determined to do that.

Deputy Eoghan Murphy: Did this opposition from certain bankers or banks ... did it interfere with or slow down the NAMA process?

Professor Alan Ahearne: No, I don't think so.

Deputy Eoghan Murphy: Thank you. You also write about, in your opening statement, about Professor Schoenmaker and the successes of NAMA. And you wrote about the relative freedom that the agency had to manage the assets. But, what about the lack of flexibility regarding the bond repayment schedules that were entered into on behalf of NAMA? Did this result in a rush to sell prime assets to meet these early repayment targets?

Professor Alan Ahearne: I mean, with an asset management company, there is always a tension between avoiding fire sales, but also avoiding hoarding. You want the asset management company ... you don't want them dumping all these assets onto the market at one stage, at one time, because there won't be enough liquidity there. If you are in a crisis and they have to sell them at very cheap rates, then they make huge losses. At the same time, you don't want them ... you don't want the asset management to be around in 20 years' time hoarding these. And that was the experience of the RTC, the Resolution Trust Corporation, in the United States. If I remember rightly, after a few years, Congress passed a law, kind of, forcing them to sell a bit more because it was felt that they weren't selling enough, that they were beginning to hoard. So, that's always a tension. It looks - and there are different reports that look at NAMA - it looks to me from the outside that that they probably got that about right. They were selling assets, but they tended to be foreign assets, often in the UK. They were getting reasonable prices for those and therefore they were beginning, they were, they were paying off their senior debt. They held the Irish assets through 2011-12 but then there was a remarkable increase in the appetite for Irish assets over the last few years and they've sold into that. So by, by luck or by design, they seem to have, have got their timing about right.

Deputy Eoghan Murphy: So you wouldn't think there's an argument for trying to restructure the repayment schedule, given what we now know in terms of the rising value of assets? You know, because we talk about the initial costs of the bailout and then the potential for NAMA to reduce some of that cost direct through its work-----

Professor Alan Ahearne: Yes.

Deputy Eoghan Murphy: -----by selling assets maybe too early and not holding on to them long enough, the ability to reduce that cost further is restricted.

Professor Alan Ahearne: I mean, that's a judgment, that's an operational issue and a judge ... and a strategic issue for their board to judge when is the best time. I'm sure people have come in in the last few years and offered to buy the whole lot off them at a certain price, but the board have to make a decision about whether that's the best price or whether they could do better.

Deputy Eoghan Murphy: Okay, and then just the understanding in the Department as to the purpose of NAMA when it came to the actual developers, the people who had the loans, and what they were pursuing, because I'm just wondering did the targets change or was NAMA always meant to only be pursuing for the costs that they paid, or were they meant to be pursuing for the full costs the banks paid when it came to the developers?

Professor Alan Ahearne: I mean, when a debt transferred, that full amount of debt was owed to NAMA, and there was no sense in which NAMA was instructed to write off large portions of it, or just to chase the selling price value. No, there is still, the full amount was owed. Now, everybody knew that NAMA was not going to get back the full amount or anything near it. It was expected that what they would get back would be about the amount of money they had paid. After all, that is why they valued it that way. So, if they could get the full ... I mean I think €72 billion transferred for €30 billion, something like that. That was something like the numbers. If they could get the 100% back, the €72 billion, then we wouldn't have this inquiry because therefore there wasn't a bubble, all assets were valued properly. It was clear that there was a bubble, that assets were not valued, were not at the height of the bubble fairly valued, so there were going to be huge losses.

So that was, but, I mean, for example if there was a developer who had bought a field, and had a loan and the collateral on that was, I don't know, the field plus a bit of a pension fund, and that pension fund rose in value for some reason, and that pension fund would then be part of the collateral behind it, so that NAMA could go after that pension fund as well as the field if they ...

so there was no sense of okay, “You’ve transferred this loan. It was originally €100 billion. It’s transferred as €100 million and is now €5 million, therefore you only owe us €5 million.” That was never the intention, and I don’t, from what I know I don’t think that has been the practice.

Deputy Eoghan Murphy: Okay, thank you. Just to move on then if I may, when you entered the Department, and what the sense was in the Department of the need for a bailout. When did that start to come into your view, as an adviser to the Minister, because we have from other evidence that it occurred to some people in the Department around the time of the guarantee, that something like that might be needed down the line, some sort of a cross-stream credit line at least? And we also have a conversation between Governor Honohan and Minister Lenihan in April 2010 where Governor Honohan says it to the Minister that we’re next in line for a bailout after Greece and the Minister said “No, it would be Portugal”. So at what point in the Department are you thinking “We might be in trouble here on the sovereign side”?

Professor Alan Ahearne: When I went in initially there was no discussion of the IMF, but when I went in initially our bond yields had, I think, moved above 5.5% and were heading towards 6%. There was huge outflows from the banking system. So, the risk that the country might not be able to fund itself, that was, that was a possibility. Now, I had no discussion with the Minister about that, but it was possible. The Minister, I know, did meet somebody from ... a retired IMF official, who gave him a sort of briefing about what a programme might look like if Ireland ever needed it and I think that briefing was sent, was e-mailed to me as well.

Deputy Eoghan Murphy: When was that?

Professor Alan Ahearne: It could have been April 2009. In or around then.

Deputy Eoghan Murphy: April 2009.

Professor Alan Ahearne: Yes.

Deputy Eoghan Murphy: And he met with, was it a retired IMF official?

Professor Alan Ahearne: Yes.

Deputy Eoghan Murphy: Okay, and that was, do you know how that was initiated, that meeting? Was it-----

Professor Alan Ahearne: I don’t.

Deputy Eoghan Murphy: But the outcome of that meeting was-----

Professor Alan Ahearne: It wasn’t official. It hadn’t come through the IMF.

Deputy Eoghan Murphy: Okay.

Professor Alan Ahearne: It was just somebody who was retired, and decided to fill the Minister in on, you know, what a programme might look like. I knew what a programme looked like. I had followed countries that had been in programmes. As bond yields fell, things stabilised, that idea of turning to the, of needing official assistance just went off-----

Deputy Eoghan Murphy: When that meeting happened in April ‘09, a document came to you. Was that what you said, that there was a document?

Professor Alan Ahearne: Yes.

Deputy Eoghan Murphy: Was that document, was there any action taken as a result of that document? Do you know did it go to Department of Finance officials?

Professor Alan Ahearne: I don't believe so. I mean, the officials knew what an IMF programme. It sort of set things out, like, you will have quarterly reviews; you will be lent money, that sort of very basic-----

Deputy Eoghan Murphy: So it wasn't necessarily sketching out an Irish-specific programme.

Professor Alan Ahearne: Not at all. It was just a very basic lady book of what the IMF, what the IMF programme is about.

Deputy Eoghan Murphy: So did the Minister inform you of Governor Honohan's opinion in April 2010, that we'd be next for bailout after Greece?

Professor Alan Ahearne: No.

Deputy Eoghan Murphy: No, okay. Were you aware that the IMF had suggested to Governor Honohan around that time, in May it was, a precautionary line of credit for the country?

Professor Alan Ahearne: No.

Deputy Eoghan Murphy: This was in May 2010.

Professor Alan Ahearne: No.

Deputy Eoghan Murphy: No, you weren't included in those conversations. Okay. In relation to the bank funding cliff that was approaching in September 2010, did the Minister and the Department, were they, were they sufficiently aware of the seriousness of that situation?

Professor Alan Ahearne: Yes, I mean, they had the numbers.

Deputy Eoghan Murphy: Okay.

Professor Alan Ahearne: We all had the numbers. They saw what was maturing. The ... I guess the view in, after the banking announcement in, at the end of March 2010, and in the weeks that followed, the Irish banks were actually able to, their funding had stabilised and they were actually bringing in, I think there was inflows of about half a million, excuse me, half a billion a week into the Irish banking system, where there had been outflows for the previous, in 2009, of a billion a week. So that at least had stabilised. The Irish banks were able to issue bonds. I think Bank of Ireland was able to issue some serious bonds, senior bonds. So the hope was that if things continued to stabilise that the banks would be able to raise private funding. It was clear they wouldn't raise enough private funding to get over the cliff, and therefore the Eurosystem, the ECB and the Irish Central Bank would have to help out temporarily, but if they had, in the months that then followed, they would continue to issue bonds and raise funds, and they would've been able to repay that. So the hope was that things would remain stable, and things would continue to improve, well they were improving marginally, but if they continued to do so, the banks would be able to get over that cliff.

Deputy Eoghan Murphy: And was there frustration in the Department on what was perhaps a delay on the part of the ECB, in terms of engaging on this issue, because Governor Honohan told us that he had to write to the ECB twice to bring it to their attention in the summer of 2010?

Professor Alan Ahearne: I don't remember anybody expressing frustration about it. There was some frustration with the European Commission about approving the guarantee, but no, I don't remember anybody saying to me about-----

Deputy Eoghan Murphy: Okay.

Professor Alan Ahearne: -----frustration with the ECB over that.

Deputy Eoghan Murphy: Okay. Just staying with the ECB, in your opening statement you talk about them misjudging the systemic nature of the crisis, and you also talk about question marks about the ECB's communications with markets about individual member states. Could you just elaborate on, when you talk about that second point, about the ECB's communications with markets about individual member states, is that the discussion that you had with Deputy McGrath earlier, that those kind of conversations that you were having?

Professor Alan Ahearne: It is, yes, about how they were discussing with the markets what was going on.

Deputy Eoghan Murphy: Okay.

Professor Alan Ahearne: Yes.

Deputy Eoghan Murphy: And, just then in relation to that, when it came down to the conversation about burden-sharing with bondholders, could it, could it have been a unilateral action on the part of the country? Is it not something that you don't announce, or you don't negotiate on, you do it, and then try and deal with it then? Was that at all part of the kind of calculations that the Department was making or looking into?

