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Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

Liam Barron

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

WRITTEN STATEMENT BY LIAM BARRON TO THE BANKING INQUIRY.

I was Director General of the Bank from 20 December 2000 to 17 August 2007 and I was a Director of the Board of the CBFSAI from 1 May 2003 to 17 August 2007.

The following are my responses to the 15 questions asked by the Inquiry.

Q1 (R1a) The Memorandum of Understanding between the CB and the FR dealt with the responsibilities of both the CBFSAI and IFSRA. Was there clarity about what should have been dealt with by the Financial Regulator Board or by the Central Bank Board?

1. A Memorandum of Understanding (MOU) was required because of the complex and unwieldy hybrid-structure of the CBFSAI. The unitary organisation with a single Board that was put in place in 2010 resolved the problems associated with that structure. I consider that the MOU was very clear on the respective responsibilities of the CBFSAI Board ("the Bank") and the IFSRA ("the Financial Regulator") The purpose of the MOU was to provide clarity on the division of labour, to facilitate the exchange of information and to avoid duplication of work. The text could not override the provisions of the 2003 Act, which clearly assigned responsibility to the Financial Regulator for the regulation and supervision of financial institutions, both individually and collectively. The reference to microprudential supervision in the Section of the MOU dealing with the Bank related to the provision of economic services to the Financial Regulator. The analytical work (scenario setting, etc) associated with the stress testing exercises was a good example of what was envisaged when the MOU was being developed. The MOU reflected the very different functions of the Bank and the Financial Regulator. The Bank's role was economic/financial analysis (a task for economists); the role of the Financial Regulator was regulation/supervision (a task for accountants, legal experts and corporate governance experts). All regulatory/supervisory staff were transferred to the Financial Regulator on the establishment of the CBFSAI in May 2003.

Q2 (R1a) Do you believe that the FR and the IFSRA Boards had sufficient powers to take direct action against banks – if it became necessary to avoid a financial stability crisis? Can you assess how those powers were used and whether in your belief, their use was effective?

1. Though I was not a member of the Regulatory Authority, my understanding was that it considered that it had sufficient statutory powers to discharge its regulatory functions. The Financial Regulator witnesses to the Inquiry seemed to confirm that this was the case. The Financial Regulator (like most EU and other regulators) adopted the principles-based approach to supervision. With its focus on processes rather than substance, that approach failed to detect poor lending practices. Because of this, the Financial Regulator presumably did not consider that there was a basis for more intensive use of its powers.

Q3 (R1b) One of the statutory objectives of the CB was 'the promotion of the financial services in Ireland'. In your view was there a conflict between this objective and the Financial Regulator's responsibility for prudential supervision?

1. In practice, no conflict arose between the Bank's mandates to contribute financial stability and to promote the development of the financial services industry. When that provision was being considered sometime in the early 1990s the Bank expressed strong reservations as it was concerned that such a provision could give mixed messages to regulated entities. Though a conflict between the two provisions did not arise in practice, the decision to remove this objective from the statute book is welcome because of the potential for conflict. Regarding the Financial Regulator, I was not aware of any conflict arising in practice, but there was the potential for conflict.

Q4 (R1b) The Financial Regulator proposed a number of initiatives to impose more explicit requirements on banks (e.g. the Directors compliance statements, corporate governance guidelines and the fit and proper requirements). These proposals were not entirely successful. What was your view of these initiatives and can you describe the circumstances in which the Financial Regulator chose not to implement the original proposals?

1. I was aware of, and supported, the Financial Regulator's proposals on directors' compliance statements, corporate governance guidelines and fit and proper requirements. As I was not a member of the Regulatory Authority, I have no knowledge of the interactions between the Financial Regulator and the Department of Finance on the matter.

Q5 (R1b) In your opinion, did the Financial Regulator, as suggested by Patrick Neary at his Hearing, have the power to stop banks from paying dividends? If so, would it have been appropriate for the Financial Regulator to use these powers in view of the potential market impact? And why?

