Tithe an Oireachtais
Houses of the Oireachtas

Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

Pádraig Ó Ríordáin

Session 47b

16 July 2015 (a.m.)

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

STATEMENT OF PÁDRAIG Ó RÍORDÁIN TO THE BANKING INQUIRY

18 JUNE 2015

AUTH/1733/AC#17379907

1. Introduction

On 21 May 2015 I received a Direction under the *Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013* (the "**Act**") to provide oral and written evidence to the Joint Committee of Inquiry into the Banking Crisis (the "**Joint Committee**") on 13 lines of inquiry in relation to the following themes:

- Crisis Management System and Policy Response; and
- Regulatory, Supervisory & Government.

This written statement is made pursuant to that Direction and addresses the 13 lines of inquiry within the context of my role as external commercial legal adviser to the Department of Finance and its related entities; the National Treasury Management Agency and the National Pensions Reserve Fund Commission (together "**the Department and its Agencies**").

2. Privilege

As my role in relation to the matters set out in the Direction was as external commercial legal adviser to the Department and its Agencies, this statement and my evidence is constrained, not only by the usual exemptions under the Act but also by my duties in respect of the privilege, and in particular the legal privilege, of the Department and its Agencies. I have been informed by the Department that it has waived, solely for the purposes of my oral evidence to the Inquiry, the privilege which attaches to any advices given in September and October 2008 by Arthur Cox to the Department of Finance in relation to the Bank Guarantee of 30 September 2008, but that it otherwise asserts privilege.

3. Source of Information

The information on which this statement is based derives generally from information provided to me at the time by the Department or its Agencies and the Office of the Attorney General or in the course of my dealings with them.

4. Role of Advisors in analysing the crisis (to include crisis management options) (C2b)

4.1 Arthur Cox was engaged by the Department on the morning of Wednesday 24 September 2008 to advise in respect of the emerging banking crisis. Prior to that time I had no involvement in the banking crisis and was not aware of its depth. I understand that the Department contacted me as it was familiar with my work through my role as Chairman of the Financial Legislation Advisory Forum, which I had undertaken at the Department's request, on a pro bono basis, from 2007. I led the Arthur Cox team throughout.

4.2 Arthur Cox was engaged to act as external commercial legal advisor to the Department and its Agencies. In fulfilling this role, we worked closely with the Office of the Attorney General and the lawyers within the Department and its Agencies. In executing our role, we worked in tandem with other Department advisors including Merrill Lynch, PwC and, later, Rothschild.

4.3 Over the seven years since the onset of the crisis, Arthur Cox's role has included:

(a) Assisting the Department and its Agencies to map out the legal landscape applicable to the banking sector;

(b) Undertaking legal due diligence exercises in respect of a number of the banks[1] which the State was supporting;

(c) Identifying legal obstacles and risks, as well as potential solutions to them, in the policy under development by the Department;

(d) Contributing to the design of legislation being prepared by the Office of the Attorney General, helping execute policy decisions by legally implementing banking sector transactions and undertaking the High Court applications required to effect Government policy;

(e) Working with the Department to satisfy the requirements of external agencies such as the EC Directorate General for Competition; and

(f) Defending the State in litigation taken against it arising out of the execution of its policy.

4.4 The legal work required to perform this role was uniquely complex and extensive, with each legal action or solution integrally connected with all others over the years of the crisis. In summary, Arthur Cox's job was to help design the legal architecture required to support policy decisions made by Government and then help provide the legal engineering required to implement those decisions.

4.5 At the beginning of the crisis in 2008, in common with many European countries, the Irish Government had available to it no specifically designed legal infrastructure or powers to intervene in or resolve banks in financial difficulty (indeed, EU-wide legislation dealing with bank recovery and resolution has only been implemented this year). As a consequence, this legal infrastructure had to be built, often under intense time pressure, from the ground up, as the crisis progressed. This was a very extensive and complicated exercise, combining statutory, contractual and judicial avenues, with the major milestones being the *Credit Institutions (Financial Support) Act 2008*, the *Anglo Irish Bank Corporation Act 2009*, the *National Asset Management Agency Act 2009*, the *Credit Institutions (Stabilisation) Act 2010* and the *Irish Bank Resolution Corporation Act 2013*.