Professor Alan Ahearne: There was no scope for burden-sharing while the guarantee was in place, so this was forward-looking. I mean, I discussed this with a senior civil servant maybe from May onwards about the Anglo bonds, could they be discounted. At the time the plan with Anglo was to split it into a good bank-bad bank, and that raises the issue of what goes into the bad bank, what creditors, what funding goes in. You put the subordinated debt in of course, and that would expose it then, but you, in theory, could put the senior bonds in. Now you are splitting the depositors and senior bonds then so that had all those legal issues but at least that was, in principle, we discussed that.

Deputy Eoghan Murphy: Just when that window opened up - end of guarantee before the bailout negotiations - and the IMF are talking to you about a figure of €4 billion and Mr. Lenihan is thinking maybe 50% of that, was anyone saying let's just do this, rather than wait to be told that we can't?

Professor Alan Ahearne: I think the Minister certainly considered it, but as September went on, and our interest rates on, facing the State, on sovereign bond markets increased, then he became worried about the knock-on effects to the sovereign. And the advice, clearly, from the NTMA was "Don't do this because it will push up your yields even more and you'll lose access to the markets and if you are pushing up the Irish interest rates as a heavier cost to the State and, therefore, any gain you are going to get you are going to lose". I mean, I was ... I remember he did an interview in New York in early October, maybe about 10 or 11 October, with, I think, the *Financial Times,* and I was sitting beside him and he said to them ... they asked him about the Anglo bonds and he said “Well, I’m not going to coercively discount them but the bank could do a liability management exercise and raise some capital that way, burn ‘em that way. That’s a voluntary ...”. In fact, most of the subordinated debt that Deputy McGrath spoke of was done that way, done through voluntary ... a voluntary way. Not long after, I remember somebody from the NTMA - a senior official from the NTMA - showing me their BlackBerry and saying “Look at this, I’m getting e-mails from ... here’s a headline, I think, from the *Financial Times* or from somebody, something like Ireland going to default”. It was that sort of tone to it - “Look at this, I’m getting e-mails from the people we sell bonds to asking me is Ireland about to default”. And I said, “Well, he didn’t ... the Minister didn’t mention anything about sovereign bonds, he was talking about bank bonds”, and the reply I got was “It doesn’t matter, look at the headline, this is creating problems”. And the Minister said ... I remember the Minister saying afterwards “Okay, I realise I’m talking about burning senior debt and you’re [the NTMA are] trying to issue senior deb”. So, they’re different debts but very difficult to do in an environment where the sovereign market is stressed.

Deputy Eoghan Murphy: And, just staying on that issue, just one last question. Do you recall any conversation between Kevin Cardiff and the ECB when - we’re later into November now, this is negotiations and discussions - and the ECB had its own legal advice on whether it was constitutional for Ireland to impose burden-sharing and Mr. Cardiff retorted that, you know, we could have a referendum if we needed to. Were you there for that conversation, do you recall it?

Professor Alan Ahearne: He ... Kevin either said to me or else I read it in a memo. I thought that was somewhat later but Kevin’s dates might be better than mine but I do remember that ... I think, reading it at the time in a memo that the ECB had said “We have got ... “, “Actually, this would be unconstitutional and we have got our own lawyers”. And maybe - I’m not sure if it was written or whether Kevin said it to me afterwards but “This is the answer I gave them: “I’m sure if we put this to a referendum the Irish people would vote to burn Anglo bonds.”.”

Deputy Eoghan Murphy: Okay. Just finally, going back to October and I think it was in your travelling over to New York you wrote in a chapter with ... for the book on Mr. Brian Lenihan about a discussion you had with him about the euro and about possibly exiting the euro. We know from other evidence that there was a unit doing work on potential contingencies should we find ourselves outside of the euro or should a decision we take bring us outside. But was that discussion a serious discussion or was it just a chat that people have, you know?

Professor Alan Ahearne: I think Brian Lenihan’s style was that he liked to consider all options. I mean, he wasn’t willing just to ... if an official said, you can’t do A, he’d want to know why can’t you do it “Well, there’s problems - X,Y and Z problems”, “Well, is there a way around the X, Y and Z?”. So, he was very open-minded and he wanted to satisfy himself that whatever route he was doing that that was the right route and that everything else had been considered. So, was it serious? It was never ... he didn’t, sort of, again, order a big ... a plan to go ahead. It wasn’t that but he wanted to kick the tyres of that particular out-of-the-box alternative route, as he did with many other things. And so I thought it was just a good way of doing policy making. He thought everything through, even things that were, sort of, real left field.

Deputy Eoghan Murphy: Okay. And you would characterise that as being real left field in terms of a possible option.

Professor Alan Ahearne: I would think so. He concluded - in many ways he is talking to himself - just thinking it through and he concluded ... and we spoke for several hours and he concluded that this would not be in the interest of the citizens of the country.

Deputy Eoghan Murphy: Did you give him any advice on it or was it-----

Professor Alan Ahearne: I mean, I wouldn't have been in favour of it either. So we just discussed a lot of the, sort of, economic issues to do with it "If you had your own currency would you peg it to sterling or would you become part of the dollar zone?", it was all that sort of stuff. It was just very broad discussion of alternatives.

Deputy Eoghan Murphy: Okay, thank you. The final section we are looking at, if I may, is the national recovery plan because you were involved in drafting that document, is that correct?

Professor Alan Ahearne: There was a team who drafted it and I was part of that team, yes.

Deputy Eoghan Murphy: Something else I wanted to ask you about was ... because, again, in that chapter you submitted ... or in that book you submitted a chapter for, you talk about this visit from Olli Rehn in November 2010 and that the Minister had a bespoke plan for Ireland at the beginning of November and he wanted to discuss that plan with the French Finance Minister and with the German Finance Minister but a call from Olli Rehn in the Commission prior to this meeting of Ministers confirmed that the bespoke plan was not going to work. So, was this the national recovery plan, this bespoke plan, or was it a separate thing?

Professor Alan Ahearne: No. So what he wanted ... I mean, Ireland was under pressure in sovereign ... in the markets. The national recovery plan would have been part of it, so what he wanted to do was get the national recovery plan out, publish it. He wanted the ECB to say that ... because the banks were separately under stress on their funding, he wanted the ECB to say publicly that they stood behind the Irish banks and provide liquidity. By the way, the ECB were never asked to give capital to the Irish banks. It's not that they were asked to pay for a single cent, they were being asked to give funding but they were repaid all the funding. But he wanted them to say that they would stand behind him. And then he was willing to enter some sort of precautionary programme and what he had in mind is they could ... I mean, he said they could do quarterly surveillance if they wanted but the Irish State had enough ... the sovereign had enough money to keep going to the middle of 2011. So he said "Look, let's use that money. If the markets haven't improved, we can run down that money. We've just given ourselves time, given everybody time [the Irish State] given the Europeans time." Because they were in turmoil over what was going on - this was, remember, the start of the EU area crisis - maybe get some money to keep the State going until the end of 2011 and at that stage if Ireland still did not have access to the markets, they had pulled out at this stage, then we'd go for a full-blown programme, but he wanted some time.

Deputy Eoghan Murphy: Right. And the national recovery plan was a part of that bespoke plan and he wanted to talk to the French and German Finance Ministers about it but Olli Rehn intervened. Was he asked to intervene or on what authority was he working?

Professor Alan Ahearne: No, Olli Rehn had been in Dublin on ... early that week - so on maybe the 8th or the 9th - and he discussed this with Olli Rehn. He met him first privately then he came into the room with several officials and I was there. And Olli Rehn said "This is certainly worth pursuing". That was the point I was making, this precautionary plan. Later that week ... you know, so it looked at this stage there was going to be some time to develop this, to get the national recovery plan out and talk to the various ... to the two Finance Ministers. Later that week - the phone call that I am talking about is from Seoul - there was a G20 meeting.

Now, I was in the United States ... I flew to the United States, to New York, later that week so I was in the US but I called back, I think, on the Friday. There was a ... Reuters or one of the news agencies had a story that said Ireland applying for the ... is going to apply for a programme. So I called back and said "What's this all about?" and I was told at that stage that a call had come in, I think, the night before, sorry, or at some stage around then, from Olli Rehn to Brian Lenihan and he had said - in the conversation as it was related to me - "Hi Brian. It's midnight in Seoul. Things have changed." And what he meant was ... "Things have changed.", is that on the Monday or Tuesday, there was this potential to explore a precautionary programme but by the time we got to later that week there was no time to do that.

Deputy Eoghan Murphy: Because of what had happened in Seoul, because of the-----

Professor Alan Ahearne: Yes.

Deputy Eoghan Murphy: Was Olli Rehn sent off as an emissary on behalf of the Government? Was he asked or tasked with, you know, sussing this out on behalf of the State or was he just picking up, you know, what was the view at Seoul and that's why he communicated that back?

Professor Alan Ahearne: I mean, he would have been asked to accept the national recovery plan - which eventually they did - and the fiscal projections and all and then so he would have agreed to that but ... that was fine. What he was relaying back is obviously there had been some sort of meeting in Seoul where they had decided that this couldn't wait, that Ireland needed to go into a programme right away.

Deputy Eoghan Murphy: Just to clarify, sorry.

Chairman: A supplementary on it and then I'll move on.

Deputy Eoghan Murphy: So Olli Rehn had a discussion with partners in Seoul on the bespoke plan that Brian Lenihan had come up with and communicated to him in Dublin and they made a decision on it, or not.

Professor Alan Ahearne: I mean, I don't know what happened in Seoul. No, I'm not necessarily saying that. He may not have brought that to ... he may not have brought that. Brian Lenihan didn't send him out to discuss this. Brian Lenihan himself was going to discuss it with the German and French Finance Ministers.

Deputy Eoghan Murphy: Thank you.

Chairman: I'll bring you back in again to wrap up, Deputy Murphy. If I can just deal with a few matters myself with you, Mr. Ahearne. In your statement, you say that the merger of Anglo and INBS and the transfer of deposits was a reasonable approach agreed with the troika. Then you, kind of, go on to say, "Ironically, I had identified as an option the transfer of deposits from Anglo to AIB in a newspaper article I wrote in January 2009." Maybe if I could just tease out some aspects of that with you please, Mr. Ahearne, in that do you think the troika was a material motivating factor in the merger of Anglo and INBS and the resultant deposit transfers?

