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Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

Nicholas O'Brien

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Joint Committee of Inquiry into the Banking Crisis

Written Statement of

Nicholas O'Brien

Assistant Secretary, Department of Finance

29th July 2015

Introduction

I refer to the Direction to make a statement in writing pursuant to section 67(1) of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013 as received by me on 16 July 2015. I note from the Direction that I am being asked to provide a statement in my role as Assistant Secretary and all relevant roles in the Department of Finance. As outlined in my letters dated 6th May 2015 and 9th July 2015 and my written statement dated 27th May 2015, I joined the Department of Finance as Head of the International Relations Unit in September 2011. My replies to the questions set out in Document 1 (as referred to in the Direction) are therefore based on the period following my appointment to that role.

Consequent to my appointment as Assistant Secretary with responsibility for the International and EU Division, on 30th June 2014, I am the Department's delegate to the Eurogroup Working Group and the Economic and Financial Committee and am a Director of the European Financial Stability Fund (EFSF) and European Stability Mechanism (ESM). My reply on matters relating to the conduct of proceedings at both Committees and at the EFSF and ESM is therefore informed by my experience since the date of my appointment.

I have adopted the numbering set out in Document 1 of the Direction for convenience and my replies to Questions 1-13 are set out below.

Q1

R6(a): Could you outline the history of the relationship between the Department of Finance and Europe. Has the strength and value of the relationship, both generally and in a supervision context, changed over time?

I joined the Department of Finance in 2011 and am not therefore in a position to comment on the relationship between the Department and its partners in Europe prior to that. However, it is probably fair to say that, since the creation of the euro, the links between Finance Ministries across the Euro Area have strengthened and the Committees at which Member States are represented play a role in coordinating Euro Area policies.

The post-crisis reforms have also changed the relationship between Ireland, the EU institutions and our EU partners, particularly fellow Euro Area Member States. There was broad agreement in the wake of the economic and financial crisis that the economic, financial and fiscal governance of the EU, and more particularly the Euro Area, required improvement. For Euro Area Member States, greater oversight at central level was considered necessary to improve the functioning of the currency union.

The Committee has heard from witnesses directly involved in banking supervision as to the impact of the changes introduced in recent years. From my direct experience as a member of the Economic and Financial Committee (EFC) and Eurogroup Working Group (EWG), the Commission and Member States play a role at committee and political level in supervising national developments in a number of different policy areas.

As set out in my statement of 27 May 2015, a wide range of EU and inter-governmental reforms were enacted in the wake of the crisis, including the Fiscal Compact and the 'six pack' and 'two pack' legislation. Examples of the enhanced scrutiny introduced by the legislative reforms include:

- A new surveillance mechanism which monitors macroeconomic imbalances, as well as debt and deficit targets. This mechanism, the Macroeconomic Imbalance Procedure, should ensure that emerging imbalances are detected at an earlier stage and acted upon. Reviews at Committee level exert peer pressure and this

should ensure that Member States who are found to be experiencing macroeconomic imbalances are challenged.

- The requirement under the ‘two pack’ legislation for Euro Area Member States to submit their budgetary plans to the European Commission each October, following which the Commission budgetary assessments are discussed by Finance Ministers at Eurogroup. This enhanced oversight ensures that each Euro Area country addresses the requirements of the Stability and Growth Pact in their national budgets.
- The European Semester framework ensures that Member States receive EU level economic and fiscal policy guidance in advance of finalising national budgets. This means that policy guidance, based on agreed priorities, should be reflected in national policy-making. Ireland received its second set of Country Specific Recommendations from the European Commission on 13th May 2015. The recommendations are formally adopted by Finance Ministers following a process of consultation.

Q2

R6(a): In hindsight and on reflection would a stronger relationship with Europe have benefitted Ireland during the crisis or not?

I was not in the Department prior to Ireland’s entry into the EU-IMF Programme and am therefore not in a position to comment on the strength of the Department’s relationship with Europe prior to the crisis. The fact that the Department, in 2011, created a new unit to focus on alliance-building indicates a renewed commitment to building relationships within Europe, and with other international partners, as one part of the strategy to ensure a sustainable recovery on emerging from the EU-IMF Programme of Financial Assistance.

Furthermore, the commitment by EU leaders to introduce a wide range of reforms to enhance horizontal scrutiny of Member State policies serves as a commentary on the original relationship framework for the EU and particularly Euro Area Member States.