1. The issue of prohibiting the payment of dividends would have arisen in the lead-up to the crisis after I retired. Therefore, my general views on the prohibition of dividend payments are from the perspective of the pre-crisis period (ie, up to the summer of 2007). The prohibition of dividends in that era would have been regarded as an extreme regulatory measure, raising sensitive and complex issues. Such action would have potential to destabilise the bank concerned, possibly with contagion effects on other banks. Therefore, the capital - conserving benefits could be far outweighed by broader negative consequences. One of the potential problems would be that a prohibition of dividend payments could create the impression in the markets that the financial condition of the bank concerned was weaker than the actual position. Therefore, any proposal to prohibit dividend payments would require a difficult judgement call as to whether the positives would outweigh the negatives. Regarding the power of the Financial Regulator to prohibit dividend payments, my understanding is that in the case of individual institutions a condition could be attached to the licence that stipulated a reduction or cancellation of dividend payments.

Q6 (R1c). Apart from publication of Financial Stability Reports, did the Central Bank ensure that the Government was at all times well informed about the current macroeconomic situation and trends?

1. The Financial Stability Reports (FSR's) were by far the most important means employed by the Bank to convey its views on matters relating to financial stability. The coverage of the Reports included: the level and rate of growth of credit; concentration of property lending; property prices; competitiveness; and the excessive reliance of the banks on external funding. The FSRs differed from the Bank's other communication channels in that they contained extensive analyses and data to support the opinions expressed in them. This permitted readers to form their own judgements on the contents of the Reports. Apart from the FSRs, the Bank's Quarterly Bulletins, the pre-Budget Letters and the regular meetings between the Governor and the Minister for Finance were the principal means employed to convey the Bank's advice on all macroeconomic matters, including those related to financial stability. These mechanisms were supplemented by the Governor's introductory remarks at press briefings on the occasions of the publication of the Annual Reports and the FSRs. Regular press briefings were also provided by senior officials at the launch of the Quarterly Bulletins. The media provided extensive coverage of all these events and frequently reinforced the Bank's messages, especially on financial stability.

2. The following are some of the comments in the pre-Budget Letters from 2004 to 2006.

The pre-Budget Letter dated the 12th October 2004 included the following points.

The prevailing rate of housing output was not very much off twice the demand for housing. The challenge ahead was to smooth the transition of demand and supply towards long run equilibrium while avoiding a shock adjustment of prices that could be highly disruptive to the broader economy. The current level of interest rates was unusually low and, in time, mortgage rates could double to about 6%. The Bank had been encouraging both lenders and intending borrowers to consider the affordability of mortgages at more normal interest rate levels in due course. Fiscal policy could also play a role in smoothing the adjustment of the demand for property by limiting the more speculative components. It would seem appropriate to allow no further extensions to the determination date of May 2006 for a range of tax incentive schemes for housing. In the December budget for that year the Minister announced a review of a range of tax incentives including those for housing.

3. The pre-Budget Letter dated 18th October 2005 included the following points.

The high level and rapid increase in private sector credit remained a concern. Much of the real growth and credit have been channelled to the housing market while the level of activity seemed to be well in excess of medium term sustainable demand for housing. The Bank's projection for the economy in the following year assumed the beginning of a gradual decline in housing output to a more sustainable level. However, a more abrupt adjustment could not be ruled out which would have a disproportionate impact on the labour market and on the public finances. The public finances needed to be in a sufficiently comfortable position to absorb such a shock. The performance of the economy together with the significant number of uncertainties both internationally and domestically would support the view that a broad balance in the public finances should be targeted. The sharp deterioration in the General Government balance from the surplus of over 4% in 2000 to a small deficit in 2002 was evidence of the vulnerability of the public finances to such a shock.

4. The pre-Budget Letter dated 23 rd October 2006 the Bank included the following points.

There were a number of domestic risks, principally surrounding the housing market and the construction sector generally. The acceleration in house prices was a particular concern as it did not appear to have been driven by fundamental factors. It seemed that a gap may be opening up between actual prices and those warranted by fundamentals. International observers such as the IMF and OECD, had produced estimates of an over valuation in range 15% to 20%. The weight of the construction sector had increased over the previous decade and accounted for 13% of total employment. About 1 in every 5 jobs was reliant on the construction sector. Any sudden downturn in construction would have serious negative consequences for both the economy and for the Exchequer. The most desirable outcome would be one that combined a gradual stabilisation of house prices with a moderate downturn in housing construction and with a gradual redeployment of labour. This pointed to the need for a sufficiently comfortable budgetary position to absorb any sudden downturn. Both private sector credit and residential mortgage lending continued to increase at annual rates of close to 30% per annum. Private sector credit had increased to 190% of GNP in the previous year and rates of increase of this order were evidently unsustainable.