Professor Alan Ahearne: It was something that they wanted to do. I mentioned that it made sense in ... I mean, there weren't huge benefits to it. In fact, the benefits were probably quite small, but they wanted to do it. One benefit was that it did put the two banks that were being wound down together and, in a way, created a separation between them and the other banks.

I thought that was probably helpful. And there was a transfer of deposits then from Anglo to AIB. The country needed the deposits, it needed the funding, but the funding really needed to be in the banks, the core banks that were going to continue, not in banks that were going to be wound down. So that made sense to me.

Chairman: And maybe if you can outline what you would've seen as the potential benefits of your suggested option in 2009 of transferring the Anglo deposits to AIB?

Professor Alan Ahearne: It was just that .... even then, in 2009, writing that, I obviously ... I didn't see a future for Anglo and, therefore, Anglo was ... my thinking on it was it was just going to eventually disappear. You had to do something with the bank's assets and liabilities. I think I wrote in that article about moving the assets to an asset management company. Well, that was done through NAMA, and then you've got to move its liabilities somewhere. So it made sense to move it to another bank.

Chairman: Okay. Could I maybe invite you also to comment upon the suggestion by the Governor of the Central Bank, Patrick Honohan, that the merger of the EBS and AIB and INBS and Anglo was largely "cosmetic", would have been the words he would've used. In your opinion, was there any real value to be obtained from these mergers?

Professor Alan Ahearne: On the EBS, I mean, it probably would have though it was a very small institution and depositors may well have become very worried about it post the programme. Is this institution going to last at all? And so that would've created worries for depositors which were unnecessary. So folding it into AIB and, therefore, depositors had AIB behind it, at least did provide some assurances to depositors. I don't think there were any big costs to it but ... and no huge benefits, but I think there was a benefit for stability or deposit stability reasons, having a bigger bank like AIB behind those deposits.

Chairman: Maybe if I can just move on to Anglo specifically in terms of its long-term future in that regard? You recall in your statement that the Minister decided in autumn 2010 to wind down Anglo. Maybe if I could ask you what advice, if any, did you give the Minister to support the decision to wind down Anglo?

Professor Alan Ahearne: I mean, I discussed it with him many times. So he would've known my opinion about it. But, as I said, he was ... he would take advice from lots of different people and he was open-minded on it. So he was giving the management an opportunity to make their case that you could get a good bank out of it and that would be positive for the Irish economy.

Chairman: So that was one operational consideration that you, kind of, had this good bank-bad bank sort of thing. What other operational factors were considered at the time?

Professor Alan Ahearne: I mean, the ... that was really ... the main one was what do you ... how do you wind this bank down gradually. In what model? There wasn't any consideration ... I mean, it was never a viable option to wind it up immediately.

Chairman: Right.

Professor Alan Ahearne: The bank had huge amounts of deposits, had borrowed a lot of money from the Eurosystem. I think it had about €70 billion of funding. The Irish State could not replace that funding.

Chairman: So what would have been the consequences to the State in two regards? One, winding it down quickly - as you just kind of said, there were some concerns there, maybe you could tell us more? And what were the concerns in terms of actually keeping it going as a going concern?

Professor Alan Ahearne: I mean, in terms of immediately winding it down, there would've been no gain in terms of ... because it was under the guarantee, the creditors were all guaranteed, so it was no benefit to ... no reduction in the costs to the State. It still had to put the capital in. It was important that Anglo had a banking licence and was able to get funds from the ECB, because those were otherwise funds that the Irish State would have to do to wind ... to gradually wind this bank down.

Chairman: Okay.

Professor Alan Ahearne: So an immediate wind-up just wasn't ... in addition, if you wind it up ... I mean, lots of the bank's bonds had clauses in them that everything had to be repaid instantly.

Chairman: And was-----

Professor Alan Ahearne: The State didn't have that sort of capital.

Chairman: At any time was it discussed that, look, we're ... the situation with Anglo is this is where it was, this is where it is now and this is where it needs to go and that, ultimately, where it needs to go is a wind-down, a liquidation or some removal of it from the financial landscape?

Professor Alan Ahearne: That was always ... that was always, I wouldn't say the preferred option, but it was always under very serious consideration that eventually this just wouldn't be here, it'd be wound down. It was all about timing. The management came up with this idea, well maybe we can save you a few bob and we can create a bit of value. So the Minister said, "Okay, well, look, just put together that proposal". But, as I said, he was open-minded on it.

Chairman: And in that regard, it's the final question specifically on Anglo. In the way that the promissory note was structured, did it enable or help or assist or hinder the ultimate liquidation of the company?

Professor Alan Ahearne: I don't think it affected the liquidation. It ... what it did do was allowed that institution to be wound down gradually, which it had to be-----

Chairman: But inevitably-----

Professor Alan Ahearne: -----and funded at a very cheap ... in a very cheap way as it was being done.

Chairman: But inevitably if you're going to liquidate something, and we'd know from earlier testimony you ... that there's very particular structures for liquidation and, in this regard, there would be emergency legislation that'd been prepared over a period of time.

Professor Alan Ahearne: Yes.

Chairman: So you would hit that junction point. So the question I'm asking you specifically is the way the promissory note was structured, was it assisting or hindering to that process?

Professor Alan Ahearne: It was neutral on it ... once the decision was made to liquidate it, the Central Bank claimed the promissory note. So that was just normal Central Bank operations. The Central Bank could've held the promissory note. They decided with the Government that it was everybody's advantage to convert the promissory note into a regular Government bond, but it could've held the promissory note.

Chairman: Okay. I just want to wrap up with a couple of matters there and to say you were in a similar kind of area with Deputy Murphy a few moments ago. I'll maybe just put the question to you. I know you came in in 2009. You came in after the banking guarantee had actually been put in place but you were dealing with the legacy issue of it in your capacity as an adviser. So maybe if I could start by putting the question to you, did the structure and design of the banking guarantee along with its period of duration - which was two years, the way that it was actually set up - have any bearing on the Irish State entering a bailout programme two years and two months later, after it had been put in place?

Professor Alan Ahearne: Well, it certainly limited options while it was in place for two years. I mentioned ... because all creditors were guaranteed. Of course, it's not at all clear that if there had been a different guarantee or low guarantee that the Irish State would have put banks into liquidation anyway and put losses onto senior creditors, depositors and bondholders. So the answer to that question, just to have it clear, I think, one has to have a clear idea of what the counterfactual is, and it's not clear to me that in the counterfactual-----

Chairman: Well, the fact is that a guarantee was put in place.

Professor Alan Ahearne: Yes.

Chairman: So there's no counterfactual of there being no guarantee.

Professor Alan Ahearne: Okay.

Chairman: There's a guarantee in place.

Professor Alan Ahearne: Okay.

Chairman: So is it inevitable or not inevitable that you're entering a bailout programme by the particular design and structure of which the guarantee was put in place?

Professor Alan Ahearne: It's not at all inevitable.

Chairman: What ... what was it-----

Professor Alan Ahearne: Let me give you an example.

Chairman: Okay.

Professor Alan Ahearne: Let's say the ECB announced ... we know that it announced in July ... summer of 2012 ... a new programme, outright monetary transactions, OMT. We know it subsequently did a quantitative easing. By announcing the OMT, it reduced the yields on Italian and Spanish bonds, which had gone up to 7%, up to where Irish bonds had been in the autumn. It reduced them ... it kept those two countries in the markets. In other words, it prevented them going into a programme. Now, the programme ... there wouldn't have been a programme because there wasn't enough money for them, but the point I'm trying to make is, if the ECB - and this is a thought experiment - if the ECB had announced in the summer of 2010 OMT, would the Irish State have required a programme. And the answer is, in my view, clearly "No".

Chairman: All right. But what we do know is ... you're advising us that the ECB didn't capitalise the banks, that the funding, in effect, was a form of quasi funding capital. But is it the case that, in reality, without that funding, the banks were dead, illiquid and insolvent?

Professor Alan Ahearne: Without the funding, the banks would not have been able to meet their obligations and there would have been a call on the guarantee.

Chairman: So in that regard, were the banks that were covered by the guarantee still solvent and therefore qualifying for ECB-ELA funding at the time of Minister Lenihan's last letter to Mr. Trichet?

Professor Alan Ahearne: I think the ... I mean, solvency is a technical issue and there are many different interpretations. They were always solvent-----

Chairman: The ECB have a very specific interpretation and that was laid out in Mr. Trichet's correspondence repetitively back to Mr. Lenihan.

Professor Alan Ahearne: They were solvent in the sense that the Irish State stood behind them and was providing capital. I mean, if the Irish State is putting capital into them, then, by definition, they have enough capital.

Chairman: But there were then questions, and your theory, if I understand it right, is that because the State is standing behind the banks, which it was in 2008, and the State is solvent, the banks are *de facto* solvent.

Professor Alan Ahearne: Yes.

Chairman: By November 2009 - or, sorry, November 2010 - there is a serious question with regard to the State's solvency, so there is a serious question *de facto* with regard to the banks' solvency. So in terms of the position of where the ECB are coming at that time, are there now concerns that are genuinely placed inside in the ECB with regard to the structure of ELA funding, with regard to the solvency of Irish banks, through the *de facto* questions of solvency with the Irish State?

Professor Alan Ahearne: I mean, it would be up to the ECB, if they wanted to, to declare Ireland insolvent. They never did.

Chairman: Were they not implying that in the correspondence? You were saying there was a lot of implication that was stated in Mr. Trichet's letter, but that was really what the real implication of those discussions was.

Professor Alan Ahearne: I don't ... There was never a decision in the governing council to say that a particular state was insolvent, so ... I mean, the Irish State was not insolvent at that stage.