Q3

R6(b): Upon taking up your role in September 2011, what was your view of the relationship between the Government, the Department of Finance and the EU?

When I commenced my role as Head of the International Relations Unit in 2011, it was evident to me that Ireland, both at political and official level, enjoyed close relationships with the EU institutions and Member States bilaterally. The progress made by Ireland in implementing reforms and agreeing the terms of the EU-IMF Programme was evident by that stage.

It was also clear that the relations between Member States were crucial to both the smooth functioning of the Euro Area and to ensuring that Ireland could maximise the benefits of both EU and Eurozone membership. It was therefore the objective of the Unit to forge closer diplomatic ties within the EU.

Q4

R6(b): What EU Co-ordination Strategies are now in place compared to when you started in the Department of Finance?

A number of new arrangements have been put in place in the Department to ensure a coordinated Departmental response to EU policy-making:

- The inter-divisional EU Strategy Committee was established as a sub-committee of the Department's Executive Board in July 2013 to provide a forum for exchange of information on policies and developments and to develop high level strategies on EU

engagement. Recent areas of focus include meetings with senior EU officials to discuss the direction of the EU and Euro Area and provision of training for officials in the EU decision making process and in developing negotiation skills.

- Oral debriefs by officials take place in advance of meetings of the EFC and EWG so that in addition to the written briefing provided, I am updated on the relevant nuances of the Department's position prior to participating in the Committee meetings. On my return from the meetings, I provide an oral and written debrief to relevant policy sections. These meetings are a valuable means of ensuring that there is a robust flow of information between the International and EU Division and the policy divisions across the Department.
- A policy coherence function has been established within the International and EU Division. This ensures that all Ministerial briefing for meetings of the Ecofin Council and Eurogroup reflects horizontal priorities across the Department.
- An official from the International and EU Division participates in the fortnightly EU Senior Officials Group held in Department of the Taoiseach to discuss horizontal EU issues which affect a number of Government Departments. This is an important forum to ensure that Government Departments adopt a coordinated position on EU policy developments (note: this pre-dates my arrival but it is worth highlighting, as it is an important forum for exchange of information.)
- Briefing is provided by the International and EU Division in advance of the Ecofin Council each month to all European diplomatic missions based in Dublin, and to the Irish EU diplomatic missions abroad, via video link.

Q5

R6b: How, in your view, are the Department of Finance and the Irish Government viewed in Europe?

It has been my experience that Ireland is viewed as a reliable and active partner by our peers and the officials working in the EU Institutions. Despite Ireland being a relatively small Member State in terms of population size, we continue to make a contribution to the development of EU policies. A number of specific examples indicate the positive light in which Ireland is viewed:

- By June 2012, Ireland's reputation had been boosted to the extent that the Minister for Finance was invited to present to his peers at Ecofin on Ireland's programme implementation to date and the elements which contributed to its successful track record.
- Ireland's Presidency of the EU from July to December 2013 was seen as very successful. The Government and officials worked effectively to facilitate the delivery of crucial reforms, including major components of Banking Union and the new economic governance regime.
- Further evidence of our successful outreach was the investment by the German development bank, KfW, in the Strategic Banking Corporation of Ireland, established to provide funding to Irish SMEs. The German Finance Minister and the President of the European Investment Bank both visited Dublin last year to formally launch the Corporation.
- Following Ireland's Presidency of the EU, Irish officials were placed in a number of key strategic positions within the European Commission under the Seconded National expert programme.

Q6

R6(b): You act as Ireland's delegate to both the Economic and Financial Committee and the Eurogroup Working Group. What do you do as a delegate and what responsibilities do you have?

The Economic and Financial Committee (EFC) was established under the Treaties. The Committee prepares the discussion by Ministers at Ecofin and drafts recommendations and decisions required as part of the multilateral surveillance cycle and excessive deficit procedure. As part of its role, the EFC prepares Ministerial discussion on economic developments, financial market matters, relations with third countries and international institutions. While the EFC prepares the discussion at ECOFIN, and will provisionally agree draft decisions, opinions and conclusions for adoption by Ministers, these are subsequently processed by the Committee of Permanent Representatives (COREPER) and all final decisions are reached by Ministers at Council.

The EFC agenda encompasses a wide range of issues for discussion and as Ireland's delegate, I represent Ireland's position on each item, based on the position of the relevant division in the Department. The Committee meets monthly, or more regularly in the event of special circumstances.

