Tithe an Oireachtais
Houses of the Oireachtas

TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

An tAcht um Thithe an Oireachtais
(Fiosrúcháin, Pribhléidí agus Nósanna Imeachta), 2013

REPORT of the Joint Committee of Inquiry into the Banking Crisis

Houses of the Oireachtas
(Inquiries, Privileges and Procedures) Act, 2013

Volume 1: Report
Volume 2: Inquiry Framework
Volume 3: Evidence

January 2016

Finalised by the Joint Committee of Inquiry into the Banking Crisis on the 26 January 2016 and sent by the Chairman, on behalf of the Joint Committee, to the Clerks of both Houses of the Oireachtas, for circulation to the members of Dáil Éireann and Seanad Éireann in accordance with Standing Orders 107G and 103L of Dáil Éireann and Seanad Éireann respectively, to enable the tabling of motions in both Houses to order the publication of this Report pursuant to section 40(1) (a) of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act, 2013.

Table of Contents

Appendix List

Introduction by the Chairman of the Joint Committee of Inquiry into the Banking Crisis

The banking crisis will be seen as a defining event in Irish history. Its dark cloud still lingers over every home in Ireland and many are still suffering from its impact today. Unemployment, emigration, unsustainable debt, negative equity and home repossession are among the legacies of the crisis. As the Celtic Tiger fell, our confidence and belief in ourselves as a nation was dealt a blow and our international reputation was damaged.

One description of this recent crisis was that it was a systemic misjudgement of risk; that those in significant roles in Ireland, whether public or private, in their own way got it wrong; that it was a misjudgement of risk on such a scale that it lead to the greatest financial failure and ultimate crash in the history of the State.

That is one part of the story. The failure to identify the potential risk posed to the overall financial stability of the State by the banking system is another key lesson which must be learned. Recognition must also be given to the lack of an overall framework, at a European level, for dealing with the financial crisis. The refusal to allow successive Irish governments to achieve burden sharing with senior bondholders undoubtedly increased the overall cost of the crisis for the Irish people.

Each crisis has at its origin a belief, that ‘this time is different’ or ‘this could never happen to us again.’ For the Inquiry to achieve its full value it must not just look at the past to learn what happened but it must also provide lessons that minimise risk into the future. These lessons must resonate with us, in order that we will be aware that it may happen again, should we start to believe that everything is different now.

The purpose of this Report is to set out the key issues surrounding the crisis, what has been done to respond to it and what remains to be done. There have already been a number of reports into the crisis, commissioned by Government and carried out in private. In this Inquiry, the Joint Committee went beyond previous reports. Its brief was to consider the political, economic, social, cultural, financial and behavioural factors and policies which may have impacted on or contributed to the crisis.

What sets this Inquiry apart is that it is the first time that the actions and decisions that visited the financial crisis on the Irish people have been examined in public, allowing us for the first time to hear the story, in their own words, from those who were involved. The Inquiry heard oral evidence from 131 witnesses over the Context and Nexus Phases. We heard from experts who placed Ireland’s crisis in a world context. We heard from those who were at the helm when Ireland ran aground, as well as from those who were in the engine room. The Inquiry also sought documents from the key players, including politicians, the banks, the Central Bank and the Department of Finance, and received over half a million pages as a result.

The Inquiry was asked to examine the reasons why Ireland experienced a systemic banking crisis. We considered evidence on relevant matters relating to:

- banking systems and practices
- regulatory and supervisory systems and practices
- crisis management systems and policy responses

as well as the preventative reforms implemented in the wake of the crisis.

We concluded that there was in reality two crises, a banking crisis and a fiscal crisis. These were directly caused by four key failures; in banking, regulatory, government and Europe.

The crisis in the banks was directly caused by decisions of bank boards, managers and advisors to pursue risky business practices, either to protect their market share or to grow their business and profits. Exposures resulting from poor lending to the property sector not only threatened the viability of individual financial institutions but also the financial system itself.

Even though they were aware of the changing behaviour in the banking sector, regulators did not respond fully to the systemic risk. In particular, the Financial Regulator adopted a principles-based 'light touch' and non-intrusive approach to regulation. The Central Bank, the leading guardian of the financial stability of the state, underestimated the risks to the Irish financial system.

The Government presided over a period of unprecedented growth in tax revenues, but adopted a fiscal policy where significant, long-term expenditure commitments were made on the back of unsustainable cyclical, construction and transaction-based revenue. When the banking crisis hit and the property market crashed, the gulf between sustainable income and expenditure commitments was exposed and the result was a hard landing laying bare a significant structural deficit in the State finances.

The almost universal adoption of the 'soft landing' theory until 2008, without any substantial test or challenge, must be regarded as a key failing for the Government, Central Bank and the Department of Finance; this theory was also adopted by many international monitoring agencies. The failure to take action to slow house price and credit growth must also be attributed to those who supported and advocated this fatally flawed theory.

The "night of the guarantee" has become a thing of myth. The idea of a guarantee was not conceived on a single Monday night in September 2008; Department of Finance documents show that it was considered as part of a range of options as early as January 2008. Decision-makers, however, were forced to decide on a course of action in the absence of accurate information about the underlying health of financial institutions; no independent in-depth 'deep dive' investigation of the banks had been commissioned by the authorities before September 2008.

Over the following two years, Ireland's entry into a Troika programme of assistance became inevitable. The ECB nevertheless put the government under undue pressure to enter a programme, but also insisted that there would be no burden sharing with bondholders.

These were all actions for which the Irish people ultimately paid and are still paying a heavy price.

Even though the major decisions and events of the crisis, including the Guarantee and the Troika Programme, are a few years behind us, they cannot yet be consigned to history. This Report's findings and recommendations show that lessons must be learned and applied. There is no certain formula to avoid another crisis but constant vigilance and early preventative action is critical.

This Report along with the oral testimony and documents submitted are the Joint Committee's primary legacy. However there is another part to that legacy. As the first Committee to carry out an inquiry under the 2013 Act, we have road-tested the legislation and set out the framework for future parliamentary inquiries. The lessons we have learned from running this inquiry will serve future committees and we have made a number of recommendations in Volume 2 for changes to the legislation and for the running of future inquiries.

This is also the first time that documents relevant to all elements of the crisis have been collated and examined in one place at one time. In Volume 3, the Joint Committee has published all of the documentary evidence considered in preparing this Report. It is a permanent repository, which will be a public resource into the future long after the Inquiry has completed its work.

The Irish people voted in 2011 to retain the current Constitutional arrangements as they relate to Parliamentary Inquiries and it is important to acknowledge these constraints. The Banking Inquiry has proved that our public representatives have the ability to play a valuable inquisitorial role while respecting the judicial process. Our work has demonstrated that the Houses of the Oireachtas can hold a fair and impartial public inquiry. The Inquiry has been held in an open and transparent manner with proceedings broadcast on the internet, on television and radio, for all to see and hear. It has portrayed our National Parliament in a positive light with members from all parties and political affiliations working together on behalf of the Irish people.

I thank the members of the Joint Committee for their hard work and commitment throughout the Inquiry. The determination of all the members of the Inquiry to complete the task put before the committee is, I believe, unique in Irish political life. Despite varying party political affiliations all members participated fully and worked together in order to deliver the best report possible within the constraints of the Act and on time. However, although Deputies Pearse Doherty and Joe Higgins continued to remain as members of the Joint Committee, they were, in the end, unable to support the final report.

Committee members are the visible side of the Inquiry. Enormous credit is due to the staff of the Inquiry and to members' staff for their hard work and dedication to making the Inquiry a success. They are exemplars of public service.

The Joint Committee would also like to acknowledge and welcome the co-operation we received from institutional participants and individual witnesses through their attendance at public hearings, preparation of written statements and provision of documents to the Inquiry. However, co-operation was not evident across the board and the Joint Committee is critical of the failure of the ECB in particular to co-operate with the Inquiry, while acknowledging that there was no legal obligation on it to do so. This is dealt with in greater detail in Volume 2 of this report. The stance of the ECB stands in stark contrast to the full co-operation and engagement offered by both the European Commission and the IMF.

Finally, it was a privilege to serve on this Committee. It was an opportunity to shine a light on a dark and difficult time in our recent past, an opportunity to piece together the events of that time, an opportunity to learn from the mistakes that were made and an opportunity to ensure that those mistakes are never repeated.

Ultimately, the Irish people will be the judges of our work and will make their own assessment of the crisis, through what they have seen and heard already in public hearings, and through their reading of this Report.

I trust that the Joint Committee's work will be seen to have earned the respect of the Irish people and that the conduct of this Inquiry will serve as an example for future Parliamentary Inquiries.

Ciarán Lynch

Ciarán Lynch, T.D,

January 2016

Findings and Recommendations

Chapter 1: Banks

Findings of the Joint Committee

1. Bank lending had traditionally been funded from customer deposits, but the banks became over reliant on the wholesale markets in borrowing short term to lend long term. This made banks more vulnerable to a liquidity risk which was not recognised.
2. The arrival of foreign banks into the Irish market increased competition for Irish banks in the late 1990s. New and more aggressive lending products and practices in the commercial real estate and residential mortgage sectors changed the competitive environment in a marked and decisive way.
3. The introduction of new and aggressive lending arising from increased competition in the period leading up to the crisis ultimately adversely affected the customer.
4. The introduction of new mortgage products masked the accumulating difficulty of the year on year increases in house prices, while facilitating a situation whereby affordability could be met in purchasing the mortgage product.
5. When the crisis struck in 2008, banks had already moved very far from prudent lending principles in their dealings with the property development sector in favour of a riskier asset value based lending model.
6. Exposures resulting from poor commercial property related lending not only threatened the business and viability of the individual financial institutions but also the financial system itself.
7. Commercial real estate lending was concentrated among a small number of debtors and in many cases lending was inadequately secured by paper equity and personal guarantees. In addition the practice of interest roll-up further exacerbated risk.
8. There was a culture of excessive executive remuneration in the banks.
9. Bank failure, which required the intervention and support of the sovereign, was the responsibility of senior executive management and the boards of directors.
10. No one single event or decision led to the failure of the banks in the lead in period to the Crisis, but rather it was the cumulative result of a series of events and decisions over a number of years.
11. Internal Audit is a key line of defence in a bank, whose role and function was not fully utilised by the banks in some key risk areas.
12. The introduction by the banks of tracker mortgages to the Irish market was based on a false presumption by banks of the stability of available funding at or near the ECB rate.
13. The reliance on moral suasion and protracted correspondence by the Financial Regulator set the culture in which banks in practice operated.

Recommendations of the Joint Committee

1. The Competition and Consumer Protection Commission should conduct an immediate review of the impact on consumers, due to the perceived lack of competition in banking in Ireland.
2. A full review should take place of section 33Ak of the Central Bank Act 1942, to ensure that only documents deemed 'secret' which are independently reviewed by a High Court judge are withheld from any future Oireachtas inquiry.
3. All members of bank boards should have requisite financial skill sets and experience and should undergo ongoing compulsory Continuing Professional Development (CPD) appropriate to banking, to include risk and governance.
4. A personal remuneration clawback provision linked to medium term performance should be part of the employment contract for senior executive management and board members.
5. A fit for purpose standard certification for Management Information Systems (MIS) in banks should be required annually and conducted by an independent party to a standard set by the Financial Regulator.
6. Governance structures in banks must ensure that the risk function has an independent, senior position in the management structure with direct access to the chairman and board.
7. Risk appetite in banks should be clearly defined at board level and should be the key driver for defining overall strategy.
8. A full risk assessment of new bank products on both the lending and deposit side should be carried out by the risk function and approved by the full board, prior to being introduced to the market.
9. The risk of a mismatch between liabilities and assets in terms of composition, stability, currency and tenure should be reviewed regularly at full board level.
10. Regular reviews of the internal audit function in banks should be strengthened to ensure that it conforms to best practice. A particular objective of such reviews should be to ensure that the internal audit focuses on the areas of highest business risk, including loan concentration levels, capital and liquidity risks, and the management of the organisation.

Chapter 2: The Role of External Auditors

Findings of the Joint Committee

1. In the 9 years up to the Troika Programme bailout, KPMG, EY and PwC not only dominated the audits of Ireland's financial institutions, but they audited particular banks for extended, unbroken periods. During the same period, Deloitte audited the accounts of Ulster Bank.
2. It was open to the banks to make voluntary disclosures of potential future provisions for loan losses, which was not required under IAS 39.
3. IAS 39 delayed the recognition of loan loss provisions when the downturn came.

Recommendations of the Joint Committee

1. The European Commission's recommendations on audit changes for banking, which include: mandatory audit rotation of audit firms (originally a maximum engagement period of 6 years with some exceptions was proposed but this was subsequently increased to 10 years), compulsory tendering for audit services, prohibition on audit firms providing non-audit services and European supervision of the audit sector should be implemented.
2. The capacity for direct reporting of critical business risk to the regulatory authority by an external auditor of banks should be strengthened.
3. Financial institutions should be obliged to obtain an independent audit of their regulatory returns. The external audit function would be strengthened significantly by such an independent audit, bringing it into line with practice in insurance companies. An independent audit should highlight any inconsistencies between the annual audited Financial Statements and the regulatory returns submitted during the year.

Chapter 3: The Property Sector

Findings of the Joint Committee

1. In the lead up to the crisis, many developers had become heavily reliant on bank debt to fund their developments. In many cases, developers adopted a business model in which a bank would bear all of the risk of a transaction, either through 100% financing or using so-called 'paper equity' to fund any element of developer's equity.
2. Property or land valuations were not carried out in all cases, even in the case of some large developments. As the property boom took hold, reliance on informal 'desktop' and 'drive-by' valuations, which did not involve any physical inspection of a property, became more prevalent. However, a number of developers gave evidence that they continued to rely upon professional valuations.
3. Relationship banking, where some developers built strong relationships with particular banks, was a part of the Irish banking system. In some cases, both parties became business partners in a joint venture.
4. Revenue from the property sector was a significant source of income for some media outlets, accounting for as much as 14% or 17% of all revenue for some newspapers. Editors denied that editorial independence was affected by their advertising relationship with the property sector.

Recommendation of the Joint Committee

1. A detailed and comprehensive commercial property price register should be introduced.

Chapter 4: State Institutions

Findings of the Joint Committee

1. The *'soft landing'* theory was cited frequently as the most likely outcome to the property boom from as early as 2000. No evidence was provided that this expectation was tested, let alone validated, through robust analysis or research. The failure to take action to slow house price and credit growth must be attributed, at least in part, to this shortcoming.
2. The Financial Regulator had sufficient powers to deliver their prudential supervision of the banking sector in a more intrusive manner through, for example, imposing conditions on banking licences, revoking a licence, suspension of banking business and (after late 2005) administrative sanctions for breaches, including lending limits.
3. While the recommendation of the European Commission to ECOFIN in 2001 to censure the Irish Government for their proposed fiscal strategy was withdrawn, this early warning about pro-cyclical fiscal strategy was a missed opportunity as the underlying message remained valid in the following years.
4. The Central Bank had sufficient powers to intervene in the banking sector to manage both the risk posed to the financial stability of the State by individual financial institutions and the banking sector as a whole, through the regulation of key ratios, the composition of assets and liabilities and the issue of guidance to the Financial Regulator that it was required to implement.
5. The Central Bank and Financial Regulator could have required banks to hold additional capital to absorb losses that could arise in the event of a financial crisis.
6. The new CBFSAI organisation created in 2003 was unnecessarily complex and led to a real or perceived ambiguity in the respective roles of the Central Bank and Financial Regulator. Once the new structure, which represented a material change in the delivery of financial supervision in Ireland, was in place, the Government should have carried out an independent review and assessment of its effectiveness and the delivery of its functions. However, it was the execution by the CBFSAI of their mandate and the absence of interventions that directly contributed to the Crisis.
7. The Financial Stability Reports monitored and provided analysis of the key risks to the financial system and financial stability. The reports did identify key risks. However, the overall assessment and tone of the reports were too reassuring and did not identify or warn of the systemic and macro prudential risks in the banking sector as well as the structural imbalances in the Irish economy despite specific, escalating and repeating risks.
8. The Central Bank and Financial Regulator were aware as early as 2003 that the Irish banking sector was placing increasing reliance on lending to the property sector, and that different lending practices were being adopted. Neither the Central Bank (at a macroprudential level) nor the Financial Regulator (at a microprudential level) intervened decisively at the time or in the years prior to the crisis.

9. Breaches of prudential limits and requirements, as well as other prudential weaknesses were identified by the Financial Regulator. However, they relied on moral suasion and protracted correspondence, (sometimes for as long as a decade) rather than an escalation in the level of formal enforcement action. In the years 2000 – 2008, there was no enforcement action taken against any institution for prudential breaches. This reflected an aspect of regulatory capture.
10. In the years leading up to the crisis, the Financial Regulator did not identify the systemic risk that was building up in the banking sector, did not identify the emerging risk to the financial stability of the overall system and, therefore, did not escalate these issues to the Central Bank. There was poor assessment by the Central Bank of the build up of micro prudential systemic risk and they continued to believe and report that the banks and overall sector could withstand and manage the building risks in the system.
11. Banks in Ireland were allowed, through the inaction of the Financial Regulator, to breach sectoral lending limits on property, without fear of any consequence. The Financial Regulator could have used its powers to enforce those limits. In doing so, it may have controlled the scale of lending to the property and construction sector. This could potentially have reduced the impact of the eventual fall in asset values.
12. The Department of Finance relied on the Central Bank Financial Stability Reports as the basis for assessing risks or threats arising from the banks. The Department relied on the overall assessment in the reports rather than responding to the specific risks identified in the reports. The Department did not carry out adequate independent analysis of the risks.
13. The Department of Finance was too reliant on external agencies such as the IMF, OECD and European Commission (who all in turn relied, to some extent, on information sourced from the Department of Finance and Central Bank) for economic forecasting and did not do sufficient analysis to successfully challenge or form an independent review on some of the key risks identified in these reports. This included, in some instances, editing and reducing the risks highlighted in the international reports and in speaking notes for the Minister.
14. The International organisations (European Commission, IMF and OECD) and ESRI assumed that the high output levels of the Irish economy and the related boom in tax revenues were permanent structural features. They relied too much on Ireland's compliance with the limits set out in the Stability and Growth Pact in assessing the true fiscal position of the Irish State before the fiscal and banking crisis emerged. The risk identification, while highlighting some key risks, was insufficient and too positive in overall assessment and conclusion.
15. The Joint Committee found that the CBFSAI stress tests of the banks in 2006 were inadequate. The model used in conjunction with the IMF for the stress tests as well as the scenarios tested did not reflect the emerging risks.

Recommendations of the Joint Committee

1. The membership of the Board of the Central Bank, appointed by Government, must include sufficient expertise and relevant direct experience in financial stability and prudential regulation.
2. While final decisions are matters for Government and often urgent, a formal process with clear procedures should be established (through legislation) in situations where there are conflicts between the advice provided by the Department of Finance on matters where exceptional risks are involved and the decision proposed by the Minister.
3. The Joint Oireachtas Committee on Finance, Public Expenditure and Reform, should be tasked with bringing forward proposals to ensure the Oireachtas can apply adequate oversight to the budgetary process, and to hold the Executive to account.
4. An Independent Budgetary Office, possibly as part of the Irish Fiscal Advisory Council, to provide independent costings of budgetary and pre-election proposals of political parties and members of the Oireachtas, should be established.
5. The Enforcement Division of the Central Bank should attend before the Joint Oireachtas Committee on Finance, Public Expenditure and Reform, on at least an annual basis, to give an account of the enforcement activity undertaken and advise of any further legislation or powers required to address emerging risks. The Enforcement Division should also report to the Committee on whether sectoral lending limits have been breached by any institution during the period, and if so, to summarise what actions have been taken to address these breaches.
6. The exemptions specified in the Freedom of Information Act 2014 should be reviewed by the Minister for Public Expenditure and Reform with a view to increasing public access to advice provided by civil servants and special advisors.
7. The banking division in the Department of Finance should be periodically subjected to a performance review by an independent third party to ensure fiscal, capital market, and banking expertise is adequate to challenge information and assumptions provided to it by the Central Bank of Ireland.
8. Clear guidelines should be developed on best practice on the recording, minuting and documentation management of meetings in the civil service. Monitoring of compliance with best practice should be the responsibility of the Information Commissioner.

Chapter 5: Government Policy and the Oireachtas

Findings of the Joint Committee

1. Taxation policy choices made by the Government contributed to the development of a Structural Deficit. The Structural Deficit which had been building in the years leading up to the crisis, had not been fully recognised until the crisis hit. Taxation policy reduced direct taxes (such as, income tax) and prompted the transfer of fiscal revenue sources to pro-cyclical taxes – this led to a vulnerable fiscal balance in the event of an economic downturn.

2. The Government's fiscal policy resulted in significant, long-term expenditure commitments being made on the back of cyclical, transaction-based revenue streams that ultimately proved to be unsustainable.
3. The erosion of the income tax base in the years leading up to the crisis did not give rise to sufficient concern at Government level at the time, primarily for two reasons:
    i. the significant increases in transaction taxes, such as stamp duty and capital gains tax, which compensated for the declining share of income tax as a proportion of total tax revenue.
    ii. the absolute increase in income tax revenue from approximately €4 billion in 1990 to €15 billion in 2007.
4. Fiscal policy after 2001 was not focused on mitigating and managing the property price increases. If steps had been taken, for example through reducing or abolishing property tax incentives, as originally planned from 2002 to 2004, the severe overheating from 2003 to 2007 could have been mitigated, at least to some degree. Tax incentives were introduced and extended without sufficient analysis of the costs, benefits and impacts. They fuelled an already strong construction industry during most years from the mid-1990s up to and including 2006.
5. The Budget Strategy Memorandum produced by the Department of Finance each June, and signed off and brought to Cabinet by the Minister for Finance, was exceeded, with the exception of one year, by the actual Budget package introduced by the Minister on Budget day. This Budget Strategy Memorandum did, in varying terms, frequently highlight the risks of pro-cyclical fiscal policy but this was not generally reflected in the Budget package agreed by Government. No evidence was provided that the Department of Finance cautioned on the ultimate fiscal impacts of the property downturn.
6. The oversight, challenge and effective scrutiny by the Oireachtas of the Government and its policy decisions in relation to fiscal policy, financial stability and the system of financial regulation was inadequate in the pre-crisis years.
7. The Constitution allows significant decision-making powers by Cabinet to make far-reaching decisions without any prior engagement with the Oireachtas. Members of the Oireachtas, including the Opposition are constrained, with the added issue of limited resources, in their ability to influence the decision-making process.
8. Government, including individual Ministers, made policy decisions, based on a range of considerations, including having regard to, but not always accepting the advice of the Department of Finance, Central Bank and International organisations, and ultimately accepted overall responsibility for decisions made.
9. All the main political parties, whether in opposition or in government, advocated pro-cyclical fiscal policies, including increasing expenditure and reducing taxation, in the years leading up to the crisis, as evidenced by their election manifestos in the 2002 general election and, especially, the 2007 general election.

Recommendations of the Joint Committee

1. Acceptable bands should be agreed with regard to the proportion of total State taxation revenue accounted for by defined cyclical, transaction-based taxes, including triggers for follow-up action when these limits are breached.
2. Members of Oireachtas committees should receive appropriate training and support in technical content, if they do not already possess the required skill set.
3. The Houses of the Oireachtas Commission should carry out a detailed analysis of the resources allocated to support Oireachtas Committees, and of its potential impact on the capacity of Committees, to carry out effective oversight.
4. The Public Service Oversight and Petitions Committee should review the most recent relevant reviews undertaken of the Irish parliamentary system and identify, along with an implementation plan, the key reforms necessary to improve accountability and oversight.

Chapter 6: Preparation for the Crisis: July 2007-29 September 2008

Findings of the Joint Committee

1. The Minister for Finance, Brian Cowen, confirmed that he saw the 'Financial Stability Issues' paper prepared by the Department of Finance in January 2008.
2. In February 2008, in a follow-up to the January Financial Stability Issues Paper, a Department of Finance presentation warned that to 'provide an open-ended legally binding state guarantee would expose the Exchequer to the risk of significant cost and should not be regarded as part of the tool kit'. The paper also stated that a State guarantee to underwrite a bank's solvency position could only be justified when the entire financial system was at risk of collapse.
3. In August 2007, the NTMA decided to stop placing deposits with any Irish bank. The Joint Committee further found that the NTMA was legally obliged by a Minister for Finance direction of 19 December 2007, to place deposits with AIB, BOI, IL&P and EBS. Two days later it was directed to place deposits in Anglo. In August 2008, further letters of instruction were issued by the Minister for Finance in this regard. The Joint Committee found that NTMA had €790 million of deposits in Irish banks.
4. The Joint Committee found that a joint approach was made to the banks in March 2008 by the Central Bank and the Financial Regulator to seek 'liquidity support' from some banks for others. It remains unclear if this approach was ever communicated to Government. It is also unclear if the approach failed because one bank asked for some form of government guarantee if it were to participate.
5. No independent in-depth 'deep dive' investigation of the banks had been commissioned by the authorities before September 2008.
6. Despite the work of the Domestic Standing Group in the period from July 2007 to July 2008, crisis management preparations never advanced to a level capable of dealing with a major bank crisis.

7. Bank nationalisation legislation had been drafted prior to the night of the guarantee. Bank resolution legislation which would have allowed for the winding up of a financial institution and which could have allowed for another legislative option had been discussed by the relevant authorities in July 2008. However such legislation had not been requested from the Attorney General or the Office of the Attorney General.
8. Legislation for a blanket bank guarantee was available on 30 September 2008.

Recommendation of the Joint Committee

1. Legislation governing the powers of the Minister for Finance relating to directions to the NTMA should be reviewed.

Chapter 7: The Guarantee

Findings of the Joint Committee

1. The option of guaranteeing the banks did not arise for the first time on the night of the guarantee meeting on 29 September 2008. The option of introducing a guarantee was first formally noted in January 2008, again in February 2008 and again in June 2008.
2. A draft press release announcing a six-month bank guarantee had been prepared by the Central Bank prior to 21:10 on the night of the guarantee. The draft release only covered deposits and interbank lending.
3. The Department of the Taoiseach did not keep minutes of the meetings on the night of the guarantee and was unable to provide any drafts of the proposed guarantee as it evolved.
4. The word 'solvent' as it pertained to the status of the covered banks was removed from the final official Government statement, announcing the guarantee.
5. Bank executives from AIB and BOI when leaving Government buildings on the night of 29 September 2008 had differing views on whether the Government was going to proceed to guarantee 4 or 6 banks.
6. Conflicting evidence was provided as to whether representatives from BOI and AIB did provide their own written guarantee proposals to the meetings on the night of the guarantee.
7. In the absence of a bank guarantee, the Central Bank had put in place sufficient measures to ensure that all banks would have opened on the 30 September 2008, and no default of any bank would have taken place that day. However, the Joint Committee found that it was the strong view of the Governor that a guarantee was necessary.
8. The information available to decision-makers on the night of the guarantee about the underlying health of the Banks was inadequate.
9. Prior to the meeting it was made clear by ECB authorities that there was no Eurozone wide initiative coming and the Sovereign was to ensure that no bank was to fail.
10. The Government was advised by the Central Bank and Financial Regulator that all 6 banks were solvent on the night of the guarantee.

Chapter 8: Post-Guarantee Developments

Findings of the Joint Committee

1. One consequence of the crisis and the ensuing bank restructuring efforts was the almost total cessation of new lending for businesses over the period 2009 to 2013.
2. The reasons that PwC's Project Atlas Report (September/October 2008) did not reveal the true extent of the capital requirements of the banks were:
    - the wider assumptions for the economy, taken from official forecasts and on which the work was based, did not materialise,
    - there was insufficient time for loan reviews given the fragility of the banking system,
    - the analysis was based on the management accounts of the relevant banks and not an independent verification of the loan books.
3. In October 2008 BOI had internal discussions about the bank's possible need for a capital injection by the State as one of a number of options reviewed by the bank at that time.

Chapter 9: Establishment, Operation and Effectiveness of NAMA

Findings of the Joint Committee

1. The acquisition of all loans, good and bad, gave NAMA full control to make decisions on the basis of a borrower's overall exposure to multiple lenders. However, the acquisition of good loans, as well as the bad, was not well received by all borrowers.
2. The review of NAMA's effectiveness was limited by the fact that only events up to December 2013 could be examined by the Joint Committee. Furthermore, it will not be possible to fully assess NAMA's performance and effectiveness until an evaluation based on medium-term property price movements is carried out.

Recommendation of the Joint Committee

1. The operation and effectiveness of NAMA should continue to be reviewed, in particular when medium term property price movements can be taken into account. When NAMA completes its work, it should be the subject of a further comprehensive and final review.

Chapter 10: Ireland and the Troika Programme

Findings of the Joint Committee

1. The Irish authorities were in discussions from September 2010 with the individual Troika partners prior to a government decision to enter into formal negotiations on a Troika programme.
2. The letter from the ECB to Minister Brian Lenihan on 19 November 2010 threatened that it would not continue to provide ELA support for Irish banks if Ireland did not enter into a bailout programme.
3. The Deauville Declaration pushed up Irish bond yields, reducing the possibility of Ireland's re-entry to sovereign bond markets at the time.

4. The National Recovery Plan was the basis for agreement between the Irish Government and the Troika.
5. By October of 2010 Ireland's entry into a bailout programme was inevitable, but the timing of the entry into the programme was determined by factors outside of the Government's control.
6. The possibility that Ireland might need external assistance from the IMF at some point in managing the economic crisis, was first considered in September 2008 by Second Secretary of the Department of Finance, Kevin Cardiff.

Chapter 11: Burden Sharing

Findings of the Joint Committee

1. IMF mission staff favoured imposing losses on senior bond holders in October/November 2010 as part of Ireland's negotiations for a Troika Programme. That position was also held by the Irish Government.
2. The Attorney General explored the possibility of burden sharing with senior bondholders with legal assistance from the IMF in November 2010.
3. There would have been no Troika Programme agreed in November 2010 if the Government proceeded with the imposition of losses on senior bondholders.
4. In March 2011, the NTMA prepared a report for the Department of Finance which suggested that a scheme of burden sharing with junior and senior bondholders be introduced.
5. The withdrawal of ELA was used as an explicit threat to prevent the Government from imposing losses on senior bondholders in March 2011.
6. The ECB position in November 2010 and March 2011 on imposing losses on senior bondholders, contributed to the inappropriate placing of significant banking debts on the Irish citizen.

Recommendation of the Joint Committee

1. The Irish Government should seek to have the relevant European statutes examined and if necessary amended to allow the ECB to participate in parliamentary inquiries.

Chapter 1: The Banks

Introduction

Irish banks had been national businesses for decades, set up to serve local and national enterprises. However, by the mid to late 1990s, the bigger banks were establishing an international presence; AIB bought into Bank Zachodni in Poland and Bank of Ireland bought Bristol and West in the UK. As Ireland's economy began to grow, National Australia Bank entered into the retail market. The International Financial Services Centre (IFSC) opened in Dublin which also provided a location for the emerging global non-retail financial business.