4.6 The common threads running through all of the work in the design and implementation of the required legal infrastructure were to enable the Government to take the actions it deemed necessary to ensure financial stability while observing the legal integrity of the banks and their stakeholders and ensuring the central objective that there be no default by any of the banks on any of their obligations.

4.7 Any default by the banks, even inadvertent, could have triggered cross defaults on their financial instruments leading to the failure of a bank and a call on the guarantee. This risk became most pronounced in the first half of 2011 when the banking sector was substantially reorganised in accordance with the Troika programme.

4.8 Each action taken by the State therefore had to be robustly designed to implement policy measures legally and effectively, while ensuring banking sector stability. This

[1] For the sake of simplicity, the terms "bank" and "banks" used throughout this statement include, where relevant, the building societies.

was legally challenging in circumstances in which the State was required to intervene strongly to maintain financial stability, even where that required the alteration of other stakeholders' rights.

4.9 The legal solutions adopted by the State in response to the issues caused by the banking crisis navigated a narrow path demarcated by the Constitution, European law, IFSRA (later the Central Bank) and banking regulation, ECB requirements, Stock Exchange Rules and the EU Commission's Directorate General for Competition as well as the legal rights of depositors, bondholders, shareholders, derivative counterparties, bank boards and employees. These solutions had to legally optimise the position of the State, comply with the requirements of the Troika programme from 2011 onwards and take into account the responses of the rating agencies and sovereign bond markets.

4.10 On crisis management, Arthur Cox contributed by assisting the Department and its Agencies to find this path, to identify, manage and resolve legal risk, and to build and implement the legal infrastructure required to effect Government policy.

4.11 Over the period of our engagement, more than 120 Arthur Cox lawyers in total worked for the Department and its Agencies on the crisis, with specialist teams required in Corporate, Litigation, Capital Markets, Finance, Financial Regulation and Insolvency/Restructuring.

5. Appropriateness of the bank guarantee decision (C3b)

5.1 Arthur Cox was retained by the Department on 24 September 2008 and briefed, along with Merrill Lynch, on the deepening crisis and, in particular, the liquidity issues facing the banks. Our assigned tasks between the 24 and 29 September were focussed on the legal structuring of two potential options being considered in response to the emerging crisis. These were the potential nationalisation of a bank or building society and the potential creation of a structure to increase liquidity across the banking sector.

5.2 Arthur Cox did not advise on the terms or appropriateness of the guarantee before it was issued on 30 September 2008. Although I was present at Government Buildings on the night of the guarantee, I was not at any of the meetings at which decisions in respect of the guarantee were made and I provided no advice in respect of it. I was informed of the terms of the guarantee once the decision had been taken.

5.3 The role of the firm in respect of the guarantee was to implement the guarantee decision by working with the Office of the Attorney General to design its enabling primary legislation, the *Credit Institutions (Financial Support) Act 2008* and assisting in legally formalising the guarantee in the *Credit Institutions (Financial Support) Scheme 2008* (the "**CIFS Scheme**"), the statutory instrument introduced on 24 October 2008.

5.4 It is beyond our expertise to assess the appropriateness of the guarantee decision as a policy decision or its effectiveness in addressing financial stability relative to alternatives.

5.5 I can, however, give a perspective on the central legal consequences of failure of a bank, each of which would have had practical implications for stakeholders and potentially the system as a whole. Had a bank failed in 2008, there was no bank resolution legislation available to the Government to step in to resolve it in a controlled manner. The legal consequences of such a failure would have included the following:

(a) without specific legislation, the bank would have been liquidated under general insolvency law with the appointment of a liquidator and the State would have had no legal ability to manage in the public interest the manner in which that was done;

(b) customer deposits, senior bondholders and trade creditors all would have been unsecured creditors and would have shared identical priority on insolvency;

(c) all deposits would have been frozen and certain depositors with deposits up to €100,000 would have claimed under the DGS Scheme and would have been entitled to have been paid within three months;

(d) depositors that were not eligible for the DGS Scheme (i.e. most corporate depositors, together with all senior bondholders and trade creditors) would have had no protection and would have been subject to the outcome of the liquidation, which would likely have taken an extensive period;

(e) parties such as the European Central Bank (the "**ECB**") / the Central Bank of Ireland (the "**CBI**") or derivative counterparties would have been entitled to seize bank collateral;

(f) subordinated bondholders and equity holders would have had to wait for the outcome of the liquidation and most likely be wiped out;

(g) the liquidator would have immediately ceased trading of the bank and all employees of the bank would have been immediately made redundant; and

(h) the liquidator would have been forced to sell the assets of the bank as quickly as possible in order to reduce the administrative cost of the liquidation – this would likely have resulted in a "fire sale" of the bank's assets, which would in turn have had a materially adverse impact on value to creditors.