The Committee also meets in a Euro Area configuration, the so called Eurogroup Working Group (EWG), in which only the Euro Area Member States, the Commission and the European Central Bank are represented. As Ireland's delegate to the EWG, I represent the Department's position on the issues under discussion which relate to matters specific to Euro Area Member States alone. The EWG serves to prepare Ministerial discussion at Eurogroup and, as is the case for the EFC, all political decisions are referred to Eurogroup.

Q7

R6(b): What is your role on the European Financial Stability Fund (EFSF)? What type of decisions do you take?

The EFSF Board of Directors comprises of 17 members, one for each of its Shareholders (i.e. the then euro area Member States at the time it was established June 2010). Each EFSF Shareholder proposes for nomination to the Board of Directors of EFSF its representative in the Eurogroup Working Group. Accordingly, as Ireland's EWG member, I have been appointed as Ireland's EFSF Director. The Commission and ECB are each entitled to appoint an observer who may take part in the meetings of the Board of Directors and may present observations, without however having the power to vote. The Board of Directors is vested with the requisite powers to perform all acts of administration and disposition in the Company's interests. The Board of Directors ensures that the EFSF is run in accordance with its Framework Agreement. The Board of Directors is authorised to transfer, assign and dispose of the assets of the Company in such manner as the Board deems appropriate.

The Directors are appointed by the general meeting of shareholders for a period not exceeding six years and are eligible for reappointment. They may be removed at any time by a resolution of the general meeting of shareholders.

The EFSF's Board of Directors normally meets between 6 and 8 times each year in a mix of face-to-face and teleconference meetings. These meetings usually take place at the same time as meetings of the EWG. It has been my experience that decisions of the EFSF Board of Directors reflect the political discussions which take place at Eurogroup.

Q8

R7(b): In creating your role do you know what specific needs the Department of Finance had? What improvements have been made to the Department of Finance as a result of the development of the International Relations Unit and subsequently the creation of the EU Co-ordination Unit?

The International Relations unit was created to strengthen the Department's EU and international outreach following on from Ireland's entry into the EU/IMF Programme. Diplomatic staff from the Department of Foreign Affairs and Trade are seconded to manage this Unit, working closely with officials across the Department. The Unit initially formed part of the Banking and Economic Division until the Department was re-structured in 2012, based on key policy divisions – EU and International, Financial Services, Fiscal Policy and Economics, supported by a Corporate Office and Finance Office. The Unit then became part of the new International and EU Division. The establishment of a separate International and EU Division to manage Departmental engagement with EU institutions and partners is in line with the recommendation of the Wright Report that there should be a dedicated focus within the Department on interaction with the EU and other international institutions.

The International Relations Unit plays a strong role in maintaining dialogue with European and international counterparts. This allows for a greater external appreciation of Ireland's situation and the progress which has been made in restoring the public finances. The Unit has put in place a structured programme of inward and outward visits with the objective of deepening alliances in order to advance our national interests.

The EU Co-ordination Unit has been in existence for a number of years but now forms part of the International and EU Division, following the re-organisation of the Department. The EU Co-ordination Unit plays an important cross-divisional role in managing the Department's engagement at Eurogroup, ECOFIN and at Committees (EFC, EWG and Economic Policy Committee). The Unit compiles briefing for use by the Minister and senior officials for their participation at EU fora, Oireachtas Committee and at Council (both Council of Ministers and the European Council). In addition to the services provided to the Minister for Finance and the Minister of State at the Department of Finance, the Division also regularly provides

support and briefings to the President, Taoiseach, Tánaiste, Minister of State for European Affairs, and Members of the Oireachtas on finance issues for bilateral engagements abroad. As a result, the Unit is the key point of contact on EU issues.

In advancing the EU policy agenda, the EU Co-ordination Unit works closely with other areas in the Department and the Permanent Representation in Brussels. The Unit also has strong links with many other Government Departments, in particular with the Department of the Taoiseach, and with the institutions involved in the development of EU policy, including the EU Commission, Council Secretariat and the European Parliament.

Q9

R7(b): What was your brief, mandate and role profile when you commenced both your International Relations Unit position and subsequently? How has this changed and if so, how?

As the Head of the newly created International Relations Unit, my role was to embed the Unit as a central part of the Department's strategy for enhanced EU and international engagement.

During my tenure as Head of the Unit, the primary objective was to enhance the Department's international relations, including by fostering closer ties with EU Member States and thereby advancing our interests at EU level. This entailed a programme of outward and inward visits, both within the EU and also to major trading partners. Importantly, the Unit acts as a liaison between the Department and the Department of Foreign Affairs and Trade, particularly the Embassy network, and between the Department and Embassies resident in Dublin.