Klaus Regling & Max Watson said in 'A Preliminary Report on The Sources of Ireland's Banking Crisis':

"From the late 1990s onwards, the world economy was characterised by relatively high growth, low headline inflation, strong liquidity creation, and low interest rates. The literature has named this period 'The Great Moderation,' which can be explained by the positive effects of globalisation, technological progress and productivity increases, and the stronger credibility of most central banks around the world, which had become independent from political interference, facilitating a stabilisation of inflation expectations."[1]

Ireland's profile in world banking and world financial services expanded rapidly and, by the early 2000s, was well established.

Cheap Money, the Euro and China

Throughout the early 2000s, trade between the US and China grew, resulting in a surplus in favour of China. The Chinese Government recycled much of the new and surplus money back into the US by investing in US treasuries (Government bonds). In turn, the US Federal Reserve (Central Bank) invested the bond monies in US banks and insurance companies for a higher return. A high-risk loop of mutual inter-dependencies stretching from Chinese investors to US householders had formed, with every party in the loop hoping to profit.

David Duffy, Chief Executive Officer, AIB, said:

"… It's a once in a generation circumstance where the availability of a huge amount of liquidity including retail bank liquidity which wasn't available before in the sense that it was made available as well as geopolitical events where China, in order to grow, was very much a supporter of a cheap cost of capital through its purchasing of US debt despite the overall levels of debt. …the US consumer became very heavily indebted and that was a contributor to the property boom."[2]

The creation of the Euro and the growth of the Chinese economy both affected the world economy. Professor Philip Lane, Professor of International Macroeconomics and Director of the Institute of International Integration Studies in Trinity College Dublin, explained some of the international background:

"China was growing so quickly that it was important in the late 1990s, but by the mid-2000s it was

1 Klaus Regling & Max Watson, A Preliminary Report on The Sources of Ireland's Banking Crisis, PUB00168-011.

2 David Duffy, former Chief Executive Officer, AIB, transcript, INQ00134-029.

very important. That had trading effects, although maybe less so here. For example, the economies of Portugal, Greece, Italy and so on were quite affected by the rise of cheap imports from China. Financially, the surpluses coming out of China were essentially flowing into the US financial system. Low interest rates in the US prompted, for example, the rise of securitisation in US financial markets and European banks were active in the US system. Therefore, there was a deep connection between what was going on in the US in the mid-2000s and what was going on in Europe. A lot of that was being intermediated through banks. European banks were important in linking the US financial system to the European financial system."[3]

David Duffy also said in his evidence to the Joint Committee:

"That cheap money was allowing every market to chase property and when it collapsed in the sub-prime and then was further influenced by allowing banks to go bankrupt in the US, there were many more banks were very close to going bankrupt. So the extraordinary measures of the US Government at the time, both negative and positive, if you put all of those together, it is an exceptional period of time. Ireland's problem was that we were very badly positioned to react to that given our concentration."[4]

From around 2003, the Irish started to invest a very high proportion of national income and personal income in property.[5] This was enabled by the ready availability of cheap money on the wholesale money markets.

Brendan McDonagh, CEO of NAMA said:

"I think, when you look at the … again, at the growth in the balance sheets of the banks between 2003 and 2008 … the banks were lending, but they were effectively lending to a longer-term asset class, which was property, but they were funded by short-term cheap, wholesale money market deposits. So, they were borrowing at, you know, one month, three month, six months at around 2% … a lot of it, you know, German money coming into Ireland, looking for a home. And, you know, once the crisis happened, all those depositors withdrew, took their money back and the banks were left long on assets but short on cash."[6]

Global Driver: Europe and the Euro

A number of factors within the single currency context contributed to the liquidity crunch preceding the economic crash of 2008, principally:

1. EU monetary union and control of monetary policy
2. Design faults of the Euro
3. Foreign exchange risk eliminated
4. Interest rate harmonisation

3 Philip Lane, Professor of International Macroeconomics and Director of the Institute of International Integration Studies, Trinity College Dublin (Now Governor of the Central Bank of Ireland), transcript, CTX00059-003.

4 David Duffy, former Chief Executive Officer, AIB, transcript, INQ00134-029.

5 Massive increase in credit, The Irish financial assistance programme, John McCarthy, Chief Economist, Department of Finance, 15 May 2014, DOF07710-004.

6 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-061.

1. EU monetary union and control of monetary policy

The free movement of capital and its attendant benefits provided a critical rationale for the introduction of the euro. The EU's developed and expanding status bolstered available liquidity. European investors began to look favourably on Ireland, given its impressive economic performance throughout much of the 1990s and into the mid-2000s.[7] A major expansion in liquidity in Ireland was the result.

"…Prior to monetary union, Ireland and Spain had probably under-invested in housing as we had a higher cost of capital than in countries like Germany or France. Given the demographic profile, we needed to invest in housing. In permitting a more rapid adjustment to the housing stock, the lower cost of capital was beneficial. However, it was the failure to appropriately control this surge in investment which eventually proved fatal…"[8]

2. Design faults of the Euro

The Eurozone was an economic and monetary union that lacked a banking union. The Stability and Growth Pact continued only certain aspects of the convergence criteria, considering that others would be successfully addressed by the European System of Central Banks (ESCB) and European Central Bank (ECB). In the absence of the exchange rate and the domestic interest rate, the behaviour of the Irish economy was allowed to change in ways that would not have been previously possible due to external pressures placed on the punt as the real effective exchange rate deteriorated.

Professor John FitzGerald, Research Professor at the Economic and Social Research Institute (ESRI), told us:

"You do not have the interest rate tool to manage an economy or to manage inflation and, in particular, asset market bubbles. You have to use other instruments, that is, fiscal policy. It was something which we did not anticipate or talk about. It is clear from the literature before monetary union, people were barking up the wrong tree about the problems of monetary union, not just in Ireland but elsewhere that one needs to use fiscal policy to manage housing market bubbles."[9]

In the absence of a banking union, where free capital flows were facilitated by the new currency system, Ireland needed to modify its approach to policy formation in the fiscal and monetary spaces. The gaps between the convergence criteria and entry into the Eurozone on 1 January 1999 were sizeable refer to following table. The reference criteria were:

- Inflation no more than 1.5 percentage points above the average of the three countries with the lowest rates.
- Long term interest rates no more than 2 percentage points above the average of the three countries with the lowest rates.
- Exchange rate – within normal band of the Exchange Rate Mechanism for previous two years.
- National budget deficit less than 3% GDP.
- National debt less than 60% of GDP – or heading in the right direction.

7 OECD Report 2006, PUB00161-009/022/023.
8 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-003/004.
9 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-032.

The criteria of an optimal currency area highlights the importance of consolidated fiscal policy across members of the currency zone and the importance of fiscal transfers, as well as labour mobility. These facts were present but considered of the utmost importance in the Irish context. The Irish approach to fiscal policy was coloured by the experience of the 1980s and the fiscal consolidation that took place as part of the protracted recession, and Ireland's labour market was nearing full employment at the time. According to John FitzGerald:

"…there was a need to use fiscal policy in a different way. In terms of the economics literature, the use of fiscal policy to manage the cycle had gone out of fashion, as the Senator is probably aware, saying fine tuning is not possible. This is not fine tuning, this is stopping disaster by using fiscal policy differently. Hopefully we have learned our lesson."[10]

Historical compliance with the Maastricht criteria

	Inflation (%)	Long-term interest rates (%)	Deficit ratio (%)	Debt/GDP (%)	ERM two-year membership
Austria	1.1	5.6	2.5	66.1	yes
Belgium	1.4	5.7	2.1	122.2	yes
Denmark	1.9	6.2	-0.7	65.1	yes
Finland	1.3	5.9	0.9	55.8	no
France	1.2	5.5	3.0	58.0	yes
Germany	1.4	5.6	2.7	61.3	yes
Greece	5.2	9.8	4.0	108.7	no
Ireland	1.2	6.2	-0.9	66.3	yes
Italy	1.8	6.7	2.7	121.6	no
Luxembourg	1.4	5.6	-1.7	6.7	yes
Netherlands	1.8	5.5	1.4	72.1	yes
Portugal	1.8	6.2	2.5	62.0	yes
Spain	1.8	6.3	2.6	68.8	yes
Sweden	1.9	6.5	0.8	76.6	no
United Kingdom	1.8	7.0	1.9	53.4	no
1998 reference values	2.7	7.8	3.0	60.0	
Greece (2000)	2.0	6.4	1.6	104.4	yes
2000 reference values	2.4	7.2	3.0	60.0	
Source: European Commission Convergence Reports, 1998 and 2000					

Source: Centre for Economic Policy Research.[11]

10 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-032/33.

11 Centre for Economic Policy Research: Nice Try: Should the Treaty of Nice be Ratified, Table 6.2, PUB00437.

3. Foreign exchange risk eliminated

The introduction of the Euro eliminated foreign exchange currency risk across the majority of EU Member States. That provided a platform for access to cheap liquidity by financial institutions from large client deposit bases in different countries. It also helped foster a perception outside the EU that the risks of euro Member States were pegged to that of the best performers, notably Germany with its AAA status. Thus, for certain types of investors, a 10 year Irish bond paying annual interest of 2% was more attractive than a 10 year German bond paying annual interest of 1%. In such a scenario, the short-term gain and risk would trump the longer-term gain and risk, even though the scale, structure, markets and risks of the Irish and German economies were vastly different.

As was stated in the Nyberg Report:

"…The Irish economy and Irish financial institutions were, furthermore, exposed to the expansionary financial incentives associated with membership of the Euro area. The disappearance of exchange risk and the absence of euro-wide inflationary pressures caused a significant reduction in interest rates, compared to the Irish Punt historic rates, while there was virtually unfettered access to funding from European and other capital markets (Figure 1.2). At the same time competition increased via new non-Irish entrants into domestic financial markets…"[12]

The EU financial institutions used the new Euro denominated liquidity to invest in bond offerings from the Irish financial institutions for an incremental return. The Irish institutions lent to developers who in turn invested in property and construction, seeking to obtain an even higher return. Some investors formed syndicates (group of borrowers pooling monies together) to invest in tax designated and non-tax designated property-related ventures. Householders, along with investors, also borrowed monies to purchase housing and second properties.

Brendan McDonagh said:

"…While some of the lending was to professional, well-managed entities, much of it was to individuals or syndicates whose primary business was not property developments, or who became involved in property developments relatively late in the cycle"[13] *and went on to say "They were new arrivals, a lot of the professional class. A lot of the professional class got into syndicates, particularly to buy land, and particularly to buy land mainly in … a lot of it in regional Ireland…"*[14]

4. Interest rate harmonisation

Under European Monetary Union (EMU), the ECB sets interest rates to meet the needs of the Eurozone economy as a whole. This resulted in an interest rate which, for many years in the run-up to the crisis, was set at a level which was too low for Ireland. That resulted in a low or, at times, negative real interest rate for Ireland, further aggravating the boom. For countries experiencing low growth or recession, the opposite effect occurred.[15]

12 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-019.

13 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-011.

14 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-035.

15 European Commission, Economic Papers 491, Design Failures in the Eurozone, Paul de Grauwe, April 2013, PUB00389-009.

David Doyle, former Secretary General, Department of Finance, said:

"…Prior to the establishment of the ECB the Irish Central Bank was fully responsible for monetary policy and financial stability and regulation. It set interest rates at a level that were appropriate to the specific conditions of the Irish Economy. It lost this authority following the entry into the Euro. The ECB did not appear to regard the question of curbing asset prices or excessive credit growth through the interest rate mechanism as appropriate, viewing this as a matter for the domestic central banks and regulators…"[16]

Bertie Ahern, former Taoiseach, said:

"…We were … able gradually to remove incentives from the property market but membership of the euro meant that we were unable to raise interest rates. Accordingly… according to the IMF report in the summer of 2009, the housing boom was caused mainly by cheap credit due to low interest rates, along with rising incomes and a strong demand for housing…"[17]

An IMF Staff Report contained the following:

"The boom years stored up immense problems. Following a decade of export- and FDI (foreign direct investment) led growth supported by broad-based productivity gains, from about 2003 on the Irish economy embarked on a domestic boom underpinned by lax lending. Stiff competition for market share from foreign-owned as well as domestic banks pushed underwriting standards lower, and the feedback effect of rising collateral values fuelled the leveraging process. Rapidly rising property prices also drove high fixed investment in commercial and residential property, and a positive wealth effect fed private consumption, raising incomes and employment. Wages and prices rose, eroding competitiveness and compressing real interest rates. The integration of the Irish financial system into the broader euro area financial landscape, as well as the apparently strong fiscal position of the sovereign, gave Irish banks unfettered access to wholesale funding that turbocharged their asset expansion."[18]

Irish Financial Institutions

During the Context Phase of the public hearings, the Joint Committee heard evidence from Peter Nyberg, Rob Wright, Patrick Honohan and Klaus Regling, all of whom had completed reviews of the crisis. The key findings of these reports as they related to the banks were as follows:

- The Banking Crisis occurred because there was a malfunctioning of risk mitigating controls (Nyberg).[19]
- Domestic factors were decisive in causing the Crisis, facilitated by international factors (Nyberg).
- Banks engaged in overly risk –taking behaviour in which the authorities behaved passively (Nyberg).

16 David Doyle, former Secretary General, Department of Finance, statement, DDO00001-011.

17 Bertie Ahern, former Taoiseach, transcript, INQ00109-008.

18 IMF Staff Report for the 2012 Article IV Consultation, DOF00382-004.

19 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156.

- The enhanced wholesale funding available from the single currency *"turbo charged"* growth prospects for the Irish banks (Nyberg).
- There was a property bubble and unsustainable growth between 2002 and 2007 (Wright).[20]
- Ineffective micro-prudential regulation due to reliance on light touch regulation that trusted the banks (Honohan).[21]
- Even though the banks might have accepted subliminally that there were risks, they brushed those aside (Honohan).
- The stress tests in 2006 were not severe enough (Honohan).
- Commercial property lending was the biggest problem (Regling).[22]
- The huge concentration of some banks in commercial real estate should have sounded the alarm bells in advance of the crisis (Regling).
- Aggressive lending policy pervaded the banks at various grades, junior and senior (Regling).

The Joint Committee wanted to establish, through evidence given by bank executives and board members, the extent to which the findings outlined above were the reasons for the collapse of the banking industry in Ireland. In particular the Committee examined the following key areas:

- The scale of Wholesale Funding Growth
- Competition
- Commercial Property/Real Estate
- Residential Property
- Large Exposures/Cross-Bank Lending
- Interest Roll-Up
- Regulation of the Banks (covered in Chapter 4).

The Joint Committee then examined how these key issues were dealt with within the banks and focused on lending practices.

Scale of Wholesale Funding Growth

Bank lending had traditionally been funded from customer deposits. This was regarded as a stable means of funding banks since deposits generally stay with a bank. Some financial institutions were completely funded by deposits in the late 1990s.

The introduction of the single currency enabled Irish banks to access credit with a low interest rate from the wholesale markets. These markets are an important part of the funding mechanism of banks, but the Irish banks became increasingly dependent on such funding. The Loan to Deposit Ratio (LDR) of the Irish banks which reflects the ratio of the size of lending book to that of customer deposits began to increase. Where the LDR exceeded 100%, it became necessary to borrow from

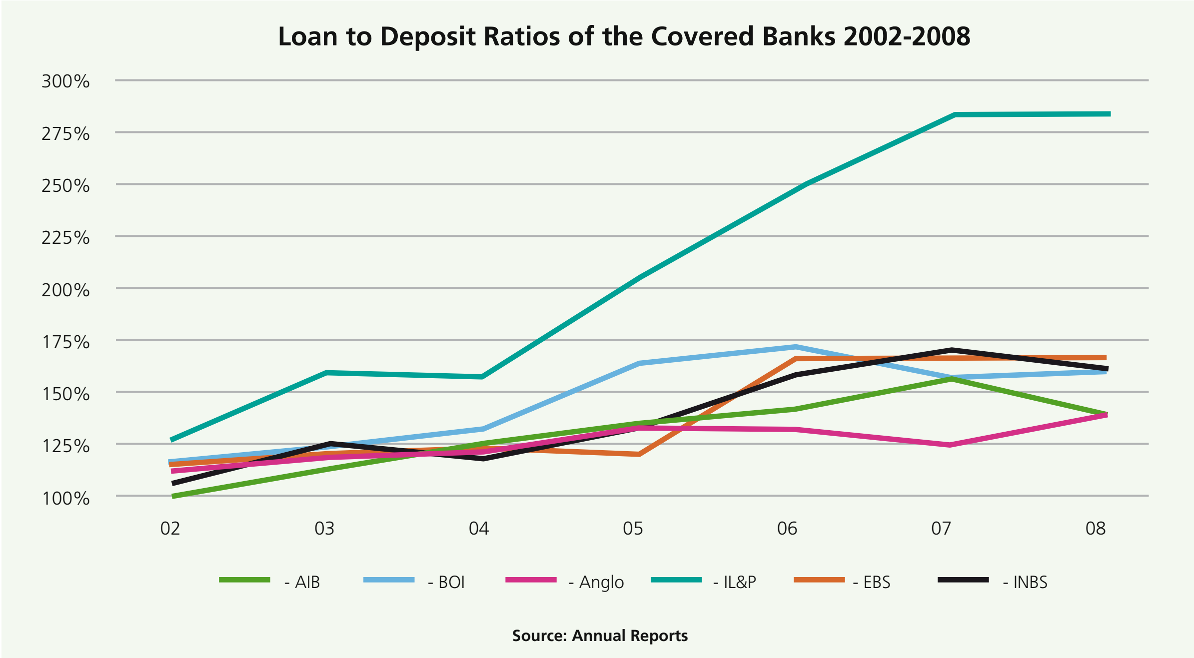
20 Strengthening the Capacity of the Department of Finance, Report of The Independent Review Panel, December 2010, PUB00175.

21 The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008: A Report to the Minister for Finance by the Governor of the Central Bank, PUB00075.

22 Klaus Regling & Max Watson, A Preliminary Report on The Sources of Ireland's Banking Crisis, PUB00168.

the wholesale money markets to fund lending. Some banks funded their lending primarily through issuing bonds, while others funded their lending primarily through a mixture of short-term deposits and bonds. The Joint Committee explored the growth of such funding with witnesses, and the effect or otherwise that the ability to borrow cheaply from the wholesale markets had on the Irish banking system.

The Loan to Deposit Ratios of the Covered Banks between 2002 and 2008 were set out in the Nyberg Report in the following graph:



Source: Nyberg Report.[23]

Access to substantial euro denominated liquidity enabled the Irish banks to finance the substantial growth of their loan books from 2002 to 2008 through the increase of debt securities and wholesale deposits. This altered the refinancing pattern of the banks dramatically from 2003 onwards. Customer deposits needed to be supplemented with additional wholesale borrowings to finance the strong credit growth.[24]

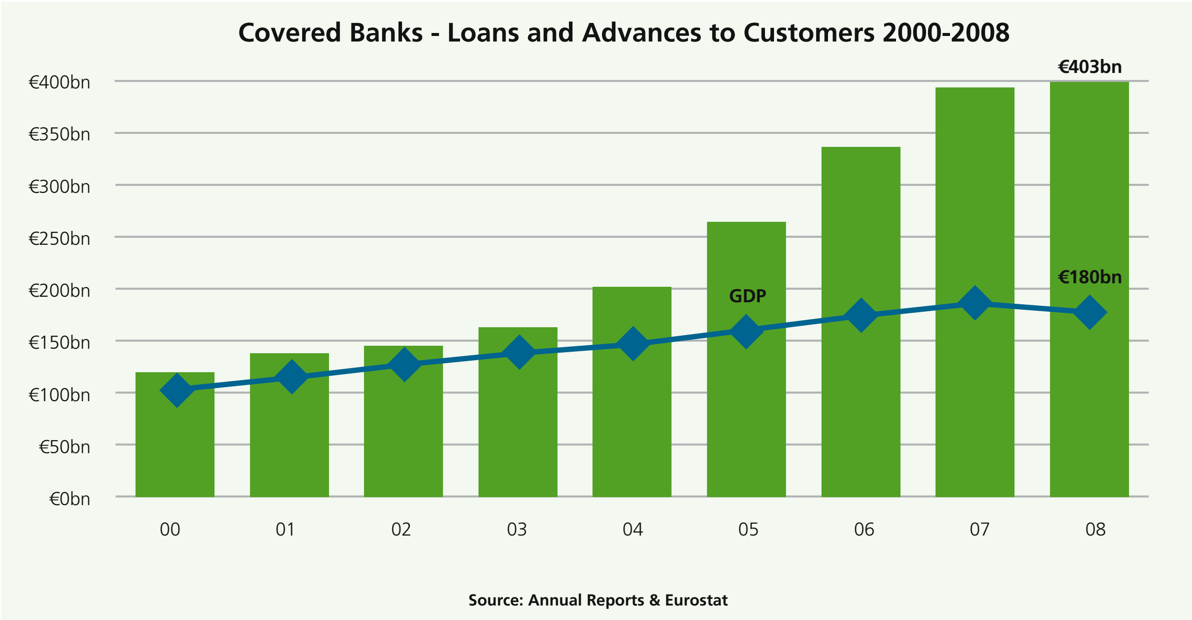
The Irish banks rapidly increased the size of their balance sheets in the years from 2000 to 2008.[25] Lending expanded by some 25% per annum, which was roughly twice the rate of growth in the Eurozone as a whole as shown in the following table.[26]

23 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, Figure 2.18, PUB00156-056.

24 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-054.

25 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-029.

26 OECD Report 2008, PUB00162-054.



Source: Nyberg Report[27]

However, as the financial institutions had insufficient deposits on their books to fund their balance sheet growth, they became increasingly reliant on short- and medium-term funding from the wholesale money markets to provide the liquidity they needed.

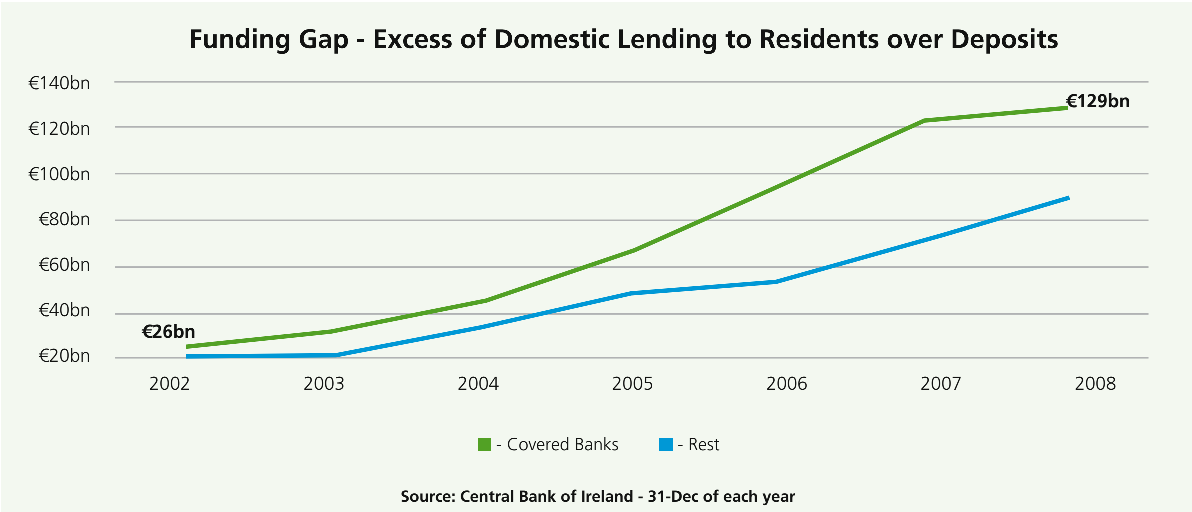
Access to wholesale funding enabled a ten-fold increase in the bond issuance activities of the main Irish banks between 2000 and 2008. Indeed, in the five years to mid-2008 the net foreign liabilities of the Irish banking sector increased from about 20% to about 70% of GDP, and wholesale funding rose to 55% of assets.[28]

Borrowings on the Irish financial institutions' balance sheets derived from wholesale sources grew from €26 billion to €129 billion,[29] between 2002 to 2008, as shown in the following table, at which stage Ireland had the highest Loan to Deposit Ratio in the European Union.

27 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, Figure 2.1, PUB00156-029.

28 IMF, statement, IMF00001-027.

29 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-036.



Source: Nyberg Report[30]

By 2007, due to growing concerns about the risks of inter-bank lending, available liquidity became more difficult to obtain across Europe, and indeed worldwide. The ECB acted to provide additional liquidity to the Eurozone from August 2007, through the injection of substantial funds.

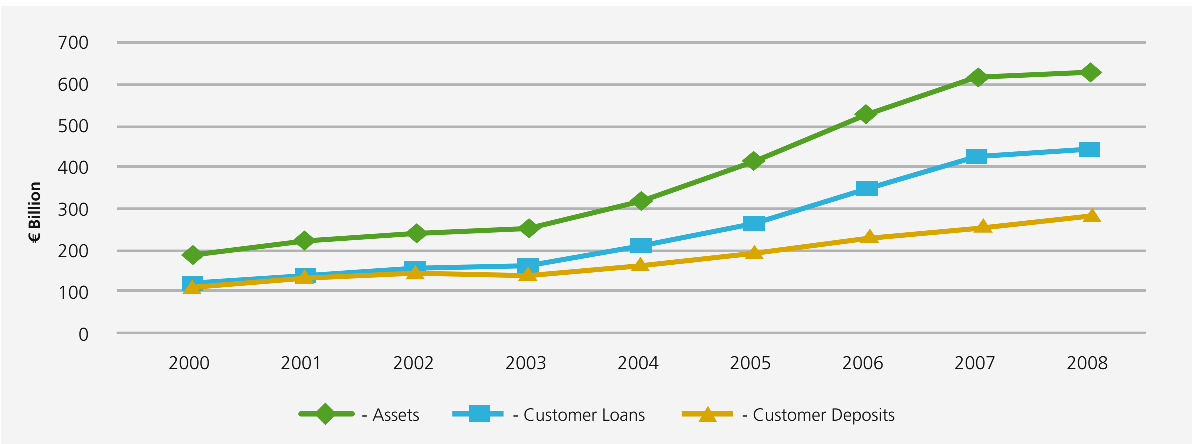
Philip Lane said to the Joint Committee:

"During 2007-2009, the availability of eurosystem liquidity provided an important buffer during the international financial crisis: banks in the euro area could replace private funding with central bank funding. For banks with insufficient eurosystem-eligible collateral, national central banks could also provide emergency liquidity assistance (ELA), within the framework set out by the eurosystem."[31]

Key Figures From Banks 2000-2008

The Joint Committee shows the key figures of the Financial Institutions between the years 2000 to 2008 below. See graphs and table below:

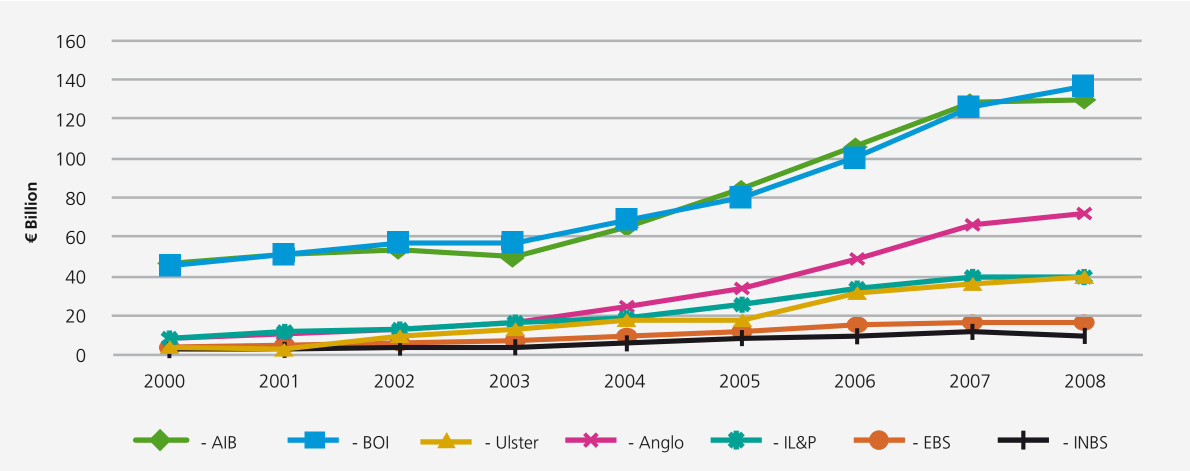
Bank Summary Sheet 2000 - 2008 Assets/Loans/Deposits



30 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, Figure 2.11, PUB00156-036.

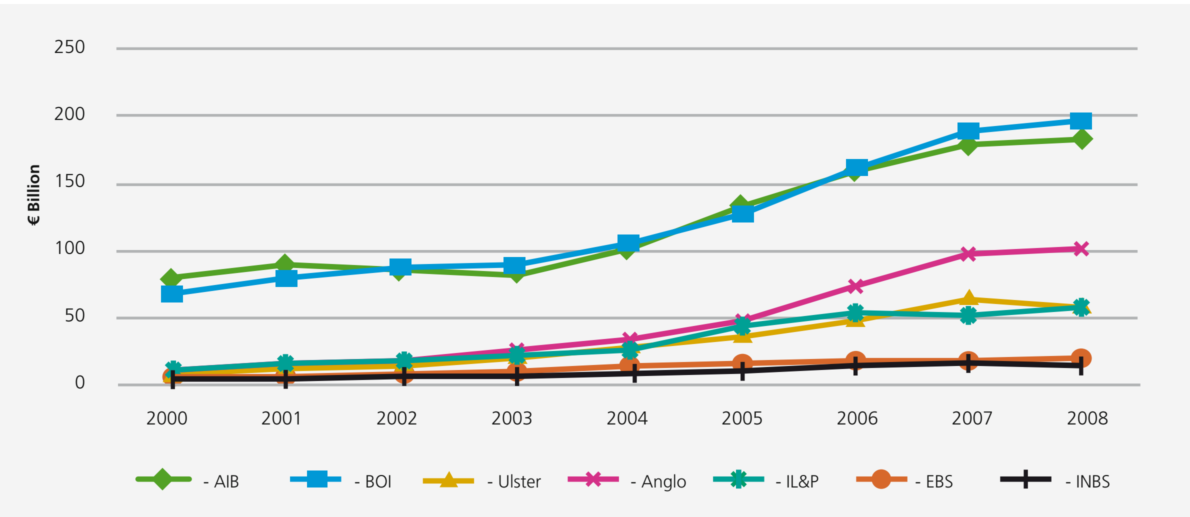
31 Philip Lane, Professor of International Macroeconomics and Director of the Institute of International Integration Studies, Trinity College Dublin (Now Governor of the Central Bank of Ireland), statement, CTX00041-010.