5.6 Arthur Cox subsequently advised on the design and implementation of *Credit Institutions (Eligible Liabilities Guarantee Scheme) 2009*, (the "**ELG Scheme**") which replaced the CIFS Scheme. The purpose of the ELG Scheme was to reduce the scope of the Government's potential liability under the guarantee and gradually transition the banking sector back to an unguaranteed normalcy. This was designed to avoid the instability which could have occurred had the CIFS Scheme simply been removed entirely when it expired in September 2010. The ELG Scheme more closely resembled schemes introduced in many other jurisdictions, in terms of scope and operation.

6. Decision to nationalise Anglo in 2009 and a review of the alternatives available and/or considered (C4a)

6.1 From a legal perspective, the State had formally accepted responsibility for most of Anglo's liabilities when it issued the guarantee in September 2008. The nationalisation of Anglo which followed therefore did not increase the State's exposure to the bank, but rather seized direct control of the bank from its shareholders by becoming its owner.

6.2 In the CIFS Scheme which implemented the guarantee, the State had imposed both restrictions and positive obligations on the banks, including Anglo, in respect of its commercial conduct, management of capital and progressive reduction of risk to the State. In addition, the guarantee introduced restrictions on executive remuneration under the auspices of the Covered Institution Remuneration Oversight Committee and provided for the appointment of public interest directors to the banks' boards. Many of the Ministers' powers under the guarantee scheme were exercisable only through the Central Bank.

6.3 However, specific corporate governance concerns in respect of Anglo had emerged publicly towards the end of 2008, its funding had weakened and it was clear that Anglo posed the greatest risk to the guarantee and the stability of the banking sector. These factors, in addition to the looming requirement for the State to recapitalise Anglo prompted the State to take full ownership of the bank in order to help stabilise and de-risk it.

6.4 As part of the Government's decision-making process in respect of the position of Anglo and its future, the Department asked Arthur Cox to prepare a High Level Material Legal Issues due diligence report which reported on issues of legal concern within the bank.

6.5 Parallel with this work, as a firm we continued to work with the Department and the Office of the Attorney General on the preparation of the *Anglo Irish Bank Corporation Act 2009* (the "**AIBC Act**") the legislation which nationalised Anglo. This was a more developed and tailored version of the nationalisation legislation prepared in advance of the introduction of the guarantee, to which we had previously contributed.

6.6 The AIBC Act provided for the transfer of all shares in Anglo to the Minister for Finance, the creation of a relationship framework between the Minister and Anglo, the removal of the Anglo Board and executives, the appointment of new directors and a number of related matters.

7. Establishment, operation and effectiveness of National Asset Management Agency (NAMA) (C4b)

7.1 NAMA was established by the Government as a policy response (based on a report by Dr. Peter Bacon) to the scale and the destabilising value uncertainty of development land loans across the guaranteed banks. NAMA's purposes were to restore balance-sheet certainty to the banks by exchanging development and related loans for bonds of clear value, consolidate all the loans of each relevant connection in one place so that they could be addressed cohesively and ensure that the loans most damaging to the Irish banks could be worked out in a managed fashion over an extended period of time, funded efficiently at Irish sovereign bond rates. This was intended to optimise the return to the State by avoiding a fire sale of assets while recognising bank losses up front and dealing with them definitively and to fund them in an efficient manner.

7.2 Arthur Cox worked extensively with the Department, the Office of the Attorney General and the NTMA in designing the legislation which established NAMA, the *National Asset Management Agency Act 2009* (the "**NAMA Act**"). It was a legally complex task as NAMA is a unique entity, without precedent and mechanisms had to be introduced under which NAMA could value and bulk purchase all the relevant loans from the banks expeditiously and without challenge or delay. Equally, once

NAMA had purchased the loans it needed all the powers foreseeably required to deal with those loans and underlying secured assets efficiently.

7.3 The NAMA Act was structured so that banks could voluntarily choose to participate or not. The Government made it clear to the banks that this was the only approach to the support of the banks which would be available. The listed banks needed to hold Extraordinary General Meetings of their shareholders to decide the issue and each of the Irish banks approved and signed up to the terms presented.