As part of my role, I also coordinated the Department's participation in the development at EU level of the Treaty on Stability, Coordination and Governance, a core component of which is the Fiscal Compact. Aligned to this part of my role, I was also involved in developing the Department's response to the proposals for further integration of the Economic and Monetary Union.

Following Ireland's successful Programme exit in December 2013, the primary role of the International Relations Unit is to further develop the Department's strategy on international and EU alliances as a basis for good national outcomes in negotiations and international / EU engagements. This outreach includes the recent development and implementation of a new strategy of international engagement for senior officials focusing on Paris, Berlin and the EU Presidencies (Latvia, Luxembourg) while also further developing the annual consultations with the British Treasury (with the last session taking place in December 2014).

Since my appointment as Assistant Secretary with responsibility for the International and EU Division in June 2014, my role has of course changed significantly and I am now a member of the Department's Executive Board. A new Head of Unit has been appointed from the Department of Foreign Affairs and Trade to the International Relations Unit. As Assistant Secretary, my primary functions are responsibility for EU/Euro Area strategy formulation and cross-Departmental co-ordination; Ecofin, Eurogroup and EU budgetary matters; co-ordination of EU-related briefing; and Post EU-IMF Programme surveillance and funding. Since my appointment as Assistant Secretary, I also serve as Ireland's member of the Eurogroup Working Group and the Economic and Financial Committee and as Ireland's Director on the board of both the European Stability Mechanism (ESM) and European Financial Stability Fund (EFSF).

Q10

R7(b): What did you intend to achieve when you took up that role and what would you say that you actually achieved to date?

The primary role of the International Relations Unit was to deepen the Department's alliances with EU and international partners, initially in the context of the EU-IMF Programme and subsequently in the changed landscape when Ireland emerged from the EU/IMF Programme.

As indicated in my reply to Question 9 above, a significant programme of Ministerial and Senior Official visits is ongoing.

By embedding a unit staffed by officials from the Department of Foreign Affairs and Trade within the Department, diplomatic expertise has become part of the toolkit used in addressing issues of concern and in reacting to policy developments at EU level. The Unit is now a core part of the Department and the staff engage on a daily basis with officials from all Divisions and the Minister's office. Alliance building is an ongoing process but the close alliances which have been fostered in recent years are evident in the positive interaction between Ireland and EU/international partners.

The successful establishment of the International Relations Unit so that it is now a key part of the Department's international strategy was the key objective of my tenure as Head of that Unit. Close ties with our EU partners are also evidenced by a number of official exchanges which have taken place recently. An official from the German Ministry for Finance joined the Department in September 2012 for a period of 12 months, to include the Irish Presidency. In exchange, an official from the Department worked for a year in the EU Division of the German Finance Ministry. During the Irish Presidency of the EU, an official from the Finance Ministry in Vilnius joined the Department and a Department official worked in the Lithuanian and Greek Finance Ministries for the duration of their EU Presidencies

Since assuming responsibility for the International and EU Division, I have introduced a number of the coordination strategies set out in my response to Question 4. In my current role, as lead EU advisor to the Minister and manager of the International and EU Division, I have implemented changes to ensure that the Division and the wider Department is well equipped to respond to developments and EU level. These include oral debriefs to officials

after EFC and EWG so as to ensure a robust flow of information between the International and EU Division and policy sections across the Department and the establishment of an EU policy coherence function within the International and EU Division.

Q11

R7(b): In your Statement, you say in relation to ‘better economic governance of the Euro Area’ that your Division ‘leads the Department’s response to developments in this area’.

How do you, or the Department, conduct analyses to determine what is ‘better’ economic governance?

In light of the financial crisis that Ireland has suffered could it be said that the Department of Finance did not manage good economic governance in the lead up to the crisis?

What is your division doing now, if anything, that is different to ensure better economic governance?

My written statement refers to the ongoing process of reflection at EU level on the future of the Economic and Monetary Union (EMU) to determine what reforms are required for the smooth and effective functioning of the currency area.