Chairman: Okay. Mr. Cardiff, when he was before this inquiry here, in his witness statement, commented upon Jean-Claude Trichet's letter in response to one of 19 November 2010 to the late Minister for Finance, and he says: "In many ways this letter was entirely superfluous, since it was already clear by the time of the letter that the Government was going to opt into a [bailout] programme." Would you concur with the statement that Mr. Cardiff said?

Professor Alan Ahearne: Yes. On the 19th? Yes.

Chairman: Okay. So was Ireland bounced into a bailout programme or was it inevitable?

Professor Alan Ahearne: I mean, I think the timing of it was determined by ... largely by the ECB. They pushed Ireland into a programme quickly.

Chairman: Was it inevitable? According ... by Mr. Cardiff's testimony, he is saying - I repeat - "In many ways the letter was entirely superfluous, since it was already clear by the time of the letter that the Government was going to opt into a programme."

Professor Alan Ahearne: I don't think there was anything the Irish side could have done to reduce our yields in the market and therefore to get back into the market. There were lots of things that could be done in Europe. I have given the example of OMT. Lots of things that eventually did occur, so-----

Chairman: But they are all programmes by their nature.

Professor Alan Ahearne: -----it wasn't inevitable in the sense that was there ... there was nobody in the world who could do anything about it. The European authorities could have done something about it but they had set up - as Brian Lenihan explained at the time - they had set up a fund, and their answer was, "Look, we've set up this fund to provide financial assistance. You need financial assistance. Go to this fund."

Chairman: But if ... just to test the proposition - the proposition being that Ireland was bounced into a programme and if we weren't bounced into that programme we wouldn't have required a programme - is that an accurate proposition? Was Ireland ultimately going to go into a bailout programme one way or the other?

Professor Alan Ahearne: If you look at what happened to the yields ... Let's say the ECB had announced - they didn't have the programme, but they announced that they would stand behind the Irish banks and that somehow stemmed deposit outflows from the Irish banks. The Irish Government's plan was to get ... would have then ... wouldn't have entered a programme. It would have issued the national recovery plan. We would have gone into 2011, but the yields on Irish Government debt were continuing to rise. They didn't stop rising until we got to the summer of 2011. At that stage the Irish State would have been well out of cash.

Chairman: Were you aware, or did you witness the engagement the inquiry had with Mr. Trichet in Kilmainham?

Professor Alan Ahearne: I did.

Chairman: Okay. You are familiar with much of the content of it. When this proposition was being tested against Mr. Trichet - and one of the purposes of engagement with Mr. Trichet was that we would have ... that that engagement would be evidence that could we test with other witnesses, so this afternoon is an opportunity to test it with another witness - Mr. Trichet says: "As you know" - he's talking about the whole ELA funding - "As you know, we could also have continued on our side after having gone from 100% of GDP to 200% - this is Irish GDP - and why not 300% of GDP? Then what would be the commission of inquiry [referring to this inquiry] be asking for? You would say, 'Were you totally crazy, at the ECB, to continue, when we were going into the wall at 100 miles per hour, to continue providing liquidity and liquidity and liquidity?' " So the question I put to you, Mr. Ahearne: is Mr. Trichet right? If this action hadn't actually happened and his correspondence of November hadn't kind of named the situation, and, as we see from Mr. Cardiff's testimony, that we were going into a bailout programme anyway - if we had just delayed and stayed on the never-never with the ELA, would the bailout have been bigger for Ireland?

Professor Alan Ahearne: Ireland would have run out of cash in ... some time in 2011, so it would have needed financial assistance.

Chairman: The position, according to Mr. Cardiff, would have been ... according to Mr. Cardiff when he was before ... he said, "The stronger the position you have the better your negotiation situation is." By running out of cash, does your negotiation position get weaker or stronger?

Professor Alan Ahearne: I mean, there is logic to that, that we probably had a stronger position in 2010 than we would have had in 2011. That said, I mean ... the ECB - they themselves were contributing to the panic we saw in markets. I mean, I gave an example earlier of briefings-----

Chairman: I just want to stay with the proposition that we have in front of us. If Ireland had delayed its entry into a bailout programme, would the cost have been larger and would our negotiation hand have been weaker?

Professor Alan Ahearne: Possibly, but that's very speculative. I don't think it would have made a huge lot of difference.

Chairman: You don't think it would have made a difference.

I have another proposition here; it is a proposal for a very short five-minute comfort break. I am going to do that. However, while we are suspending, I just want to advise the witness that he is still under oath. You can refer to any legal advice and support you have here and we will resume in five minutes.

Sitting suspended at 1.26 p.m. and resumed at 1.35 p.m.

Chairman: We will resume in public session and, in doing so, continue on. And if I can invite Deputy O'Donnell, please. Deputy, you have ten minutes.

Deputy Kieran O'Donnell: Thanks, Chairman. Welcome, Mr. Ahearne. On your appointment to the position of special adviser to the late Brian Lenihan in March '09, were you satisfied that the Minister and his officials were in possession of the management information that was necessary to make informed decisions such as the initial injection of capital of €4 billion into Anglo in May 2009? Was there recognition at that time by the Minister and officials that the data available to them was not as accurate as it could have been? And maybe you could put that in the context that we had PwC in before us this morning and Project Atlas ... one of the assumptions they took was that commercial property would only fall by 4% in value between '08 and 2011, when, in fact, property fell by over 60% during that time period. And, they were ... PwC were subsequently involved in doing work for the Department in around May '09, at which time you would have been in situ, where they agreed with that €4 billion that the new management in Anglo suggested was needed in terms of recapitalisation of Anglo.

Professor Alan Ahearne: I think the Minister fully expected that there was ... the amount of capital needed by Anglo was going to be bigger than €4 billion.

Deputy Kieran O'Donnell: So, when you joined on 18 March '09, what figure did the Minister for Finance believe was needed to be invested in Anglo?

Professor Alan Ahearne: He ... they didn't give me a figure that stage, but not ... a few months later, I would think, I remember him saying that-----

Deputy Kieran O'Donnell: When you say a few months later, precisely?

Professor Alan Ahearne: I can't be precise. Probably, you know, May, June, July, something like that. He thought that Anglo ... I think he said between €5 billion and €10 billion upfront.

Deputy Kieran O'Donnell: €5 billion and €10 billion?

Professor Alan Ahearne: Yes, if I remember rightly. But he thought that the other banks ... that intervention in the other banks could make ... they could profit, particularly Bank of Ireland, and that the ultimate bill might come down to something like €5 billion.

Deputy Kieran O'Donnell: For ... net overall?

Professor Alan Ahearne: Net overall.

Deputy Kieran O'Donnell: And, did you feel at the time ... what was the basis for that view held by the Minister at the time?

Professor Alan Ahearne: I don't know. Presumably, it was the, sort of reports, that he was getting.

Deputy Kieran O'Donnell: And you, obviously, would have come in and reviewed reports and Project Atlas and so forth. And were you ... what was your view on the reports that had been provided to the Minister to that point?

Professor Alan Ahearne: I did say to him, when he said that, "I think it's going to cost a lot more than that". But, ultimately-----

Deputy Kieran O'Donnell: What did you think the banks would be-----

Professor Alan Ahearne: I didn't have a number. Ultimately, it would depend on ... the amount of recapitalisation that was going to have to be done by the State depended on lots of different things. It depended on, one, on how much private capital the banks could attract. There was always, right from day one, I think, some confidence that the Bank of Ireland would be able to attract private capital, and therefore, save the State having to inject the money. There was more scepticism about whether AIB would by then, so it was seen as a more troubled bank than Bank of Ireland.

Deputy Kieran O'Donnell: Did you believe-----

Professor Alan Ahearne: But ... So that was one of the factors, how much private capital. The other was how much capital ratios the Central Bank would set and, ultimately, the decision about how much capital the banks needed was a decision for the Financial Regulator and the Central Bank. I remember being in a meeting at some stage where there was a bit of a discussion - the Central Bank and the Governor and the Financial Regulator were there - a bit of a discussion about what's a good capital ratio for banking and the regulator abruptly stopped it and he said, "Excuse me, there's only one person who can set capital ratios, and that's me", which he was correct. It was not a political decision or a decision for a Minister or a Department.

Deputy Kieran O'Donnell: When was this, Mr. Ahearne, roughly?

Professor Alan Ahearne: Probably 2009.

Deputy Kieran O'Donnell: When in 2009?

Professor Alan Ahearne: Maybe the autumn of 2009.

Deputy Kieran O'Donnell: And-----

Professor Alan Ahearne: So, the point was that, yes, there was going to be more capital put into the banks. How much? That was a question for the Central Bank. It was going to do its stress test and its PCARs, and it was going to report the number ... up to the Minister to decide whether he puts the money in or not, the overall strategy, but the quantum of money that was required of capital to meet capital requirements, all that was to be determined by the Central Bank.

Deputy Kieran O'Donnell: And did you believe, when you took up your position in special adviser to Minister Lenihan in March 2009, that the information at his disposal, the PwC reports, information from the Financial Regulator, NTMA, everyone else, all other various advisers, did you believe he had sufficient and accurate information?

Professor Alan Ahearne: I realise that, I mean, the, sort of, accurate information you're talking about takes time to gather. The NAMA process, for example, was going to gather very accurate information - time-consuming, but they were going to drill down and, on a loan-by-loan basis get the, sort of, information that, ultimately, you needed. So, the Government ... I think at that stage it was very difficult for them to have a complete picture. How could they have? You're dealing with aggregates. This is what the, sort of, reports were dealing with. If you really want to get into the, sort of, assessment that NAMA did, and that, let's say, eventually, the ECB did in its comprehensive assessment and stress test, then you have to go into incredible detail, one-by-one, and that just takes a lot of time.

Deputy Kieran O'Donnell: Well, were you surprised that, six months after the guarantee when you joined with Minister Lenihan, that the Department of Finance or the Minister hadn't a full handle on the state of the balance sheets of the banks?