Customer Loans per Bank 2000 - 2008

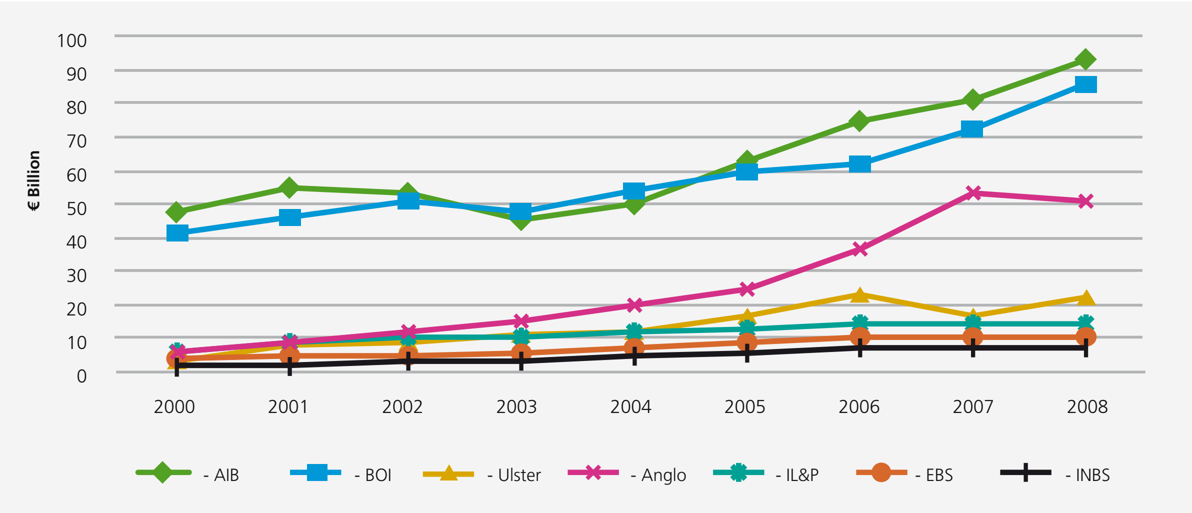


Customer Loans (€billions)	2000	2008	% Growth
AIB	46	129	180%
BOI	45	136	202%
ULSTER	4	39	875%
ANGLO	8	72	800%
IL&P	8	40	400%
EBS	4	17	325%
INBS	3	10	233%
TOTAL	**118**	**443**	**275%**

Asset Growth per Bank 2000 - 2008



Customer Deposits per Bank 2000 - 2008



Source: All figures taken from published Annual Reports. IL&P figures include figures for banking activities only. For 2005-08 the Assets figures are extracted from consolidated IFRS statements.

The degree of dependence on wholesale markets of each of the banks is set out below.

Allied Irish Bank

Customer Loans (€billions)	2000	2008	% Growth
AIB	46	129	180%

In 2003, AIB had a LDR of 114% and this grew to 143% in 2006.[32] In a proposal to revise the Adjusted Loan Deposit Ratio in the June 2007 forecast, a 2007 figure of 162% was indicated for LDR on a balance sheet that had moved from €78.2 billion to €188 billion in the same period. The presentation to the AIB board, dated 21 June 2007,[33] highlights the use of an Adjusted Loan Deposit Ratio, which AIB had been using since 2004, to introduce amendments to the use of Mortgage Trust Promissory Notes, Issued Covered Bonds and Wholesale Funding (greater than one year) as adjusting factors.

John O'Donnell, former Chief Financial Officer of AIB, said that the bank's level of wholesale funding was in line with peer banks and suggested long-term wholesale funding *"may be the most reliable and stable funding available in a crisis."* He noted that the bank was conscious of the *"greater risks"* of shorter-term wholesale funding and steps were taken to put a proportion of it on a longer duration. He said that, prior to the crisis, AIB's funding profile would not have been considered high risk and referred to a 2007 Standard & Poor's Report. To his knowledge, no more than 20% of the bank's funding would mature in a year.[34]

32 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-056.

33 Global Treasury Proposal to Revise the Adjusted Loan Deposit Ratio – Board Presentation, 21 June 2007, AIB01299-004/005.

34 John O'Donnell, former Finance Director, AIB, statement, JOD00001-007.

Bank of Ireland

Customer Loans (€billions)	2000	2008	% Growth
BOI	45	136	202%

Ronan Murphy, former Group Chief Risk Officer, BOI, noted the *"super-abundance of liquidity"* after 9/11 and prior to the liquidity crisis of 2007. He noted that the bank's "Strategy 2012", signed off by the board in July 2006, called for significant growth which could only be funded by access to wholesale funding, which he then believed was *"an acceptable and reasonable risk."*[35]

John O'Donovan, former Chief Financial Officer of BOI, noted the shift from retail deposit funding towards wholesale funding after 2000. He indicated that 41% of the Group's balance sheet was sourced from the wholesale markets in March 2008 and the expansion of the bank's loan book, particularly into areas that did not generate deposits, had brought a greater reliance on wholesale funding. He said that the funding was diversified by geography and product line and that the risk was mitigated by the extension of the maturity profile. However, these measures were not sufficient to cope with the closure of wholesale markets.[36]

Anglo Irish Bank

Customer Loans (€billions)	2000	2008	% Growth
ANGLO	8	72	800%

In his opening remarks, Tom Browne, former Managing Director of Lending Ireland, Anglo, said:

"over the ten years to 2005, Anglo Irish Bank had transformed from being a small player in the Irish marketplace to becoming a serious player in terms of market share in chosen segments in Ireland."[37]

The bank achieved this, in his opinion, by reason of a number of factors:

"a very active long-standing client base, many of whom had become the leading players in the property development and investment sectors; very strong customer loyalty across the core client base, which ensured a high level of repeat business for the bank; and an economic environment with low interest rates and wholesale bank funding at unprecedented levels."[38]

He pointed out that throughout the early part of 2007, while there was no indication of stress

"…the pressure which emerged ultimately, post the Northern Rock issue, demonstrated that the funding base was not sufficiently wide, deep or stable to underpin the scale of the loan book."[39]

Matt Moran, former Chief Financial Officer, Anglo, pointed out that the bank's funding model had a limited degree of geographic diversity with the main sources from within the Irish and UK markets.

35 Ronan Murphy, former Group Chief Risk Officer, BOI, statement, RMY00001-009.
36 John O'Donovan, former Group Chief Financial Officer, BOI, statement, JDV0001-005/006.
37 Tom Browne, former Managing Director of Lending Ireland, Anglo Irish Bank, transcript, INQ00095-004.
38 Tom Browne, former Managing Director of Lending Ireland, Anglo Irish Bank, transcript, INQ00095-004.
39 Tom Browne, former Managing Director of Lending Ireland, Anglo Irish Bank, transcript, INQ00095-005.

He said that the bank, not being a retail bank with a wide branch network, did not naturally have a customer funding franchise linked to current accounts. He said that the availability of money and the different sources available in capital markets was unprecedented post the introduction of the Euro. He also said:

"The ample supply of money made it relatively easy for banks to access funding. This is undoubtedly one of the core factors which set the environment for the root cause of the crisis experienced across Europe. Its impact should not be underestimated."[40]

He went on to point out that following the collapse of Lehman's Brothers, the bank was

"…far too small to control its destiny in this area. The Market set the mix, maturity profile and cost. From the 15 of September 2008 onwards, it was very difficult to raise any funding in the markets" [41]

Peter Fitzgerald, former Director of Corporate and Retail Treasury, Anglo Irish Bank, pointed out that *"Anglo was always attracting funds that were highly mobile in nature. In hindsight this was a risk that quickly escalated in line with the rapid growth in that business."*[42]

He acknowledged that this growing dependence on wholesale funding was an issue and that it was obvious to them in late 2007, early 2008. He said:

"…I think one of the messages from the 2008 results was that the aim of the bank, predominately through the customer deposit side, was to be 100% loan to deposit ratio by 2011."[43]

Ulster Bank

Customer Loans (€billions)	2000	2008	% Growth
ULSTER	4	39	875%

RBS Group Treasury assumed responsibility for treasury and balance sheet management and undertook to meet the capital and funding needs of Ulster Bank directly. This effectively took control of the liquidity funding out of the hands of the Irish entity and the capital funding requirements were viewed in the context of the overall RBS Group situation. By September 2007, 45% of Ulster Bank's group funding was provided by wholesale markets.[44]

The former Group Finance Officer, Michael Torpey, said *"… I very much regret that, like so many others, I did not foresee… the extent or duration of the turbulence in wholesale funding markets."*[45]

40 Matt Moran, former Chief Financial Officer, Anglo Irish Bank, statement, MMO00001-014.
41 Matt Moran, former Chief Financial Officer, Anglo Irish Bank, statement, MMO00001-016.
42 Peter Fitzgerald, former Director of Corporate and Retail Treasury, Anglo Irish Bank, statement, PFI00001-010.
43 Peter Fitzgerald, former Director of Corporate and Retail Treasury, Anglo Irish Bank, transcript, INQ00083-014.
44 Credit Liquidity Market Update, UBI00329-077.
45 Michael Torpey, former Group Finance Director, UB, transcript, INQ00088-004.

Irish Life and Permanent (IL&P)

Customer Loans (€billions)	2000	2008	% Growth
IL&P	8	40	400%

The Nyberg Report found that *"IL&P was very dependent on wholesale funding"* and it was noted that:

"IL&P had the backstop of being able to use residential mortgages (which are deemed to be less risky than commercial mortgages) to access ECB funding when wholesale funding markets became less accessible."[46]

David Gantly former Group Treasurer of IL&P, told the Joint Committee that:

"Irish Life and Permanent's balance sheet differed from the two main banks in that 85% of the assets comprised of residential mortgages, which were highly liquid in normal market conditions."[47]

He explained that the bank's funding *"was broadly split into three thirds: long-term debt, customer accounts and short-term wholesale debt."*[48]

Towards late 2007, however, the bank was increasingly aware of potential problems arising from its exposure to wholesale market funding. David Gantly said that the bank moved to prepare pools of mortgage assets as a contingency measure. He said in his witness statement: *"This is exactly what we would have done if we were to prepare a portion of the mortgage portfolio for a conventional securitisation."*[49]

Despite having the ability to securitise these assets, the bank found itself in severe difficulties during the crisis. David Went, former Group Chief Executive of IL&P, informed the Joint Committee:

"Events subsequently proved this funding model absolutely inadequate. External events together with negative views on Irish credit portfolios ensured that very rapidly all capital markets were closed to IL&P with the disastrous effects that we now know. The error here was clearly failing to recognise Peter Nyberg's point that in the capital markets there is only one counter-party and hence if one source closes to a borrower all will close simultaneously."[50]

He was asked by the Joint Committee *"were you aware of the issues and did you regard this as a fundamental risk or not?"* to which he replied:

"Well, we were clearly aware of the issues because we reviewed on a monthly basis the make-up of our funding portfolio. However, we concluded that for us the primary thing that we looked at was the extent to which customer deposits, long-term debt and securitisation funded our total loan book. And that was about two-thirds of it was funded through that, and these were seen as relatively stable source of funding … and that proportion had been relatively stable over a number of years."[51]

---

46 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-056.
47 David Gantly, former Group Treasurer, IL&P/ptsb, transcript, INQ00080-003.
48 David Gantly, former Group Treasurer, IL&P/ptsb, transcript, INQ00080-003.
49 David Gantly, former Group Treasurer, IL&P/ptsb, statement, DGA00001-013.
50 David Went, former Group CEO, IL&P/ptsb, statement, DWE00001-010/011.
51 David Went, former Group CEO, IL&P/ptsb, transcript, INQ00084-012.

On the issue of wholesale funding, he told the Joint Committee that Irish banks *"had been somewhat constrained in terms of their access to funding"*[52] before the Euro but after its introduction *"they now had access to the second, or one of the two widest and deepest and most liquid markets in the world."*[53] He concluded that the access the Euro gave Irish banks to wholesale funding *"was seen as a very attractive proposition."*[54]

"The Group's lending book grew aggressively from €12.9bn in 2001 to €39.2bn in 2007. This growth was largely funded through the wholesale markets … customer accounts only grew from €9.5bn to €13.6bn in the same period… The Group's position was highly precarious in 2008 due to its high level of short term funding and therefore its high loan to deposit ratio."[55]

IL&P did not go down the commercial property route to growth. However, it did fund the expansion of its loan portfolio to a noticeable degree through the wholesale markets.

David Went also told us that the bank, as part of its contingency plans,

"assumed that the regulatory authorities would be aggressive in providing support to the system, making Central Bank borrowing effectively the swing factor in ensuring the survival of the institution."[56]

It would appear that, for IL&P at least, the assumption that the regulatory authorities and the Central Bank would not only have, but would implement, a contingency plan formed part of their own assumptions about what a worse-case scenario would actually entail.

INBS

Customer Loans (€billions)	2000	2008	% Growth
INBS	3	10	233%

John Stanley Purcell, Director and Secretary, INBS said:

"INBS was funded in equal amounts from customer accounts and the wholesale market…The funds raised on the wholesale market extended the maturity profile of borrowings"[57]

When Michael Fingleton, former Chief Executive, INBS was questioned in relation to access to wholesale funding at the time of the Guarantee he said *"We in 2008 and prior to the guarantee, had no need to access the…wholesale market."*[58]

Michael Walsh, former Chairman, said that, with the benefit of hindsight, *"I believe that the difficulties which the Society subsequently encountered and the associated losses arose from a combination of factors."*[59] He outlined these as the bubble of cheap credit, hyper competition,

52 David Went, former Group CEO, IL&P/ptsb, transcript, INQ00084-013.

53 David Went, former Group CEO, IL&P/ptsb, transcript, INQ00084-013.

54 David Went, former Group CEO, IL&P/ptsb, transcript, INQ00084-013.

55 PTSB Report to the Oireachtas Joint Committee of Inquiry into the Banking Crisis: Significant Changes in the Management of Property-Related Credit Risk and Funding/Liquidity Risk 2008-2013(2015), PTSB02660-008.

56 David Went, former Group CEO, IL&P/ptsb, transcript, INQ00084-024.

57 John Stanley Purcell, former Director and Secretary, INBS, transcript, INQ00078-004.

58 Michael Fingleton, former CEO, INBS, transcript, INQ00077-067.

59 Michael Walsh, former Chairman, INBS, statement, MWA00009-011.

markets freezing and inability to finance. He stated that the inability to refinance due to:

"…the resulting drying up of liquidity in the international inter-bank markets (Lehmans, Bear Stearns) meant that banks could not source adequate funding and therefore the Society's customers found it increasingly difficult to refinance their short term loans from the Society with other lenders as had been traditionally been the case."[60]

EBS

Customer Loans (€billions)	2000	2008	% Growth
EBS	4	17	325%

Fergus Murphy, former Group Chief Executive Officer at EBS said in evidence that the society had traditionally pursued a conservative funding strategy, but the impact of the contraction in the global funding markets that began in mid-2007:

"…was significantly impeding EBS's access to the wholesale and corporate funds…The complete dislocation of the wholesale funding markets in the latter half of 2007 prevented EBS from securing any long term funding."[61]

Fergus Murphy explained:

"when this influx of liquidity across the world churning around was taking place we received, and our financial institutions received, more of that liquidity than we should have and it meant that Irish banks were able to go to the wholesale markets in a way that they never were before. For example, in 1998, the EBS balance sheet was 100% funded by retail deposits. When I took over in 2008, it was 26% funded by retail deposits. So what had happened in the interim was the effect of what I was just describing."[62]

Competition

Faced with increased competition, some of the financial institutions responded to market pressure in order to protect their customer base and market shares. Management in these banks were also concerned about peer group comparisons.

Michael Walsh commented on market share:

"if you look at [total] market shares … basically Anglo increased its market share and AIB and Bank of Ireland decreased. But if you were to actually look at it in terms of […] property and construction, you'll find that, you know, the two big lenders into property and construction in this country were AIB and Anglo. Bank of Ireland is less than half of either of those."[63]

In his evidence to the Joint Committee, Michael Fingleton said:

"following the entry of Bank of Scotland and the other foreign-owned banks into the market in 1999 it became increasingly difficult for the society to compete in the residential loans market."[64]

---

60 Michael Walsh, former Chairman, INBS statement, MWA00009-011.

61 Fergus Murphy, former Group CEO, EBS, statement, FMU00001-010.

62 Fergus Murphy, former Group CEO, EBS, transcript, INQ00120-006.

63 Michael Walsh, former Chairman, INBS, transcript, INQ00079-036.

64 Michael Fingleton, former CEO, INBS, transcript, INQ00077-003.

Allied Irish Bank

In particular, evidence was given to the Joint Committee to the effect that hitherto established lending policies were relaxed, or re-interpreted, as mere *"guidelines"* in the rush to secure new business at AIB. For example, Jim O'Leary, former Independent Non-Executive Director of AIB, stated that:

"There was no doubt that the activities of competitors influenced decisions made by AIB…in the area of mortgage lending, for example, in order to protect market share, AIB felt compelled to relax its underwriting standards, (most obviously in respect to LTV ratios) over time, in response to aggressive competition."[65]

When asked to compare the growth of the development, property and construction book in AIB as against BOI and Anglo, Eugene Sheehy, former Chief Executive Officer, AIB, responded as follows:

"I note the comparators you're making and I'm only going to talk about a comparison between ourselves and Bank of Ireland because that's the only equivalence. They were a retail commercial bank; so are we. There was a slight difference in our customer base. We were much heavier than they were in the SME sector and property and construction was widespread. We had, you know, in the … we had very large customers and then we had 650 customers who had property and construction loans of over €1 million, so it wasn't … it was very broadly spread and reflected our franchise and the nature of our franchise."[66]

Bank of Ireland

Bank of Ireland, in turn, saw AIB as their *"most significant competitor."*[67] The evidence given to the Joint Committee by Bank of Ireland included an analysis carried out in 2005 of all its competitors across the retail spectrum.[68] This analysis, which focussed on retail banking, set out the view Bank of Ireland had of others such as Ulster Bank, Danske, BoSI and Rabobank but it did not refer to Anglo.

However Richie Boucher, Chief Executive Officer, BOI, said, in his evidence to the Joint Committee, *"certainly, we did compete with Anglo at the higher end…corporate property market."*[69]

Brian Goggin, former Chief Executive Officer, BOI, gave evidence that:

"Bank of Ireland had a market share across most of its product lines, ranging depending on which product line one would pick, but market shares ranging from kind of high teens right up to mid-30s, mid-30s in the case of working accounts or current accounts."[70]

---

65 Jim O'Leary, former Independent Non-Executive Director, AIB, statement, JOL00001-007.

66 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-012.

67 Developments in Retail Banking in Republic of Ireland, 07 April 2005, BOI01169-001.

68 Developments in Retail Banking in Republic of Ireland, 07 April 2005, BOI01169-001.

69 Richie Boucher, Group CEO, BOI, transcript, INQ00085-008.

70 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-042/043.

Anglo

Tom Browne addressed the question of Anglo and market share in his evidence. He said:

"Over the ten years to 2005, Anglo Irish Bank had transformed from being a small player in the Irish market place to becoming a serious player in terms of market share in chosen segments in Ireland. The success of Anglo over the ten-year period to 2005 was reflected not just in the growth of the loan book, but also in year-on-year increases in earnings and a strong market rating."[71]

He also said that competition grew in the domestic banking sector and that *"this competition came from existing universal banks in Ireland and from emerging foreign lenders in the market."*[72]

Tom Browne also referred to a decision taken by the board of Anglo in early 2006:

"on the basis of management advice, to change its lending policy reflecting the concerns we held about the acceleration in asset values and given the growing intensity of competition." However, he said that *"the failure to more forcibly implement the policy decision […] was a serious mistake."*[73]

Despite the fact that Anglo *"could see from early 2006 that the market was getting seriously overheated"*,[74] the bank did not strictly adhere to the board's decision.

Ulster Bank

Robert Gallagher, former Chief Executive Corporate Markets Division, Ulster Bank said that *"the bank's strategy was to become a third force in the Irish universal banking market, to challenge the dominance of the big two."*[75]

Upon further questioning with regard to Ulster Bank acting *"in support of the Group's ambition to be the Number One Bank in Ireland"* Robert Gallagher said that *"We had … we had an ambition for that, yes."*[76]

In addressing that same point, Michael Torpey said:

"it is entirely acceptable from a business perspective, in my view, that a small challenger can seek to grow significantly more rapidly than the general marketplace and significantly more rapidly than a competitor's, in the interest of bringing competition to the marketplace and growing its position relative to the incumbents."[77]

He also dealt with the question of how the bank attempted to grow market share, by saying:

"The assumptions we made, unfortunately, were the wrong assumptions and it … it is unfortunate and in every respect - and it's something that I very much regret - that we didn't in fact challenge sufficiently on the variety of assumptions that underpinned the expectations of continuing growth in the market."[78]

---

71 Tom Browne, former Managing Director of Lending Ireland, Anglo Irish Bank, transcript, INQ00095-004.

72 Tom Browne, former Managing Director of Lending Ireland, Anglo Irish Bank, transcript, INQ00095-004.

73 Tom Browne, former Managing Director of Lending Ireland, Anglo Irish Bank, transcript, INQ00095-004.

74 Tom Browne, former Managing Director of Lending Ireland, Anglo Irish Bank, transcript, INQ00095-009/010

75 The "big two" being AIB and BOI. Robert Gallagher, former Chief Executive Corporate Markets Division, UB, transcript, INQ00088-005.

76 Robert Gallagher, former Chief Executive Corporate Markets Division, UB, transcript, INQ00088-043.

77 Michael Torpey, former Group Finance Director, UB, transcript, INQ00088-016.

78 Michael Torpey, former Group Finance Director, UB, transcript, INQ00088-054.

Irish Life and Permanent (IL&P)

David Gantly was asked about the bank's position on market share. He said that *"a very stated objective of the group to be the No. 1 provider of retail financial services so I think there was an element of cross-sale seen in this, to be fair, as well."*[79] David Went also said that IL&P *"decided essentially to be, you know, a mortgage lender, a plain vanilla mortgage lender."*[80]

In expanding on the business model, David Went said:

"The adopted strategy won market acceptance at the time, and appeared logical focussing on lower risk widely spread portfolios of lending in a home market where we had operated successfully for many years and had substantial market presence while exiting a number of overseas investments that were high risk and sub-scale in order to invest capital in Ireland that appeared to offer substantial opportunities."[81]

INBS

In his written submission to the Joint Committee, Michael Fingleton said that:

"The Society was not focused on increasing its market share but concentrated on lending to customers who were well known to the Society and who had been tried and tested and performed successfully in the past."[82]

Michael Walsh, corroborated Michael Fingleton's evidence, when he said in his statement that *"Hyper Competition: progressively from 2004 onward larger financial institutions piled into the market in which the Society had operated since 1992."*[83]

In explaining the effect of the entry of foreign-owned banks into the market, Michael Fingleton said: *"They undercut everybody, competition intensified, our book was attacked and we, effectively, couldn't compete …"*[84]

EBS

Fergus Murphy said, to the Joint Committee, that his view of EBS's approach to market share was that it was driven *"More by survival than market share."*[85]

The society, according to Fergus Murphy's evidence, had concerns about its future as a mutual society. In the early 2000s *"EBS were looking at options in terms of was there another way to preserve the mutual or mutual-like environment and code and heritage and, at the same time, get access to a bigger balance sheet and a more powerful engine…"*[86] Interestingly, he did not see these concerns purely in terms of market share.

79 David Gantly, former Group Treasurer, IL&P/ptsb, transcript, INQ00080-013.
80 David Went, former Group CEO, IL&P/ptsb, transcript, INQ00084-021.
81 David Went, former Group CEO, IL&P/ptsb, statement, DWE00001-004.
82 Michael Fingleton, former CEO, INBS, statement, MFI00001-017.
83 Michael Walsh, former Chairman, INBS, statement, MWA00009-011.
84 Michael Fingleton, former CEO, INBS, transcript, INQ00077-036.
85 Fergus Murphy, former Group CEO, EBS, transcript, INQ00120-021.
86 Fergus Murphy, former Group CEO, EBS, transcript, INQ00120-021.

EBS was using land and development lending as part of a strategy to hold residential mortgage market share, and this strategy, in the opinion of Fergus Murphy, was a factor in its demise as an independent society. [87]

Former Finance Director at EBS, Alan Merriman, gave evidence regarding the problems the society faced in maintaining its mortgage lending market share. He told the Joint Committee that two of the society's core areas of business were the mortgage refinance market and the first-time buyer market, and that it found itself under increasing pressure from its competitors for market share in these areas. Alan Merriman noted that:

"… EBS as a traditional building society, having in an environment where it was one of the few players in a normal mortgage market, now found itself in a market where both ends were being very aggressively competed for."[88]

The issue of increased competition was also discussed by Fidelma Clarke, former Chief Risk Officer and Company Secretary, who said:

"I think I would and have described it as excessive competition. Absolutely there was excessive competition in the market, which led to downward pressure on the society's core business, which led it to take decisions about what it could do to remain viable…"[89]

Commercial Property/Real Estate

Having seen the increased use of wholesale market credit by Irish financial institutions, the next question to ask was: to what purpose was this credit put?

It is no secret to say that in the years leading up to the 2008 crisis, Irish financial institutions were over-concentrated in real estate lending, both commercial and residential, at home and abroad. The purpose of this section is to summarise the evidence the Joint Committee heard in relation to commercial real estate credit activity, and to decide whether or not it played a systemic role in the crisis experienced by Irish financial institutions in late 2008. Whereas the focus is on the engagement or otherwise of the financial institutions in this market, rather than the market itself, there is still a need to give a brief overview of the market for clarity. There is more to real estate than home mortgages.

As can be seen later in the report, the transfer of loans from the covered institutions into NAMA crystallised losses in the banks. These losses were covered by government recapitalisation. NAMA had commercial property transferred onto its book, as can be seen in Chapter 9. The total par value of these loans was €74.4 billion for which NAMA paid €31.7 billion. Residential property only consisted of 16.5% of the latter amount, which is similar to office developments which made up 16.6% and hotels alone accounted for 9.6%. Of the loans that remained on the banks' balance sheets, commercial real estate had an impairment rate of 56.9%[90] which was over three times that of residential mortgages and over twice the average of all impaired loans.

---

87 Fergus Murphy, former Group CEO, EBS, transcript, INQ00120-026.

88 Alan Merriman, former Finance Director, EBS, transcript, INQ00137-011.

89 Fidelma Clarke, former Chief Risk Officer, EBS, transcript, INQ00135-028

90 Dirk Schoenmaker, "Stabilising and Healing the Irish Banking System – Policy Lessons", PUB00371-015.

The issue of commercial real estate lending and its impact on individual banks was discussed with the bank economists.

Pat McArdle, former Group Chief Economist, Ulster Bank, said: *"However, the real problem was commercial and not mortgage lending, and this was not adequately stress tested."* [91] Later on he said:

"But let's assume that it was okay because no one ever reported these stress tests were going to cause any Irish banks to collapse, you know, we never got any inkling of that. So the banks, some banks anyway, Ulster Bank had stress tested for very significant house price falls and there was no problem. The problem was in the commercial mortgage book."[92]

Dan McLaughlin former Chief Economist, Bank of Ireland, said: *"Plus, the major problem for the Irish banks wasn't just Irish commercial property; US commercial property prices fell 40%, and UK commercial property prices fell 35%."*[93] He said, subsequently:

"I would point out is [sic] the major losses for the Irish banks were not in residential property, they were in commercial property … in commercial property. Not many people, if I recall, wrote anything about commercial property, and that was what caused the damage for Irish banks' profitability and caused them to require significant capital inflow … injection from the State, not residential property."[94]

He also said:

"I think what happened for all of the banks, in 2008, 2009, was that having commercial property in different jurisdictions didn't prove a very good risk diversification strategy, because in a crisis, unfortunately the correlations collapsed to one. In other words, they all collapsed together, and that is a rare phenomenon but that's what happened."[95]

Later on Dan McLaughlin said: *"I think just factually it is the commercial property price falls, asset price falls that opened up the huge capital losses in most of the banks."*[96]

When asked, if house prices had not fallen but commercial property had fallen to the extent it did (67%), whether the banks would still have needed the amount of capital provided by the Irish state, Dan McLaughlin said:

"Well a lot of it, yes. They didn't get the capital to cover residential mortgage losses because they haven't put it in the results that they've had massive losses in residential mortgages."[97]

John Beggs, former Chief Economist, AIB Global Treasury, said:

"We had no information or very little information about what was happening in commercial property. We've done a lot of talking and analysis around housing because we had monthly statistics, we had population. When it came to the commercial side, we didn't have that

91 Pat McArdle, former Group Chief Economist, UB, transcript, INQ00087-006.
92 Pat McArdle, former Group Chief Economist, UB, transcript, INQ00087-059.
93 Dan McLaughlin, former Chief Economist, BOI, transcript, INQ00087-020.
94 Dan McLaughlin, former Chief Economist, BOI, transcript, INQ00087-032.
95 Dan McLaughlin, former Chief Economist, BOI, transcript, INQ00087-033.
96 Dan McLaughlin, former Chief Economist, BOI, transcript, INQ00087-058.
97 Dan McLaughlin, former Chief Economist, BOI, transcript, INQ00087-058.

information. So we were acting in a very, almost naive way in that we didn't have full information."[98]

When asked if he agreed with the opinion that commercial property broke the banks, John Beggs said:

"Yes, I do, based on the sort of analysis and the way they are thinking about it and looking at it. I mean, it wasn't house prices that ended up requiring the additional capital… It was on the commercial property book, which had grown dramatically in the years leading up to the … to the banking crisis."[99]

The then Taoiseach Bertie Ahern agreed with this assessment. He said:

"I'm just talking about the debate - in the residential side. I mean, look what happened in the commercial property side. I mean, there was where the madness really took place…"[100]

It is clear that commercial property loans were one of the fundamental fault lines in the Participating Institutions which led to them being rescued by the Irish State. A characteristic of this lending strategy was that it was, for the most part, concentrated within a very small number of borrowers.

In relation to the Irish real estate market, the Joint Committee heard evidence from John Moran, Managing Director of Jones Lang LaSalle Ireland. He started off by giving an explanation of the market:

"The Irish retail real estate market is made up of various components. There is the residential market, the development land and agricultural market, the investment market and the various occupier markets such as offices, retail, industrial, hotels and licensed and leisure premises."[101]

He went on to give an overview of the Irish commercial real estate market from the perspective of Jones Lang LaSalle, which specialises in that market:

"Up to 2008 the commercial real estate market was growing strongly. There were increased levels of purchasing, leasing and construction activity. Ireland's economy was performing well with GDP and employment driving the expansion. It is worth remembering that, at that time, we were the fastest growing economy in western Europe, the second wealthiest economy on a per capita basis measured by GDP and we had the fastest growing population in Europe. During that period unemployment averaged just over 4%, which was effectively full employment. That is important because the real strength in occupier and investor demand is what was supporting the property market. That demand was driving activity levels and increases in values and the capital values of Irish commercial investment property increased by 72% in the five-year period up to 30 September 2007, the date we define as the peak of the market in terms of value appreciation. Property yields were at record levels, which was a reflection of both the strong investor demand and the availability of significant amounts of debt."[102]

---

98 John Beggs, Chief Economist, AIB Global Treasury, transcript, INQ00087-027.

99 John Beggs, Chief Economist, AIB Global Treasury, transcript, INQ00087-059.

100 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-041.