7.4 The NAMA Act is a very extensive and detailed piece of legislation, the description of which goes beyond the scope of this statement. However, the legislation as introduced enabled NAMA to execute Government policy by very quickly establishing and acquiring all of the relevant development land and related loans from the banks. This was an unprecedented practical exercise requiring the valuation, due diligence and transfer of approximately 12,000 loans which was enabled by the legal infrastructure and efficiencies introduced by the NAMA Act.

7.5 One of the impacts of the purchase by NAMA of the development land and related loans of the banks was that the banks had to recognise their losses on those sales, which led to a further need for recapitalisation in 2010. However, this capital replaced assets which had become toxic and destabilising in the banks with new capital and NAMA bonds, which provided the banks with clearer and more reliable balance sheets.

7.6 It is not within my expertise to comment on the effectiveness of NAMA as an agency, but from a legal perspective, the NAMA Act worked very effectively.

7.7 As a firm, Arthur Cox continued to work with NAMA following its establishment as one of a large number of legal firms on its panel.

8. Decision to recapitalise Anglo, Allied Irish Banks (AIB), Bank of Ireland (BOI), Educational Building Society (EBS), Permanent TSB (PTSB) and alternatives available and/or considered (C4c)

8.1 Once the policy decision was taken in September 2008 to stand behind the Irish banking system and the guarantee was introduced, the focus shifted away from liquidity and onto the quality of the assets on the banks' balance sheets, market-confidence in respect of the banks' regulatory capital levels and balance sheet solvency. All of the banks were subject to regulatory capital requirements set by EU and domestic law.

8.2 The purpose of regulatory capital is to act as a buffer to absorb losses incurred by a bank, in order to protect depositors and other creditors. In simple terms, the impairments on the loan books of the banks were such that, absent recapitalisation, all of the available capital would have been used up. The primary kind of capital which the banks required was loss absorbing capital, or Core Tier I in regulatory capital terms. This is equity or equity equivalent which is automatically available to fill capital holes in the balance sheet as losses occur. This is the capital that became progressively unavailable to the Irish banks in the market as the crisis unfolded and as it became apparent that the volume of capital required could not be met through private resources.

8.3 The initial recapitalisations of AIB and Bank of Ireland of €3.5 billion respectively were undertaken by way of perpetual preference shares with an 8% coupon (payable in cash or shares) and warrants. These instruments were negotiated to optimise the return to the State and were accepted at the time by the Central Bank as Core Tier 1 capital for regulatory capital purposes. However, due to the fixed coupon payable on the preference shares and the associated reduction in their ability to absorb losses, the policy of the Central Bank has since changed to no longer accept new capital introduced by way of preference shares as Core Tier 1.

8.4 As the balance sheets of the banks became more stressed and as the Prudential Capital Adequacy Review undertaken by the Central Bank identified the requirement for fresh capital, the Government responded by providing Core Tier 1 capital to the banks through a combination of share capital and promissory notes, supported by contingent capital notes ("**Cocos**"). Cocos are themselves Core Tier 2 capital but are designed to convert into Core Tier 1 equity and be available to absorb losses, once the Core Tier 1 ratios of the bank reduce to a set trigger point. Of these, only the promissory notes did not require an immediate cash injection by the Government, but the promissory notes did attract a high coupon payable by the Government in cash.

8.5 The use of equity, preference shares and Cocos, through which the Government recapitalised banks, continue to have economic value for the State. To date this has been most notably demonstrated in the sale by the Government of equity, preference shares and Cocos in Bank of Ireland.

9. Credit Institutions Stabilisation Act 2010 – effectiveness of the actions to merge AIB and EBS, Anglo and INBS and deposit transfers (C4d)

9.1 In order to address the challenges posed by the requirement to reorganise the banking sector, a completely new set of legal tools was required. Arthur Cox worked closely with the Department and the Office of the Attorney General to design and develop these tools, which were passed into law on 21 December 2010 as the *Credit Institutions (Stabilisation) Act 2010* ("**CISA**").

9.2 CISA, through a High Court judicial process, allowed the Minister for Finance to apply to court to make direction orders compelling banks and building societies to take the steps necessary to reorganise and recapitalise in the manner required by the Troika programme. Equally, through a similar judicial process, it enabled the Minister to mandate and legally effect the transfer of assets and liabilities of a relevant bank without the normal consents and legal restrictions which would have rendered such transfers practically impossible to implement.