Professor Alan Ahearne: I don't say I was surprised. I had ... in the previous time I was in front of the committee, I had said that I had met the Minister in, maybe, August of 2008 and had suggested to him that he should try and get as full a picture ... as good a picture as he could possibly get in the thinking about policy for banks but, again, you know, this is a ... to do the, sort of, exercise that NAMA did, for example, just takes a lot of time.

Deputy Kieran O'Donnell: Can I just ... one quick question. Do you believe that if Anglo Irish Bank had been nationalised or had been ... ELA funding had been put in place on the night of the guarantee and you had gone to the ECB and gone to the European Commission, that you would have been able to burn bondholders and save the Irish taxpayer money?

Professor Alan Ahearne: There's nothing that happened subsequently that would suggest that that would have been a possibility. The ECB was stridently against the burning of bondholders in ... once the guarantee had expired. The whole approach, from what I can see, and I wasn't there in September '08, ... but from what I can see, the whole approach from the ECB, and from Europe in general, was no more Lehman Brothers, no defaults so-----

Deputy Kieran O'Donnell: Well, do you believe that Anglo Irish Bank was solvent on the night of the guarantee?

Professor Alan Ahearne: Again, this goes to an issue of ... in a set of ... to do with solvency, is there a set of accounts that shows positive capital ... the capital ratio, and I think there is.

Deputy Kieran O'Donnell: In your professional judgment,-----

Professor Alan Ahearne: I think there is.

Deputy Kieran O'Donnell: In your professional judgment as an economist, was Anglo Irish Bank solvent on the night of the guarantee?

Professor Alan Ahearne: If you think ... so ... but if the solvency includes, sort of, forward looking, so what losses? It's not the losses as actually recognised today under what I think are imperfect accountancy rules but - you could step back from that, which is in a regulatory or an accounting approach to solvency, and say that, as an economist, this is what is going to happen in the property market and here's the real story with these loans, that there's really not much collateral and stuff like that. If you knew ... if you add on what subsequently happened and the losses, then it was ... it is clearly completely burst on the night, but that is not what the data would have shown on that night.

Deputy Kieran O'Donnell: Okay. Can I take you to the bailout? You've stated earlier to the Chairman that it's your view that if the current bond buying programme that's in place under Mario Draghi and the ECB was in place, Ireland would not have ended up in a bailout programme. Is that correct?

Professor Alan Ahearne: Again, it's somewhat speculative but, I think, if they had introduced OMT earlier, that would have calmed sovereign bond markets and Irish spreads would have fallen ... Irish yields would have fallen in the same way that German and in the same way that the Spanish and Italians' did in 2012.

Deputy Kieran O'Donnell: And how would we ... if we hadn't gone into the bailout programme, how would we have ended up funding the investments that were required in the banks subsequently?

Professor Alan Ahearne: We would have borrowed it from markets.

Deputy Kieran O'Donnell: And do you believe the markets would have tolerated that?

Professor Alan Ahearne: Well, that's just the point. This is ... if you have a backstop, a lender of last resort who is doing what they're doing now under ... it's now under quantitative easing where they're buying and they've driven Irish bond yields to 1.5%. But even under the OMT, which ... actually, there was no bonds bought under OMT - it was just an announcement - but that did reduce the yields. And if your yields are low enough, then when you have access you, obviously, have people who are willing to lend, then you can borrow from them and you can do the plans. I mean, ... if ... and, again, we are talking counterfactuals, which are extremely difficult. In that counterfactual, it wouldn't have made an iota of difference, I think, to the fiscal adjustments that were made. Ireland would still have had to do its fiscal adjustments. The fiscal adjustments that were done weren't done because we entered a programme; they were done because we had a very large budget deficit. Under a scenario where we could borrow from the markets, the borrowing would have been financed by the financial markets as the Government did the fiscal consolidation it did. It turns out that that money came from the official sector, but it's still the budget that had to be narrowed. It didn't make any difference to that. It may well not made a whole lot of difference on the ... what was done in the banking front. So, there was work needed to be done. The issue was who was going to finance it. Ideally, it would be financed by the markets. If the markets aren't going to finance it, then it had to be financed officially.

Deputy Kieran O'Donnell: And who do you believe vetoed at the G7 meeting? Who vetoed the burning of the €4 billion in unsecured bondholders in Anglo?

Professor Alan Ahearne: I don't think it was a meeting; it was a conference call. I wasn't involved in it. I had very ... I have no information about it so I don't know.

Deputy Kieran O'Donnell: And, I suppose, the very final point. Do you think anything different could have been done in terms of dealing with the banking crisis and the guarantee that would have saved the Irish taxpayer the at least €64 billion gross that has gone into the bank and, more particularly, the €30 billion of funds that are gone into Anglo Irish Bank that they will never see a red cent of again?

Professor Alan Ahearne: Stuff could have been done while the bank ... while the property market bubble was inflating, yes, so if you're talking about ... if you're ... but once we got to where we were in, let's say, 2008, I think there wasn't a whole lot could be done on the Irish side. There was a lot of work to be done in restructuring the banks and fixing the public finances, but if you're talking about, sort of, avoiding the pain of the bursting of the bubble, then not a whole that could be done on the Irish side.

If we had the, sort of, European mechanisms - the banking union, quantitative easing - and if they had been in place in 2008, that would have made, I think, the deleveraging and the deflating of the Irish economy, and the recovery, easier, but that's not an issue for the ... I mean, that would ... that's not something that the Irish authorities had control of.

Chairman: Okay, thank you. Deputy Pearse Doherty.

Deputy Pearse Doherty: Go raibh maith agat agus fáilte ar ais chuig on choiste. Can I ask you, Mr. Ahearne ... or Dr. Ahearne, you mention in your statement, "Asset management companies like NAMA have been used in many countries ... to facilitate bank restructuring and to manage and dispose of troubled assets." Can you comment on the different structures and mechanism used in other countries and, in particular, outline their respective success in addressing their own particular issues as briefly as you can?

Professor Alan Ahearne: I mean, there are many different types of asset management companies. They're publicly-owned. Some of them are privately owned. Sometimes there's an asset management company per bank; I think, the Swedes did it that way. Sometimes its an overall stay-alone asset management company, like NAMA or, I think, the Spanish have a very similar asset management company. So there's different variants of it.

Deputy Pearse Doherty: Did anyone copy NAMA?

Professor Alan Ahearne: The Spanish copied it almost exactly. I mean, if you look at the legislation, it is hard to - one's in Spanish and one's ... but if you had a translation, it would be very difficult to tell the difference. Slovenia, I think, have copied it.

Deputy Pearse Doherty: And successful outcomes or unsuccessful outcomes in those areas?

Professor Alan Ahearne: Well, the Spanish economy is improving. I mean, I'm not an expert on the Spanish economy. My understanding is that that economy is ... this second, is growing at a decent clip now, not as fast as Ireland. But it does appear to be a recovering-----

Deputy Pearse Doherty: But in terms of the-----

Professor Alan Ahearne: So I would need somebody else to make an assessment about whether ... they were a bit later to it than Ireland was - we were out ahead of them - but they eventually did set up a NAMA, a Spanish NAMA, and as I said, the Spanish economy does look to be in recovery.

Deputy Pearse Doherty: But in terms of ... obviously, NAMA wasn't set up for the purpose of the economy. Obviously, it would have an effect on the economy. It was set up in terms of the banks ... in terms of getting the bad assets off the banks so do you have an analysis of how successful the NAMA ... the copying of NAMA in Slovenia and Spain ... how it worked out in relation to its stated purposes as opposed to the wider economy?

Professor Alan Ahearne: I mean, ultimately, you're trying to fix a banking system for economic reasons. This is all about the welfare of the citizens so you're not stabilising your banking system or setting up an asset management company for the benefit of developers or borrowers or bankers. That was a ... NAMA ... the Government was accused of that when it was being set up. It was false then and it's clearly false. There aren't many developers going around saying that they benefitted greatly from NAMA-----

Deputy Pearse Doherty: No, that's not the point.

Professor Alan Ahearne: -----and there's very few bankers going around-----

Deputy Pearse Doherty: That's not the point, Mr. Ahearne. The point is in relation to the establishment of NAMA to bring bad assets off the loan books of the banks. For example, it didn't really help Anglo Irish Bank or Irish Nationwide. Those two banks went bust. What I'm saying is you make the point that NAMA was replicated in two other European member states. With the stated purpose that it was set up for, was it successful or not?

Professor Alan Ahearne: Yes.

Deputy Pearse Doherty: The economy could have recovered in those countries or could begin to recover for other reasons, but the banks could have still been left as some of our banks were that were not able to be ... that didn't recover.

Professor Alan Ahearne: As I say, I'm not an expert in the Spanish or Slovenian economy. I know in the Irish case that NAMA did achieve its objectives. It deleveraged and de-risked the banking system, and that was crucial. You can imagine-----

Deputy Pearse Doherty: Okay. We heard-----

Professor Alan Ahearne: Sorry, Deputy. You can imagine newspaper reports coming out about depositors, let's say, with AIB ... every day news coming out of the property market continuing to fall in 2009 and '10. If AIB had held onto those assets, people would say, "Is this additional decline or is bankruptcy of this borrower, does that mean that this bank is now bust and I have to withdraw my ... and I should withdraw my deposits?" One of the advantages was, you took the high-risk loans and you put them into an institution that did not need to raise deposits, and that cleaned up ... helped to clean up the bank's balance sheets.

Deputy Pearse Doherty: Okay. We heard in testimony from various witnesses on the issues of NAMA and their belief that NAMA crystallised losses at the wrong point in the property cycle. For example, we also heard from Mr. Fingleton last week and he gave examples of three loans that he would be familiar with which were haircutted by NAMA which he believe will ... has already accrued close to half a billion euro of profit to NAMA. We also heard from developer Michael O'Flynn, where he gave evidence to this committee on 23 July and he said:

> By paying low prices for assets and by taking good loans as well as bad, it was always likely that [an] entity would generate a profit. However, this profit has been achieved at the cost of an earlier recovery in the banking system and serious damage to some developers, who had loans acquired and who had lost an opportunity to work out those loans. It also ignore[d] the huge hidden cost of fees which [were] not included on NAMA's balance sheets but, instead, added to the account of the borrower.