5. Aside from the pre-Budget Letters, regular informal meetings were held between the Minister for Finance and the Governor. The discussions at the meetings were wide ranging and included the following: the prospects for the economy, including upcoming or recently issued economic forecasts by the Bank; issues relating to the property market; recent decisions of the Governing Council of the ECB, including discussion of perceived risks to price stability in the Euroarea; and the global economic environment. The meetings also provided an opportunity for the Governor to elaborate on the matters contained in the Bank's pre-Budget Letters and its publications. In his testimony to the Inquiry, Mr Cowen commented favourably on the quality and effectiveness of his meetings with the Governor.

6. The participation of the Secretary General of the Department of Finance in the Board of the Bank constituted a very important indirect link with the Department. It enabled the Secretary General to participate in decisions and to get an insight into how they were derived.

7. The pre-Budget Letters and the discussions at the meetings of the Governor and the Minister for Finance were on the understanding that the risks to the economy and financial system were of a much lower order than that which materialised. Expectations would have been based on the typical recessions of the past several decades and not the 1930s scale recession that actually occurred. The Bank's advice to the Minister for Finance on budgetary matters was within the framework of the EU Stability and Growth Pact (SGP). .Throughout the pre-crisis period fiscal policy was fully compliant with criteria set out in the SGP. This was in contrast with other EU members where many of them, including the largest countries, were frequently in breach of the Pact. The Irish Government's Debt/GDP ratio was about 25% (Second lowest in the EU), compared with the requirement in the SGP to be at, or approaching, a ratio of 60%. With fiscal surpluses in almost all years the deficit criterion of 3% was never even remotely approached. The crisis exposed major flaws in the SGP,

which allowed large undetected structural deficits to emerge in some EU countries. The Irish structural deficit (nearly 9% in 2010) was not detected until the crisis was well underway. It is the resolution of this problem that has led to the bulk of the austerity endured by the country. The failure by all organisations and observers to detect the flaws in the SGP until it was too late resulted in the EU system for the surveillance of Irish fiscal policy to be ineffective.

8. Apart from the problems with the SGP, the Bank's advice to the Minister was adversely affected by five other major factors.

First, the Bank (or anybody else) did not anticipate the Lehman global shock. That episode seriously exacerbated the crisis by transforming it into a global panic. It is the panic element that caused Lehman to be more than a trigger for the crisis; it accelerated and intensified it. The resulting downward spiral led, inter alia, to a large overcorrection in many global markets, especially property markets. As a small open economy, the impact on Ireland was exceptionally severe. In particular, there was a substantial overcorrection of Irish residential and commercial property prices. That overcorrection is likely to have resulted in losses even on some proportion of good quality loans. The crisis also led to an overcorrection in housing output which is partly responsible for the current shortage. Absent the Lehman episode, it seems reasonable to assume that the Irish crisis would not have involved such an abrupt adjustment, but it would still have been very painful because of the domestic vulnerabilities.

Secondly, in line with a global consensus, the Bank believed that monetary policy and microprudential regulation were sufficient to maintain overall macroeconomic stability.

Thirdly, the Bank was not aware of the design flaws in the EMU (especially the no bail-in policy) which only became apparent during the Euroarea crisis.

Fourthly, the serious defects in the global frameworks for macroprudential regulation (mostly reliance on moral suasion) and microprudential regulation (flaws in the Basel Accords/EU Directives) did not become apparent until the crisis exposed them.

Fifthly, global market failure had not yet been recognised; the orthodoxy of the time was a belief that markets were efficient, rational and self-regulating. However, rather than penalising risky strategies, the markets rewarded them by superior stockmarket performance. Most importantly, banking business models involving rapid balance sheet growth and aggressive pursuit of market share were not discouraged.

