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Joint Committee of Inquiry into the Banking Crisis

Further Clarification Statement of

John Hurley

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

**Response to Document 1 Questions attached to the Committee's Letter
dated the 2nd October 2015**

Preliminary

1. Arising from the Committee's correspondence dated the 2nd and 8th October 2015, this response should be read together with my response of even date to the written statements of Frank Browne.

Question 1

2. I did not attend the Roundtable discussions referred to in Question 1. My understanding is that the Roundtable discussions with the financial institutions, including that of December 2004, were led by the Director General of the Central Bank and the Chief Executive Officer of the Financial Regulator.
3. Regarding the reference in Question 1 to a 'soft landing' for the housing market, the question of a gradual decline in the growth in housing prices and in the prices themselves was subject to much discussion in the context of the preparations of the various financial stability reports including the 2004 report. Taking all the evidence into account, including all research from the various economic departments in the Bank, it was as far as I was concerned at the time, the consensus view of the Bank that a gradual decline in house prices was the most likely outcome though it was always acknowledged that there were downside risks to this outcome that could make for a more difficult adjustment path.
4. As I stated in my earlier evidence two factors which could have a positive bearing on this outcome were the phasing out of property tax incentives and an upward adjustment in interest rates.

5. In October 2004 because of the continuing growth in property prices and also the growth of the property sector in the Irish economy the Central Bank raised the issue of tax incentives in the pre-budget letter to the Minister for Finance. In the event a review of tax incentives was announced in the Budget in December 2004 with an expectation that it would lead to a phasing out of such incentives. This started in the 2005 Budget. The Central Bank at the time also expected that a new ECB interest rate tightening cycle, which would have a strong psychological impact on investors and house buyers, would start in 2005.
6. The Central Bank had pointed out that the equilibrium rate for retail mortgages was approximately 6% and that while it could take time to reach that level it was twice the then prevailing level. While the interest rate increases started later than expected because of changed economic circumstances in the Euro area, there was aggressive monetary tightening starting from December 2005. Rates were increased between then and mid 2007 from 2.25% to 4.25% with consequential adjustments to retail mortgage rates.

Question 2

7. So far as I am aware the main initiative for the major themes in the reports came from the Financial Stability Unit itself and were subsequently discussed at the Financial Stability Committee and in my meetings. They were also informed by discussions on economic and financial issues at the Board in the course of its monthly meetings.
8. Similarly, to the best of my knowledge the initiative for the articles referred to came mainly from the Economic Department and the Financial Stability Unit. Again discussion at the Financial Stability followed and they were raised in the meetings chaired by me. Draft articles were regularly reviewed at the Board meetings and commented upon.

9. Draft Financial Stability Reports including the summaries were considered at meetings chaired by me before their presentation to the joint Board meetings. The meetings were attended by all relevant senior staff including senior economic staff. To the best of my recollection no disagreements on any of the decisions made to that point surfaced. The meetings I chaired were wide-ranging. Some amendments were made to the drafts before finalisation though any amendments made did not affect the substance of the drafts. At all meetings some variation in opinions or in emphasis inevitably arise. The purpose of the meetings is to iron out these differences and come to conclusions taking all views into account. This is precisely what happened at the meetings which I chaired. As amendments were finalised, I do not recall any serious disagreement on any of the changes made.
10. The content and wording of the reports were subsequently discussed and agreed at joint meetings of the Central Bank Board and Regulatory Authority. Drafting changes were made at the meeting. As is normal some residual drafting not finalised at the meetings was left to me to complete in consultation with the appropriate staff. In all cases such drafting was in full accord with the thrust of the decisions of the Joint Board meeting.

Question 3

11. As regards the update of the McQuinn/O'Reilly model, I have no recollection of this update being raised at any of the meetings chaired by me leading up to the finalization of the 2007 Report nor have I any recollection that it was referred to in any document received by me at that time. I do not believe that it was discussed at the Board meeting.
12. It was my understanding from the Honohan Report that this update was undertaken in April 2008 after the publication of the 2007 Financial Stability Report.

Question 4

13. As regards the question of two reports giving estimates on house price valuation for the 2007 Financial Stability Report, I have no recollection of this matter arising or of any discussion with me on the matter.

Question 5

14. To the best of my recollection the meetings on the 24th September were concerned with assessing the position of financial institutions at the time and considering options for intervention. These included liquidity support, an SLS-type scheme, guarantees, nationalisation and a bad bank approach. The Central Bank was represented at these meetings by the Director General and myself. The initial meeting was attended by the Taoiseach, Minister for Finance, Attorney General and officials from the Departments of Finance and the Taoiseach, the NTMA and the Financial Regulator. Technical experts from Merrill Lynch, PWC and Arthur Cox were also present.
15. The meeting continued (or what might be regarded as a second meeting was held) after the withdrawal of some representatives. I believe these were mainly technical experts but I cannot be sure of this. To the best of my recollection this meeting continued to consider options for intervention. At some stage towards the end of the meeting, possibly as it was breaking up, a brief side discussion took place between the Taoiseach, Minister for Finance, myself and I believe the Department of Finance. It related solely, so far as I can recall at this remove, to further work on the preparation of options for Government consideration the following week.
16. As I stated in my earlier evidence to the Committee, at meetings held during the weekend before the guarantee decision, it was considered likely that the financial institutions would be sufficiently liquid to get

through the following week. This would have facilitated the consideration of the various options by the Government as planned. However, the liquidity outlook changed quickly on the morning of 29th September when it became clear that without assistance one bank would not be able to open for business the following morning.

Question 6

17. I cannot recall a substantive discussion taking place in the course of the meeting on the 29th September on the views of the NTMA. I believe reference was made to the NTMA view by the Department of Finance representatives but I find it difficult to recall details at this stage. It was always my understanding that the views of the NTMA were already well known to the Minister for Finance and his officials as a result of earlier discussions with the NTMA.

Question 7

18. After I returned from sick leave in September 2008, post the collapse of Lehmans, the question of issuing a broad guarantee started to emerge as one of the options that needed to be seriously considered. As stated by me in evidence to the Committee, a broad guarantee arose at a meeting in the Department attended by the Minister on the 18th September 2008. To the best of my recollection an overall liability of around €400bn was referred to. As indicated above various options for intervention were also considered at the meetings on 24th September.

19. I considered it essential to brief the Board of the Central Bank on the emerging guarantee option and on other developments and did so at the Board meeting of the Central Bank of the 25th September. I indicated to the Board that the option of a full guarantee covering liabilities of some €400bn was not one I favoured up to then but in the evolving difficult situation it required serious consideration. The options

of a broad guarantee and nationalisation were also among those considered in the context of discussions on the Merrill Lynch paper of 26th September 2008.

20. The question of the nationalisation of a financial institution had already arisen earlier in the year, and as a consequence of discussions at the Domestic Standing Group it was decided that draft legislation to nationalise a financial institution, should that prove to be necessary, should be prepared. This matter was taken forward by the Department of Finance in consultation with the Attorney General's Office.

Question 8

21. I cannot recall any financial institution expressing to me a preference for a full guarantee prior to the meeting of the 29th September. I am not aware of any such request made to any other officers of the Central Bank or Financial Regulator.
22. In my evidence to the Committee I stated that it was possible that in the course of meetings with financial institutions on liquidity matters post Northern Rock, guarantees could have been mentioned by a financial institution but I have no specific recollection of a broad guarantee being raised at that time.

John Hurley
23rd October 2015