Firstly, what's your assessment of the assertion by Mr. Fingleton that NAMA was a factor in the losses experienced by those banks ... by his bank?

Professor Alan Ahearne: The losses were there because the loans went bad and so if somebody lent €100 million to a borrower to buy a field to build houses in the middle of nowhere and it turned out those houses were not built and that field is now worth €10,000 because there's cattle and sheep on it, then there's a massive loss but that loss isn't ... NAMA didn't create that loss, the transfer didn't create that loss, the money-----

Deputy Pearse Doherty: But does the-----

Professor Alan Ahearne: -----was incorrectly lent.

Deputy Pearse Doherty: But does the transfer ... the example that was given, which we haven't seen as a committee, but the example that was given in terms of the haircuts that were provided on three particular loan cases, NAMA actually generated a profit of close to half a billion euro on them. So, therefore, it was because of the crystallisation, in Mr. Fingleton's view, of the losses at that time on the books of Irish Nationwide that resulted in half a billion euro of additional capital being required for that bank through the taxpayers.

Professor Alan Ahearne: I don't have the detail of individual notes either but I can look at the aggregate. It looks like NAMA is going to recover in or about, say ballpark, as the money it paid. That sounds to me ... doesn't sound to me, therefore, that they completely underpaid the banks.

Deputy Pearse Doherty: Well, Mr. Ahearne, we've also heard, and I think it was Deputy McGrath who talked about what's been referred to as vulture funds and private equity funds which are flipping loans, and we have much of this in the media which ... where they're making massive profits because not only did NAMA crystallise the losses at a point in time of the property cycle but it also ... it also sold on the properties as a result of the troika programme to redeem its bonds. So, therefore, even ... if it was allowed to, as a bank would, to work those loans over a longer period of time, it would have gained the benefit. So to say that they're only going to make €1 billion, for example, you also have to look at how many billions the private equity funds have made in flipping the properties.

Professor Alan Ahearne: I mean, if somebody wants to make the case that a bank, AIB, that it's clear that the ... if the ... those ... they would have worked out those loans much better. You look at the way they have dealt with the mortgage arrears and if somebody wants to stand up and say, "It's clear that these bankers are actually really good at working out problem loans," then by all means go ahead and make that case.

Deputy Pearse Doherty: That's not-----

Professor Alan Ahearne: But I most certainly wouldn't-----

Deputy Pearse Doherty: That's not the case that's being put to you, Mr. Ahearne, with all due respect. The case is that NAMA's structure meant that they had to sell on these loans. They had to sell on these assets within a certain period of time and that was being done at a time when the property prices were either at rock bottom or just starting to recover, whereas if the structure of NAMA were allowed to hold on to the loans for a longer period of time, then you would actually receive greater amounts of money and be able to pay back the taxpayer a lot more.

Professor Alan Ahearne: I mean, NAMA, I think was allowed ten years and, in fact, the legislation said it could go on longer if it needed to.

Deputy Pearse Doherty: Yes.

Professor Alan Ahearne: But this goes back to the earlier comment that there is always this tension about hoarding versus trying to sell off the assets and avoiding fire sales. There's always controversies in the war with the RTC as well about people making money buying at the bottom, but that's an operational issue, strategic issue for the asset management company. They sometimes feel that by getting a few assets out there that begins to get some transactions and that gets things going. That's a strategic, a strategic decision.

Deputy Pearse Doherty: My time is limited on this here but I would probably ... if we get a chance maybe somebody would pick it up. I don't think it would be fair to lay that on the door of the asset management agency because there was very strong criteria laid down as to the amount of deleveraging that NAMA would have to do as a result of the programme that Mr. Lenihan agreed with the troika. But can I ask you in relation to the book that's been referenced, *In Calm and Crisis*, and we talked about burning bondholders, on page 111, Mr. Ray MacSharry, who writes in the book along with yourself said:

> One morning I got a call at about quarter-past eight and it was Brian. He told me ... he was able to burn the bondholders and he was very happy because the European Central Bank ... Jean-Claude Trichet had told him he could do it.

Did Minister Lenihan tell you that Jean-Claude Trichet had phoned him and told him to go ahead-----

Professor Alan Ahearne: No.

Deputy Pearse Doherty: -----and burn the bondholders?

Professor Alan Ahearne: No.

Deputy Pearse Doherty: Do you believe that Jean-Claude Trichet phoned him and told him that he could burn the bondholders?

Professor Alan Ahearne: I don't know, Deputy. I don't know. He ... Brian Lenihan never said that to me.

Deputy Pearse Doherty: Well, from ... you've had numerous conversations with Brian Lenihan. You've recounted some of them to the committee here today.

Professor Alan Ahearne: Yes.

Deputy Pearse Doherty: Is this conversation that Jean-Claude Trichet phoned Brian Lenihan and told him he could burn the bondholders and then rescinded that, said that he ... when he looked at it, because it was, I think, French and Germans that were going to get burnt that he could no longer do it. Would that be something that you believe that Brian Lenihan would keep from you, as his adviser?

Professor Alan Ahearne: He may have. I mean, he ... I worked for him, he didn't work for me. So he didn't have to tell me everything. It's ... I'm ... it's surprising ... I find it somewhat surprising but I don't know. You're asking me-----

Deputy Pearse Doherty: Why do you find it surprising?

Professor Alan Ahearne: Just, given the ECB's view, which was made very clear in November, but I think they were so strident ... it was ... it seemed so contrary to their approach, and their approach was no default, that it just seems surprising that there would have been some enthusiasm from the ECB over it. There was no senior bonds burnt in euro area banks.

Deputy Pearse Doherty: No, I understand that. I accept that Mr. Trichet-----

Professor Alan Ahearne: And ... so that you ... it would have got you into a-----

Deputy Pearse Doherty: Just finally ... just one-----

Professor Alan Ahearne: It would have got you into a territory where I think the ECB didn't want to go.

Deputy Pearse Doherty: Okay. One last question is, in relation to the Credit Institutions (Financial Support) Scheme, which the banks that were guaranteed signed up to and gave effect to the guarantee, there is ... one of the paragraphs there allows for the Minister to amend the terms and condition and also to discontinue the guarantee for any financial institution if it weren't keeping with the objectives of the scheme, which is that it is in the public interest. So, therefore, the scheme allowed for the cessation of the guarantee to any individual institution at any time. It's in article 8 of the scheme. Was this ever considered? Because you've made numerous comments about you couldn't burn bondholders until the guarantee extinguished in 2010, but the scheme actually allowed for the Minister to do that at any point. It had to be at six-month intervals that the review would have to take place. Was that ever considered? Did you look at this scheme in relation to that purpose? Was there ever a view offered that we should maybe look at this area in terms of discontinuing it for the likes of Anglo Irish Bank?

Professor Alan Ahearne: Well, I'm not a lawyer but I think ... you're talking about the European Commission, on a six-month basis would-----

Deputy Pearse Doherty: No.

Professor Alan Ahearne: -----would approve it.

Deputy Pearse Doherty: No.

Professor Alan Ahearne: But the legislation was for two years.

Deputy Pearse Doherty: No.

Professor Alan Ahearne: The money that came ... that came flying into the Irish banks after the guarantee was issued came in on the understanding that it would be guaranteed and was there for two years.

Deputy Pearse Doherty: But the Minister ... just to clarify there, it's article 8, which says:

> The Minister may review and vary the terms and conditions of this Scheme from time to time ... no later than six-month intervals, to ensure that it is achieving [its] purposes [under] the Act ... At such ... review, the Minister shall consider, *inter alia*, the continued requirement for the provision of financial support under this Scheme with regard to the objectives of this Scheme and section 2(1) of the Act ... The results of [the] review shall be provided to the European Commission.

But it's the Minister had the ability to review whether the likes of Anglo Irish Bank should continue to provide ... to be guaranteed under the scheme.

Professor Alan Ahearne: Well, the advice I heard, and the officials said this from early on, was the Minister should say nothing even publicly about discounting guaranteed bonds, and that was true right up until ... until the day the guarantee finished. I'm not even ... I'm not even talking about in the future. So if you look at statements through the summer of 2010, the Minister didn't say, "Well, we're now considering what we'll do after the guarantee." The legal advice was "Say nothing." That, that in itself, talking about discounting guaranteed bonds or even talking about discounting bonds after they came out of the guarantee while the guarantee was in place, that that may well trigger a call on the guarantee-----

Deputy Pearse Doherty: That wasn't the question.

Professor Alan Ahearne: -----and therefore-----

Deputy Pearse Doherty: It wasn't the question.

Chairman: I ... the question is ... and I need to move this on because we have more witnesses coming today-----

Professor Alan Ahearne: Yes.

Chairman: The question is that the legislation was structured in a particular way. This has been discussed with other witnesses that have been here before us. The legislation had provision for re-examination on a six-month basis. The question is not with regard to bond values. Was that provision - if I understand the question correctly - was that provision ever discussed or looked at in terms of being activated?

Professor Alan Ahearne: Em-----

Chairman: Because you spoke about all these other options that were out there, so in the context that there might have been other options, was that provision ever looked at?

Professor Alan Ahearne: I would say that I had a discussion with Brian Lenihan, sort of an out-of-the-box discussion, about rescinding the guarantee on Anglo. So we did discuss that for a while. I think at that stage there was several billion of bonds, but those bonds were not going to mature - these are the €4 billion ... were not going to mature until 2011 in any event. It was mostly deposits, and so that rescinding, which would have had all these various negative effects to do with essentially what would have been perceived as a default - as a default on the sovereign promise, but it's still a default - it would have had all those negative effects, and you would have - if you wanted to save money, ultimately you would have ended up discount ... discounting the positives. So we had that discussion and he ... he didn't pursue-----

Chairman: Senator-----

Deputy Pearse Doherty: Okay.