101 John Moran, Managing Director, Jones Lang LaSalle, transcript, CTX00047-003.

102 John Moran, Managing Director, Jones Lang LaSalle, transcript, CTX00047-003.

A supporting document from Jones Lang LaSalle, provided to the Joint Committee by John Moran, stated:

"Between 2004 and 2008 almost €8 billion worth of commercial investment property was sold in Ireland. 2006 was the peak year for investment volumes, with €3.6 billion traded in 12 months. For context, this compares to the previous record of €1.2 billion in 2005 and an average of €768 million per annum between 2001 and 2004."[103]

The document then went on to make a small but significant observation: *"In addition to domestic spending, there was also considerable Irish investment activity overseas, particularly in the UK and continental Europe."*[104]

In other words, according to Jones Lang LaSalle, the size of the Irish real estate market in the years leading up to the 2008 crisis was not the sum total of Irish developer investment in real estate, and neither should it be assumed that the Irish commercial property market was the sum total of credit advanced by Irish financial institutions alone for real estate investment purposes during the period under discussion.

Residential Property

Three key developments in the residential property market are considered in this section: Buy-To-Let Mortgages, 100% LTV Loans and Tracker Mortgages.

Buy-to-Let

As the property market became ever more buoyant, many of the banks' retail customers were able to purchase a second or more properties leading to a significant increase in the buy-to-let market. This type of mortgage became more accessible for borrowers with the introduction of interest-only repayments for one, two or three years. When applying for one of these loans, an applicant would generally be permitted to use the equity of other properties that they owned as security.

Nyberg identified[105] two risks associated with the buy-to-let market that are not associated with mainstream residential lending:

- a borrower, when experiencing financial difficulty, would tend to prioritise the repayment of debt on the principal residence instead of the buy-to-let loan.
- ability to repay the buy-to-let loan was based on the potential rental income. Therefore if interest rates were to increase or the expected rental income was overestimated, the borrower may have difficulty in keeping the loan repayments up to date. This may also occur when the 'interest only' repayment term ended.

Richie Boucher, Group Chief Executive, BOI, stated that the buy-to-let lending *"hadn't been seasoned"* in the Irish context and consequently *"there hadn't been sufficient experience of what would happen in a downturn."*[106]

---

103 Jones Lang LaSalle (2015), Issues relating to the nature and functioning of the commercial real estate market in the period prior to 2008 in the context of the Banking Crisis in Ireland. CTX00023-001.

104 Jones Lang LaSalle (2015), Issues relating to the nature and functioning of the commercial real estate market in the period prior to 2008 in the context of the Banking Crisis in Ireland. CTX00023-001.

105 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-053.

106 Richie Boucher, Group CEO, BOI, transcript, INQ00085-033.

Increasing prevalence of 100% LTV loans

In 2005 Ulster Bank through First Active were the pioneers in offering 100% mortgages generally (i.e. applicants could borrow up to 100% of the purchase price of a property). As the purchase of property was not contingent on the borrower having to provide any capital, the bank bore 100% of the risk. To explain why Ulster Bank made 100% mortgages available in the first place, Cormac McCarthy, former Group Chief Executive and Director, said:

"…from a competitive position, we were losing share of the first-time buyer market because others were doing 100% mortgages. The second thing was we had seen customers who were to try and get the deposit for a house, were extending themselves on personal loans and credit cards, which is not the right way for people to find deposits for houses.…"[107]

Some of the banks were less enthusiastic about the 100% mortgage as a product. In July 2005, David Went, the Group Chief Executive of IL&P, sent a *"File Note"*[108] to the other executive directors in the bank, in which he stated that he had spoken to the Regulator and *"expressed reservations about the introduction of this product to the market."* He told us *"…we concluded, having reviewed the options and having reviewed the risks that were inherent in this, we concluded that we had no option but to proceed."*[109]

Similarly Brian Goggin stated that Bank of Ireland was a *"reluctant follower"* and that in order to protect its franchise, the bank offered 100% mortgages initially to professionals and then broadened the offer to first-time buyers.[110]

Tracker Mortgages

Another product innovation within the banking sector was the introduction of tracker mortgages. Banks offered tracker mortgages at a fixed rate above the ECB rate. They used this product as a method to gain market share. Tracker rates were considered stable and the commercial Irish banks could access low cost funding directly from the wholesale markets to fund their needs.

When asked if BOI thought it was going to make money from tracker mortgages, Richie Boucher said: *"We had a presumption, I think, that we would always be able to borrow at or near ECB rates."* He then said that this presumption was:

"A very big mistake. You must always price your product based on the cost of your raw material, not of what you presume you might buy it. I don't think a farmer would sell milk on the basis of what he thinks it might cost. You know we made a basic misassumption of not aligning the pricing of our product to the cost of the raw material. We presumed we could get the raw material and we guaranteed the customer that we always thought we could get the raw material at different price … it transpired we couldn't."[111]

---

107 Cormac McCarthy, former CEO, UB, transcript, INQ00086-022/023. Note: other financial institutions were providing 100% mortgages to specific categories of customers.

108 PTSB File Note re IFRSA and 100% mortgages, PTSB00447-001.

109 David Went, former Group CEO, IL&P/ptsb, transcript, INQ00084-010.

110 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-019.

111 Richie Boucher, Group CEO, BOI, transcript, INQ00085-023.

John O'Donnell, former Finance Director of AIB, stated that he *"believed the risk was known and understood, albeit historically it had not been significant."*[112]

Ethna Tinney, former Non-Executive Director EBS, stated in her evidence to the Inquiry:

"And the volumes of tracker mortgages that, therefore, that we were attracting blinded us to the dangers of what would happen in terms of depressing the margin and so the final outcome … we can't afford the tracker mortgages…"[113]

Large Exposures/Cross-Bank Lending

John Stanley Purcell was asked the following by the Joint Committee:

"Mr. Purcell, in the Project Harmony report, it would show that the society had a concentration of loans in the higher risk development sector, a concentration of loans in the higher loan-to-value bands, a concentration in its customer base – the top 30 commercial customers, for example, accounted for 53% of the total commercial loan book – and a concentration in sources of supplemental arrangement fees, representing 48% of profit in 2006. Indeed, 73% of those fees came from just nine customers. Did the board ever consider or did they become concerned or did they discuss those levels of concentrations and the correlation between them and whether or not they could increase the risk to the society's business model?"[114]

In response, he said: *"The board were aware of the concentration. The large exposures report would be produced and it would be a board document."*[115]

In her written statement, Niamh Brennan, former Non-Executive Director with Ulster Bank, wrote:

"In retrospect, it is now clear that growth in lending and, in particular, lending to the property development and construction sectors made Ulster Bank, like other Irish banks, vulnerable to a collapse in property values."[116]

It is clear that a feature of lending to the property sector during the boom years was cross-bank lending whereby a number of different banks lent money to the same borrower.

In his evidence, Frank Daly Chairman of NAMA gave evidence that NAMA's impression was that the banks seemed to have been acting *"almost in isolation"* from one another. *"They didn't really have much interest in what a particular client's exposure was to another bank across the system."*[117] NAMA's view was that, not only did the banks not have sight of a particular client's exposure to another bank across the system but also, *"they didn't really have much interest."*[118] Frank Daly was of the view that retaining the client was undoubtedly a key factor: *"there was an emphasis on a kind of relationship lending as much as lending for particular projects that actually seemed feasible."*[119]

112 John O'Donnell, former Finance Director, AIB, statement, JOD00001-008.
113 Ethna Tinney, former Independent Non Executive Director, EBS, transcript, INQ00138-030.
114 John Stanley Purcell, former Director and Secretary, INBS, transcript, INQ00078-022/023.
115 John Stanley Purcell, former Director and Secretary, INBS, transcript, INQ00078-022/023.
116 Niamh Brennan, former Audit Committee Member/Chair, UB, statement, NBR00007-028.
117 Frank Daly, Chairman, NAMA, transcript, PUB00331-022.
118 Frank Daly, Chairman, NAMA, transcript, PUB00331-022.
119 Frank Daly, Chairman, NAMA, transcript, PUB00331-022.

Pat McArdle said that 'cross borrowing' by developers between banks *"wasn't known to me and I suspect wasn't known to the banks either"*, before concluding *"so I think that was a key factor [in the problems that materialised]."* [120]

Apart from the clear need for effective regulatory oversight, the Joint Committee is of the view that the banks had a prudential duty to themselves to inquire, challenge and assess hidden risks arising from multi-bank borrowing by major clients.

Fintan Drury, a former Non-Executive director of Anglo Irish Bank, pointed out in his statement that:

"The property-related lending strategy of Anglo Irish Bank achieved exceptional returns over the period 2002 – 2008 and no one questioned their appropriateness over those years when the bank was revered by shareholders, analysts, rating agencies and commentators in Ireland and overseas."[121]

He told the Inquiry that Anglo Irish Bank *"… was, you know, clearly it was a monoline bank, that's what it did"* and in terms of investment property lending he believed that *"somewhere between 80% and 90%"* of the bank's loan book related to property investment activities.[122] He continued:

"I was aware that there was a relatively small … that the ratio, if you like, in terms of the number, a relatively small number of clients who had quite a significant percentage of … of the lending, yes. Was I concerned about that? Not particularly."[123]

Matt Moran told the Inquiry:

"Concentration risk, amongst a small number of developers, partly due to the size of the economy, is now understood to have been too high and the ready availability of funding to banks led to too high a concentration of activity in such a small market."[124]

---

120 Pat McArdle, former Group Chief Economist, UB, transcript, INQ00087-059.

121 Fintan Drury, former Non-Executive Director, Anglo Irish Bank, statement, FDR00001-004.

122 Fintan Drury, former Non-Executive Director, Anglo Irish Bank, transcript, INQ00142-044.

123 Fintan Drury, former Non-Executive Director, Anglo Irish Bank, transcript, INQ00142-021/022.

124 Matt Moran, former Chief Financial Officer, Anglo Irish Bank, statement, MMO00001-011.

Distribution of NAMA debtor connections by size of nominal debt

Table provides a breakdown of all debtor connections by size of nominal debt exposure. It should be noted that many of the debtors are also indebted to financial institutions which are not part of the NAMA scheme

Nominal Debt	Number of debtor connections	Average nominal debt per connection €m	Total nominal debt in this category €m
In excess of €2000m	3	2,758	8,275
Between €1000m and €2000m	9	1,549	13,945
Between €500m and €999m	17	674	11,454
Between €250m and €499m	34	347	11,796
Between €100m and €249m	82	152	12,496
Between €50m and €99m	99	68	6,752
Between €20m and €49m	226	32	7,180
Less than €20m	302	7	2,117
Total	**772**	**96**	**74,015**

Source: NAMA[125]

Interest Roll-up

Interest roll-up refers to the practice whereby interest on a loan is added on to the outstanding loan balance (*"rolled-up"*) where it effectively becomes part of the loan capital outstanding and accrues further interest. *"Rolling-up"* interest would generally allow a borrower not to repay interest as it falls due, but this would be done without placing the loan in default.

Of the €74.4 billion worth of loans which were transferred to NAMA, interest which had been rolled up amounted to €9 billion.[126] The breakdown of the interest roll-up figure estimated by NAMA for the Participating Institutions was as follows:[127]

- AIB - €3.1 billion
- Anglo - €3 billion
- BOI - €1.8 billion
- INBS - €1 billion
- EBS - €0.1 billion

125 Distribution of largest debtors, Table 2, NAMA00015-001.
126 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-032/033.
127 NAMA submission to the Banking Inquiry, 31 March 2015, NAMA00104-002.

The provision of an interest roll-up facility to a borrower arose in two ways, either by an "interest repayment holiday" being agreed in advance between the bank and borrower or where the borrower had not been able to make a loan interest repayment and the accrued unpaid interest was added to the outstanding loan principal.

Michael O'Flynn, Founder and Managing Director, O'Flynn Construction, gave evidence that the banks' practice was to allow interest to accumulate and be paid out of either the proceeds of a sale or rental income. The banks generally permitted such roll-up only for the limited period required to bring the project to market. The banks benefitted from a higher amount of interest and borrowers benefitted from not having to pay interest until the development or construction project had been completed.[128]

In his evidence, Sean Mulryan, Chairman and Chief Executive, Ballymore Group, explained the concept and practice of interest roll-up in the following terms:

"In either a land or development scenario … interest is either cash serviced from borrower or shareholder equity or rolled up until ultimate proceeds are generated … Ballymore almost always requested interest roll up facilities over the term of the loan. Such was the competition in the lending market during the period 2001 to 2008, in Ireland and overseas, that interest roll up facilities were frequently offered by financial institutions."[129]

Brian Goggin gave evidence that *"…roll-up of interest in a land bank transaction was perfectly in accordance with policy."*[130] Eugene Sheehy said *"…there was interest roll-up because there was cash flow problems generally in the second half of '08."*[131]

NAMA's evidence to the Joint Committee was that, on acquisition of the property-related loans, the existence of interest roll-up *per se* was not surprising. It was the extent of interest roll-up, especially cases where *"new loans were being created to take account of the rolled up interest"* that took NAMA by surprise.[132]

Tom Browne was asked if interest roll-up had left Anglo exposed in the downturn. He acknowledged that it had and that it was a large concern for the bank. As a result of Anglo's concern over property related loans, the bank changed their policy on interest roll-up in 2006 in an attempt to curtail this activity.[133]

Interest roll-up benefited both banks and borrowers when market conditions were positive but, a serious difficulty arose when Ireland's property market crashed and borrowers became unable to repay the principal into which the interest had been rolled up.

Gary McGann, Independent Non-Executive Director at Anglo, when asked in relation to interest roll-up *"with such a narrow field of individuals did the bank consider that in terms of risk",* answered *"Not specifically."*[134]

---

128 Michael O'Flynn, Founder and Managing Director, O'Flynn Construction, statement, MOF00006-010.

129 Sean Mulryan, Chairman and CEO, Ballymore Group, statement, SMU00001-018.

130 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-050.

131 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-032.

132 Frank Daly, Chairman, NAMA, transcript, PUB00331-025.

133 Tom Browne, former Managing Director of Lending Ireland, Anglo Irish Bank, transcript, INQ00095-036.

134 Gary McGann, former Independent Non-Executive Director, Anglo Irish Bank, transcript, INQ00082-017/18.

Statement of Affairs

A "Statement of Affairs" is a summary of a borrower's assets, liabilities and overall net worth.

Brian Patterson, former Chairman of IFSRA, said:

"after the crash, it emerged, as we know, that some large developers had never been asked by their bank to provide a statement of affairs nor had the bank properly assessed their net worth."[135]

Brendan McDonagh gave evidence that NAMA found that statements of affairs had frequently been relied upon by banks to provide comfort that a debtor's financial position could support new lending and service liabilities, but that these were not always audited and were instead often self-certified by the borrowers themselves.[136]

Reliance on Statements of Affairs was compounded by the fact that the assets of most relevant borrowers were comprised mainly or exclusively of property assets. As market prices had risen in the years up to 2007, the self-assessed net worth of borrowers also appeared to rise; this gave the banks *"a sense of false comfort."*[137]

Frank Daly explained the risk in the following terms:

"…once you begin to rely on personal guarantees then by definition you are relying on the personal wealth of the debtor. If the process by which that personal wealth is assessed is in any way doubtful – in other words if it is done on the basis of Statements of Affairs where the valuation of assets is essentially done by the debtor and maybe not rigorously examined or overseen by the banks – then you are getting into a cross-collateralisation right across the loan book and you are getting into it on the basis again of relationship banking, with not a huge amount of oversight."[138]

Michael O'Flynn, however, gave evidence of significant equity invested in the O'Flynn Group developments and also confirmed that the loans of the O'Flynn Group were not secured by any personal guarantee.[139]

Types of Developers

At one end of the spectrum were developers who generally operated to high standards of governance, business case development and financial controls. At the other end of the spectrum were borrowers who lacked critical experience, knowledge and skills.

This classification was shared by a number of the developer witnesses. Sean Mulryan stated there were:

"ordinary people calling themselves property developers, buying properties, not alone in Ireland, in Bulgaria, in Romania, all over the world and in Ireland and building big portfolios on 95%, 100% finance."[140]

135 Brian Patterson, former Chairman IFSRA, transcript, INQ00063-008. Mary Burke, Head of Prudential Policy, Central Bank (June 2010 to present), transcript, INQ00131-020, also said "…I know the net worth statements, we felt, were not reliable and not consistently sought across the system."

136 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-010.

137 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-010.

138 Frank Daly, Chairman of NAMA, transcript, PUB00331-069.

139 Michael O'Flynn, Developer, O'Flynn Group, statement, MOF00006.

140 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-041.

Michael O'Flynn, stated that there were:

"…part-time developers or people who had gone into the development business without having any understanding of the fundamentals involved."[141]

Joe O'Reilly, Executive Chairman, Castlethorn Construction and Chartered Land Group also stated:

"…a number of people came into the business … they weren't necessarily … they were in other businesses that changed into … that changed into … or they suddenly became a property developer overnight."[142]

Brendan McDonagh gave evidence that:

"The banks were quite clearly lending to individuals and companies that, notwithstanding the massive sums involved, had little or no supporting corporate infrastructure, had poor governance and had inadequate financial controls and this applied to companies of all sizes."[143]

In his evidence, Frank Daly said that there was also *"…lending on hope value to people at the bottom."*[144] He added that a substantial amount of that type of borrowing was related to *"land which wasn't even zoned, which had hope value more than anything else."*[145] Brendan McDonagh said that in the case of some 600 or so such NAMA debtors, *"…very few of them seemed to have any expertise in construction."*[146]

The CRE sector loan exposure remaining in the Irish covered institutions at the end of 2013 totals €36.5 billion with an impairment rate of 56.9% totalling an amount of €20.8 billion. This issue will be considered further in Chapter 8: Post Guarantee Developments.

Outstanding loans and impairments of Irish banks, end-2013, (in €bn)

	Outstanding loans				Impaired loans	
	BOI	**AIB**	**PTSB**	**Total**	**Impairment rate**	**Impairment loans**
Mortgages	51.6	40.7	29.0	121.3	17.7%	21.5
CRE	16.8	19.7		36.5	56.9%	20.8
SME	13.6	13.7		27.3	25.1%	6.9
Corporate	7.8	4.3		12.1	25.1%	3.0
Consumer	2.8	4.3	0.3	7.4	6.1%	0.4
Total	92.6	82.7	29.3	204.6	25.7%	52.6

Note: Only five of the six Irish banks participated in the NAMA process. Anglo and INBS merged into IBRC. EBS was acquired by AIB.
Source: Annual reports 2013 of banks for outstanding loans; Central Bank of Ireland for impairment rates, there is only a joint impairment rate for SME and Corporate available.

Source: Schoenmaker[147]

141 Michael O'Flynn, Developer, O'Flynn Group, transcript, INQ00121-004.
142 Joe O'Reilly, Executive Chairman, Castlethorn Construction and Chartered Land Group, transcript, INQ00126-006,
143 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-013.
144 Frank Daly, Chairman, NAMA, transcript, PUB00331-022.
145 Frank Daly, Chairman, NAMA, transcript, PUB00331-022.
146 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-035.
147 Stabilising and Healing the Irish Banking System: Policy Lessons, Table 4, PUB00371-015.

Bank Boards and Remuneration

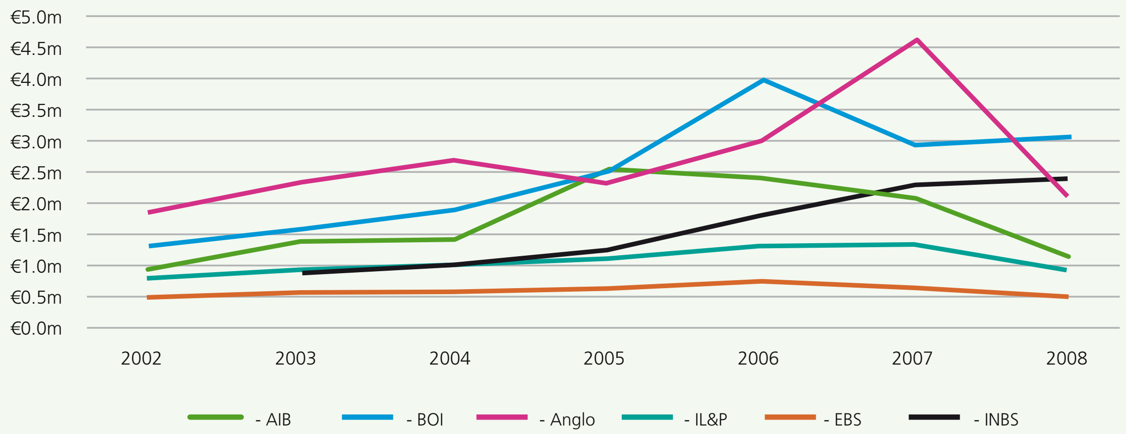
Introduction

Significant changes in leadership in the banks took place in the years leading to 2007. The remuneration of the senior executives of those boards at that stage should be considered. The Joint Committee was provided with details of the top ten salaries and bonuses paid to the senior executives in each of the six Covered Institutions. We will now outline the position with regard to the CEOs.

Chief Executive Remuneration

The Nyberg Report showed CEOs remuneration in the covered banks as follows:[148]

CEO Remuneration in the Covered Banks



Source: Annual Reports

Note:
1. **CEO remuneration includes all reported remuneration including salary, fees, bonus, pension contributions other than shares or share options granted.**
2. **INBS CEO remuneration for 2002 not disclosed in annual report.**
3. **Amounts relate to reported remuneration of officer holding period for the majority of the financial year except AIB 2005 where two CEOs' figures are combined due to mid-year hand-over**
4. **The 2008 (31/3/09) figure for BoI includes €1.46m for payment in lieu of notice**

'000	2002	2003	2004	2005	2006	2007	2008
Anglo	€1,885	€2,346	€2,721	€2,354	€3,015	€4,656	€2,129
INBS	(Note 3)	€910	€1,034	€1,269	€1,836	€2,313	€2,417
AIB	€940	€1,399	€1,445	€2,563	€2,436	€2,105	€1,152
BoI	€1,318	€1,594	€1,919	€2,525	€3,998	€2,972	€3,095
EBS	€513	€589	€601	€655	€760	€678	€522
IL&P	€822	€946	€1,025	€1,138	€1,335	€1,362	€942

148 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, Figure 2.13, PUB00156-046/047.

2007

The remuneration of the CEO, or person of equivalent standing, at each bank in 2007 was as follows:

Remuneration of Bank CEOs, 2007 (sourced from Audited Annual Accounts of the Banks)

Bank	CEO	Salary & Fees (€'000)	Bonus/ Profit Share (€'000)	Benefits (€'000)	Pension (€'000)	Total (€000s)	B/S (€bn)	PBT (€bn)	Employ ('000s)
Bank of Ireland	**Brian Goggin**	1,100	2,025	1,227	*(354)	3,998	188.81	1.96	15.95
Anglo Irish	**David Drumm**	956	2,000	44	274	3,274	96.65	1.24	1.71
INBS	**Michael Fingleton**	865	1,400	48	*0	2,313	16.10	0.39	0.37
AIB	**Eugene Sheehy**	916	862	65	262	2,105	177.86	2.51	25.89
IL&P	**Denis Casey**	694	617	51	300	1,662	59.82	0.48	5.01
EBS	**Ted McGovern****	353	290	34	***201	878	19.45	0.67	0.66
Totals		4,884	7,194	1,469	683	14,230	558.69	7.25	49.59

* **Pension capped therefore a clawback occurs or zero payment**
** **Retired 30 September 2007, Compensation payment of €1.87m on early retirement**
*** **Approximation of pension for year**

The average industrial wage in 2007 was €37,726, according the CSO's National Employment Survey. By comparison, the average senior bank executives in AIB were receiving total remuneration of over 42 times that figure and those in Bank of Ireland were receiving 48 times that figure, in the same year.

The Evidence of the Bank Senior Executives

The three Executive Directors of AIB, Eugene Sheehy, John O'Donnell and Colm Doherty, former Managing Director of AIB Capital Markets and former Group Managing Director of AIB, shared a total remuneration pot of €5.5 million in 2006, which was an average of €1.83 million each. When Donal Forde, former Managing Director AIB in the Republic of Ireland, is added to these three Executive Directors, the figure increased to €6.4 million, or an average of €1.6 million each. When asked to comment on the fact that the total remuneration for four AIB directors amounted to €6.435 million in 2007, Eugene Sheehy stated that there was no evidence of the bank crisis at that stage - *"Well, at that stage there wasn't any evidence of what was going to come."*[149]

149 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-022.

At BOI the equivalent remuneration figures for Brian Goggin and John O'Donovan in 2005/06 was a total of €3.64 million (averaging at €1.82 million each). With the addition of Richie Boucher, Des Crowley and Denis Donovan to the Board in 2006/07, the overall figure increased to €8.98 million, which averaged at €1.79 million each.

At Anglo the total figure for their five Executive Directors in 2007 was €8.5 million, giving an average of €1.7 million each.

In the course of Hearings before the Joint Committee, a number of the senior executives of the Irish banks gave evidence and defended the high remuneration received by them by reference to the independence of the process of determining their remuneration. They were questioned on whether they had been overpaid before the crash and having regard to the huge losses subsequently incurred. None of these witnesses said that their pay was particularly excessive, even though the banks within their charge ultimately exposed the Irish taxpayer to a cost of €64 billion to cover the losses. However, Eugene Sheehy, of AIB, said *"The numbers are very high, not justifiable in my view in today's terms."*[150]

Similarly when responding to a question regarding bonus payments, Michael Fingleton stated that: *"I certainly would say in hindsight they were excessive."* He explained:

"I did not determine my bonuses. They were done by the remuneration committee, which comprised the three, or all the non-executive directors, and they decided what my bonus was."[151]

When asked if he had merited his remuneration, Brian Goggin stated:

"I was paid exceptionally well as chief executive of the bank. My remuneration as chief executive and the remuneration of the chief executive was determined by the board. I had no input or involvement in that determination."

He also said *"It wasn't for me to determine."*[152]

Richie Boucher said:

"My salary was approved by the Minister for Finance at the time and was voted on by the shareholders who were paying for it and that continues to be the case. Every year I stand before the shareholders to be elected as to whether I stay in my job or not and the shareholders decide what I'm paid. I don't have anything further to say on that."[153]

A number of these witnesses explained how their remuneration packages were determined.

When asked to explain how he ended up with a salary of €2.4 million per annum and how it could be justified, Eugene Sheehy explained:

"…there were a number of components to it and they were scientifically constructed. We had three external consultants who looked at it."

---

150 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-015/016.

151 Michael Fingleton, former CEO, INBS, transcript, INQ00077-008.

152 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-014/017.

153 Richie Boucher, Group CEO, BOI, transcript, INQ00085-026/027.

He also said:

"And if you look at the Nyberg report you will see that AIB was much, much lower…rather than… of the peer group, in terms of size. So, there was a science to it."

and

"But the actual amounts that we were paid were too high … I mean, when I came from the States I was paid a lot less over there, but they had a totally different philosophy about long-term compensation."[154]

Gary McGann gave evidence to the Joint Committee that:

"…the remuneration arrangements in any business, particularly plcs, are based on best practice in the marketplace as advised by the various people who are expert in this area and Anglo Irish Bank's structure was no different fundamentally than anybody else's. There are obviously three elements to it - there is salary, there is short-term bonus and there is long-term incentive schemes. And the basis of each of those is against market practices, the quality and the size of the business and the performance of the business."[155]

Cormac McCarthy explained in relation to remuneration in Ulster Bank that:

"the salaries and remuneration, remuneration generally was bench marked and there was significant comparability and oversight from Royal Bank of Scotland, not just Ulster Bank. So at any point in time our salaries were independently benchmarked and found to be competitive. Certainly with the benefit of hindsight, Chairman, yes there was an excessive element to things, yes."[156]

Risk Management & Relaxation of Lending Rules

Some of the evidence presented to us indicated that a number of factors coalesced to bring about excessive reliance on the property market. These include:

1. Increased competition in the banking market.
2. Poor risk monitoring.
3. Inadequate management information systems.
4. Deteriorations in lending practices and criteria.
5. Ineffective regulatory oversight (covered in Chapter 4).

154 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-015/016.

155 Gary McGann, former Non-Executive Director, Anglo Irish Bank, transcript, INQ00082-007.

156 Cormac McCarthy, former CEO, UB, transcript, INQ00086-038.

1. Increased competition in the banking market

This factor has been explored already and it has been found that increased competition was a significant factor in the issues that arose in the banking sector.

Brendan McDonagh, as Director of Finance, Technology and Risk at the NTMA, stated:

"There appeared to be a highly accommodating attitude among financial institutions towards the more prominent debtors and a concern that, if that institution was not particularly amenable, the debtor would look elsewhere for the funding of future projects. Clearly debtors were not slow to exploit the unusual lending market." [157]

It was noted in a Bank of Ireland memorandum, dated 28 August 2008, from Group Credit to Group Risk Policy Committee, that *"changes may be merited/required in the interests of protecting our "franchise"/market share…"* [158] At the end of this memo, Group Credit expressed a warning:

"we are concerned that the proposal to significantly relax Income Multiples may result in an unacceptable level of exposure to High LTV, High Income Multiple FTB's and it will be important that TMB monitors the quality of new business written under the revised Policy."[159]

2. Poor risk monitoring and exceptions to lending policy

As the competition for market share increased over the period, adherence to established policies and procedures, in at least some of the banks, weakened. An AIB report from 2010 noted that during the pre-financial crisis period *"……breaches of policy became common and were treated as routine events even if they were escalated."*[160]

Evidence was provided to the Joint Committee in relation to exceptions to lending policies. In the case of Anglo, for example, exceptions to group lending policy were running at 26% to 28% of loans approved each month by early 2008 and by July of that year, they reached a high of 42%.[161] The exceptions from the policy in the case of mortgage approvals by Ulster Bank, peaked at 40% of loans approved in July 2006.[162] Exceptions to mortgage policy in AIB peaked at 30% in 2004 but had reduced to 21% in 2007.[163]

3. Inadequate Management Information Systems

Evidence was provided that, in some cases, Management Information Systems (MIS) may not have been adequate and/or capable of providing consolidated, insightful information on the status and trends in loan portfolios, especially through filtering sectoral lending by debtor concentrations and accompanying risks. Robust MIS are crucial to providing the necessary information to management. In the absence of such systems, evidence-based decision-making at the institutional level is made more difficult.

157 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, PUB00331-011.