Upon the new European Commission taking office in 2014, President Juncker set out in his work programme the early objective of achieving a ‘deeper and fairer’ EMU. In February 2015, President Juncker circulated a note on the next steps for better economic governance of the Euro Area. Member States submitted a written response to the note, which formed the basis for discussions at subsequent meetings of senior Member State officials. The resulting report, ‘*Completing Europe’s Economic and Monetary Union*’ (also known as the Five President’s Report) was published by the Presidents of the Euro Summit, ECB, Eurogroup, European Parliament and Commission on 22 June.

The report sets out a vision for a “deep, fair and genuine” EMU, which it envisages would be achieved by 2025, in two stages and based on four Unions: economic, financial, fiscal and political. A first stage, starting immediately and lasting two years, would focus on making best use of existing Treaties and would address the following issues: boosting competitiveness and structural convergence, completing the Banking Union, maintaining responsible fiscal policies (including by the establishment of a European Fiscal Advisory Board) and enhancing democratic responsibility. A second stage, beginning in 2017, would involve measures of a more far-reaching nature, such as binding benchmarks for convergence and a Euro Area fiscal stabilisation function.

The report was presented under the personal authority of the Five Presidents and as such was noted by EU leaders at the June European Council and referred back to the Council for ‘rapid’ examination. Ecofin and Eurogroup will play a key part in this examination by the Council of Ministers of the proposals outlined in the report. The EFC may also be involved in preparing the Ecofin discussion of the Report.

The EU Division leads the coordination of the Department’s engagement in this process but the Department’s policy advice to the Minister is developed following inter-divisional and cross-Governmental collaboration. This issue is managed centrally by the Department of the Taoiseach.

The reference in my written statement to ‘Better economic governance at EU level’ is not directly related to the Department’s management of economic governance but rather to the current examination at EU level as to whether the rules themselves, which Ireland as a member of the EMU is required to respect, are adequate. The issue which the ongoing process of reform, of which the latest Report forms part, seeks to address is whether the rules-based architecture of the Euro Area is effective to avoid future crises. The International and EU Division manages the Department’s engagement in the deliberative process to develop the next stages of Euro Area reform but the relevant policy divisions (such as Budget, Financial Services and Economics) manage the Department’s analysis and implementation of the proposals.

Q12

R7(b): What, if any, further developments are still required to ensure that we have an optimum relationship with Europe in the event that we face any further challenges?

In our relationship with international stakeholders, it is important that Ireland does not become complacent and that we continue to build on achievements, not least our successful 'clean' Programme exit and the Presidency of the European Council in 2013. Government was mindful that the goodwill generated by Ireland among our EU partners following the delivery of key legislative reforms during the Presidency would be maintained. This included the establishment of an Inter-departmental Committee on supporting the placement of staff in International and EU Institutions, on which I serve, and the creation of a fund at central level to support the secondment of national experts to positions of strategic importance. The placement of staff in key positions in the EU institutions should continue to assist Ireland in engaging effectively on all major initiatives and policy proposals going forward.

It is important for Ireland to work with its partners in participating in and responding to the reformed post-crisis surveillance and supervision regime, in both its preventative and corrective arms, as coordinated action is our best defence against a crisis of similar magnitude emerging again.

The Department's ongoing alliance building and the new structures to ensure a coherent approach to development of high level EU strategy will continue to provide Ireland with a strong and persuasive voice both within the EU and internationally.

Q13

R7(c): Describe the formal and informal interactions between the Department of Finance and the ECB. How have they changed since you joined the Department in 2011?

The Department enjoys good working relations with ECB officials, within the context, of course, of the ECB's full independence. It is also true to say that the Central Bank of Ireland (CBI), separately to the Department, engages with the ECB in the CBI's respective national and European roles. The CBI has a member on the EFC, of which I am also a member as set out above in my response to Question 6.

The Governor of the ECB participates in meetings of the Eurogroup and, as an observer, in meetings of the Ecofin Council of Ministers. ECB officials also participate in meetings of the EWG, EFC, the Economic Policy Committee and the EFC-Alternates.

As one of the three Troika institutions, the ECB was involved in quarterly missions to Dublin. Ireland's successful Programme implementation was facilitated by effective working relationships between Government officials and the Troika. The ECB remains involved in post-programme surveillance on a six monthly basis.

The discernable change in the relationship between the Department and the ECB since I joined the Department is in the context of Ireland's change from a Programme country to our 'clean' exit whereby we are subject to a different form of monitoring under the Post-Programme Surveillance process which now takes place during twice-yearly (rather than quarterly) reviews.

I confirm that the contents of this written statement are true and accurate to the best of my knowledge.

Nicholas O'Brien

29 July 2015