Chairman: I need to move on, Deputy. Senator Michael D'Arcy.

Senator Michael D'Arcy: Mr. Ahearne, you're welcome.

Professor Alan Ahearne: Thank you.

Senator Michael D'Arcy: Can I just slip back into the NAMA mode following Deputy Doherty? The amount of moneys that were transferred across was €74 billion. That was the full amount. The discounted amount was ... moneys paid ... was €32 billion. A discount of €42 billion was the quantum in its ... in actual figures. How much of the €42 billion would the State get back that was discounted?

Professor Alan Ahearne: I think NAMA are projecting at the moment that they'll ... some small surplus, maybe a billion or so. So the answer is ... maybe a billion or so.

Senator Michael D'Arcy: A billion of the 42.

Professor Alan Ahearne: Is whatever NAMA is projecting. Ultimately, we don't know it until NAMA has all closed up, but ... of the ... of the 42, the way you've divided it there - of that amount, it'll be determined by how well NAMA do - what surplus they make.

Senator Michael D'Arcy: Would it be fair, then, to say, according to the NAMA numbers, that there'll be a loss of €41 billion in the entire figure, on the 74?

Professor Alan Ahearne: The banks would have lost €41 billion on the loans that they made during the bubble, yes ... on those particular loans.

Senator Michael D'Arcy: Yeah. So the conversation about NAMA making a €1 billion loss ... can I ask you your view on that? Is it a €1 million - sorry, a €1 billion profit, or is it a €41 billion loss?

Professor Alan Ahearne: The banks have made losses of €40 billion off it - on those particular loans.

Senator Michael D'Arcy: Which is the fairest? Is it NAMA making a €1 billion profit or the banks losing €41 billion?

Professor Alan Ahearne: Well, you can say both of them-----

Senator Michael D'Arcy: Well, I'm asking you-----

Professor Alan Ahearne: -----because they'll both be true.

Senator Michael D'Arcy: I'm asking you which is yours.

Professor Alan Ahearne: I'd say both.

Senator Michael D'Arcy: Well, I'm asking you to select one, please.

Chairman: The witness can ... you can get to choose the question, but the witness gets to choose the answer.

Senator Michael D'Arcy: I'll give you another go at it.

Chairman: No.

Professor Alan Ahearne: They're both true.

Chairman: Move on, Senator, please.

Professor Alan Ahearne: They're both true, Senator.

Chairman: The witness was asked.

Senator Michael D'Arcy: Okay. Mr. Ahearne, on 7 September 2007, Professor Morgan Kelly stated in an article in *The Irish Times* that his view was the exposure to the commercial real estate sector posed a grave threat to the banks' solvency. Why do you think, as a professor of economics, he got such a little ... such a small hearing?

Professor Alan Ahearne: I ... I don't ... he ... there weren't many voices. Part of it ... there were a lot more voices on the soft landing - the economy would be okay, the property market will be okay. They probably drowned out any voices that were giving warnings like that. I think I said last time in front of this committee that ... that a huge amount of people were benefiting from the bubble, and therefore I know people didn't want to hear that. It's also ... I mean, the ... presumably politicians, the political system, would ... in hearing something like that would have turned to, say, the Financial Regulator, the Central Bank or officials and got their opinion on it, and I think the consensus opinion was that whatever's happening is manageable.

Senator Michael D'Arcy: If I could slip back a little bit before your time, before you started with Mr. Lenihan ... Minister Lenihan. In the book that's been quoted to you in relation to Minister Lenihan, in Governor Honohan's article, Governor Honohan said the Minister told him he was overruled on the night of the guarantee. Did Minister Lenihan ever tell you that ... make that statement to you?

Professor Alan Ahearne: No. I had no discussions with the Minister about what happened on the night of the guarantee.

Senator Michael D'Arcy: None?

Professor Alan Ahearne: No.

Senator Michael D'Arcy: Okay. We'll fast forward a little bit, then. In previous evidence, it's been stated that the ECB was briefing against the Republic of Ireland prior to the State taking the national bailout. Were you aware of people briefing against the State?

Professor Alan Ahearne: I gave an example earlier from my own experience of engaging with people - market participants-----

Senator Michael D'Arcy: Yes.

Professor Alan Ahearne: -----that they were saying that they were hearing worrying things from ECB ... ECB or officials on ... someone like that. So I was ... I was aware of that. I mean, there were other briefing ... I don't know where it came from. For example, I mentioned earlier that there was a ... newswire report on the Friday, the 12th - I guess - of November 2010 saying that Ireland was going into a bailout. So there issues about where that came from and who briefed there. I don't ... I don't know.

Senator Michael D'Arcy: Okay. You say on page 5 of your opening statement, the third bullet point down - this is the market participants who you'd spoken with - and they had made the point to you that investors were expressing concern. Who were the market participants who expressed that concern to you?

Professor Alan Ahearne: They were ... I don't ... I don't remember their names or what institutions they came from. They were people who came from pension funds. They were inter ... people from abroad, who were with some sort of financial institutions, perhaps pension funds or insurance companies. But they were obviously people who were in the market, potentially, for Irish bonds, and the people who bought Irish bonds.

Senator Michael D'Arcy: Mr. Ahearne, could you enlighten the committee in relation to your opinion and the Minister's opinion following the intervention by Governor Honohan on the "Morning Ireland" programme announcing that there was a likely bailout about to occur?

Professor Alan Ahearne: In my opinion ... I heard it on the radio. I ... I called, I think, maybe someone in the press - the press office - and I said, "Was that expected or was that planned? What's the story here?". So it was a big surprise to me. I didn't speak to the Minister immediately after that - it would probably be a good bit later that day - and I didn't discuss it with him. He had moved on. My understanding is, from all the people who spoke to him very quickly, is that he was ... he was annoyed about it, but it was ... by the time I spoke to him, it was a fact of life and we had moved on.

Senator Michael D'Arcy: Mr. Ahearne, you joined the Minister's staff in March 2009.

Professor Alan Ahearne: Correct.

Senator Michael D'Arcy: We had representatives from PwC here this morning and Project Atlas was discussed, and there were three separate versions - Project Atlas 1, 2 and 3. The final version was presented to the Minister in early 2009. I think it was February, shortly before you had started. Around that same period Mr. Peter Bacon was conducting research, and Mr. Peter Bacon was the first person to state that the cost to the State would now be tens of billions. Were you party to any conversation with the Minister in relation to how PwC could say that the banks were solid and solvent, and at practically the same time - a matter of a few weeks later - Mr. Peter Bacon was making his assertions that the cost to the State would now be tens of billions?

Professor Alan Ahearne: No, I didn't. I mean, I discussed with the Minister, Peter Bacon, the NAMA plan ... quite a lot of them. I did discuss it with Peter Bacon himself. I spent a lot less time on the PwC plan. I mean, I would have maybe been given copies of it, or summaries of it, but I'd say that ...

I think by the time I got in there, we ... we had moved on and the name of the game was to try to separate the assets into NAMA.

Senator Michael D'Arcy: Could I just-----

Chairman: Senator, I need to be moving you to wrapping up as well, okay? Thank you.

Senator Michael D'Arcy: Yes. I just want to finish this point. PwC were paid millions of euros and they had access to all the banks. Mr. Peter Bacon had no access to the banks' information and you're telling me that you ignored or paid less attention to the PwC report and you followed Mr. Bacon, is that correct?

Professor Alan Ahearne: I would've got probably a summary or maybe I read parts of the PwC report. I can't remember. It was a fast-moving crisis. Things were moving on.

Senator Michael D'Arcy: No, I understand.

Professor Alan Ahearne: The economy was continuing to ... to contract. The property market was continuing to contract.

Senator Michael D'Arcy: But there were two reports.

Professor Alan Ahearne: We were talking about - if I remember right - with PwC is stress tests, which are ... have ... there may be some information on them but that's ... there's lots of imperfections with that particular approach. It's not the value ... the loan-by-loan or the detailed-----

Senator Michael D'Arcy: But, Mr. Ahearne, what I'm saying is that PwC had access to all the banks, all their loan books, all the information-----

Professor Alan Ahearne: Yes.

Senator Michael D'Arcy: -----and you set that aside and you went with Mr. Bacon's. Is that what you're saying?

Professor Alan Ahearne: The most ... when I went in, the most immediate ... there was a budget - a supplementary budget - and then the next phase for the banks was the creation of NAMA and the separation of assets. So, that's what I was working on.

Chairman: Just to bed this down - because I need to deal with one other issue and just to be very, very clear as well just in case people might have a misinterpretation - Ministers and politicians are responsible for making decisions; officials advise and advisers advise as well. So, I ... the issue here is you're not responsible for a decision that is made by a politician. Let's be very, very clear about that. But, in regard to the advice that Senator D'Arcy is referring to, did you fall on one side of the advice over the other; Mr. Bacon's or the PwC position?

Professor Alan Ahearne: I wasn't asked any advice about the PwC. The banks had-----

Chairman: Okay. All right, okay.

Professor Alan Ahearne: I think they were-----

Chairman: I need you to wrap up, Senator, quickly please.

Senator Michael D'Arcy: Yes. Just ... on 9 April 2009, Mr. Paul Carty, the chairman of the

NPRF, wrote to the Minister in relation to the due diligence exercise on AIB, ultimately citing AIB would need additional capital of up to €1.6 billion in 2010-'11 over the already injected €3.5 billion. Do you recall why the Minister proceeded with the injection of €3.5 billion only having been informed that additional capital would be required?

Professor Alan Ahearne: Sorry, what day was this?

Senator Michael D'Arcy: April 9, 2009.

Professor Alan Ahearne: I don't. That was very shortly after I went in, so I don't.

Chairman: You're not overly familiar with that process, no?

Professor Alan Ahearne: No.

Chairman: Okay.

Senator Michael D'Arcy: And can you explain the eventual injection of €19.8 billion into AIB and how that total was reached?