158 Internal memo from Group Credit to Group Risk Policy Committee 12 August 2002, BOI02903-001.

159 Internal memo from Group Credit to Group Risk Policy Committee 12 August 2002, BOI02903-004.

160 Interim Review of Credit Management in AIB June 2010, AIB02042-007.

161 Anglo Irish Bank, Risk Management Reporting July 2008, IBRC02733-012.

162 Ulster Bank Ireland Limited Board Meeting 7 June 2007, UBI00367-082.

163 AIB Credit Review 12 months to December 2007, AIB01375-024.

Ronan Murphy said in his witness statement:

"…in retrospect as the OW [Oliver Wyman] report found, there was not enough Management Information System (MIS) functionality, controls, stress testing or scenario evaluation. As a consequence, inter alia, the risk committee structure to manage risk was not geared as it should have been towards fully understanding the aggregate risk profile of the book."[164]

David Dilger, former Non-Executive Director of Bank of Ireland also noted that:

"…as a result of the multiplicity of systems and technologies throughout the Group…all Group wide reporting had to be subjected to very considerable consolidation and manual processes rendering it difficult for management to assess or report on Group wide issues on a day to day basis."[165]

Kieran Bennett, former Group Chief Credit Officer AIB, stated that *"AIB's credit management information and stress test systems were poor and required considerable investment."*[166] He also said that *"Very poor credit management information at portfolio level meant it was harder to measure and therefore manage concentration risk or correlated risk"*[167] and he noted that: *"There was an absence of a group-wide data warehouse, which makes the reporting on credit risk exposures a manual and time consuming process."*[168]

Mike Aynsley, former CEO of Anglo, said in his evidence to the Joint Committee:

"What we found was that they were in such a hurry to transact business and write new business that they had put a minimum amount of information into the computer systems."[169]

Niamh Brennan commented as follows:

"As is usual on boards, the Ulster Bank boards only received data from management information systems (MIS) at a very high level. The financial-MIS data at board level was primarily accounting data, in the form of budgets, monthly management accounts and quarterly/half-yearly/annual financial statements."[170]

This view was underpinned by Helen Nolan, former Group Chief Internal Auditor, Bank of Ireland, who quoted from the 2009 Oliver Wyman report in her statement to the Inquiry, as follows:

"reporting to the Court [the Board] is weighted towards value adding commentary and contains minimal regular reporting of charts, thus limiting the Court's ability for independent conclusions and challenge. In addition, current reporting does not allow easy drill-down."[171]

David Dilger said, in relation to the question of information flow to the board:

"…as a result of the multiplicity of systems and technologies throughout the Group…assessing Group level risks and exposures was, therefore, rendered more difficult for management and non-executive directors."

---

164 Ronan Murphy, former Group Chief Risk Officer, BOI, statement, RMY00001-012.

165 David Dilger, former Non-Executive Director, BOI, statement, DDI00001-004.

166 Kieran Bennett, former Group Chief Credit Officer, AIB, statement, KBE00001-004.

167 Kieran Bennett, former Group Chief Credit Officer, AIB, statement, KBE00001-008.

168 Kieran Bennett, former Group Chief Credit Officer, AIB, statement, KBE00001-014.

169 Mike Aynsley, former Group Chief Executive, IBRC, transcript, INQ00141-039.

170 Niamh Brennan, former Audit Committee Member/Chair, UB, statement, NBR00007-010.

171 Helen Nolan, former Group Chief Internal Auditor and current Group Secretary, BOI, statement, HNO00001-005.

Notwithstanding this, he said that he believed that the board did receive sufficient information. He said: *"I was satisfied that, despite the shortcoming…the Board was at all times able to discern the financial position of Bank of Ireland…"*[172]

The opinion of NAMA regarding the management information systems within the five covered institutions was furnished to the Joint Committee.[173] This opinion was based on its interaction with the five covered institutions during the loan acquisition and due diligence phase from 2009 to 2011.

NAMA reported issues with:

- *Multiple MIS systems*[174]
- *Limited central data repositories*[175]
- *Paper-based records*[176]
- *Unreliable key performance metrics*[177]
- *Poor data collation capacity*[178]

Overall, based on interaction with staff from the covered institutions during the period 2009 to 2011, NAMA found it difficult to obtain key management information on the loan books, such as loan-to-value ratios (LTV ratios). That, according to NAMA:

"might suggest that their management information systems did not have the capacity to adequately monitor their exposures, both to individual debtor connections and in aggregate."[179]

It would appear from the evidence set out above, that there is a question as to the adequacy of the management information systems.

4. Deteriorations in lending criteria and practices

On the basis of evidence presented to the Joint Committee, it is clear that the drive for growth resulted in a deterioration in lending criteria and practices over the period 2002 to 2008 which manifested themselves in a variety of ways. These are considered below.

The net effect of such practices was that the banks provided all of the real cash funding and the safety zone of borrower equity usually existed only on paper. According to Frank Daly: *"The result is that the borrower was typically not the first to lose. In the event of a crash the banks stood to take 100% of the losses, and that's what happened."*[180]

When asked whether Bank of Ireland engaged in the practice of using the equity growth in the purchase of one development as the security for another purchase, Richie Boucher stated: *"We did……we didn't do it to the extent of other people, but we did."*[181]

---

172 David Dilger, former Non-Executive Director, Bank of Ireland, DDI00001-004.
173 NAMA Submission to the Banking Inquiry, 11 March 2015, NAMA00097-006/007.
174 NAMA Submission to the Banking Inquiry, 11 March 2015, NAMA00097-006.
175 NAMA Submission to the Banking Inquiry, 11 March 2015, NAMA00097-007.
176 NAMA Submission to the Banking Inquiry, 11 March 2015, NAMA00097-007.
177 NAMA Submission to the Banking Inquiry, 11 March 2015, NAMA00097-007.
178 NAMA Submission to the Banking Inquiry, 11 March 2015, NAMA00097-007.
179 NAMA Submission to the Banking Inquiry, 11 March 2015, NAMA00097-007.
180 Frank Daly, Chairman, NAMA, transcript, PUB00331-012/013.
181 Richie Boucher, Group CEO, BOI, transcript, INQ00085-023.

Eugene Sheehy stated the following, in response to a similar question:

"It wasn't a business model. It did happen. And most of the uplift in valuation came from the investment side property. So, if you somebody who was a residential developer, but they had a successful let investment property, you would take an uplift value in that and pass it on. But I agree with Mr. Daly, you know, that it would've been a lot better off if the structure … the industry structure in Ireland around property, had more private equity, you know, and I think that's happening now. It would have been far superior, and it did increase the bank's exposure, the fact that we released funds on the basis of valuations of uplift."[182]

Michael Buckley, former Chief Executive Officer of AIB, was questioned by the Joint Committee as to whether he believed that the bank had taken too much risk in his time. He replied:

"No. In my view… in … property overall from €6 billion to €19 billion … I would say "No." And from €4 billion to €11 billion in the Republic of Ireland I would say "No" in the context of what the economy required and what customer needs were at the time."[183]

In contrast, Eugene Sheehy, his successor, said, immediately prior to this comment, *"I did yes."*[184] when he was asked if he believed that the bank had taken too much risk.

This divergence of views with regards to the level of risk being taken by AIB was further commented upon by Donal Forde who gave his view to the Joint Committee of the impact of the credit risk management policy within AIB:

"…with my personal conclusion that the failure of the bank was primarily attributed to the failure of our credit risk management policy. Our stress testing of customers' repayment capacity was not sufficiently challenging, and our loan to value constraint on security was inadequate."[185]

When asked about the expansion of the loan book in AIB for property and construction, Donal Forde commented:

"I consider it ill-judged but I did not consider it reckless at the time, you know. And the reason I didn't consider it reckless was for the very reason that you'll see in those stress tests. My understanding was that the level of exposure we were running was not threatening to the bank even in an extreme case. That would be my definition of reckless."[186]

At IL&P the monitoring of the expanded loan portfolio in terms of risk appetite was, according to a special report, *'somewhat lacking in structure; with no reliance on portfolio concentration limits.'*[187]

It would appear that, for IL&P at least, the assumption that the regulatory authorities and the Central Bank would not only have, but would implement, a contingency plan formed part of their own assumptions about what a worse-case scenario would actually entail.[188]

---

182 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-040.

183 Michael Buckley, former CEO, AIB, transcript, INQ00133-043.

184 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-040.

185 Donal Forde, former Managing Director, AIB in the Republic of Ireland, transcript, INQ00122-004.

186 Donal Forde, former Managing Director, AIB in the Republic of Ireland, transcript, INQ00122-046.

187 Significant Changes in the Management of Property – Related Credit Risk and Funding/Liquidity Risk 2008-2013, PTSB (2015), PTSB02660-013.

188 David Went, former Group CEO, IL&P/ptsb, transcript, INQ00084-024.

Exposures resulting from poor property-related lending not only threatened the business and viability of individual financial institutions, but also of the financial system itself, for the following reasons:

a) all the institutions were acquiring property-related risk to varying degrees over the same period.

b) multiple bank risks were vested in individual major borrowers.

c) there was cross-bank lending whereby multiple banks were lending to the same borrower(s).

Role of Internal Auditors

Introduction

The objective of the Internal Audit (IA) function should be to ensure that the financial institution is not exposed to fraud or risks (both internal and external), to ensure that staff cannot process transactions or access data to which they are not authorised and to ensure that the financial institution complies with all other legal and regulatory requirements.

According to the Nyberg Report:

"IA is generally recognised as "a third line of defence" coming after business unit control functions (first line of defence) and risk/compliance control functions (second line of defence). IA is there to provide independent assurance on the continuing effectiveness of the institution's corporate governance and control environment."[189]

The Public Accounts Committee Report on the Banking Crisis adopted this definition.[190]

When performing an audit, Internal Audit is focused on reviewing the controls and processes underpinning all of the bank's transactions. The Joint Committee sought and obtained evidence on the Internal Audit and risk control functions from relevant persons in BOI, AIB and Ulster Bank on a range of relevant lines of inquiry. In response, detailed statements were received from:

- John O'Donnell, who served as Chief Financial Officer of AIB from 2005 to 2009.
- Kieran Bennett, who served as Group Chief Credit Officer of AIB from 2006 to 2010.
- Professor Niamh Brennan, who served as a Non-Executive Director on the Board of Ulster Bank from 2001 to 2009. (Professor Brennan also served on the Ulster Bank Group Audit Committee and on the board of a number of subsidiary companies. She served as chairman of First Active from 2006 to 2008).[191]
- Helen Nolan, who served as Group Chief Internal Auditor of BOI from May 2003 to July 2009.
- John O'Donovan, who served as Group Chief Financial Officer of BOI from 2001 to 2011.
- Ronan Murphy, who served as Head of Group Risk Management, BOI from 2004 to 2009.

---

189 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-063.

190 PAC: Report on the crisis in the domestic banking sector, A preliminary analysis and a framework for a banking inquiry, July 2012, PUB00072-044.

191 Niamh Brennan, former Audit Committee Member/Chair, UB, statement, NBR00007-006.

The Joint Committee also received a detailed statement describing the Internal Audit function of INBS from Eamon Daly, who served as Internal Auditor of INBS from 2000 to 2004. This was submitted in response to the testimony of several INBS witnesses, though he was not asked to respond to specific questions.

A number of directors from the banks were also asked similar questions relating to Internal Audit and risk control function, including Colm Doherty and Jim O'Leary, both of AIB.

Only a portion of the evidence can be examined here and the evidence examined relates to the following themes:

- The quality of business model setting and the internal culture of the banks.
- The adequacy of board oversight over internal controls to ensure risk is properly identified managed and monitored.
- Reviews of risk culture and risk appetite.
- The effectiveness of internal audit and the review of risks associated with customer concentration levels and short-term funding to service long-term lending.
- Staffing and resources of the Internal Audit divisions.

Quality of business model setting and internal culture of the banks

A number of events, which illustrated significant cultural problems within the credit institutions, took place during the period covered by this Inquiry. These events include the subject matter of the DIRT Inquiry, the Forex Probe[192] and the investigation of Allfirst Bank scandal.[193] Having regard to these events, the Inquiry witnesses were asked to comment on the internal culture of their organisation, how ethics and values were defined within their organisation, whether written policies were in place to address these issues and the extent to which such policies were understood and included as personal objectives to be adhered to by all personnel.

John O'Donovan referred to the BOI Code of Conduct, which governs the relationship between the bank's employees and customers, suppliers, fellow employees, shareholders, the Government and Regulators and sets out standards of behaviour. He also referred to the focus on *"leadership excellence"* in BOI's business strategy.[194]

Questioned on the internal culture of Ulster Bank, Niamh Brennan described three distinct cultures. She said that, when she joined the bank there was *"a strong and distinctive conservative and prudent culture, with an emphasis on processes and procedures."* After the acquisition of Ulster Bank by RBS, Niamh Brennan said that *"greater ambition and performance demands became apparent, together with a command-and-control management style."* She said that the acquisition of First Active in 2004 *"introduced another culture."* Niamh Brennan noted that RBS had a full range of written governance policies reflecting its emphasis on governance with a *"strong*

192 The Forex Probe was a financial scandal that involved the investigation of bank collusion in the manipulation of exchange rates for financial gain.

193 The Allfirst Bank scandal involved fraud at AIB's former subsidiary Allfirst Bank, where a former employee concealed mounting trading losses for at least five years before they were revealed in February 2002.

194 John O'Donovan, former Group Chief Financial Officer, BOI, statement, JDV00001-003.

imperative from RBS that all group companies adopt RBS policies and that RBS policies operate consistently across the group." Ulster Bank adopted RBS policies. Those particularly relevant to ethics and values were the RBS code of behaviour for employees and the whistleblowing policy. She stated: *"To the Ulster Bank Boards' knowledge, the policies were practised across Ulster Bank."* As a non-executive director, Niamh Brennan was not in a position to comment on personal objectives for individual personnel. [195]

John O'Donnell noted that, given that he was Finance Director with AIB from 2005 to 2009, he was not able to comment on events prior to 2005, including those leading to the Allfirst Bank investigation and the Forex Probe. He stated his view that: *"a very strong emphasis was placed on operating to a high level of compliance and ethics"* in the bank which was, in part, a response to the Allfirst Bank and Forex events. He noted that the ethics and values of the organisation were defined by a Code of Business Ethics and a separate Code of Leadership Behaviours from 2004. He referred to a 2006 review of the Code by the Institute of Business Ethics, which confirmed that AIB was *"following good practise in training, assessing effectiveness and reporting on the working of its ethics policy."* He believed that these policies were practised by the Managing Director, Directors and Senior Management.[196]

Adequacy of Board Oversight Over Internal Controls to Ensure the Proper Identification, Management and Monitoring of Risk

The January 2011 Promontory Financial Group/Mazar report noted failings in AIB's corporate structure and stated: *"there appears to have been considerable reluctance among senior management to give priority to robust governance and risk practices."* [197]

These criticisms were put to John O'Donnell of AIB. He stated that he was not aware of these weaknesses and noted: *"that the Bank was very strongly focused on ethics and regulatory and compliance issues."* He stated: *"Board meetings generally spent a very clear majority of its time on such issues."* He referred to a number of favourable external valuations of the AIB's Group Audit function by PwC and positive reviews of the bank's Corporate Governance by Governance Metrics International. He noted the May 2006 report by Promontory Financial Group praising the bank's progress in enhancing risk management systems and its conservative appetite for risk. [198]

Niamh Brennan stated: *"Ulster Bank boards actively discussed and, where appropriate, challenged management in relation to all issues brought to the boards attention"* and management *"generally"* took the necessary remedial actions. She referred to the actions taken to address operation risk at the Dublin Mortgage Centre as an example. [199]

---

195 Niamh Brennan, former Audit Committee Member/Chair, UB, statement, NBR00007-015/016.

196 John O'Donnell, former Finance Director, AIB, statement, JOD00001-003.

197 Promontory/Mazar Report, a review of the effectiveness of the Board and of the Risk Framework of AIB plc January 2011, AIB03292-014.

198 John O'Donnell, former Finance Director, AIB, statement, JOD00001-004.

199 Niamh Brennan, former Audit Committee Member/Chair, UB, statement, NBR00007-016.

Review of risk culture and appetite

Several witnesses were asked whether a review of the risk culture and risk appetite of their bank had been carried out by external consultants or the internal audit divisions within their institutions.

John O'Donovan, former Group Chief Financial Officer with BOI stated that:

"aspects of risk culture and appetite were reviewed by Group Internal Audit (GIA) in a range of audits, but no single review focussed exclusively on these matters, prior to the financial crisis."

He listed several reviews of the BOI's risk culture carried out by external consultants in 2009, 2010 and 2012. [200]

Helen Nolan of BOI gave similar evidence, stating that: *"elements of risk culture and appetite were reviewed in a range of internal audits, but there was not a review which focused exclusively on risk culture and appetite."* [201]

Ronan Murphy was *"unaware"* of any review of the risk culture and appetite of the BOI being carried out during his tenure as Chief Risk Officer, though he believed *"a strong level of risk awareness prevailed in the Group and was a material influence in behaviours."* He noted that BOI's approach was *"conservative relative to its peers"* but that *"there was not enough Management Information System functionality, controls, stress testing or scenario evaluation"* which meant the risk committee was *"not geared as it should have been towards fully understanding the aggregate risk profile of the book."* Ronan Murphy referred to the creation of a *"Group Risk Framework document"* in 2007. He noted that the recommendations in the Oliver Wyman report[202], including those relating to risk appetite have been accepted and were in the process of implementation.[203]

Kieran Bennett, Group Chief Credit Officer, AIB noted that the AIB Group Internal Audit had conducted a number of audits in 2005 relating to management of credit across the bank which had noted the absence of a group-wide credit risk strategy and risk appetite and a lack of stress-testing at group and divisional levels. A 2006 AIB Group Internal Audit review of processes for sanctioning and monitoring property/construction exposures identified a number of problems and recommended that a more formal framework be considered to ensure a more consistent approach. Kieran Bennett also referred to the findings of a PwC review conducted in November 2008 which examined property concentrations. [204]

John O'Donnell could not *"recall a review specifically addressing risk culture and appetite"* within AIB, though he referred to the 2006 Promontory Report which described AIB as having a conservative appetite for risk. He also referred to a 2006 report prepared for Group Internal Audit, which indicated that Group Risk was designing and implementing a management process to identify, measure and manage property concentrations. A further report, prepared in 2007 in response, concluded that AIB had a significant property concentration and recommended specific limits for the portfolio.[205]

---

200 John O'Donovan, former Group Chief Financial Officer, BOI, statement, JDV00001-013/014.

201 Helen Nolan, former Group Chief Internal Auditor and current Group Secretary, BOI, statement, HNO00001-014/015.

202 Oliver Wyman - Review of Risk Governance, May 2009. This was a report on the independent review of BOI's Risk Governance.

203 Ronan Murphy, former Group Chief Risk Officer, BOI, statement, RMY00001-011/012.

204 Kieran Bennett, former Group Chief Credit Officer, AIB, statement, KBE00001-013/015.

205 John O'Donnell, former Finance Director, AIB, statement, JOD00001-010/011.

Jim O'Leary stated: *"I don't recall that Internal Audit carried out any explicit review of risk appetite during my term."*[206]

Colm Doherty said that he was: *"not aware of any specific review of risk culture and appetite having been carried out by either external consultants or Internal Audit in AIB."* [207]

Niamh Brennan said in her evidence that, to her knowledge, no independent review by an external party or internal auditor of the risk culture and appetite of Ulster Bank was carried out.[208]

Eamon Daly, former Internal Auditor of INBS, was not questioned on this issue but did note that the Internal Audit Division of INBS had no role in strategy or planning and that there was no specific Risk Officer or Risk Unit within INBS *"so it was unclear where the responsibility for risk assessment and risk mitigation rested."* [209]

Wholesale Funding: Auditors

Several witnesses were asked whether the level of wholesale funding in their institution was a concern and whether the associated risks were clearly understood at Senior Management and Director Level.

Helen Nolan indicated that this was addressed in a range of internal audits during her time as Group Chief Internal Auditor with BOI and was subject to significant senior management oversight, supported by the liability management infrastructure and contingency arrangements, a comprehensive governance process and regular management information updates to senior management. BOI Group also communicated on this issue with external debt and equity investors and the rating agencies. [210]

Ronan Murphy noted the *"super-abundance of liquidity"* after 9/11 and prior to the liquidity crisis of 2007. He noted that BOI's *"Strategy 2012"*, signed off by the bank's board in July 2006, called for significant growth which could only be funded by access to wholesale funding, which he then believed was *"an acceptable and reasonable risk."* Ronan Murphy stated that wholesale funding was *"carefully scrutinised"* by senior management within BOI and that the risks were recognised and managed. In his view, the risks were clearly understood at both senior management and director level and stress tested. However, he said that the complete collapse of the wholesale markets was not anticipated. [211]

John O'Donovan noted the shift by BOI from retail deposit funding towards wholesale funding after 2000. He indicated that 41% of the Group's balance sheet was sourced from the wholesale markets in March 2008 and the expansion of the bank's loan book, particularly into areas that did not generate deposits, had brought a greater reliance on wholesale funding. He said that the funding was diversified by geography and product line and the risk was mitigated by the extension of the

---

206 Jim O'Leary, former Independent Non-Executive Director, AIB, statement, JOL00001-018.

207 Colm Doherty, former Managing Director of AIB Capital Markets and former Group Managing Director, AIB, statement, CDO00001-012.

208 Niamh Brennan, former Audit Committee Member/Chair, UB, statement, NBR00007-024.

209 Eamon Daly, former Internal Auditor, INBS, Section 25 statement, WSCL00002-005/006/021.

210 Helen Nolan, former Group Chief Internal Auditor and current Group Secretary, BOI, statement, HNO00001-007.

211 Ronan Murphy, former Group Chief Risk Officer, BOI, statement, RMY00001-009.

maturity profile. However, these measures were not sufficient to cope with the closure of wholesale markets. He pointed to a number of other factors which had increased BOI's reliance on wholesale funding. John O'Donovan said that he believed that the quantum and composition of the bank's wholesale funding was clearly understood by BOI's senior management and board. [212]

In relation to AIB, John O'Donnell stated that the bank's level of wholesale funding was in line with peer banks and suggested that long-term wholesale funding *"may be the most reliable and stable funding available in a crisis."* He noted that AIB was conscious of the *"greater risks"* of shorter-term wholesale funding and that steps were taken to put a proportion of it on a longer duration. John O'Donnell stated that, prior to the crisis, AIB's funding profile would not have been considered high-risk and referred to a 2007 Standard & Poor's Report in this regard. He said that, to his knowledge, no more than 20% of the bank's funding would mature in a year, but *"the level of risk which emerged in the crisis was…unprecedented and accordingly would not have been understood in advance."*[213]

Kieran Bennett, former Group Chief Credit Officer with AIB, said he did not have direct knowledge of this area. [214]

Effectiveness of Internal Audit: Staff and resources

Several witnesses were questioned on whether the Internal Audit Division within their bank had staff with sufficient skills and experience to enable them to perform reviews on all risks relating to commercial lending and funding risks.

John O'Donovan of BOI stated that it was not the responsibility of BOI Group Internal Audit to perform reviews on risks relating to commercial lending. He said that the responsibility lay with Group Credit Review, which, in his view, *"had the required skills and personnel to deliver on its responsibilities."* In his view, Group Internal Audit had the *"requisite skills to perform audits/reviews on funding risks."* [215]

The minutes of the BOI Group Audit Committee meeting on 10 November 2008 noted that the Group Internal Audit was then operating with 14 fewer staff than when it was established with a staff of 96. Questioned on this minute, Helen Nolan stated that it did not affect the scheduling of audits on high risk or areas or the quality of audits. She noted that Internal Audit *"reassessed on a quarterly basis, the risks facing the business and adapted the Audit Plan to ensure it remained focussed on the key risks."* She suggested that staff and budget increases in the Internal Audit division indicated that management had provided required resources, as required. She stated that the skills and experience to perform reviews on all risks to commercial lending were within Group Credit Control, rather than Internal Audit. She also provided details of the qualifications of several staff members in BOI Internal Audit. [216]

212 John O'Donovan, former Group Chief Financial Officer, BOI, statement, JDV00001-012.
213 John O'Donnell, former Finance Director, AIB, statement, JOD00001-007.
214 Kieran Bennett, former Group Chief Credit Officer, AIB, statement, KBE00001-011.
215 John O'Donovan, former Group Chief Financial Officer, BOI, statement, JDV00001-012.
216 Helen Nolan, former Group Chief Internal Auditor and current Group Secretary, BOI, statement, HNO00001-011/013.

With regard to AIB, John O'Donnell stated: *"There was no shortage of staff or skills that I was aware of."* He noted that staff numbers were increased by 243% between June 2005 and June 2008, with a comparable increase in the division's budget.[217]

Chapter 2.10 of the Nyberg Report examined the effectiveness of the Internal Audit departments in the banks. The Nyberg Report refers to a review of Anglo by external consultants in April 2004, which classified the bank as a *"strong performer"* but *"with a number of opportunities for improvement"*, particularly in relation to the *"greater clarity of the role of IA in the risk management framework."* Their review described the Internal Audit function in INBS as *"inadequate in the growth orientated commercial lending market"* and *"lacking the requisite knowledge and skills in key areas as IT, Treasury and Commercial Lending."* Responsibility for these areas had been outsourced to a large auditing firm.[218]

Eamon Daly, former Internal Auditor with INBS, stated that the Internal Audit Division was not prohibited from auditing any specific area of INBS operations but that the *"very limited resources"* allocated to the department was a limiting factor in practice. He regarded the Division as *"very under-resourced at the time and in hindsight even more so."* Eamon Daly also recalled comments by the Central Bank describing the department as *"clearly under-resourced"* in 2000. [219]

KPMG, after a review of the INBS Internal Audit Function in 2009 observed that:

"…the Society's Internal Audit department needs to build up its experience training in order to perform reviews of key risks areas which are currently outsourced to third parties." KMPG also noted that the INBS Internal Audit performed compliance work and were not acting as "a second line of defence." KPMG recommended that "Internal Audit should be more focused in the key risk areas of the Society."[220]

While the Internal Audit units of the other financial institutions were not singled out specifically in the Nyberg Report, they are covered by a general comment that: *"The other banks had well developed IA functions"* but their *"remit…tended to be somewhat constrained and limited in relation to their role in reviewing the effectiveness of risk management"* resulting in *"certain credit risk areas receiving inadequate scrutiny from an independent IA unit."*[221]

217 John O'Donnell, former Finance Director, AIB, statement, JOD00001-009.

218 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-063.

219 Eamon Daly, former Internal Auditor, INBS, Section 25 statement, WSCL00002-005/006/021.

220 KPMG review of Internal Audit, KPMG00189-016.

221 Nyberg Report, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, PUB00156-064.

Effectiveness of Internal Audit: Review of risks associated with customer concentration levels and short term funding to service long-term lending

A number of witnesses were questioned on whether the banks' Internal Audit units reviewed the risks associated with commercial lending, including customer and sectoral concentration levels and the risks associated with short-term funding to service long-term lending.

Ronan Murphy stated that BOI Group Internal Audit did not carry out these functions, but the Portfolio Review Committee reviewed the composition of the Group's portfolio and identified emerging risk concentrations. He also stated that the Group Asset and Liability Committee reviewed the funding profile of the book and reported to the Group Risk Policy Committee. [222]

Helen Nolan stated the examination of the risks associated with commercial lending was carried out by BOI Group Credit Control, rather than Internal Audit. She stated that aspects of funding risks were reviewed by Group Internal Audit, including management of liquidity and funding, intra-group funding and reflection of the cost of funding in product pricing decisions, the accuracy of the information supplied to the Group Asset and Liability Committee, management of securitisation, internal liquidity management in normal and stressed conditions and reporting practises and compliance with the Financial Regulator's requirements.[223]

John O'Donovan noted that BOI Group Internal Audit did not perform reviews or audits of risk relating to commercial lending. He said that, in his view, responsibility for this lay with Group Credit Review, whose work was audited by Group Internal Audit. He gave similar evidence to Helen Nolan on BOI's review of funding risks. [224]

With reference to AIB, John O'Donnell believed that Group Internal Audit did address management of concentration risk in a 2005 Credit Framework Audit but he said that he was not on the AIB board at that time. He said that he was not aware of AIB addressing the issue of short-term funding servicing long-term lending but suggested this would have been addressed through the bank's liquidity policy. John O'Donnell noted the results of the ICAAP Report, which concluded that credit concentration risk was acceptable. He referred to December 2008, when AIB had carried out an audit of risk management of concentration risk which identified a number of *"important"* issues, but none of which were *"material or significant."*[225]

Kieran Bennett of AIB referred to the December 2008 Group Internal Audit review, noting that this did not include an audit of funding structure. He said that, though action plans were put in place to address the *"important"* issues *"ultimately the situation was too far gone for the GIA recommendations to have any material impact."* [226]

222 Ronan Murphy, former Group Chief Risk Officer, BOI, statement, RMY00001-011.
223 Helen Nolan, former Group Chief Internal Auditor and current Group Secretary, BOI, statement, HNO00001-011.
224 John O'Donovan, former Group Chief Financial Officer, BOI, statement, JDV00001-012.
225 John O'Donnell, former Finance Director, AIB, statement, JOD00001-010.
226 Kieran Bennett, former Group Chief Credit Officer, AIB, statement, KBE00001-013.

In the context of INBS, Eamon Daly said that: *"internal audits of Treasury were conducted in accordance with the risk-based internal audit programme and various issues for improvement were identified."* [227]

The evidence given to the Joint Committee indicated that, up to 2008, Internal Audit in the banks did not normally involve a review the banks' funding decisions or their liquidity position, nor did they comment on the quality of the underwriting performed by the lending teams.

When asked by the Joint Committee whether she had concerns over the concentration of the loan portfolio in property and construction, Niamh Brennan noted that concerns had been expressed by non-executive directors at board/audit committees within Ulster Bank, of which she was a member. She said that management had assured the Ulster Bank board that there were no sectoral concentration issues and that Ulster Bank had operated within regulatory sectoral limits. She said that the board received limited data on sectoral concentrations which influenced its views. Niamh Brennan also noted that as RBS made capital available to support the business and that she had no concerns about concentration risk. [228]

Niamh Brennan did suggest that *"the increasing demands of the shareholder, RBS…adversely affected Ulster Bank's risk appetite"* and RBS's oversight of risk in the bank.[229]

John O'Donovan, CFO BOI, in his witness statement submitted to the Inquiry, stated that *"Group Internal Audit did not review loan advances concentration levels"* and that this was reviewed by Group Credit Control. In relation to Internal Audit reviewing short term funding, he stated *"It was not possible to match fund all assets on the Bank of Ireland Balance Sheet, principally because of the quantum of residential mortgage lending on its balance sheet."* [230]

Helen Nolan noted that:

"…A number of years before my appointment as Group Chief Internal Auditor, responsibility for the function of assessing the quality, control and safety of lending was transferred from Group Internal Audit to Group Credit Control. Minutes of the Group Audit Committee in 1992 record the change. While Group Internal Audit (reporting to the Group Audit Committee) had responsibility for reviewing Group Credit Control's processes and controls and reviewed all other aspects of risk, it did not have an audit function in relation to lending or credit policies. Instead, lending portfolios were reviewed by Group Credit Review, who reported as the third line of defence to the Board through Group Risk Policy Committee (GRPC), a subcommittee of the Board. Concentration risk was monitored by the Portfolio Review Committee, which also reported to the Board through GRPC…"[231]

227 Eamon Daly, former Internal Auditor, INBS, Section 25 statement, WSCL00002-012.

228 Niamh Brennan, former Audit Committee Member/Chair, UB, statement, NBR00007-018.

229 Niamh Brennan, former Audit Committee Member/Chair, UB, statement, NBR00007-017.

230 John O'Donovan, former Group Chief Financial Officer, BOI, statement, JDV00001-013.

231 Helen Nolan, former Group Chief Internal Auditor and current Group Secretary, BOI, statement, HNO00001-003.

Findings of the Joint Committee

1. Bank lending had traditionally been funded from customer deposits, but the banks became over reliant on the wholesale markets in borrowing short term to lend long term. This made banks more vulnerable to a liquidity risk which was not recognised.
2. The arrival of foreign banks into the Irish market increased competition for Irish banks in the late 1990s. New and more aggressive lending products and practices in the commercial real estate and residential mortgage sectors changed the competitive environment in a marked and decisive way.
3. The introduction of new and aggressive lending arising from increased competition in the period leading up to the crisis ultimately adversely affected the customer.
4. The introduction of new mortgage products masked the accumulating difficulty of the year on year increases in house prices, while facilitating a situation whereby affordability could be met in purchasing the mortgage product.
5. When the crisis struck in 2008, banks had already moved very far from prudent lending principles in their dealings with the property development sector in favour of a riskier asset value based lending model.
6. Exposures resulting from poor commercial property related lending not only threatened the business and viability of the individual financial institutions but also the financial system itself.
7. Commercial real estate lending was concentrated among a small number of debtors and in many cases lending was inadequately secured by paper equity and personal guarantees. In addition the practice of interest roll-up further exacerbated risk.
8. There was a culture of excessive executive remuneration in the banks.
9. Bank failure, which required the intervention and support of the sovereign, was the responsibility of senior executive management and the boards of directors.
10. No one single event or decision led to the failure of the banks in the lead in period to the Crisis, but rather it was the cumulative result of a series of events and decisions over a number of years.
11. Internal Audit is a key line of defence in a bank, whose role and function was not fully utilised by the banks in some key risk areas.
12. The introduction by the banks of tracker mortgages to the Irish market was based on a false presumption by banks of the stability of available funding at or near the ECB rate.
13. The reliance on moral suasion and protracted correspondence by the Financial Regulator set the culture in which banks in practice operated.