9. All of the foregoing factors are relevant in assessing the quality of the Bank's advice to the Minister and also its overall performance in relation to financial stability.

Q7 (R1d) In your view did the Financial Regulator have sufficient staff to carry out its tasks in relation to Prudential Regulation, Consumer Protection, The introduction of the IFRS/Capital Directive and its statutory roles? If the Financial Regulator lacked sufficient staff and resources to carry out all of these roles can you explain why additional staff were not hired?

1. As I was not a member of the Regulatory Authority, I cannot judge whether the Financial Regulator had sufficient staff. Both the numbers and allocation of staff were a matter for the Regulatory Authority and its budgets were approved by the Minister for Finance rather than the Board of the Bank.

Q8 (R2a) What influence did the Department of Finance have in slowing down/stopping the Financial Regulator's initiatives to tighten down bank regulation (Compliance Statements, Fit and Proper requirements, changes to regulatory capital requirements?

1. I was aware of the initiatives on compliance statements, fit and proper requirements and changes to regulatory capital and I strongly supported them. As I was not a member of the Regulatory Authority, I had no knowledge of the interactions on these matters between the Financial Regulator and the Department of Finance.

Q9 (R2b) In your recollection, what were the reasons for the CBFSAI Board/Department of Finance in favouring a soft landing scenario for the property market over a hard landing? Were these reasons ever discussed in detail? Honohan points out that the FSR cites no quantitative analytical evidence for this conclusion.

1. The soft landing discussions took place at a time when there was a consensus that house price increases needed to slow or stabilise and that housing output was well above the sustainable medium term level. The key issue was whether there would be an abrupt adjustment (a hard landing) or a more orderly one (a soft landing). Mainly because housing output was so far from sustainable levels, even a soft landing would have involved some declines in GDP growth and employment and a

tightening of fiscal policy. The Bank's views on the soft landing represented what it considered to be the most likely scenario on the basis of the available evidence. It did, however, continually highlight the downside risks to that benign scenario.

2. In considering the soft landing scenario, it is relevant to note that historically, in a majority of episodes, rapid increases in house prices were not followed by disorderly adjustments. The UK provides a good contemporary example; in the 10 years from 1997 to 2007, UK house prices trebled (ie, c. 12% p.a. compound), but there was no significant decline decline during the crisis. (For comparison, in the same 10-year period, Irish house prices doubled (ie c. 8% p.a. compound).

3. There were extensive analyses of the soft landing scenario in the Bank's FSRs over the years. The first major study of residential property prices was contained in the FSR of 2004. The body of the Report had a section on fundamental and non fundamental influences on house prices. The model based on fundamentals did not provide evidence of overvaluation, while the non fundamental models gave very mixed results and showed overvaluations of 0% to 63%. The 2004 FSR also contained an article that assessed the housing sector from a financial stability perspective. With some qualifications, that study concluded that house prices were in line with long run equilibrium values.

4. The 2005 FSR contained a lengthy study of mortgage indebtedness. It concluded that the vast bulk of the growth in mortgage indebtedness over the previous 20 years could be explained by fundamental factors. This conclusion mirrored that in the 2004 FSR that there was no conclusive evidence of overvaluation in the housing market. The Bank's view in 2005 on the soft landing scenario was supported by developments in house prices at that time. House price increases nearly halved from 11½% in the year to August 2004 to just over 6% in the year to August 2005. Significantly, this coincided with a strong international trend. For example, UK house price growth slowed sharply from about 19% in the year to June 2004 to just over 6% by end-June 2005. The 2005 FSR saw developments in house prices as a transition from a high level of growth to a more stable rate. Rather than being concerned, as previously, about house price increases the Report raised the question as to what effect a slowdown in house prices would have on the health of the economy. Because of the slowdown in house prices, the 2005 Report concluded that the main risks to financial stability were predominantly from the external side.

5. The FSR of 2005 contained a lengthy study on the implications of a reduction in housing output from 75,000 to 50,000 units per annum over two separate horizons. In the first scenario output would decline over 4 years. In that case, the reduction in GDP would cumulate to 2% to 3% in year 4. In the second scenario (2 years), the cumulative decline in GDP would be 2 ½% to 3%. To put this decline in perspective, GDP growth in 2004 was 4 ½%. The conclusion of the article was that the effect of the correction in output would be significant but that it could be accommodated reasonably well by the economy. The study cautioned that the benign outcome would be jeopardised in the event of shocks, such as a decline in competitiveness or a sharp fall in foreign direct investment.