Professor Alan Ahearne: It would've been reached because the Central Bank determined a certain capital ratio eventually. That was determined with the troika and that's the amount of money they needed to bring their capital up to that given the amount of losses they were experiencing and were expected to experience.

Chairman: Okay. Thank you. I'm going to wrap up. Deputy McGrath, please.

Deputy Michael McGrath: Thank you very much, Chair. Mr. Ahearne, I'd just like to quote an extract from Ajai Chopra's witness statement which will be put into evidence and to ask you a question and I know you haven't ... you haven't seen it before. He said:

> It is understandable that there is a strong sense in Ireland that burden sharing between Irish taxpayers and bank creditors has been unfair. In late 2010, remaining unguaranteed and unsecured senior bondholder exposure was about €16 billion, somewhat above the magnitude of envisaged fiscal adjustment over the next four years. [The] comparison made the issue very visible. [He said] Even if spillover risks dominated, the question remains - why should Irish taxpayers have to bear a disproportionate burden to address wider euro area concerns?

So, do you believe that Irish taxpayers did bear a disproportionate burden to address wider euro area concerns arising from the banking crisis?

Professor Alan Ahearne: I think Ireland should have been allowed to discount senior bank bonds, in particular the Anglo bonds. I think the Europeans have given their reasons why they didn't think that was in the Irish interest or in their interest and I think a big part of the reason was they felt there would be contagion to ... elsewhere in the euro area. So, that does mean that Ireland ends up having a higher cost for systemic ... in order to save ... for systemic reasons. That said, you know, Ireland ... there were various things done that saved Ireland a lot of money. For example, the reductions in the interest rates in the summer of 2011. So, although there was stuff taken away on one hand, there was a break given on the other hand and how all those things ... how they all net off is a difficult ... difficult calculation.

Deputy Michael McGrath: Sure. And, finally, to what extent, Mr. Ahearne, was the failure to get to the bottom of the black hole in the Irish banks over the course of 2010, when there were various statements about the likely overall bill ... is it the case that the markets eventually lost confidence in our ability to get to the bottom of that black hole and lost patience in that? How significant a role did that play in Ireland ending up in the programme?

Professor Alan Ahearne: I wouldn't overstate it. The main reason we ended up in the programme was because of the scale of the losses combined with the huge budget deficit and everything that was going on in Europe with the euro area crisis. So, there was a big combination of factors. It would have been better ... and it was ... if a number could have been produced and we didn't have to revise up the numbers during the course of 2010 as you explained it. There's no doubt about that. So, I think the revisions would have hurt investor confidence some and part of the programme was to bring in BlackRock to do this very detailed analysis. That was ... turned out to be a very good thing to do. It helped in confidence. So, I think it would be better if we could have got to the bottom of it earlier but in terms of would it have ... would that would have meant that we could have retained market access, I very much doubt it.

Deputy Michael McGrath: Yes. Thank you.

Chairman: Okay, thank you. Deputy Murphy.

Deputy Eoghan Murphy: Thank you, Chair, and thank you, Mr. Ahearne, again. I just want to return to where we left off with the national recovery plan just to finish up a couple of questions on it. Could you just outline the relationship between that plan and the bailout that we entered into - in terms of it being a blueprint for it - when you were made aware that this was actually going to become a blueprint for what would be our bailout and then the parties that became involved or if parties became involved subsequently once you'd begun your work or the different people had begun their work once the bailout became ... came into view, please?

Professor Alan Ahearne: I mean, I think as we went through the autumn and bond yields were rising and market access was becoming more and more difficult, then it was ... it was clear that this national recovery plan initially had been put forward as something to present to the markets to say "Look, you should lend to us because we have a plan here", but it was clear that if we were to enter a programme - and the probability that we would enter a programme was rising - that it could, therefore, serve as a blueprint. I mean, Brian Lenihan had said that he thought it would be ... the Irish public would find it difficult to accept the huge amount of budgetary adjustment that was still to come - and it was obvious that it was still to come - to correct the public finances if it appeared to be imposed from outside and, therefore, he thought it was important that if there were to be more adjustments - and there were going to be - that they would be seen to have been part of a plan made ... written in Dublin. So, that was a big part of the reason that there was a big push to get the national recovery plan done and, therefore ... before the troika plan was announced.

Deputy Eoghan Murphy: But was that a presentational issue or was this actually our plan and to what extent then was that plan amended when we entered the bailout negotiations?

Professor Alan Ahearne: I don't think there was any amendment. I mean this was ... the national recovery plan was written in Dublin. I ... there was some comments ... when Olli Rehn came in early October ... excuse me, in early November, he must have had some details because he ... there was a little bit of discussion there about the national recovery plan. I mean, he just had some suggestions about if you're going to do a VAT increase, you shouldn't do it right away, you should do it in the future so people can ... will, anticipating the VAT increase, bring forward their expenditures. Just some issues like that. But the plan was written in Dublin and it was more than presentation. It was ... the Irish Government felt - Brian Lenihan felt - that they were doing the right things, they had been doing fiscal consolidation, that they were on the right path and they wanted to go down that path and they knew they had more information about - economically and politically - about the Irish economy than ... than outsiders did.

Deputy Eoghan Murphy: Can you just finally comment on your role in evaluating the amount of money that was going to be needed as part of the bailout and the different breakdowns and what you were advising versus what was ultimately secured?

Professor Alan Ahearne: I didn't advise on the particular breakdown. I mean, the quantum of money needed was, sort of, mechanically produced. Certainly, for the public finances, it was a case of crunching the numbers and seeing what sort of money would be borrowed and what maturity ... what money was maturing. On the banking part, the number was extremely large. I remember that - €35 billion. It seemed very unlikely that we required €35 billion but the troika had insisted on that. They ... I mean, they wanted large amounts of capital put into the bank. I think the ECB wanted large amounts of capital because the bank would then have cash and they could repay the ECB. Ultimately, the ECB's ... my perspective on it's approach to this in the weeks leading up to the entering the programme was that they wanted their cash back and they wanted restructuring of the Irish banking system in a way that the Irish banks would repay quickly the amount of money that had been borrowed and the ECB would, therefore, reduce their exposure.

Deputy Eoghan Murphy: Okay, thank you and just finally if I may then, Chair, just in relation to your time in the Department working for Minister Lenihan and the actions that he took over that period, is there anything that's been left out from the public record or you think misinterpreted or misrepresented from your time working with the Minister in terms of the actions that he took and why he took them?

Professor Alan Ahearne: I had mentioned in my statement about the fiscal consolidation. I mean, at the ... when ... I remember in 2009, there was a lot of arguments about ... the Government surely should be putting money into the economy not taking it out. I think that was a misunderstanding of the nature of the deficit. As I mentioned in the statement, it was a structural deficit. I mean ... and I said a few times in the statement if the work that was done over that period had not been done, the Irish economy would not be growing at 5% this year. I think that's ... to me, that's absolutely clear and, therefore, in his work, he set the groundwork for the recovery that would follow.

Deputy Eoghan Murphy: Thank you.

Chairman: Thank you very much, Mr. Ahearne. I'm going to bring matters to a conclusion. Mr. Ahearne, this is your second time before the committee and I'd like just to acknowledge that you were here in the Context Phase as well. Given that and standard practice for all the witnesses when we come to a conclusion, is there anything else you'd like to say by closing comments or final remarks or any additional information?

Professor Alan Ahearne: The initial date I'd been given was very awkward for me and I asked for a new date and I just thank you, Mr. Chairman, and the members of the committee for facilitating that. This is a very important committee and I know that you're winding down or winding up this part of the phase. I just want to say that the report that comes out will be extremely important so I very much look forward to reading it.

Chairman: Okay. I thank you. With that said, once again, to thank you, Mr. Ahearne, for his participation today and in the earlier process in the inquiry as well. With that said, I now wish to formally excuse the witness and propose that we return at 3.10 p.m. is that agreed? Agreed. So the witness is now excused and we're formally suspended until then, thank you.

Sitting suspended at 2.23 p.m. and resumed at 3.30 p.m.

Central Bank of Ireland - Mr. Alan Gray

Chairman: I now propose that we return back into public session for our third session of today. Is that agreed? Agreed. Okay. As we can now commence our public hearings with Mr. Alan Gray, former board member of Central Bank of Ireland, the Committee of Inquiry into the Banking Crisis is now resuming in public session. Can I ask members and those in the public Gallery to ensure that their mobile devices are switched off?

Our first hearing of this afternoon is with Mr. Alan Gray, former non-executive director, Central Bank of Ireland. Alan Gray has worked as an economist for over 30 years in Ireland, Europe and in Canada. He was a non-executive director of CBFSAI, that is, the Central Bank, from December 2006 to September 2008 and was ... and recently he has been appointed by the Government as director of the IDA. He is a managing partner of Indecon International Economic Consultants. Mr. Gray, you're very welcome before the committee this afternoon.

Mr. Alan Gray: Thank you, Chairman.

Chairman: Before hearing from the witness, I wish to advise the witness that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you're directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you're entitled thereafter only to a qualified privilege in respect of your evidence. You're directed that only evidence connected with the subject matter of these proceedings is to be given.

I would remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry which overlap with the subject matter of the inquiry. Therefore, the utmost caution should be taken not to prejudice those proceedings. In addition, there are particular obligations of professional secrecy on officers of the Central Bank in respect of confidential information they have come across in the course of their duties. This stems from European and Irish law, including section 33AK of the Central Bank Act 1942. The banking inquiry also has obligations of professional secrecy in terms of some of the information which has been provided to it by the Central Bank. These obligations are being taken into account by the committee and will affect the questions asked and the answers which can lawfully be given in today's proceedings. In particular, it'll mean that some information can be dealt with in a summary or aggregate basis only, such that institutions or individuals will not be identifiable.

Members of the public are reminded that photography is prohibited in the committee room. To assist the smooth running of the inquiry we will display certain documents on the screens here in the committee room. For those sitting in the Gallery, these documents will be displayed on your screens to your left and right and members of the public and journalists are reminded that these documents are confidential and they should not publish any of the documents so displayed.