9.3 CISA also provided for Subordinated Liability Orders ("**SLO**") which, again through a judicial procedure, allowed the Minister to apply to 'haircut' subordinated bonds in the relevant banks, effectively by altering their terms. For the reasons outlined elsewhere in this Statement, this legal avenue was required to enable effective liability management exercises to be undertaken in the banks to buy-back subordinated debt at significantly reduced levels and strengthen the banks' capital.

9.4 Crucially, this was all enabled by the *European Credit Institutions Winding Up Directive* ("**CIWUD**"). CIWUD provides that certain reorganisation measures applied to credit banks in their home states shall be directly effective throughout the member states of the European Union. In this way, an Irish reorganisation measure meeting the CIWUD requirements would, for example, in effect be recognised under English law and could amend the terms of English law denominated financial instruments (English law being the governing law of many of the banks' finance documents). By designing the CISA orders to meet the definition of "reorganisation measure" under CIWUD, the Minister for Finance was, for example, able to 'switch off' events of default which would have been triggered by the required bank reorganisations.

9.5 It is important to note that if CIWUD did not exist, it would not have been possible to reorganise the banks in 2011 without risking default through breach of covenant, resulting in failure of the relevant bank and, critically, a call on the bank guarantee. This problem was caused by Irish banks having predominately issued financial instruments subject to laws other than Irish law, a problem perhaps not unique to Ireland but nonetheless quite particular.

9.6 The first Direction Order under CISA was made on 23 December 2010 to effect the €3.7 billion recapitalisation of AIB. Between that date and June 2012 direction orders were issued by the High Court on application of the Minister for Finance on four further occasions and transfer orders were issued on two occasions to enable the transfer of the deposits and related assets of Anglo and Irish Nationwide Building Society ("**INBS**") to AIB and Irish Life and Permanent ("**ILP**") respectively, to procure the divestment of Irish Life Limited by ILP, to transfer the assets and liabilities of INBS to Irish Bank Resolution Corporation ("**IBRC**), to recapitalise ILP and to mandate the sale of Irish Life Limited to the Minister for Finance.

9.7 In addition, the High Court granted a SLO to 'haircut' subordinated bonds in AIB, which became effective from April 2011 following resolution of a challenge in June/July 2011.

10. European Union ("EU")/International Monetary Fund ("IMF")/European Central Bank ("ECB") programme of assistance (C5a)

10.1 Arthur Cox did not have a role in the development of the EU/IMF/ECB (together "**the Troika**") programme of assistance. The firm did, however, play an advisory role in identifying and implementing the legal steps required to reorganise the banking sector in fulfilment of the Government's commitments to the Troika on financial sector stability and advised legally on some of the loans.

10.2 The objective of the programme was to substantially downsize the banks, isolating the non-viable parts of the system and returning the sector to healthy functionality. This involved separating the viable from the non-viable banks, de-risking the latter and recapitalising the former. The objective was to complete the structural work required in the first seven months of 2011.

10.3 The reorganisation of the banking sector in this manner and at the required speed was legally a very demanding objective. It is important to note in this respect that AIB, Bank of Ireland and Permanent TSB ("**PTSB**") all remained publicly listed companies and while the State had various levels of control over each through the guarantee scheme and the previous recapitalisations, this control was legally limited. EBS and INBS were building societies with a legal framework quite distinct from that of the banks. The reorganisation of the banking sector also affected the rights of many stakeholders such as depositors, bondholders and derivative counterparties. Negotiating the consents and agreements required from all of the required stakeholders would have been problematic, if not impossible.

10.4 An additional central challenge was that most of the bonds issued by the Irish banks were, as noted previously, drafted to be subject to English law rather than Irish law. As a result, the bonds were not capable of being amended by Irish legislation, as Irish legislation can only change Irish law governed contracts. This had immense practical implications as many of the bonds issued by the banks had covenants and events of default which would have been triggered by the reorganisation steps required by the Troika programme. Such a breach would have led to a default under the terms of the bonds leading to a potential demand for immediate repayment and cross-defaults into other bonds and financial instruments leading to a potential failure of the bank and a call on the guarantee.