6. The 2006 FSR contained a lengthy study on the effect of income and interest rates in determining Irish house prices. Subject to a number of qualifications, the study concluded that house prices may be overvalued by about 15%. The study noted that, over the sample period, there had been divergences between actual house prices and the long-run predicted price based on the model used in the study of greater magnitude than those witnessed in the previous couple of years. It was also stated that the gap between actual and fundamentals had tended to dissipate over time without any major decline in actual house prices. The 2006 FSR warned that the increase in house prices since the Autumn of 2005 was unlikely to be justified by fundamental factors.

7. Regarding the 2007 FSR, I presume that the last sentence in Question 9 above relates to that year. For the first time in a number of years, there was no analysis of house prices. By that time the Bank had undertaken a significant body of research on the housing market. In the context of the 2007 FSR, it was very significant that from the second half of 2006 house price increases slowed significantly and by late Autumn 2007 they were 3½% lower on a year-to-date basis. Credit growth had also begun to moderate from the end of 2006 and through 2007. The Report contained a lengthy study of the commercial property market. The analysis did not provide conclusive evidence of overvaluation. It tentatively concluded that office, retail and industrial properties may be overvalued by 8%, 11% and 15%, respectively. Such overvaluations would not be a major concern from a financial stability perspective as they could be expected to dissipate over a number of years. Possible explanations as to why commercial property was not studied earlier than 2007 may be found in Figure 2.9, Page 19 of the Nyberg Commission Report and Chart 35, Page 36 of the FSR 2006. Figure 2.9 in the Commission's Report shows that the real price Index for commercial property was fairly flat for the period 2000 to 2005. Chart 35 in the FSR gives a mixed picture of the evolution of property prices in that period, with the office and industrial sectors recording price declines during some of the time.

Had a study of commercial property prices been undertaken earlier, it is unlikely that the conclusion would have been much different from that in the 2007 study.

8. Turning to the tone of the 2007 FSR, as I retired on 17 August 2007 I was involved only in the first iteration that was considered by a joint meeting of the Board and the Regulatory Authority on 20th June 2007. A decision on the tone of the Report was postponed until a time closer to its publication in November 2007. By that time, in contrast to the stable conditions that prevailed in June, the global financial situation had deteriorated significantly; the run on Northern Rock had already occurred and the global credit crunch was underway. Though I was not involved in the decision, I believe that based on the available evidence the tone of the 2007 FSR was appropriate. With the benefit of hindsight, the tone was too moderate. However, the adoption of a strong negative tone - if that were considered warranted by the evidence - could have exacerbated the instability that prevailed in late 2007.

9. Regarding the substance of the FSRs over the years, since they were in production over a period of about 6 months, changes in economic and financial variables (eg, house price trends) over that period could lead to consequential changes in the analyses and in the text. The final text reflected the latest available evidence at around the time of publication of the FSRs towards the end of each year.

10. Turning to the tone of financial stability reports generally, it is conventionally accepted that central banks must achieve a delicate balance between influencing the markets in a positive manner and destabilising them (For example, causing a property crash or a bank run). Economists in the Bank would have been cognisant of the need to strike the appropriate balance. Timothy Geithner, former US Secretary to the Treasury, in his book "Stress Tests" highlights the need for this trade-off when he states: "I was careful to express my concerns in understated, nuanced, and deliberately dull language that wouldn't move the markets" He then refers to a comment by one of his predecessors that triggered a damaging run on the dollar. In his testimony to the Inquiry, Governor Honohan also highlighted the importance of achieving the appropriate balance when he said that the Bank had to avoid " frightening the horses"(ie, destabilising the markets).

11. The purpose of the foregoing lengthy discussion was to demonstrate that the Bank's incorrect assessment of the prospects for a soft landing was not due to a lack of analysis; it had undertaken a large body of research on the matter. Rather the incorrect assessment was due to a misjudgement of

the risks that subsequently materialised during the worst global recession since the 1930s. A Study by the Kansas Federal Reserve Bank concludes that most central banks underestimated the risks and vulnerabilities in their financial systems. (The relevant Study is referenced in footnote 120, Page 93 in the Honohan Report).