Recommendations of the Joint Committee

1. The Competition and Consumer Protection Commission should conduct an immediate review of the impact on consumers, due to the perceived lack of competition in banking in Ireland.
2. A full review should take place of section 33Ak of the Central Bank Act 1942, to ensure that only documents deemed 'secret' which are independently reviewed by a High Court judge are withheld from any future Oireachtas inquiry.
3. All members of bank boards should have requisite financial skill sets and experience and should undergo ongoing compulsory Continuing Professional Development (CPD) appropriate to banking, to include risk and governance.
4. A personal remuneration clawback provision linked to medium term performance should be part of the employment contract for senior executive management and board members.
5. A fit for purpose standard certification for Management Information Systems (MIS) in banks should be required annually and conducted by an independent party to a standard set by the Financial Regulator.
6. Governance structures in banks must ensure that the risk function has an independent, senior position in the management structure with direct access to the chairman and board.
7. Risk appetite in banks should be clearly defined at board level and should be the key driver for defining overall strategy.
8. A full risk assessment of new bank products on both the lending and deposit side should be carried out by the risk function and approved by the full board, prior to being introduced to the market.
9. The risk of a mismatch between liabilities and assets in terms of composition, stability, currency and tenure should be reviewed regularly at full board level.
10. Regular reviews of the internal audit function in banks should be strengthened to ensure that it conforms to best practice. A particular objective of such reviews should be to ensure that the internal audit focuses on the areas of highest business risk, including loan concentration levels, capital and liquidity risks, and the management of the organisation.

Chapter 2: The Role of External Auditors

Introduction

Three large audit firms KPMG, EY and PwC, audited the 2008 accounts for the six Covered Institutions[1], and Deloitte audited those of Ulster Bank and gave unqualified audit reports to the effect that the banks' financial records and statements were a true and fair view. Yet within a few months of providing those audit reports, the Government had to rescue the Covered Institutions through a blanket bank guarantee and a programme ultimately costing some €64 billion. That programme was funded by monies borrowed by the Government at highly unfavourable interest rates and involved substantial risk to the State.

This Chapter will examine how such a significant bailout was required for each of the six Covered Institutions in circumstances where unqualified audit reports had issued in respect of each of the Covered Institutions within the previous two years.

This requires consideration of the performance of external auditors in the lead-up to the financial crisis and of the following questions in particular:

- Question 1: Were the external audits of the Covered Institutions conducted to the requisite technical standards?
- Question 2: Where identified, did the external auditors have a professional obligation to notify the shareholders of the Covered Institutions of any potential material risk, even if to do so is outside their reporting parameters?
- Question 3: Should the external auditors have pushed for adequate loan provisions for a *'rainy day'*?
- Question 4: Did the external auditors make appropriate assessments on bank business viability?
- Question 5: Should the external auditors have spotted what NAMA reported?[2]
- Question 6: Is the International Accounting Standard 39 (IAS 39) appropriate for banks?

As noted previously, in certain limited cases, the Joint Committee felt that engaging with certain relevant persons or directing that certain documents be furnished created too great a risk in terms of prejudice to criminal proceedings. Accordingly, the Joint Committee worked within these parameters in issuing its directions.

---

1 See Glossary of Terms for the definition of the Covered Institutions.

2 See Chapter 9, NAMA.

Audits and Requisite Standards

Question 1: Were the external audits of the Covered Institutions conducted to the requisite technical standards?

In order to assess this, it is necessary to understand the values and limitations of an audit. Critical in that respect are the following:

1. Standardised methodology: Financial reporting and audits use an international set of independently produced frameworks, standards and rules to ensure uniformity, consistency and transparency.[3]
2. *"Point in time":* An audit is conducted on Financial Statements prepared by the directors of the client company; they are just a point-in-time record of financial information (i.e. the balance sheet date which is usually 31 December).
3. All *'look-back':* It only provides a *'look-back'* through a rear view mirror of past financial performance.
4. No *'look-forward':* An audit does not have predictive capability or function; it does not seek to forecast future performance, anticipate future trading risk or predict the valuation of assets which a bank has taken as security for loans underwritten.
5. *'True and fair view':* An auditor is required to provide an opinion on whether the Financial Statements give a *'true and fair view'* of past financial performance for the period under review.
6. Constrained nature of *'Notes to the Accounts':* The annual accounts typically include *'notes'* that provide details and insights on a company's balance sheet and other areas of the accounts for consideration by the client's management.

The limitations of an audit must be borne in mind in considering the substantive question of whether the external audits were conducted to the requisite technical standards.

Although the *'notes'* are generally constrained by *'point in time'* and *'look-back'*, those features are also beneficial for enabling past risk to be described. Despite this, up to 2007,[4] *the 'Notes to the Accounts*' in the Financial Statements relating to the Covered Institutions gave the reader little detail on the large loan concentrations in previous years.

The following table identifies the external auditors for each of the Covered Institutions from 2002 to 2010, being the time when the Troika Bailout Programme was put in place.

3 Known as financial reporting standards (IFRS), these are set by independent international bodies, apply in 280 jurisdictions and are underpinned by national and by EU Regulations.

4 IFRS 7 – From the 1 Jan 2007 Financial Statements were required to make more detailed disclosures.

Bank	2002	2003	2004	2005	2006	2007	2008	2009	2010
AIB	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG
EBS	EY	EY	EY	EY	EY	EY	EY	KPMG	KPMG
BOI	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC	PWC
Anglo	EY	EY	EY	EY	EY	EY	EY	DT	DT
PTSB	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG
INBS	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	KPMG	N/A

Source: All Auditors names taken from Published Annual Reports.

In the 9 years up to the Troika Bailout, the three large audit firms not only dominated the audits of Ireland's Covered Institutions but they did so for extended, unbroken periods. During the same period, Deloitte audited the accounts of Ulster Bank

The Joint Committee was informed that the Chartered Accountants' Regulatory Board (CARB)[5] reviewed the 2008 audits of each of the Covered Institutions and, where relevant, some 2009 audits.[6] This review was designed to determine whether the auditors of the Covered Institutions complied with the relevant auditing standards when carrying out the audit of the loans and the associated provisions for 2008/2009. The review did not set out to determine the appropriateness of the auditing standards.

Each of the witnesses who gave evidence to the Inquiry on behalf of the four large audit firms asserted that they had complied fully with the auditing rules and standards of the time.[7]

In October 2010, the European Commission issued a green paper entitled *"Audit Policy: Lessons from the Crisis."* The paper set out a series of proposals for improving the statutory audits of public-interest entities such as banks by enhancing auditor independence and making the statutory audit more dynamic. Amongst the key proposals set out in the green paper were:

- mandatory rotation of audit firms (originally a maximum engagement period of 6 years with some exceptions was proposed but this was subsequently increased to 10 years).
- compulsory tendering for audit services.
- prohibition on audit firms to provide non-audit services.
- European supervision of the audit sector.

Of special relevance to this Inquiry is the proposal in the green paper on debtor concentrations where it is recommended that, in future, an external audit of a financial institution should comprise

5 This Board was established by the Institute of Chartered Accountants in Ireland to regulate its members, in accordance with the provisions of the Institute's bye-laws, independently, openly and in the public interest. The CARB is responsible for developing Standards of Professional Conduct and supervising the compliance of members, member firms, affiliates and students, PUB00415.

6 Paul Dobey, Partner, KPMG, transcript, INQ00105-009.

7 Paul Smith, former Managing Partner, EY, transcript, INQ00116-004; Terence O'Rourke, Partner, KPMG, transcript, INQ00105-004; John McDonnell, Partner, PwC, transcript, INQ00117-027; Gerry Fitzpatrick, Partner, Deloitte, transcript, INQ00103-006.

a specific and detailed review of the institution's loan book on behalf of the Financial Regulator or equivalent authority. Notably, the review could include analyses of loan concentrations which would be free from the constraints of the accounting standard IAS 39. Currently this proposal has not been brought into law in Ireland.

In addition, in order to further strengthen the auditors' reporting to the Financial Regulator, as noted by Paul Smith, former Managing Partner of EY, these regulatory returns should be subjected to an independent third party audit, as is the current approach within insurance companies.

In evidence he said:

"Insurance companies are required to provide detailed information to regulators in their regulatory returns and to ask an external auditor to provide an opinion on those returns. It seems logical…that banks and other financial institutions could be subject to the same requirements. Their returns could be independently audited as well. That would improve the transparency of the system and increase regulators' confidence in the information that financial institutions provide. It would also ensure … it would also serve to ensure that auditors were aware of current trends in the Financial Regulator."[8]

The Joint Committee would strongly endorse this approach.

Audits and Risk Identification

Question 2: Where identified, did the external auditors have a professional obligation to notify the shareholders of the Covered Institutions of any potential material risk, even if to do so is outside their reporting parameters?

The role of auditors, if any, in identifying, assessing and reporting on risk, especially of a business critical nature, featured strongly throughout the Inquiry. The question arises as to whether the external auditors could have done more to flag emerging risks as regards the level of loan concentration in the banks? In the search for an answer, the assessment of external auditors provides a useful starting point.

Banks, through their Audit Committees, conduct periodic reviews of the effectiveness of external auditors. In the case of BOI, for example, it is noteworthy that, following review of PwC's 2010 audit, the Group Audit Committee (GAC), commented that *"the external auditors were performing effectively"* even though it had *"generally not been part of the terms of engagement of external auditors to look at a bank's risk model."*[9] It is difficult to reconcile the fact that BOI produced healthy financial statements, which had been audited, shortly before that bank required a capital injection from the Government of €4.7 billion. However, under IAS 39, as the auditors could not have due regard to future anticipated credit losses, this would appear to have caused difficulty with the criteria under which the financial statements were audited.

8 Paul Smith, former Managing Partner, EY, transcript, INQ00116-005.

9 Group Audit Committee Meeting Minutes 6 August 2010, PWC00449-003/004.

Clearly in this case, the GAC was challenged as well and to its credit, it sought to determine what guidance could be offered in order to avoid repeating the problems arising from inadequate loan impairment provisions.[10]

One of the purposes of this Chapter is to examine the question of what an external auditor could or should do if the auditor has serious concerns about a bank's excessive exposure to land and development lending. A number of issues arise for consideration in this regard:

Limited role of an auditor: As already mentioned, the audit firms maintained that it was not their role to advise their clients on the risks attaching to a disproportionate reliance on property-related lending. Dargan Fitzgerald Audit Partner, EY, said:

"Disagreement with the bank's commercial decisions [and drawing attention to the attendant risks] would not have been a basis to resign or qualify the previous year's Financial Statements, unless, for example, those financial statements were misstated or there were corporate governance issues which had led the auditor to doubt the integrity of management."[11]

Generic treatment: During the years leading up to the financial crisis, the *'Notes to the Accounts'* did not raise alarm bells over property-related loan concentration levels or associated risks.

Loan provisions: A loan provision can be described as an expense to account for future losses on loans underwritten by a bank. Under the International Accounting Standard IAS 39, which was adopted by the Irish banks in 2005, only recognised losses – and not anticipated credit losses – can be provided for.

Audits and Loan Provisions

Question 3: Should the external auditors have pushed for adequate loan provisions for a 'rainy day'?

Since the financial crisis, IAS 39 has been heavily criticised on two grounds in particular:

1. ***'Point in time'* asset valuation:** Under IAS 39, the asset is valued at a point in time only. The valuation of an asset does not anticipate any future potential decline in the asset's value when calculating the amount of a provision.
2. **No *'rainy day'* provision:** IAS 39 does not allow a financial institution to anticipate a potential unknown loss into the future. It only allows the institution to provide for loans where it is actually aware of a loss and not to anticipate the future potential loss. Thus, it is an inherently pro-cyclical construct i.e. when times are good, there are few *"recognised"* losses and so, low provisions. When times are bad, there are more *"recognised"* losses and, therefore, more provisions required. This delays the recognition of the loan losses coming down the track and gives rise to significant additional provisions in a downturn i.e. making provisions to cover the loan losses as they occur. This is what happened with the Irish banks, but on a previously unimagined scale.

---

10 Group Audit Committee Meeting Minutes 6 August 2010, PWC00449-003/004.

11 Dargan Fitzgerald, Audit Partner, EY, transcript, INQ00116-007.

When the downturn came in 2008, the financial institutions were not permitted by the rules of IAS 39 to make impairment provisions for all of the losses they were forecasting for subsequent years. Thus, instead of making provision in the audited accounts, AIB, for example, found itself having to disclose to the market in February 2009 that it expected to book further losses of between €4.6 billion (base case) and €6.7 billion (stress case) in 2009 and 2010. However, during Joint Committee questioning of the external auditors, it became evident that there is in fact an exception to the *'rainy day'* rule that potentially could have been invoked.[12]

Exception to the 'rainy day' rule and the IBNR

IAS 39 does not allow banks to create or hold general provisions in the good years to offset problems in the bad years. The concept of booking a *"general provision"* or increasing the provision amount calculated under the accounting standard through the *"Incurred but not Recognised"* (IBNR) criteria was raised with Paul Dobey, Partner at KPMG, during the Inquiry hearings.[13] Paul Dobey explained that the IBNR can be used to calculate a provision, where a customer of a bank, who has funds and is currently up to date with their loan repayments, but who will have cash flow problems in the future and so may not be able to repay their outstanding loan.[14] However, the use of IBNR, as outlined under IAS 39, to increase the loan provisions would not have resulted in the banks' loan provisions matching the actual loss booked when the banks sold their loan portfolios to NAMA. The loan provision loss percentage adopted in the provision calculation under the *"rules"* of the IBNR must be based on previous loss experience. The level of loss experienced by the banks as a result of the loan portfolio transfers to NAMA was unprecedented.

An example of a provision calculated under IBNR criteria would be, where a bank had a number of home loans in a town and the borrowers were employed in a local factory. If it were announced that the factory was closing down, the bank would know that a certain percentage of these borrowers would not be able to repay their loans (a *'known unknown'*). Under the IBNR criteria, the bank would be allowed to use its experience of a previous similar situation to extrapolate the default percentage and calculate the default rate. In short, the bank could make provision for such loan losses.

The Joint Committee formed the opinion that the management teams within the banks arguably had the capacity to ensure that critical business risk would feature in the deliberations during audit. Alan Merriman, Director of Finance, EBS, said:

"If management in any bank or any building society felt that the loan loss provisions under IAS were shy or weren't appropriate, it was open to management to share that through voluntary disclosure or other data. So, tables giving statistics on loan defaults, tables giving insights about future expected losses, they were all open to banks, regulators, everybody, to try and get that type of information."[15]

12 Paul Dobey, Partner, KPMG, transcript, INQ00105-044/046.

13 Paul Dobey, Partner, KPMG, transcript, INQ00105-045.

14 Paul Dobey, Partner, KPMG, transcript, INQ00105-045.

15 Alan Merriman, former Finance Director, transcript, EBS, transcript, INQ00137-013.

Notably though, he added that, despite the external auditors having had no difficulty with impairment provisions being made on the development finance book for the 2008 accounts, the Central Bank and Financial Regulator raised this as an issue:

"… they [the Central Bank and Regulator] were concerned that our provisioning might cause wider difficulties for the other banks and we were cautioned at the highest of levels to be very sure that what we provided was really needed."[16]

Audits and 'Going Concern'

Question 4: Did the external auditors appropriately identify bank business viability?

The audit concept of *"going concern"* needs to be explained as it is one of the fundamental assumptions underpinning the basis on which Financial Statements are prepared. Points of note include the following:

Statement of business viability:

Financial Statements, which are prepared on a going concern basis, state, in effect, that the business entity will continue to operate into the foreseeable future without the need or intention on the part of management to liquidate the entity or significantly curtail its operational activities.

Board approval of appropriateness:

Prior to approving Financial Statements prepared by management each year, the board of a financial institution is required to assess the appropriateness of the going concern basis. This involves:

- An assessment of the assumptions relating to the financial institution's capital and liquidity.
- The future business plans of the financial institution and their impact on the ability to continue as a going concern for a period of at least one year from approval of the financial statements.

Auditors' assessment

The auditors assess and conclude on the appropriateness of the Directors' conclusion in adopting the going concern basis for the preparation of the Financial Statements by the directors. Of particular note is that the auditors form a view as to whether there are material uncertainties about a financial institution's ability to continue as a going concern which need to be disclosed in the statements and referred to in the audit report.

When assessing whether the external auditors appropriately reviewed and assessed the future business viability of the banks, a number of considerations arise:

Appropriateness of 'going concern' in the Covered Institutions

Up to and including 2006, the assessment of the external auditors of the Covered Institutions was that the going concern basis of preparation of the banks' Financial Statements was appropriate. Those assessments took account of available economic assessments and forecasts.[17]

---

16 Alan Merriman, former Finance Director, EBS, statement, AME00002-007.

17 Terence O'Rourke, former Managing Director, KPMG, transcript, INQ00105-005.

The economic context for banking

The auditors and other witnesses referred to the sense of economic security and favourable outlook enunciated by widely respected sources of authority in the pre-crisis period. Brendan McDonagh, CEO of NAMA, described the connection between positive commentary and the feel-good factor in the following terms:

"All we had were publicly available documents such as credit rating agency reports, market updates, annual reports and broker/analyst reports. Not surprisingly, by reference to this published material from respected and financially literate commentators from 2005 to 2007, one could conclude that, while there were risks, there were no strong warning signals of the financial carnage that would ultimately emerge." [18]

Economic Deterioration

In 2007, economic conditions began to deteriorate and, as they did, audit firms became increasingly concerned about the effects of the worsening financial markets on the liquidity and funding positions of banks. In this regard, extensive loan reviews on the property and construction loan portfolios were conducted, identifying the top exposures and determining whether appropriate judgement around provisioning had been taken.[19] Similar detailed analyses of the quality of loans where conducted in the other banks with data showing details of deterioration.[20]

Given the unfolding economic circumstances and the fundamental property lending and funding challenges being faced in 2007 and into 2008, greater emphasis came to be placed on the preparation of detailed going concern status by the banks'. This included contingency liquidity plans and greater Bank Audit Committee oversight in order to satisfy auditors that the going concern basis of preparation of a bank's Financial Statement was appropriate.[21]

Directors' Responsibilities Emphasised

The Financial Reporting Council (FRC)[22] issued two reports, one at the end of 2008 and the other in October 2009, providing comprehensive guidance to Directors on how to fulfil their responsibilities with regard to going concern assessment.[23]

Assurances sought

General auditor concerns about the impact of the developing financial crisis on the Covered Institutions' audits led the four largest audit firms in Ireland, Deloitte, EY, KPMG, and PwC, to meet as a group with the Financial Regulator in early 2008.[24] Issues considered during this meeting included auditor-regulator communications, bank liquidity, asset valuations, provisioning and 100% mortgages.[25]

---

18 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-003/004.

19 Paul Dobey, Partner, KPMG, statement, PDO00001-004.

20 Gerry Fitzpatrick, Partner, Deloitte, transcript, INQ00103-007.

21 Terence O'Rourke, former Managing Director, KPMG, statement, TOR00001-011.

22 The FRC sets the standards framework within which auditors, actuaries and accountants operate in the UK. It also sponsors the UK Corporate Governance Code (for companies) and the Stewardship Code (for investors). The FRC monitors the implementation of these standards and promotes best practice by companies and professionals through the issue of guidance and publication of leadership papers.

23 Terence O'Rourke, former Managing Director, KPMG, statement, TOR00001-008.

24 Arranged via the Institute of Chartered Accountants of Ireland (ICAI), Paul Dobey, Partner, KPMG, transcript, INQ00105-041; John McDonnell, Partner, PwC, transcript INQ00117-012/016.

25 General Auditor Concerns in early 2008, Nyberg, 3.7.1, PUB00156-072.

On occasions, some audit firms interacted directly with the Financial Regulator and the Department of Finance prior to finalising their opinion on the going concern preparation of a particular bank's Financial Statement.[26] The purpose of this was to ensure a full understanding amongst the authorities of the risks now evident in the financial system and of the actions being taken by the Financial Regulator, the Central Bank and the Irish Government to address these risks, especially through the availability of Emergency Liquidity Assistance (ELA).

During this period (2008 and 2009), various external Bank audit reports commented on the worsening economic conditions, citing in particular the unpredictability of asset values, the significant deterioration in property loan portfolios, the loan loss provisioning in an illiquid market and the need to conduct extensive loan reviews, particularly on large exposures.

Yet despite the absence of strong language in the audit report commentaries prior to 2007,[27] the option to reflect the significant and accelerating uncertainties in the audit commentary was not taken and only 'Notes to the Accounts', the preparation of which are the responsibility of the directors, were made. Accordingly, it was necessary to extrapolate the risks associated with the business models adopted by the banks from the reports.

More fundamentally, Modified Audit Opinion, including an *'Emphasis of Matter'* paragraph – a note indicating significant uncertainty or concern – was not raised in any of the accounts for 2007, 2008 or 2009 of any of the Covered Institutions to draw the reader's attention to the severe difficulties unfolding and gathering pace in the banks over that period.[28]

Unqualified Opinions and the Bank Guarantee

For all the Covered Institutions, the going concern basis of preparation was considered appropriate in the 2008/2009 Financial Statements. That position was underpinned by assurances received from the Department of Finance including the Government Guarantee.[29] As Dargan Fitzgerald said, the Guarantee had become *"a key factor"* when assessing the bank's going concern designation.[30]

It was not until 2010, when the assurances provided by the State Guarantee ceased, that Emphasis of Matter started to appear in banks' annual accounts[31] e.g. those of AIB and EBS. This suggests that the provision of the State Guarantee influenced the behaviour of the external auditors in their assessments of the banks' going concern designation. Terence O'Rourke, former Managing Partner of KPMG, gave evidence was to this effect:

"In respect of the financial year 2010, when the general bank guarantee had expired and all of the previous assurances from the Central Bank and Department of Finance in relation to the continued support of the banks were no longer available to us, KPMG modified our audit opinions."[32]

---

26 Paul Dobey, Partner, KPMG, transcript, INQ00105-042; John McDonnell, Partner, PwC, transcript, INQ00117-015.

27 Gerry Fitzpatrick, Partner, Deloitte, transcript, INQ00103-055/056.

28 Nyberg, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, Chapter 3, External Auditors, paragraph, 3.2.8. PUB00156-068.

29 Paul Dobey, Partner, KPMG, transcript, INQ00105-018; John McDonnell, Partner, PwC, transcript, INQ00117-059; Dargan Fitzgerald, Partner, EY, transcript, INQ00116-016.

30 Dargan Fitzgerald, Audit Partner, EY, statement, DFI00001-002.

31 Nyberg, Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland, Chapter 3, External Auditors, Sect 3.1.2, PUB00156-067.

32 Terence O'Rourke, former Managing Director, KPMG, statement, TOR00001-011.

Audits and What NAMA Reported

NAMA provided detailed evidence on what it regarded as poor lending practices and controls on property-related lending by the Covered Institutions (see Chapter 9, NAMA). Excessive exposures to a small number of major debtors, massively over-valued loans, extensive non-performing and under-performing loans, significant interest roll-up, weak and sometimes non-existent collateral, and risky reliance on solicitors' undertakings were amongst the main deficiencies referred to by NAMA.

Question 5: Should the external auditors have spotted what NAMA reported?

NAMA imposed an aggregate haircut of almost 58% across all loans transferred to it whereas the banks had estimated that the loan discounts would be 30%.[33] From the perspective of external audit, a number of factors must be considered:

- property-related exposures
- challenge to the banks' business strategies
- interest roll-up
- valuation methodologies

1. Property-related exposures

Of particular relevance in this context is a term called *'Own Funds'*. This is a critically important prudential monitoring ratio designed to prevent over-exposure to any one sector or series of related sectors.

The Central Bank's Licensing and Supervision Requirements and Standards for Credit Institutions (the *"Standards"*) provided in the pre-crisis years that a credit institution should not have risk assets (e.g. loans issued) amounting to more than 200% of shareholder funds (*'Own Funds'*) in any one sector of business or economic activity. Where considered to apply to two or more separate sectors, the Standards provided that the limit was 250%. In its totality, the Irish financial system over-extended the limits by a considerable margin.

John McDonnell, Partner with PwC, gave similar evidence in relation to the audits of the BOI's accounts, citing adherence to prevailing rules and regulations and the introduction of IFRS 7 reporting requirement in January 2007 as having led to a *"substantial increase"* in information on loan disclosures.[34]

2. Challenge to the banks' business strategies

Auditors have asserted that it is not their role to report critical risk in a bank to the Central Bank/ Financial Regulator, nor is it their role to question any client's business model and/or strategy. During the Inquiry, the auditors who gave evidence were questioned in relation to this position.[35]

33 Brendan McDonagh, former Director of Finance, Technology and Risk, NAMA, transcript, PUB00331-044.

34 John McDonnell, Partner, PwC, transcript, INQ00117-052.

35 Paul Smith, former Managing Partner, EY, transcript, INQ00116-004; Paul Dobey, Partner, KPMG, statement, PD00001-003.

For example, John McDonnell was asked whether there was any consideration given to the fact that it may be an issue of interest to the Financial Regulator that one of the main banks in Ireland had, for example, 44% of its non-mortgage related lending in property and construction.

John McDonnell replied:

"…the Regulator has its own regular returns [from the banks] … and those returns deal with various concentration risks. So the Regulator has its own mechanism to be well aware of what the banks do … So, the fact that we see something in our work which as part of our audit doesn't lead us to report per se to a Regulator in that situation because the Regulator has its own framework."[36]

The belief that the Financial Regulator already had the requisite information may, in some instances, have influenced the nature of the content reported by external auditors. Client confidentiality considerations may also have inhibited auditors from reporting critical risks arising from a client's business model or strategy – a situation which is different in the UK.[37]

Nonetheless, it is clear that avenues were open to external auditors to bring matters of significant importance to the attention of the Financial Regulator. In this regard, John McDonnell said:

"we have an obligation to report certain matters to the Financial Regulator…it's only if something comes to our attention….when we are completing our work as auditors…looking at risks of material misstatement in the financial statement."[38]

Dargan Fitzgerald said:

"the auditors were constrained by client confidentiality and could only have divulged confidential information to the Financial Regulator in limited circumstances, such as where there had been a regulatory breach."[39]

In the lead-up to the financial crisis, formal and informal engagements were taking place across a number of management strata, including top management level. This was supported by significant financial reporting, including copies of findings arising from discussions between the external auditor and the Audit Committee as part of each reporting cycle.

There were also formalised guidance procedures, such as Auditing Practice Note 19(1), which is designed to assist auditors in applying audit standards of general application to particular circumstances and settings. Included in Practice Note 19(1) is guidance for circumstances where:

"…the auditor concludes that a matter does not give rise to a statutory duty to report but nevertheless feels that in the public interest it should be brought to the attention of the Financial Regulator."[40]

36 John McDonnell, Partner PwC, transcript, INQ00117-054.

37 Public Accounts Committee, PUB00072-061.

38 John McDonnell, Partner PwC, transcript, INQ00117-054.

39 Dargan Fitzgerald, Audit Partner, EY, transcript, INQ00116-007.

40 The Audit of Banks in the Republic of Ireland - Nyberg, Chapter 3, External Auditors, Sect 3.4.1, PUB00156-070/footnote 74.

3. Interest roll-up

Loans in respect of 'interest roll up' amounting to €9 billion were transferred to NAMA.[41] These types of loans arose from the borrower either having been offered an 'interest repayment holiday' by the bank or where the borrower was not able to make an interest repayment on their loan.

The external auditors were not questioned on the treatment of interest roll-up in the accounts, nor were they asked to comment on the evidence given by NAMA in this regard. However, in response to a question from the Joint Committee as to when a loan could be regarded as impaired under IAS 39, Paul Dobey said:

"well, non-payment of capital or interest, in accordance with the contracted terms. That's difficult, as you can understand, in relation to loan where there's roll up of interest"[42]

It is not apparent whether or not the external auditors identified interest roll-up loans, where the borrower was not able to make an interest repayment, and/or insisted that these amounts be included in the loan provisions of the bank.

4. Valuation Methodologies

In the 18 months to 2 years leading up to the transfer of impaired assets to NAMA, significant haircuts were being noted on the banks' values. From the evidence of witnesses, it is clear that the ultimate discount applied by NAMA did not come as particular surprise.[43]

While it is true that differences in methodology and timing issues influenced the scale of the discounts applied by NAMA, it would appear that poor and non-existent collateral for property-related loans may have been of some significance.[44] From an audit perspective, a recommendation – even if informally conveyed – to senior management to probe the underlying collateral of a very large loan(s) would have been warranted in certain circumstances, such as new market indicators casting serious doubts on the reliability of a valuation.

Appropriateness of IAS 39 for Banks

Question 6: Is the International Accounting Standard 39 (IAS 39) appropriate for banks?

IAS 39 was adopted by the Irish banks in 2005 for the calculation of their loan impairment (*'provision'*) figure. Unlike its predecessor, Irish GAP, IAS 39 does not allow for a general amount to be set aside for unknown bad debts.

Whatever the merits of that restriction in general business settings, IAS 39 was referred to by Eugene Sheehy as *"a totally nonsensical accounting standard from a banking point of view"* and Michael Buckley said that probably *"99% of people in the banking industry held this view as*

41 This is considered in Chapter 9, Establishment, Operation and Effectiveness of NAMA.

42 Paul Dobey, Partner, KPMG, transcript, INQ00105-044.

43 Paul Dobey, Partner, KMPG, transcript, INQ00105-013. The discount is considered at Chapter 9, Establishment, Operation and Effectiveness of NAMA.