10.5 In order to address these challenges a completely new set of legal tools was required. Arthur Cox worked closely with the Department and the Office of the Attorney General to design and develop these tools, which were passed into law on 21 December 2010 in the form of CISA. I have described the operation of this Act in some detail in Section 6.

10.6 The very extensive banking sector reorganisation measures required under the Government's commitments to the Troika were completed on schedule by 31 July 2011. This was an unprecedented reorganisation of an entire banking sector and was completed within a particularly short timeframe.

11. The liquidation of the Irish Bank Resolution Corporation ("IBRC"), the promissory notes refinancing and relationships with the ECB (C5b)

11.1 The promissory notes were introduced as an option to maintain the solvency of Anglo, INBS and EBS without requiring an immediate injection of cash. The promissory notes constituted promises to pay an amount over time to the bank but were accounted for as capital as if they had been paid in cash. However, accounting rules required that they carry a high coupon or interest rate to be paid by the State. The banks then pledged the promissory notes as collateral with the Central Bank, which in return provided the banks with cash in the form of emergency liquidity assistance ("**ELA**").

11.2 It became a central objective of both the Government and the Central Bank to unwind this arrangement as the cost of the promissory notes to the Government was very high and the ECB /Central Bank wished to wean the Irish banks off ELA. As INBS had by this stage been merged into IBRC, all of the promissory notes, bar a relatively small amount remaining in EBS, were in IBRC.

11.3 The core enabler in terminating the promissory notes was to remove the requirement for them. On the liquidation of IBRC, the need for the balance sheet support provided by the promissory notes was ended.

11.4 On liquidation of IBRC, the Central Bank became owner of the IBRC promissory notes, which it held as collateral for the ELA it had provided to the bank. The Central Bank then exchanged those notes for a series of lower cost sovereign bonds issued on behalf of the State by the NTMA. The promissory notes and the elevated interest costs associated with them were then terminated.

11.5 The remaining balance of the ELA debt owing by IBRC to the Central Bank was secured by a floating charge over all of the assets of IBRC, backed by a Ministerial guarantee. NAMA was directed by the Minister to buy that remaining IBRC debt from the Central Bank. NAMA did so, and took the benefit of the floating charge and guarantee associated with the debt, and paid for the IBRC debt by issuing NAMA bonds to the Central Bank. This ended the Central Bank's provision of ELA to the IBRC and made the Central Bank whole.

11.6 The Special Liquidators of IBRC were then tasked with selling the bank's assets which were subject to the floating charge now held by NAMA. In order to avoid a fire sale of the assets, which would have resulted in depressed returns, independent experts were appointed to value the assets. If the Special Liquidators could not sell the assets above that valuation, NAMA was mandated to buy the assets at the valuation, therefore providing a safety net or value floor for the assets. As it transpired, the Special Liquidators sold the assets very successfully on the market, and significantly above the valuation price, and repaid the NAMA debt in full from the proceeds without NAMA having to purchase any of the assets.

11.7 The liquidation of IBRC was the first time a material bank was liquidated in the Eurozone. In order to execute the liquidation in an orderly manner in the interests of the State, while avoiding causing further instability and to ensure that the transactions outlined above with the Central Banks and NAMA occurred as planned, it was necessary to pass the *Irish Bank Resolution Corporation Act 2013* (the "**IBRC Act**").

11.8 In formulating its strategy with respect to the winding-up of IBRC, the State tried to ensure that the liquidation would be carried out in a manner that was as similar as possible to a normal liquidation under the Companies Acts. The reason for this was to ensure that the creditors of IBRC (the largest by far being the State itself) would be treated fairly and in accordance with the hierarchy of priorities that usually apply in any liquidation of a company.

11.9 The IBRC Act provided the speed and certainty in the liquidation of IBRC which was necessary to minimise market uncertainty and provide the timing required to underpin the promissory note and related transactions with the Central Bank outlined above. Under the IBRC Act, the bank was liquidated immediately, which would not have been possible under normal insolvency legislation and the required level of confidentiality was maintained until the moment the Government decided to liquidate, which was essential for stability.

11.10 Critically, the IBRC Act also allowed the Minister for Finance to direct the Special Liquidators to undertake the liquidation in a manner which met the State's interests and objectives in the liquidation and enabled the Central Bank and NAMA transactions.

11.11 The liquidation of IBRC and the associated termination of the promissory notes was, in my view, executed very successfully and achieved each of its central objectives.