Q10 (R2c) Can you give your perspective on the solvency of the banks in 2008 in the context of the capital injections that followed?

1. I am unable to respond to this question since I retired from the Bank in August 2007.

Q11 (R3b) Looking back to the period leading to the crisis, what is your view on what is called "Constructive Ambiguity"? Was it effective or did it possibly obscure the hard realities of the liquidity and solvency issues of the banks?

1. I am unable to respond to this question as it became an issue in 2008 after I had retired from the Bank.

Q12 (R4c) Morgan Kelly published an article on a potential house price bubble in the Irish Times at the end of 2006 and later published a report on the same theme as part of the ESRI bulletin in Summer of 2007. Can you recall if any discussions were held at Senior Management level in the Central Bank/Department of Finance afterwards? Were Morgan Kelly's concerns given serious consideration?

1. Morgan Kelly's views on house prices were given careful consideration by the Bank and there was considerable discussion on the matter. In December 2006, Morgan Kelly predicted a decline in house prices of 40 % to 60% over 8 or 9 years, ie, declines of about 5% or 6% p.a. over the period. In its assessment of Morgan Kelly's work, the Bank was cognisant of the IMFs view that house price crashes in the 1970s and 1980s would be unlikely to be repeated in the 1990s. Among the reasons cited by the IMF was that the earlier booms tended to be fuelled by expansion of fiscal policies and ended in tight monetary policies, whereas the economy of the 1990s was generally one of fiscal restraint and low inflation and interest rates. (The so-called Great Moderation) The Bank's analysis of Morgan Kelly's predictions are contained in Box C, Page 30 of the FSR of 2007. The view expressed in the Box is that, from a financial stability standpoint, nominal prices were more important than real prices. Based on nominal prices the majority of house price booms had not been

followed by any fall in nominal prices. The analysis in the Box concludes that past international experience may not be an accurate guide to future developments in house prices.

2. On the issue of external contrarians generally, by the time most of them expressed strong views property prices were not far from peak levels. The contrarians rightly predicted the fiscal problems but they underestimated them partly because they (or anybody else) did not identify the large structural fiscal deficit of nearly 10%. They also significantly underestimated the problems that subsequently affected the banking sector. In its analytical work the Bank took into account all views, including contrarians, both in Ireland and abroad. The more prominent among the latter were White and Borio at the Bank for International Settlements. These analysts warned that excess global liquidity created a risk of asset bubbles in the future. Some of their work was referenced in a Study in the 2005 FSR on global developments in asset prices and liquidity, including the implications for Ireland.

3. Regarding internal contrarians, as might be expected, because of the complexity of many of the issues and the diversity in qualifications and experience among directors and officials very differing views were regularly expressed on a wide range of issues. However, following discussion and careful consideration a consensus was always reached and without much difficulty.

4. There were numerous opportunities over the years to express dissent with the Bank's analyses and policies pertaining to financial stability. The following are some examples of such opportunities. First, had there been dissent on the manner in which regulation and supervision were being applied from a financial stability perspective, it is reasonable to assume that a proposal would have been brought forward to issue a formal Guideline to the Financial Regulator under Section 33D of the 2003 Act. The fact that no proposal was bought forward at any time is a strong indication that there were no significant dissenters in the Bank. Secondly, and most importantly, I do not recall any dissent being expressed at the regular meetings of the Financial Stability Committee (FSC); this recollection is consistent with the record in the Minutes of the Committee. As the FSC membership comprised senior personnel from the Bank and the Financial Regulator, it was the most opportune forum to express dissent. Thirdly, there was no dissent on the adverse scenarios employed in the stress tests; for example, in the 2006 to 2008 Stress Test the extreme adverse scenario was a cumulative 2% decline in GDP and a fall in house prices of 20% over the 3 years. Though the adverse scenarios adopted by the Bank were in line with the practice of central banks generally, they subsequently proved to be too mild. Fourthly, there was no dissent on the Comment sections in the

Quarterly Bulletins and pre-Budget Letters to the Minister for Finance. These documents concisely set out the Bank's views on a wide variety of topics, including financial stability. Fifthly, there was no dissent on either the substance or the tone of the FSRs; I cannot recollect having sight of any document that expressed disagreement on these or any other aspect of the Bank's policy on financial stability. Finally, there was no dissent on the budgetary advice to the Minister for Finance. That advice proved to be inadequate because, inter alia, the Bank (or any other organisation or observer) did not identify the large structural fiscal deficit.