44 Neither AIB nor BOI were expressly given an opportunity to accept or challenge the evidence given by NAMA regarding the extent of the haircut needed. See Chapter 9, Establishment, Operation and Effectiveness of NAMA.

well."[45] Notwithstanding the consensus amongst bankers on the serious shortcomings, this IAS 39 was widely adopted, in Ireland and abroad. However, there were exceptions, for example the United States and Spain.[46]

When asked by the Joint Committee whether he thought IAS 39 becoming IFRS 9 in 2018 was 15 years too late, Frank Daly, Chairman, NAMA, replied:

"It is. And again, certainly as a lay person, I'd find it difficult enough – and I'm not an auditor and I'm not an accountant … the problem seems to have been recognised two to three or maybe more years ago. It's a puzzle to me as to why it is taking so long to actually… because it will only kick in in respect of reporting periods after 1 January 2018." [47]

Brendan McDonagh, CEO, NAMA, also stated that a fatal flaw of IAS 39 was that:

"…they [the banks] weren't obliged to recognise those losses [losses on loans acquired from institutions by NAMA]…at 31 December 2009 because under IFRS effectively the NAMA event had not yet happened. It was something that was going to happen after 31 December, and that is the fatal flaw in IAS 39."[48]

Eugene Sheehy said that the United States regulator had advised that, while compliance with IAS 39 was advisable, it could in fact be ignored. Consequently, US banks did just that, and ignored it. It also appears that a similar position was adopted by the Spanish banks because the Spanish Regulator had advised that banks had already made additional provisions.[49]

Jim O'Leary, Economist and board member with AIB Group, estimated the AIB's losses across the cycle at 0.35%, whereas Nick Treble in 2009[50] estimated a charge of 0.66% on average for the years 2008 to 2010. In reality, the average provision for that period turned out to be 4.7% - some 7 times greater than Treble's estimate. Thus, Jim O'Leary concluded that it was the unexpected loan losses – not the expected ones – that brought down AIB.[51]

Conclusions:

On the basis of evidence provided to the Inquiry, it seems clear that the external audits of the Covered Institutions were conducted in accordance with the standards and rules of the time. However, as the auditors were precluded from taking account of anticipated future losses, the audited Financial Statements did not identify, describe or report on critical business risks in the financial services sector.

Arguably, however, the banks could have brought such risks to the attention of the auditors and the banks could have then have included them in *'Notes to Accounts'*.

45 Eugene Sheehy, former Group Chief Executive, AIB, transcript, INQ00133-045/046; Michael Buckley, former Group Chief Executive, AIB, transcript, INQ00133-045/046.

46 Paul Dobey, Partner, KPMG, transcript, INQ00105-033/034.

47 Frank Daly, Chairman, NAMA, transcript, PUB00331-060.

48 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-020.

49 Eugene Sheehy, Group Chief Executive, AIB, transcript, INQ00133-047.

50 Nick Treble, CRO, Presentation at Board Seminar, Title of Paper Why has the Credit Crisis hit AIB so Hard?, AIB02691-044.

51 Jim O'Leary, Economist, AIB, statement, JOL00001-019.

The disconnection between the audit function and risk assessment enabled healthy Financial Statements to be issued very shortly before the banks required re-capitalisation. The Financial Regulator received these healthy reports, which had been audited, and it appears that no issue was raised by the Financial Regulator as to the nature of these reports. It appears to the Joint Committee that a closer alignment between the audit function and risk analysis could have heightened awareness across the financial system much earlier than it did.

In 2007 and 2008 in particular, it would appear that there was a compelling argument for strong direct language in the audit report commentaries to reflect the significant and accelerating uncertainties. However, the absence of this language does not amount to a failure to adhere to IAS 39.

In the accounts for the years leading up to 2007 and 2008, when the banks were concentrating their lending *"assets"* on loans to the property and construction industry at record rates, there were few *'notes to the accounts'* informing the reader of the potential risks involved with this strategy. Therefore, the audited accounts provided little information as to the implications of the risks undertaken.

In evidence, the auditing firms maintained that it was not their role to advise client financial institutions on the risks attaching to a disproportionate reliance on property-related lending. Nor did they believe that it was their role to challenge the banks on their business models. That, they argued, would have strayed beyond their sphere of responsibility and competence as auditors.

On the regulatory side, there was passivity. The inadequacy of IAS 39 for banking was not challenged, let alone flexed for the unique conditions pertaining in Ireland up to the crash. The particular characteristics of IAS 39, along with the limitations in the methodology of an audit, played a significant part in masking critical business risk within individual banks and, more widely, systemic risk across the entire financial system.

Findings of the Joint Committee

1. In the 9 years up to the Troika Programme bailout, KPMG, EY and PwC not only dominated the audits of Ireland's financial institutions, but they audited particular banks for extended, unbroken periods. During the same period, Deloitte audited the accounts of Ulster Bank.
2. It was open to the banks to make voluntary disclosures of potential future provisions for loan losses, which was not required under IAS 39.
3. IAS 39 delayed the recognition of loan loss provisions when the downturn came.

Recommendations of the Joint Committee

1. The European Commission's recommendations on audit changes for banking, which include: mandatory audit rotation of audit firms (originally a maximum engagement period of 6 years with some exceptions was proposed but this was subsequently increased to 10 years), compulsory tendering for audit services, prohibition on audit firms providing non-audit services and European supervision of the audit sector should be implemented.
2. The capacity for direct reporting of critical business risk to the regulatory authority by an external auditor of banks should be strengthened.
3. Financial institutions should be obliged to obtain an independent audit of their regulatory returns. The external audit function would be strengthened significantly by such an independent audit, bringing it into line with practice in insurance companies. An independent audit should highlight any inconsistencies between the annual audited Financial Statements and the regulatory returns submitted during the year.

Chapter 3: The Property Sector

Introduction

In this chapter we explore the role of the property sector in the crisis. We examine the evidence of developers and valuers in relation to their processes and behaviours, and look at interactions between the property sector and financial institutions, political parties and government. Finally, we briefly examine relationships between the property sector and the media.

Section 1 - Role of Developers

A. Introduction

Developers played a major role in the economy during the 1990s and 2000s. Property prices during the period skyrocketed, and construction-related output accounted for 23% of GDP at the peak of the boom in 2006, as compared with 12% today.[1] In 2007 the construction sector accounted directly for over 270,000 jobs[2], which represented over 13% of all those in employment in the country[3] and an increase of over 100,000 in just seven years.[4]

As the property sector grew, more and more developers with access to cheap money entered the market. The sector began to crowd out other sectors of the economy, through a combination of increased speculative construction and rapidly rising property prices.

A very significant proportion of the sector was concentrated in a small number of developers; of the €74.4 billion worth of loans taken over by NAMA, €33.7 billion was concentrated in only 29 commercial borrowers.[5]

When the bubble burst, the sector was left in a sundered state, its most visually impactful legacy being 'Ghost Estates' across the country.[6]

During the boom, there was an excessive reliance on property-related activity, income and taxes. In her evidence to the Inquiry, Mary Harney, former Tánaiste, said that:

"…spending was allowed to increase too rapidly as the economy overheated with continued growth and the exchequer finances becoming over-dependent on construction."[7]

The Joint Committee received evidence from nine of the country's largest developers and property investors, four of whom gave evidence in public hearing and five by written statement.

1 Tom Parlon, Director General, CIF, transcript, INQ00064-007.

2 Tom Parlon, Director General, CIF, transcript, INQ00064-007. He said that 273,900 people were directly employed in the industry in Q2 2007.

3 Liam Barron, Director General, Central Bank, statement, LBA00001-006.

4 In 2000, there were 166,300 engaged in the construction industry, which represented just under 10% of the total number in employment and close to 100,000 fewer than in 2007. (Source: CSO, QNHS).

5 Brendan McDonagh, CEO, NAMA, statement, BMD00001-010.

6 NIRSA & NUIM report, A Haunted Landscape: Housing and Ghost Estates in Post-Celtic Tiger Ireland, PUB00263-009.

7 Mary Harney, former Tánaiste and leader of the Progressive Democrats, statement, MHA00001-005.

B. Developers' Business Models

During the boom, the business models of developers differed greatly depending on the nature and scale of the business.

As evidenced in public hearings and from written witness statements, some of the more established, long-standing individuals and firms in the industry had robust and easily adaptable business strategies. The evidence indicates that, while they tended to diversify activity and investment by asset type, geography and income stream within Ireland, some developers diversified by investing in the same asset type in different regions outside of Ireland. The evidence suggests that the business was supported by highly qualified professionals, such as surveyors, economists and accountants, to assist with risk assessments and business planning.[8] The evidence further suggests that they invested time and money preparing to bid on assets or submitting proposals to financial institutions.[9]

However, as will be seen later in the report, there was an increasing use of drive-by valuations and computer-generated valuations while other developers made bids on so-called "trophy chasing."[10]

When signs of a slowdown in the Irish property market were becoming evident around the mid-2000s, some developers began to deleverage by, for example, selling their land and development assets while, at the same time, retaining income-creating assets to generate cash flow. Other developers increased their concentration and bought at the height of the boom.[11] However, the sheer scale and suddenness of the downturn caught out even the most experienced developers. The property market disintegrated and the loans of most developers who had total exposures over €20 million were transferred into NAMA.[12]

C. Relationships with Banks

In the lead up to the crisis, many developers had become completely reliant on bank debt to fund their developments. Brendan McDonagh noted that *"the majority of debtors were, in effect, sole traders and they were totally reliant on bank debt."*[13] Sean Mulryan and Michael O'Flynn both said that there should be less reliance on bank funding in the future and more emphasis placed on equity from professional investors.[14]

8 Sean Mulryan, Developer, Ballymore Group, statement, SMU00001-005/012; Michael O'Flynn, Developer, O'Flynn Group, statement, MOF00006-009; Joe O'Reilly, Developer, Castlethorn Construction and Chartered Land Group, statement, JOR00001-006.

9 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-004; Michael O'Flynn, Developer, O'Flynn Group, transcript, INQ00121-003; Joe O'Reilly, Developer, Castlethorn Construction and Chartered Land Group, transcript, INQ00126-007/029; John Ronan, Developer, RGRE, statement, JRO00002-005/006; Michael O'Flynn, Developer, O'Flynn Group, statement, MOF00006-008/009; Joe O'Reilly, Developer, Castlethorn Construction and Chartered Land Group, statement, JOR00001-003/004; Sean Mulryan, Developer, Ballymore Group, statement, SMU00001-005/009; Gerard Gannon, Developer, Gannon Homes, statement, GGA00001-003/004; Gerard Barrett, Developer, Edward Holdings, statement, GBA00001-004 to 007.

10 Frank Daly, Chairman, NAMA, transcript PUB00331-013.

11 John Moran, International Director, Jones Lang LaSalle, and Managing Director, Jones Lang LaSalle Ireland, transcript CTX00047-004/005.

12 C&AG Special Report, Progress Report 2010 – 2012, NAMA00010-019.

13 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-011; Derek Quinlan, Developer, Quinlan Private, transcript, INQ00092-007 also says that "…there was definitely, in some instances, you know, too much leverage being given…" by way of bank debt.

14 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-021; Michael O'Flynn, Developer, O'Flynn Group, transcript, INQ00121-006.

It was not uncommon for 100% financing to be advanced, or when developers' equity was required, for it to be made up by paper equity;[15] each case would ultimately result in the bank taking all of the risk.[16] In his evidence to the Joint Committee, Eugene Sheehy advised that while it was not part of AIB's business model, this method of increasing the bank's exposure by releasing funds on the basis of an uplift in the valuation of another secured asset did happen and it would have been better if the lending structure for property in Ireland had included more private equity.[17]

In his evidence to the Joint Committee, Sean Mulryan said that one weakness in the Ballymore Group's business model was its overwhelming dependency on Irish financial institutions. Having had long-standing relationships and built up a level of trust with a particular financial institution, some developers were slow to diversify and spread the risk across international banks.[18]

Evidence to the Joint Committee suggests, however, that some large developers sought to avail of loans from a number of financial institutions. Gerard Gannon advised that it was a way of introducing an element of competition and therefore of reducing costs.[19] Sean Mulryan gave evidence that spreading the risks across banks would have allowed the Ballymore Group to mitigate its level of dependence or overreliance on any one financial institution. Despite that, Ballymore Group borrowed 50% of their loans from one financial institution as a result of the long-standing relationship they had built up over twenty years.[20]

A syndicated loan was another form of multi-bank lending, but normally instigated by the bank to mitigate risk arising from a large development and to manage the concentration limits set by the regulatory authorities. However, the Joint Committee heard evidence that property syndicated loans were not common in the Irish market.[21] Eugene Sheehy stated in his statement to the Joint Committee that *"arising from the lack of syndicated lending we had a poor sight of how leveraged the sector had become."*[22]

In contrast, John Moran of Jones Lang La Salle gave evidence that syndicated loans were relatively common. He said that in the peak year of 2006, *"Out of the total of 121 [commercial property transactions], one could probably argue that 40 or 50 were syndicated transactions."*[23]

Gerard Barrett commented that his company, Edward Holdings, was required to provide up-to-date positions to each of their banks vis-à-vis their other banks.[24] This was also reiterated by Tom Browne, Head of Lending Ireland, Anglo, in his evidence to the Joint Committee. He stated: *"… with our bigger clients, the top ten, top 20. We would have … in the latter years been looking at … their total banking obligations across all their banks."*[25]

15 A charge over the unrealised equity position in another development.

16 Frank Daly, Chairman, NAMA, transcript, PUB00331-012.

17 Eugene Sheehy, former Group Chief Executive, AIB, transcript, INQ00133-040.

18 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-004/005/007/008/017.

19 Gerard Gannon, Executive Director, Gannon Homes, statement, GGA00001-002.

20 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-030/031.

21 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-026.

22 Eugene Sheehy, former Group Chief Executive, AIB, statement, ESH00001-005.

23 John Moran, International Director Jones Lang LaSalle and Managing Director Jones Lang LaSalle Ireland, transcript, CTX00047-026.

24 Gerard Barrett, Developer, Edward Holdings Group, statement, GBA00001-004.

25 Tom Browne, former Director, Anglo, transcript, INQ00095-013.

Pat McArdle, Group Chief Economist in Ulster Bank, told the Joint Committee: *"It was only when the loans were transferred to NAMA in 2010 that it was revealed that the big developers had multiple exposures to the different banks."*[26]

A Department of Finance summary of the initial business plans of the six covered financial institutions undertaken in late 2008 commented that Anglo's lending model was *"driven off the back of established relationships with net worth individuals predominantly in the property sector."*[27]

According to Frank Daly of NAMA, a relationship was the predominant driver of a lending decision in some instances, rather than an impartial assessment of the viability of the business proposal.[28]

Brendan McDonagh of NAMA also gave evidence that:

"… €34 billion of the €74 billion that came to NAMA was borrowed by 29 people … and while it was spread around by banks, there was certainly a concentration of lending around one institution. So I think the issue really comes down to the fact that … relationship lending was a big part of it."[29]

In some cases, they became the developer's business partner in a joint venture.

Michael Fingleton, former Chief Executive, INBS, referred in evidence to joint ventures between INBS and Ballymore Properties, the first such venture having been in 1992:

"In 1992 the Society acquired 70 acres of land in Lucan with planning for 650 houses for £1.4 million. It then entered a joint venture with Ballymore Properties for the development of these lands, which was successfully and profitably completed."[30]

Sean Mulryan said that with this joint venture, the project was *"100% debt funded"* by INBS, who would *"charge an interest rate of about 2.5% over the Libor and …for … putting up all of the capital, they would take 50% of the profits."*[31]

Michael Fingleton said that INBS:

"continued to provide finance for such ventures [as with Ballymore] right through the 90's and expanded into the UK London market with some of our own customers and later UK-based customers."[32]

In joint ventures with financial institutions other than INBS, Sean Mulryan said in his evidence that the financial institutions' capital investments varied: *"70%, 80%."*[33]

26 Pat McArdle, former Chief Economist, UB, transcript, INQ00087-006/059.
27 Summary of Business Plans submitted by the Covered Institutions, DOF01602-013.
28 Frank Daly, Chairman, NAMA, transcript, PUB00331-022.
29 Brendan McDonagh, Chief Executive Officer, NAMA, transcript, PUB00331-023 to 028.
30 Michael Fingleton, former CEO, INBS, statement, MFI00001-004.
31 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-009.
32 Michael Fingleton, former CEO, INBS, statement, MFI00001-004.
33 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-010.

In his evidence to the Joint Committee, Michael O' Flynn, O' Flynn Group, stated that with regard to property acquisitions:

"a mix of our own cash and bank borrowings was generally applied with the exception of joint venture arrangements where a lender sought a much higher return based on profit share. In such cases funding was provided by the lender and time, skills and expertise were provided by us and profits were shared."[34]

The IMF observed in 2012 that *"rapidly rising property prices was a key factor that drove high fixed investment in commercial and residential property."*[35] On the commercial side specifically, the Department of Finance recognised as far back as 2003 that commercial property prices presented *"…a potential source of vulnerability for the Irish banking system."*[36] These observations are supported strongly by the body of evidence presented to the Joint Committee.

Taken as a whole, the Irish bank sector was excessively and disproportionally exposed to commercial property lending by 2008.

AIB's business became increasingly dependent over time on commercial lending. Eugene Sheehy acknowledged in evidence that at the peak of the boom the bank had *"650 customers who had property and construction loans of over €1 million."*[37] In the case of Bank of Ireland, it was acknowledged that:

"…while property lending as a proportion of the Group's balance sheet was not considered disproportionate; the actual quantum of property lending was too large…"[38]

By mid-2008, Anglo had a *"sizable degree of exposure"* to the commercial investment property market[39] and INBS sought to fill what was perceived as a void *"…by expanding its activity in the commercial lending market."*[40]

EBS – originally a building society for funding of mortgages for teachers – had moved into this form of lending, with commercial property loans having grown from €460 million in 2001 to €2.3 billion by 2008.[41]

In the case of IL&P/PTSB, commercial lending expanded as well such that, by 2008, it had grown to almost €2 billion.[42]

34 Michael O'Flynn, Developer, O'Flynn Group, transcript, INQ00121-003.

35 IMF Staff Report for the 2012 Article IV Consultation, DOF00382-004.

36 Speaking Note, Informal ECOFIN, 13 September 2003, Department of Finance, DOF06749-005.

37 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-012.

38 Ritchie Boucher, Group CEO, BOI, statement, RBO00023-003.

39 Moody's Credit Opinion of Anglo, 2nd May 2008, IBRC03516-002.

40 Michael Fingleton, former CEO, INBS, statement, MFI00001-008.

41 Ethna Tinney, Non-Executive Director, EBS, transcript, INQ00138-007.

42 IL&P Group Annual Report 2008, page 13.

Ulster Bank also had an exposure to commercial lending. In his evidence to the Joint Committee, Robert Gallagher, CEO Corporate Markets Division, said:

"On my arrival into the business [in 2004], Ulster Bank already had a well developed and long-standing property division. The commercial property loan book was then approximately 60% of the corporate loan book. On joining, a key objective of mine was to diversify the portfolio."[43]

D. Public Affairs

The Construction Industry Federation (CIF) - the main representative body for the construction industry in Ireland - played a major role in lobbying the Government on taxation policy, public capital spending and other issues affecting the construction sector. Its responsibility was primarily to represent the needs of members.[44]

Membership subscriptions varied with 10 to 12 firms paying the largest membership fee of €30,000 per annum at the peak.[45] The CIF's annual budget was in the region of €5 - €6 million.[46]

90%[47] was spent on services, such as health and safety expertise, industrial relations & employment advice, advice on payment disputes and planning & development advice for their members. When asked by the Joint Committee if the CIF had undertaken or commissioned research into the construction or property sector in 2007, Liam Kelleher responded: *"The short answer is no, to the best of my knowledge."*[48] The CIF relied heavily on the research of others, which was taken at face value; Liam Kelleher also told the Joint Committee that he wished he had paid more attention to contrarian views.[49] The CIF continued to actively pursue property-based tax incentives and income tax incentives, even in light of the evidence that house prices were beginning to fall.[50]

From the late 1990s and well into the 2000s, a large variety of tax incentives were introduced which greatly benefitted developers. From 2000 to 2007, developers enjoyed a reduced tax rate on the sale of land for development purposes, which was halved from 40% to 20% by the former Minister for Finance, Charlie McCreevy.[51]

Over the ten year period from 1997 to 2007, Fianna Fáil received an average of €54,600 and the Progressive Democrats received an average of €8,900 annually in disclosed donations from the property and construction sector. Other parties did not disclose any donations from property interests.[52] In the opinion of Elaine Byrne *"…the property barons of the 1990s and 2000s had replaced the beef barons of the 1980s."*[53]

We raised the issue of personal contacts between larger developers and senior politicians. Several politicians said that they were not influenced by developers on policy matters. We learned of some

43 Robert Gallagher, former CEO, Corporate Markets Division, UB, transcript, INQ00088-005.

44 Liam Kelleher, former Director General, CIF, transcript, INQ00064-004/012.

45 Tom Parlon, Director General & Liam Kelleher, former Director General, CIF, transcript, INQ00064-016/017.

46 Liam Kelleher, former Director General, CIF, transcript, INQ00064-028.

47 Liam Kelleher, former Director General, CIF, transcript, INQ00064-028.

48 Liam Kelleher, former Director General, CIF, transcript, INQ00064-040.

49 Liam Kelleher, former Director General, CIF, transcript, INQ00064-028.

50 CIF Pre-Budget 2009 Submission, 30th September 2008, DOT00717; CIF Submission to the Department of the Taoiseach on Ireland's Economic Recovery, 23rd January 2009, DOT00718; CIF Pre-Mini Budget 2009 Submission, 24th March 2009, DOT00721.

51 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-013.

52 Elaine Byrne, Consultant to European Commission on corruption & governance, transcript, CTX00055-006.

53 Elaine Byrne, Consultant to European Commission on corruption & governance, transcript, CTX00055-006.

personal friendships between politicians and developers.[54] In response to a question on the issue of relationships between developers and politicians, Elaine Byrne said:

"often … it is indirect and is a case of doing someone a favour and thereafter, down along the line, that person will return the favour in an indistinct way. Were one intent on committing corruption, one would no longer be doing it the old-fashioned way. I mean giving money for a favour committed because these things can be traced. What the Moriarty tribunal in particular exposed was benefits in kind through different land transactions that may have arisen. Decisions were made and perhaps down along the line, certain benefits were conferred on individuals. Corruption is not black and white and is not direct. It is indirect and these relationships are very difficult to examine."[55]

The journalist, Simon Carswell, said:

"I would characterise the relationship between the major players in the property sector, the construction industry, government, certain elected representatives and the banks, as well as the relationship between the Government, the banks and the financial supervisory authorities, as extremely cosy in the period leading up to the 2008 banking crash. To take a phrase from former Finnish civil servant Peter Nyberg's thorough report on the causes of the banking crisis, the various players, including politicians, builders, bankers and regulators, displayed 'behaviour exhibiting bandwagon effects both between institutions (herding) and within them (groupthink).' Nothing I came across in my research would contradict that statement."[56]

He went on to say:

"These relationships appear to have been too cosy to have allowed any one of these collective groups, be it banks, government, builders or regulators, to shout stop and offer the kind of critical dissent that might have changed the behaviour of all and the direction in which the country was heading. If one of these groups had had the courage to put its head above the parapet, I believe there might not have been the crisis we had or at least it might not have been as severe as it was. For these parties, it was too comfortable and self-serving for some to stay in the crowd and stick with the consensus, particularly when so many were making so much money. The result was that contrarians were ridiculed, silenced or ignored to ensure the credit fuelled boom continued for years as their past warnings did not come true. These cosy relationships would prove extremely costly. While the cost of the banking bailout to the Irish people stands at €64 billion, excluding recoveries coming from the sale of shares in the banks or better than expected returns from the National Asset Management Agency, it is worth stressing that the overall losses and capital wiped out by the crash amount to far in excess of this sum. The losses on loans, mostly to the property sector, across all of the banks in Ireland came to well in excess of €100 billion, including tens of billions of euro covered by the UK Treasury. This is sometimes forgotten."[57]

54 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-018; Charlie McCreevy, former Minister for Finance, transcript, PUB00346-079/080.

55 Elaine Byrne, Consultant to European Commission on corruption & governance, transcript, CTX00055-029.

56 Simon Carswell, Journalist, transcript, PUB00179-003.

57 Simon Carswell, Journalist, transcript, PUB00179-003/004.

Section 2 - Property Valuation

A. The Valuation Process

A number of economic factors led to a considerable increase in property values from the early 2000s. As the boom gathered pace, property valuations gained greater importance and there was a major growth in large multinational and local property service advisers.

A valuer is an individual who appraises property, land and developments in order to reach an opinion of the market value of the asset. In its simplest form, this is an estimate of the amount for which an asset should sell on the valuation date between a willing buyer and a willing seller in an arm's length transaction in which each of the parties acted knowledgeably, prudently and without compulsion and after the property had been properly marketed.[58]

Witnesses from INBS and Ulster Bank gave evidence that they established valuer panels and sought independent valuations to underpin their credit decisions.[59] Donal Forde, former Managing Director, AIB, said that *"…the seeking of an independent valuation would be confirmatory more than anything else."*[60]

Richard Burrows, former Governor, BOI, told the Joint Committee, *"…it always is a subjective process, except when the loans were issued, there was a free market operating. Properties were being bought and sold, landbanks were being bought and sold, there was a determination of what market value was."*[61]

There were two professional bodies representing valuers in Ireland during the boom years: the Institute of Professional Auctioneers and Valuers (IPAV) and the Irish Auctioneers and Valuers Institute (IAVI), the latter having since merged with the Society of Chartered Surveyors (SCS) to form the Society of Chartered Surveyors Ireland (SCSI).

In evidence, Patrick Davitt, CEO, IPAV, stated that there were no national valuation standards for valuers in Ireland prior to the property crash and that remains the position today.[62] Thus the professional bodies like IPAV were left with the role of self-regulating their members by, for example, ensuring that appropriate qualifications were held and continuous professional development (CPD) was up to date.[63]

Ireland also had no national property register. According to Marie Hunt, CBRE, a national property register would have enabled valuers *"to track the market better"* – for example in terms of quantifying the size of the commercial market.[64] The need for a national register of commercial property prices in Ireland was also reiterated by John Moran, Managing Director, Jones Lang LaSalle Ltd (JLL), in his evidence.[65]

---

58 Market Value as defined in Article 4, par 76 of EU Regulation No. 575/2013.

59 Michael Fingleton, former CEO, INBS, statement, MFI00001-018; Robert Gallagher, Chief Executive, Corporate Markets Division, UB, transcript, INQ00088-040; Cormac McCarthy, Group Chief Executive & Director, UB, transcript, INQ00086-051.

60 Donal Forde, former Managing Director, AIB, transcript, INQ00122-013.

61 Richard Burrows, former Governor, BOI, transcript, INQ00104-045.

62 Patrick Davitt, CEO, IPAV, transcript, INQ00066-009 and statement, PDA00025-005.

63 Patrick Davitt, CEO, IPAV, statement, PDA00025-006.

64 Marie Hunt, Executive Director, CBRE Ireland, transcript, CTX00046-004.

65 John Moran, International Director, Jones Lang LaSalle, and Managing Director, Jones Lang LaSalle Ireland, transcript, CTX00047-032.

Prior to the property collapse, valuers followed either 'Red Book'[66] or 'Blue Book'[67] standards which prescribed how a valuation should be carried out.[68]

Features of the valuation model included a methodology to arrive at the valuation figure and the standards used in writing the valuation report, such as the financial institution's instruction to the valuer, the basis and purpose of the valuation, the valuation date, a property description, the legal context, commentary on the market for the property, the market value, the methodology and analysis involved, any assumptions made, any limitations on the report, and the Valuation Standards applied.[69]

Methodologies depended on a number of assumptions and judgements[70] and the very nature of a value being attributed on a given day left it open to variance as circumstances changed from day to day. According to Patrick Davitt, *"…the open market valuation is going to be … a moving figure at any time…"*[71]

Even in the case of large developments, valuations were not done in all cases. Gerard Gannon of Gannon Homes, which had debts of €214 million in respect of Irish assets and £22 million in respect of UK assets at 30 September 2008, gave evidence that *"it was not our policy to engage third party valuers to value my property assets either at time of acquisition or during the development phase"*, instead leaving it to the relevant financial institution to engage valuers as required.[72]

On differences between the Irish banks and non-Irish banks, three of the developer witnesses, Sean Mulryan, Derek Quinlan and Michael O'Flynn, did not observe any difference in the level of rigour applied to valuation requirements for large loans.[73]

More widely, however, the demand for asset valuations increased significantly as the property boom took hold and reliance on informal valuation standards, such as 'desktop' and 'drive-by' valuations, became more prevalent. These did not involve any physical inspection of the property, but were a limited (and sometimes fully automated or computer generated) process of estimating value. A Central Bank review of financial institutions found that many used these informal valuations as if they were formal valuations.[74] A number of developers gave evidence that they continued to rely on professional valuations.

Valuations exert significant impact on a financial institution's credit risk management. As mitigation against risk, it is imperative that the valuation process is robust and that the value attributed to

66 The Royal Institution of Chartered Surveyors (RICS) has published valuation standards in the UK known as 'Red Book' since 1974.

67 The European Group of Valuers Associations (TEGoVA) has published the 'Blue Book' valuation standards since the early 1980s.

68 Central Bank Report, Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future, 18 December 2012, PUB00252-004/005.

69 Patrick Davitt, CEO, IPAV, transcript, INQ00066-005 and statement, PDA00025-003/004.

70 Patrick Davitt, CEO, IPAV, transcript, INQ00066-004/005.

71 Patrick Davitt, CEO, IPAV, transcript, INQ00066-011.

72 Gerard Gannon, Developer, Gannon Homes, statement, GGA00001-005/006.

73 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-013; Derek Quinlan, Property Investor, Quinlan Private, transcript, INQ00092-037; Michael O'Flynn, Developer, O'Flynn Group, transcript, INQ00121-035; Joe O'Reilly, Developer, Castlethorn Construction and Chartered Land Group, transcript, INQ00126-026.