12. Options for burden sharing during the period 2008-2013 (C7a)

12.1 The options for burden sharing in banks under Irish law in 2008 were very limited and no legal tools existed to enhance them. For example, there was no legal infrastructure to 'bail-in' bondholders by converting their bonds to loss absorbing equity, as has just recently been introduced on a European level from 1 January 2015 in the Bank Recovery and Resolution Directive, and subordinated bondholders were subordinated only on insolvency.

12.2 Burden sharing by shareholders in the banks happened extensively with all of Anglo's shareholders reduced to zero, the shareholders in AIB and Permanent TSB reduced to less than 1% and the shareholders in Bank of Ireland substantially diluted. The building societies, by their nature, do not have shareholders, but their members lost their economic rights (e.g. a share in the proceeds of the society on sale).

12.3 Burden sharing by depositors, until it was used in Cyprus in 2013 for depositors over €100,000, was not known in Europe and in an Irish context would likely have increased the deposit outflows from the banks, exacerbating the banking sector funding problems and related stability issues.

12.4 Senior and subordinated bonds are not fully loss absorbing in nature like equity is. As long as a bank is solvent, senior and dated subordinated bonds legally must be repaid in full on maturity and their respective interest rates must be paid until then. In contrast, equity gets eroded to pay for losses as they occur with equity automatically reducing closer to zero in value the closer the bank gets to insolvency.

12.5 Although dated subordinated bonds are lower in priority than deposits or senior bonds they are paid a higher interest rate to reflect that risk, and legally they are designed to be subordinated only on *insolvency* of the issuer. A significant problem in their design emerges in the case of banks where Governments, like the Irish Government, step in to ensure that the bank does not fail by ensuring it remains solvent at the cost of the State. In these circumstances, subordinated bondholders, irrespective of the fact that they accepted an elevated level of exposure to the insolvency of the bank, expect to be paid in full as, legally, the bank is not insolvent due to the life support provided by the State. In other words, notwithstanding that the insolvency risk, which subordinated bondholders are paid a premium to take, has in practical terms occurred, subordinated bondholders get shielded by the State's intervention.

12.6 In addition, any default by a bank on its dated subordinated debt triggers a cross default across other financial instruments such as senior bonds. This would trigger immediate repayment obligations and potentially the failure of the bank.

12.7 The Government addressed this problem through the introduction of the SLO mechanism in CISA, which is described in detail elsewhere in this statement. Legally, through a judicial process involving High Court approval, this allowed Irish law to see through to the nature of the risk subordinated bondholders took and impose losses on them accordingly irrespective of their formal terms.

12.8 Although only one SLO was applied for in respect of AIB, the introduction of the mechanism was sufficient to support a successful liability management exercise in other banks where subordinated bondholders voluntarily agreed to sell their bonds back to the banks at a haircut rather than remain exposed to an even greater haircut under a subordinated liabilities order.

13. Role of the euro zone and international partners in this decision (C7b)

13.1 Arthur Cox had no direct involvement with the Eurozone in respect of options for burden sharing. With the Department, we had a limited interaction with the IMF in respect of the legal manner in which senior bondholders could participate in burden sharing. Ultimately it was decided as a matter of policy not to pursue the senior bondholders for burden sharing.

14. Appropriateness of the macro-economic and prudential policy (R1c)

14.1 It is beyond my expertise to comment on the appropriateness of macro-economic or prudential policy.

15. Appropriateness of the expert advice sought, quality of analysis of the advice and how effectively the advice was used (R4a)

15.1 The legal challenges facing the Government in addressing the financial crisis were of unprecedented complexity and scale and were unique in nature. The Department and its Agencies succeeded in negotiating all of the legal challenges presented in implementing Government policy and Arthur Cox's advice was used effectively by them in securing that outcome.

16. Appropriateness of the advice from the Department of Finance to the Government and the use thereof by Government (R5b)

16.1 Outside of a number of Department of Finance draft memoranda for Government to which Arthur Cox contributed from a legal perspective, I do not have direct knowledge of the advices given by the Department to the Government.

16.2 I believe that the legal advice given by Arthur Cox was at all times appropriately considered by the Department and its Agencies.

16.3 I have no basis on which to comment on the use by the Government of the advice provided by the Department of Finance.

Signed: Pádraig Ó Ríordáin

Pádraig Ó Ríordáin

Date: 18 June 2015