5. To summarise, there was ample scope to express contrarian views on financial stability matters. Since frank and open debate was encouraged at all times, there was no reason to withhold dissenting views. I cannot recall such views being expressed at any of the fora that I attended; these included Board meetings and its joint meetings with the Regulatory Authority. This recollection is consistent with the assessments in the Nyberg Commission, which states that doubters were few, late and low key. It also states that a long period of good times had reduced the numbers of those willing to go against the prevailing and apparently proven consensus. The Report also suggests that there may have been an element of self-censorship because of fears of internal criticism. I feel that, rather than being concerned about criticism, a more plausible explanation would be the reputational consequences of continually predicting serious economic problems that did not materialise.

Q13.(R6a) Do you judge the IMF country reports and OECD reports as an important information instrument to aid banking regulation, banking supervision and financial stability issues? If yes, why? if not, why not?

1. Under its Financial Stability Assessment Programme (FSAP) the IMF concluded reviews of the financial stability and prudential regulation frameworks in 2000 and 2006. The 2006 review made no recommendation for improving the overall financial stability framework. The principal proposal was that work should continue on the development of stress testing. The IMF made a number of proposals for improving the prudential regulatory system. However, it made no criticisms of the system, including the principles-based approach to supervision. The Report noted that "there was a high level of observance by the Financial Regulator on the Basel Core Principles with the main challenge being to ensure a continuation of the existing very high standards." The Bank took considerable comfort from the IMF's favourable assessments. It valued that institution's cross-country experience and, especially, its hands-on experience on the management of past crises in

many countries. The Bank's analyses of the housing market were strongly influenced by the IMF's extensive work in this area over many years. It took comfort from the fact that the IMF considered that a soft landing in house prices was the most likely scenario. The IMF was very positive in its assessments of the financial health of the Irish banks. Apart from one Indicator (Net interest margin) the IMF's Financial Soundness Indicators were - with minor exceptions - positive throughout the pre-crisis period. The positive assessment of the Irish banks was also shared by the rating agencies. Because of their cross-country and cross-sector perspectives the Bank also valued their assessments of the financial health of the banks. The following statement by Standard and Poors in 2006 captured the prevailing very positive sentiment towards banks internationally at that time. It stated "the potential for nationwide banking crises and individual bank failures over the medium term appears lower in 2006 than at any point in the last decade. The past few years through to the present is looking more and more like a golden age in global banking"

2. The Bank also had a high regard for the work of the OECD. Like the IMF, that Organisation regarded a soft landing to be the most likely scenario, though it did not rule out a hard landing. The OECD considered the banks to be well capitalised and profitable, with considerable shock absorption capacity. These views were expressed as late as 2008.

3. I concur with the conclusions of the three Reports on the crisis that external surveillance generally proved to be inadequate in the pre-crisis period.

Q14 (R6a and R6b) The IMF Mission in 2009 referred to a lack of a resolution regime, can you explain the delays in initiating such a regime in Ireland bearing in mind the UK implemented one by way of its Banking Act in March 2009?

1. As this question relates to an IMF Mission in 2009, I cannot comment as I had retired.

Q15 (C1d) a) The Domestic Standing Group (DSG) was established in 2007. Its remit was to monitor the banking and financial sector for early signs of distress and to put in place a national contingency plan. b) Looking back, what is your view on the effectiveness of the DSG? c) Given the composition of the Financial Sector Stability Group (FSSG), what deficiencies of the DSG did the FSSG address?

1. The first meeting of the Domestic Standing Group (DSG) took place in 2007 after I had retired. During my time in the Bank, I was fully supportive of the initiative to establish such a Committee.

Liam Barron, 30 July 2015.