74 Central Bank Report, Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future, 18 December 2012, PUB00252-008.

the underlying assets can be relied upon when fully assessing the risk of a credit decision or the ongoing management of the loan. For that reason a reliable valuation document is central to the credit risk decision.[75] Patrick Davitt, IPAV reiterated this in his evidence to the Joint Committee:

"…The valuation figure derived becomes the critical part of the valuation, as it helps banks and other financial institutions to decide the worthiness of the risk it's going to lend on."[76]

Valuations were not always carried out for assets that were indirectly securing a loan. For example, Kieran Bennett, former Group Chief Credit Officer for AIB, gave evidence that "in most cases, an independent valuation would only be sought for assets directly securing a project. Otherwise AIB would have relied on a Statement of Net Worth from the borrower."[77]

B. The Accuracy of Valuations

Around the mid-2000s, there were a number of commentators and analysts with contrarian views who raised the possibility of a collapse. Amongst them was Morgan Kelly, who accurately predicted a potential 40-60% fall in real house prices over an 8 year period, in a feature in the ESRI's Quarterly Economic Commentary during the summer of 2007.[78]

Shortly afterwards in October of that year, the ECOFIN Council warned that in Ireland's case, *"… more work is needed on standards to ensure reliable valuation of assets, particularly of those assets where markets are potentially illiquid in time of stress…"*[79]

Around that time and even before then, developers began to see the escalation of property prices in Ireland as a challenge; by then, development prices had gone into a state of complete disequilibrium. In the experience of Sean Mulryan, assets bought in Dublin's Docklands were up to five times more expensive than assets bought in the equally strong London Docklands market during the period.[80] The PwC Project Atlas Report suggested: *"The acquisition of large 'trophy' development sites has put some major developers/property investors under significant cash flow pressure."*[81]

According to Sean Mulryan, owning a prestigious 'trophy' site became a measure of success.[82] There are many well-publicised instances of such sites having changed hands for multiples of what they had been worth a few months previously, often purchased without planning permission for re-development.

Sean Mulryan also provided an indication in evidence of the time and resources spent relating to preparing for a number of high profile projects, such as the Irish Glass Bottle site and the Jurys and Burlington Hotel sites in Dublin. In those cases, Ballymore subsequently learned that its bids had

75 Central Bank Report, Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future, 18 December 2012, PUB00252-016.
76 Patrick Davitt, CEO, IPAV, transcript, INQ00066-005.
77 Kieran Bennett, former Group Chief Credit Officer, AIB, statement, KBE00001-009.
78 Special Articles on the likely extent of falls in Irish house prices by Morgan Kelly, PUB00258-002.
79 ECOFIN, financial markets situation, 4 October 2007, DOF01640-003.
80 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-006.
81 PwC's Project Atlas II, 17 November 2008, DOF02573-107.
82 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-006.

been as much as 35% off the pace at the time.[83] The highest price Ballymore were willing to offer for the Irish Glass Bottle site was €140 million; it was subsequently sold for €412 million in 2006.[84] In 2010 its long term economic value was estimated to be in the region of €62.5 million.[85]

Some developers reacted to increased asset prices by diversifying into foreign markets, such as London and Eastern Europe.[86] In turn, Ireland's property market experienced a slowdown in property turnover culminating in house prices falling from early 2007. A Central Bank review indicated that financial institutions' over-reliance on out-of-date professional valuations and weak internal valuation methodologies did not warn them in time of the ever increasing fall in property values which would in turn impact on the recoverability of their loans.[87]

In late 2008, after the Government Guarantee had been issued, PwC were engaged to review the loan books of each of the covered institutions, known as the 'Project Atlas' report. PwC instructed Jones Lang LaSalle (JLL) to carry out an analysis of the financial institutions' underlying valuations. JLL uncovered many issues of concern. The following small sample[88] of valuation findings illustrates those concerns forcefully:

a) a site was independently valued at €3 million in March 2008 on the assumption that the zoning status could be amended from industrial/commercial to retail. That did not transpire and JLL gave a 'normalised value' of only €1.85 million a few months later in November 2008.[89]

b) an internal memo in November 2008, with an independent summary figure attached, valued a 6 acre site (with mixed-use planning permission) at €140 million. JLL suggested the approach was not appropriate and gave a 'normalised value' of just €25 million.[90]

c) a 97 acre site independently valued at €150 million in October 2005 was still being relied upon in late 2008. JLL gave it a 'normalised value' of €55 million in November 2008.[91]

d) a development site and work in progress was internally valued by a financial institution in September 2008 at €429 million. JLL gave it a 'normalised value' of €325 million in November 2008 and advised in their report that the financial institution's methodology for valuing the asset was not market practice.[92]

However, with the property market experiencing a number of adjustments which were unprecedented in their speed and severity, and exacerbated by the sudden effective withdrawal of credit from the property market,[93] JLL also found that in a number of cases the market value of an asset had fallen and an updated valuation was provided.[94]

83 Sean Mulryan, Developer, Ballymore Group, statement, SMU00001-009.
84 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-006 and statement, SMU00001-008/009.
85 NIRSA & NUIM report, A Haunted Landscape: Housing and Ghost Estates in Post-Celtic Tiger Ireland, PUB00263-015.
86 Derek Quinlan, Developer, Quinlan Private, transcript, INQ00092-020.
87 Central Bank Report, Valuation Processes in the Banking Crisis – Lessons Learned – Guiding the Future, 18 December 2012, PUB00252-008.
88 Jones Lang LaSalle Report for Project Atlas, December 2008, DOF05858.
89 Jones Lang laSalle Report for Project Atlas, December 2008, DOF05858-140.
90 Jones Lang laSalle Report for Project Atlas, December 2008, DOF05858-053.
91 Jones Lang laSalle Report for Project Atlas, December 2008, DOF05858-112.
92 Jones Lang laSalle Report for Project Atlas, December 2008, DOF05858-080.
93 Jones Lang laSalle Report for Project Atlas, December 2008, DOF05858-007.
94 Jones Lang laSalle Report for Project Atlas, December 2008, DOF05858-021/256.

The true extent of the fall in value of underlying collateral was not realised until loan tranches began to transfer out of the financial institutions to NAMA in 2010. That culminated in an overall discount of 57% being applied.

Section 3 – Property Sector Relationships with the Media

As part of the Context Phase, the Joint Committee received evidence from academic commentators and media professionals under the theme of the role of the media during the property boom.

Harry Browne, a lecturer in journalism in the School of Media of Dublin Institute of Technology, gave evidence that:

"Print and broadcast media in Ireland played a difficult-to-measure but almost certainly significant role in the inflation of the property bubble and the legitimisation of risky behaviour by the financial services sector in the lead up to the crisis of 2007 and 2008."[95]

He also said that glossy magazines, property and lifestyle sections were significant sources of income:

"Those supplements were, after all, paying the bills. When The Irish Times Limited infamously paid €50 million for myhome.ie in 2006, it appeared to confirm the company's dedication to what increasingly looked like its core business – the advertising of property sales."[96]

Property advertising was a considerable source of income for some media organisations. Maeve Donovan, former managing director, "The Irish Times", gave evidence that property revenue for that newspaper ranged from €10 million in 2002 to €22 million in 2006;[97] at its peak, this accounted for 17% of the newspaper's total revenue from all sources.[98] The Joint Committee also heard evidence that the equivalent figures for the "Irish Examiner" and Independent News and Media were 7%[99] and 14%[100] respectively.

The evidence from the academic witnesses was that, as a result of the significant revenue streams that came from relevant sources, it was necessary for media outlets to (at least unconsciously) protect these sources. Harry Browne gave evidence that:

"Much of the mainstream media seems to me to be very conflicted because of their reliance on real-estate and recruitment advertising. That doesn't mean reporters consciously avoid writing bad news stories, but it's hard to run against the tide when everyone is getting rich."[101]

On the other hand, he also said:

"… journalists and the organisations that employ them do also have an interest in producing strong stories that challenge conventional thinking, and afflict the powerful."[102]

---

95 Harry Browne, DIT, transcript, CTX00017-002.

96 Harry Browne, DIT, transcript, CTX00017-003.

97 Maeve Donovan, former Managing Director, "The Irish Times", transcript, CTX00071-020.

98 Maeve Donovan, former Managing Director, "The Irish Times", transcript, CTX00071-021.

99 Tom Murphy, Chief Executive, "Irish Examiner", transcript, CTX00065-009.

100 Gerry O'Regan, former Editor, "Irish Independent", transcript, CTX00075-005; Michael Doorly, former Finance Director, Independent News and Media, transcript, CTX00075-005.

101 Harry Browne, DIT, transcript, CTX00017-003.

102 Harry Browne, DIT, transcript, CTX00017-006.

Tim Vaughan of the “Irish Examiner” gave evidence that property advertising was an important source of revenue but that in the case of that newspaper *“…advertisers did not seek to influence the editorial policy of the newspaper.”*[103]

It is clear, however, that property advertisers did attempt to put pressure on “The Irish Times”. Geraldine Kennedy, former Editor, gave evidence that she was aware that many telephone calls were made to her colleague Maeve Donovan, former Managing Director of the newspaper, by the property sector about coverage in not just the property supplement, but the main newspaper also. [104] As Editor, she was aware of statements made by some in the property sector that “The Irish Times” would never get an advertisement again after the publication of an article by Professor Morgan Kelly which predicted a drop in property prices. [105]

Media outlets only occasionally featured contrarian views that might undermine the property sector. For instance, Geraldine Kennedy gave evidence that “The Irish Times” was:

“…the only newspaper to publish the article by Morgan Kelly, professor of economics in University College Dublin, predicting there would be a property crash with prices falling by between 40% and 60%.”[106]

Newspaper editors said in their evidence, however, that their editorial policy had not been influenced.[107] Gerry O’Regan, former Editor of the “Irish Independent”, expressed his views that there was *“…no hidden agenda in the Irish Independent to try to artificially bolster the property market for the period under review.”*[108]

---

103 Tim Vaughan, Editor, "Irish Examiner", transcript, CTX00065-004.

104 Geraldine Kennedy, former Editor, "The Irish Times", transcript, CTX00071-014.

105 Geraldine Kennedy, former Editor, "The Irish Times", transcript, CTX00071-014.

106 Geraldine Kennedy, former Editor, "The Irish Times", transcript, CTX00071-005.

107 See for instance Tim Vaughan, transcript, CTX00065-004 and Geraldine Kennedy, transcript, CTX00071-014.

108 Gerry O’Regan, former Editor, "Irish Independent", transcript, CTX00075-004.

Findings of the Joint Committee

1. In the lead up to the crisis, many developers had become heavily reliant on bank debt to fund their developments. In many cases, developers adopted a business model in which a bank would bear all of the risk of a transaction, either through 100% financing or using so-called ‘paper equity’ to fund any element of developer’s equity.
2. Property or land valuations were not carried out in all cases, even in the case of some large developments. As the property boom took hold, reliance on informal ‘desktop’ and ‘drive-by’ valuations, which did not involve any physical inspection of a property, became more prevalent. However, a number of developers gave evidence that they continued to rely upon professional valuations.
3. Relationship banking, where some developers built strong relationships with particular banks, was a part of the Irish banking system. In some cases, both parties became business partners in a joint venture.
4. Revenue from the property sector was a significant source of income for some media outlets, accounting for as much as 14% or 17% of all revenue for some newspapers. Editors denied that editorial independence was affected by their advertising relationship with the property sector.

Recommendation of the Joint Committee

1. A detailed and comprehensive commercial property price register should be introduced.

Chapter 4: State Institutions

Introduction

In this Chapter, we explore the state institutions that were accountable for the regulation and supervision of both the banking sector and the financial stability of the state during the period leading up to the financial crisis. We consider the institutions' roles, powers and the choices that they made during this critical period. We also consider the role and contribution of both international and domestic agencies in flagging and highlighting the emerging risks and growing threats to the Irish economy. These will be covered in three sections:

- Section 1: Warnings and Signals
- Section 2: Central Bank and Financial Regulator
- Section 3: Department of Finance

Section 1: Warnings and Signals

The availability of accurate and independent analysis of macro-economic and systemic risk is crucial to the role of the Central Bank and the Department of Finance in assessing, communicating and responding to such risks. A key role is also played by non-state actors in providing review, analysis, forecasts and challenge in the area of risk. This includes international bodies such as the European Commission, the Organisation for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF), the ratings agencies and the relevant domestic non-government body, the Economic and Social Research Institute (ESRI).

We examined the extent to which the domestic institutions, namely the Central Bank and the Department of Finance, relied or purported to rely on such analysis in their own assessment of the risks.

In the years leading up to the crisis, multiple warning signals were given by domestic and foreign experts and economic institutes.[1] These warnings highlighted concerns in respect of:

- property overvaluation.
- growth of credit in the banks.
- growth of household debt.
- loss of international competitiveness through productivity issues and wage inflation.
- growing dependence of the Irish economy on the construction sector.
- over-reliance of the fiscal system on property-related taxes.

Not all warnings were robust enough and were mixed with positive comments and praise for the Irish economy. Most of these warnings were however, either discounted or ignored by both the Irish regulatory and governmental authorities and decision-makers until it was too late to avert the crisis.[2]

---

1 John FitzGerald, Research Affiliate, former Research Professor, ESRI, statement, CTX00022-004; Morgan Kelly 'on the likely extent of the fall in Irish house prices' in Quarterly Economic Commentary 2007, PUB00258; Patrick Honohan, Governor, Central Bank, transcript PUB00273-051.

2 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-005/032/040; Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-102/108; Richard Bruton, Minister for Jobs, Enterprise and Innovation and former Fine Gael Opposition Finance Spokesperson, statement, RBR00001-009.

The impact of warnings from international and national economic agencies on decision-makers in Government and the Central Bank

The evidence provided by a number of witnesses relating to this period confirmed that a high degree of reliance was placed by Government and state institutions on the reports of international organisations and economic committees regarding the Irish economy. They appeared to take comfort from these reports as they viewed them as independent.

Speaking about the impact of the views expressed by International institutions such as the European Commission, IMF, OECD and ratings agencies, former Taoiseach, Bertie Ahern, said:

"These organisations have the advantage of having international perspectives, and the insights they provide are especially valuable when considering economic conditions and prospects in a comparative context."[3]

Former Governor of the Central Bank, John Hurley also said: *"Given their cross-country perspectives and their experience of crises, the Central Bank regarded the views of the OECD and the IMF as very important."*[4]

Early Warnings: Pre-2002

Between 1994 and 2000, the average national house price increased by more than 150%.[5] Between 1998 and 2000, a broad consensus had emerged that these increases were justified by the stronger domestic economy and lower interest rates resulting from the forthcoming entry to the Euro.[6]

In 2000 and 2001, concerns were evident that the international economic cooling after the bursting of the so-called *'dotcom-bubble'* and other events would also negatively impact on Ireland's economy.[7] Although a slowdown in the Irish economy was noticeable, it did not last long, as the stronger domestic demand soon led to re-acceleration of GDP and house price growth.

2002-2008 - The warnings of economic forecasting institutes - International and Domestic

Following the relatively short slowdown in 2001 – 2002, the economy resumed its upward momentum, with strong growth continuing from 2003 to 2007.

In his evidence to the Joint Committee, former Research Professor at the ESRI, John FitzGerald, described the economic background for the pre-crisis period. He noted the rapid decrease in productivity growth in the early years of the 21st century and the ensuing loss of competitiveness, the growth in house prices, a rate of house completions not justified by population growth, the rising current account deficit, increased borrowings from abroad raising the vulnerability of the banking system and a rapid increase in household indebtedness.[8]

---

3 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-004/005.

4 John Hurley, former Governor, Central Bank, transcript, INQ00047-005.

5 Based on the average of national new and second-hand house price, CSO statistics, PUB00399-001.

6 John FitzGerald, Research Affiliate, former Research Professor, ESRI, statement, CTX00022; OECD Economic Survey Ireland 2001, PUB00159-034.

7 Charlie McCreevey, former Minister for Finance, transcript, PUB00346-013/014.

8 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-004.

In considering the extent to which the state institutions heeded and responded to the signals from economic forecasting institutes and other commentators in the pre-crisis period, two key questions arise:

- What warnings did international and national economic institutes and rating agencies actually give?
- Did they expect a major crisis and consequently, alert the Irish authorities to this risk?

a) The European Commission and ECOFIN

The European Commission is an independent supranational authority. It is separate from governments and acts as the executive body of the European Union (EU). The European Commission is responsible for proposing legislation, implementing decisions, upholding the EU treaties and managing the day-to-day business of the EU, including drawing up the budget of the EU. Economic regulation is one of the key areas in which the European Commission has extensive legislative powers.

It is important to note that the assessments of external economic forecasters like the European Commission/ECOFIN, IMF or OECD were, to a certain degree, based on data and information provided by the Irish authorities, including the Department of Finance and the Central Bank.[9]

The first material warning from the European Commission was in 2001, when it recommended to the ECOFIN Council (known as ECOFIN) that there should be a censure to the Irish Government on the Irish economy. The Commission concluded in a published opinion by ECOFIN that the Irish Government's planned 2001-2003 Stability Programme was not consistent with the European Council's Broad Economic Policy Guidelines. While the Council acknowledged that Ireland had *"fully and comfortably"* fulfilled its obligations in relation to Debt to GDP, it nonetheless warned about the pro-cyclicality of planned cuts in indirect and direct taxes, describing them as *"aggravating overheating and inflationary pressures."* [10]

ECOFIN also highlighted the threat posed by the Government's expansionary fiscal policies:

"The Council recalls that it has repeatedly urged the Irish authorities…to ensure economic stability by means of fiscal policy. The Council regrets that this advice was not reflected in the budget for 2001, despite developments in the course of 2000 indicating an increasing extent of overheating. The Council considers that Irish fiscal policy in 2001 is not consistent with the broad guidelines of the economic policies as regards budgetary policy."[11]

9 See, for example, IMF Statement, IMF00001-003.

10 Council of European Union economic and financial questions, Council Opinion 05 April 2001, DOF02901-013; Draft Minutes of ECOFIN meeting 12/02/2001, DOF02900-012/014.

11 Draft Minutes of ECOFIN meeting 12/02/2001, DOF02900-012/014.

On a review of the minutes of the ECOFIN meeting of 6 November 2001, it is apparent that measures were taken to re-visit the recommendation of ECOFIN in light of the sudden cooling-off of the economy after *"unexpected developments"* (e.g. the slowdown in the US, the foot and mouth disease crisis and events of 11 September 2001). The minutes stated:

"…the inconsistency addressed in the Recommendation between the Irish budgetary plans and the goal of economic stability has lost part of its force for this year… However, the Commission argues that the experience of overheating in the Irish economy justifies continued vigilance regarding the evolution of the fiscal stance."[12]

In his evidence, Marco Buti, Director General for Economic and Financial Affairs with the European Commission, confirmed that *"the assessment no longer raised any major issues."*[13]

In their supervisory role, general commentary from the European Commission and IMF contained critical remarks in relation to pro-cyclical fiscal policies of the Irish Government during this period. However, there was no specific warning on the development of a potentially large fiscal structural deficit.[14]

Marco Buti said that *"…the Commission regularly stressed the uncertainty surrounding estimates of the structural budget balance for the Irish economy"*. He also mentioned that there was *"the sense that the structural fiscal position was weaker than the official estimate suggested, but there was no way to substantiate this view,"*[15] and he confirmed that the European Commission was of the opinion that the Government's targets for the budget balance were not regarded as *"particularly ambitious"* in view of the strong economy.[16]

Marco Buti explained that the European Commission recognised that the Irish Government relied increasingly on income from property taxes and housing taxes, but given that the country was in surplus, it was *"very difficult to say it was not behaving according to the Stability and Growth Pact, because it did."* [17] Marco Buti admitted that the European Commission did not signal the risks in a sufficiently strong way.

The models employed by economists in the European Commission and the IMF did not give an early or good indication of the structural deficit in the years before the crisis. However, this was only identified after the crisis. It was explained that the available tools to measure a structural deficit were harmonised for all EU member states, which impacted in different ways on larger and smaller countries/economies, making it more difficult to assess compliance. In addition the model methodologies assumed that high output levels of the Irish economy and the related booms in tax revenues were permanent structural features.[18] In hindsight, this assumption was proven to be wrong.

12 ECOFIN 2382nd meeting, Minutes, 6th November 2001, DOF03080-008.

13 Marco Buti, Director General Economic and Financial Affairs, European Commission, transcript, CTX00057-006.

14 Klaus Regling, Author, A Preliminary Report on The Sources of Ireland's Banking Crisis, transcript, CTX00060-007.

15 Marco Buti, Director General Economic and Financial Affairs, European Commission, transcript, CTX00057-007.

16 Marco Buti, Director General Economic and Financial Affairs, European Commission, transcript, CTX00057-007.

17 Marco Buti, Director General Economic and Financial Affairs, European Commission, transcript, CTX00057-021.

18 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-021/023; Donal Donovan, former IMF staff member, former member of the Irish Fiscal Advisory Council, transcript, PUB00296-005.

There was an over reliance on Ireland's compliance with the limits set out in the Stability and Growth Pact. As Marco Buti said in his evidence to the Joint Committee:

"As the Government deficit remained below the Maastricht limit of 3% of GDP, the post-2001 Council opinions did not identify any formal conflict with existing EU fiscal rules."[19]

While the economic models in use at a European level have improved since the crisis, [20] doubts still remain in the Department of Finance as to the effectiveness of such modified models, in a small open economic setting such as Ireland. John McCarthy, Chief Economist of the Department of Finance confirmed that the methodology being applied even today is: *"… a methodology that is designed to fit France and Germany. Unfortunately, it is a one-size-fits-all approach. It does not work for Ireland and I can say that quite definitely".*

He confirmed that there *"have been some minor improvements to the methodology but they are not game changers".* [21]

Between 2001 and 2007, no specific assessment of the Irish banking sector was required under the European Commission's Irish Stability Programme updates.[22] The European Commission focused instead on the key ratios of the Stability and Growth Pact.[23] As these requirements were mainly adhered to until 2007, no further in-depth studies that could have identified additional risks to the macroeconomic financial stability were carried out. The then Minister for Finance, Brian Cowen, stressed Ireland's adherence to the Stability and Growth Pact in responding to questions about his tenure.[24]

The European Commission identified the risks of a sharp downturn of house prices and of a sudden end to the construction boom in its 2005 update of the Irish Stability Programme. However, this provided only limited understanding of the extent to which these risks presented a challenge to overall macroeconomic stability.[25]

b) The IMF

A substantial part of the IMF's work involves the monitoring of economic and financial developments and the provision of policy advice which is focused on crisis-prevention. In relation to this work and under its established Financial Stability Assessment Program (FSAP), the IMF also prepares regular Financial System Stability Assessments (FSSA) for most of the developing and emerging market countries.

During the pre-crisis years, the IMF provided and published annual Article IV consultation reports. These reports are generated from the bilateral discussions with member countries and cover the economic outlook and the Financial Regulators' policies.[26]

19 Marco Buti, Director General Economic and Financial Affairs, European Commission, transcript, CTX0057-007.

20 Klaus Regling, Author, A Preliminary Report on The Sources of Ireland's Banking Crisis, transcript, CTX00060-007.

21 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-021/022.

22 Marco Buti, Director General Economic and Financial Affairs, European Commission, transcript, CTX00057-028

23 Marco Buti, Director General Economic and Financial Affairs, European Commission, transcript, CTX00057-005.

24 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-011.

25 Marco Buti, Director General Economic and Financial Affairs, European Commission, transcript, CTX000057-007

26 IMF Article IV Report 2003, PUB00118; IMF Article IV Report 2004, PUB00119; IMF Article IV Report 2005, PUB00120.

The regulatory authorities in Ireland were aware of the considerable risk which the overheating construction sector posed to the economy. Bertie Ahern stated that besides others, the IMF had warned about the risk in 2004:

"In October 2004, the IMF alluded to a possible overheating in the housing market, even though, subsequently, they themselves, and other economic commentators, implied there was no bubble."[27]

In 2006, in addition to its annual Article IV Consultation,[28] a detailed Financial System Assessment Programme (FSAP) was also published, in which it was stated that Irish banking had capital buffers sufficient to cover losses arising from a 55% fall in house prices and a 10% default rate.[29] The IMF statement said: *"The authorities did not provide detailed supervisory data as requested by the FSAP team, so the FSAP team could not perform its own stress tests."* [30] While certain macroeconomic scenarios for stress tests had been agreed between the CBFSAI and the FSAP team, the lack of detailed supervisory data had apparently not been sufficient reason for the IMF to query the stress test results.

Ajai Chopra, former Deputy Director of the IMF, said that the IMF had pointed out several significant risks for Irish banks in its 2006 FSAP but he regarded it as a failure that the top line conclusion in the FSAP said:

"The outlook for the financial system is positive, with financial institutions having sufficient cushions to cover a range of shocks and fighting [sic] the diversification of wholesale funding as a source of strength."[31]

Although routinely identifying the risks arising from house price inflation or strong credit growth, none of the FSAP reports gave a clear indication of the impending crisis.

With regard to these reports, Ajai Chopra noted that the IMF had previously acknowledged significant faults in its surveillance ahead of the crisis.[32] The IMF statement to the Joint Committee also acknowledged the limitations of the Financial Stability Assessment Process, which *"relies in part on the quality and detail of financial information provided by national authorities"*. The IMF statement also noted that *"until 2010, the FSAP was an entirely voluntary program and not an instrument of IMF surveillance."*[33]

c) The Organisation for Economic Co-operation and Development (OECD)

The OECD is, *inter alia*, an economic research institute dedicated to support economic development by continued monitoring of events in member countries as well as outside the OECD area. Its research includes regular projections of short and medium-term economic developments. The OECD publishes regular outlooks, annual overviews and comparative statistics. Among them is the *'OECD Economic Outlook'*, which assesses prospects for member and major non-member economies and

27 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-08.
28 IMF Article IV 2006, PUB00074.
29 IMF Financial Stability Assessment Update August 2006, PUB00130-045.
30 IMF Written Statement, IMF00001-003.
31 Ajai Chopra, former Deputy Director IMF, transcript, INQ00101-026.
32 Ajai Chopra, former Deputy Director IMF, transcript, INQ00101-036.
33 IMF Written Statement, IMF00001-003.

'OECD Economic surveys', which provide individual national analyses and policy recommendations.

European Commission representatives participate alongside OECD members in discussions on the OECD's work programme and are involved in the work of the entire OECD organisation and its different internal bodies.

Like the IMF, the OECD undertook a detailed country review process every year in the lead-up to the financial crisis. While the OECD identified property inflation and strong credit growth, it did not identify a major risk emanating from the Irish banking sector.[34]

As late as April 2008, the OECD Economic Survey of Ireland affirmed that the health of the banking sector remained robust, based on a range of indicators and the results of stress-testing exercises.[35] The stress tests used were Central Bank tests but they did warn of limits to the tests, the impact of a commercial property downturn or liquidity risks.[36] Highlighted in the OECD Economic Survey was the risk, in the event of a shock, that the performance of the property loans were correlated, which would result in a deterioration of the asset quality of many loans.

Of particular note is that a *"soft landing"* theory for the housing market was the expectation voiced by the OECD in its Economic Survey published in 2006: *"A soft landing is the most likely scenario."*[37] The OECD noted in its 2006 Working Paper on Ireland's housing boom that: *"If a soft landing is defined as something that is both mild and gradual, there has not been a single case out of the 49 boom-bust cycles."*[38]

The limitations of the external monitoring processes were also acknowledged by staff members of the Department of Finance. A former Assistant Principal with the Department of Finance, Robert Pye, said that *"most of the analysis"* produced by the IMF and OECD was based on information supplied upon request by the Department of Finance.[39]

According to the evidence of a number of witnesses, the OECD was not immune to domestic pressures. Tom O'Connell, the former Assistant Director General and Chief Economist at the Central Bank, described being instructed to contact the authors of an OECD report to request retraction of a potentially problematic examination of Irish property prices in around 2005.[40]

d) The ESRI

The Economic and Social Research Institute (ESRI) is an Irish independent research institute. Its research focuses on Ireland's economic and social development to inform policy-making and societal understanding. It is involved in research programmes with government agencies and departments and commissions research projects and competitive research programmes.

34 OECD Economic Surveys – Ireland, 2006, PUB00161-118.
35 OECD Economic Surveys – Ireland, 2008, PUB00162-056.
36 OECD Economic Surveys – Ireland, 2008, PUB00162-056.
37 OECD Economic Surveys – Ireland, 2006, PUB00161-009.
38 Ireland's Housing Boom: What has driven it and have prices overshot?, OECD Working Paper, 2006, PUB00259-020.
39 Robert Pye, former Assistant Principal, Department of Finance, statement, RPY00002-017.
40 Tom O'Connell, former Assistant Director General and Chief Economist, Central Bank, statement, TOC00001-005.

The ESRI provided regular quarterly macroeconomic reviews to both the Central Bank and the Department of Finance. In October 1999, it commented that a continuation of a strong economy and lower interest rates would likely further drive housing demand, increasing the risk of a house price crash in the future.[41]

Other key risks identified in papers produced by the ESRI included house price inflation, necessity of fiscal policy adjustments, dependence on the construction sector, loss of competitiveness, wage inflation, rise of personal indebtedness, overheating of the economy and stimulatory fiscal policy which the ESRI felt to be unwise.[42] John FitzGerald provided a summary to the Joint Committee of the assessment of such risks in previously published ESRI reports between 2001 and 2008.[43]

In the years before the crisis, the ESRI did not undertake analysis or assessment of the Irish banking sector, as it had insufficient expertise in this area. John FitzGerald noted that the ESRI had stopped carrying out research on the financial sector before 2000 and expressed his regret that the data on the balance sheet of the banking system was not examined by the ESRI. He described this as *"a serious mistake."*[44]

In its medium term review 2005-2012 the ESRI did include the economic assessment of a housing shock, including the possibility of a major fall in house prices. It stressed that this was not a forecast per se and that the ESRI was not suggesting that such a serious shock was inevitable. While the ESRI review noted the possibility of a soft landing for the construction industry, it suggested that this was increasingly unlikely.[45] In October 2006, the ESRI highlighted the dependency of the employment market on the construction sector and recommended a cut in Government investment in the housing sector.[46]

In summer 2007, the ESRI included an article by Professor of Economics, Morgan Kelly, on the likely fall of house prices in its Quarterly Economic Commentary.[47]

Surprisingly however, the ESRI Medium Term Review published in May 2008 did not foresee any major problems and described the fundamentals of the Irish economy as sound. Professor FitzGerald said that the *"upbeat tone"* of the May 2008 Medium Term Review was *"wholly unwarranted… The review completely missed the possibility of a financial collapse"*.[48]

41 'Irish House Prices: Will the Roof Cave In?' The Economic and Social Review, Vol. 30, No. 4, October, 1999, pp. 343-362, PUB00396-015.

42 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-003 to 005; OECD Working Paper No. 492 of June 2006, DOF07893-001; OECD Economic Surveys Ireland 2006, PUB00161-119; IMF Article IV Consultation Staff Report 10/2005, PUB00120-005/008/009.

43 John FitzGerald, Research Affiliate, former Research Professor, ESRI, statement, CTX00022-008 to 014; ESRI Medium Term Review 2005-2012, PUB00307 & Dept of Finance Comment on ESRI Medium Term Review 2005-2012, DOF01029; Dept of Finance Comment on ESRI Summer 2006 Quarterly Economic Commentary, DOF00933; ESRI Quarterly Economic Commentary, Spring 2007, PUB00292-032 to 035; Comment on ESRI Spring 2007 forecast, DOF00938 and ESRI Medium Term Review 2008-2015, PUB00306.

44 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-008.

45 ESRI Medium Term review 2005-2012, PUB00307-102/105; Department of Finance, Notes to Minister on ESRI Medium Term Report, DOF01029-001.

46 John FitzGerald, Research Affiliate, former Research Professor, ESRI, statement, CTX00022-008/014.

47 Morgan Kelly, "On the likely extent of falls in Irish House Prices" ESRI Quarterly Economic Commentary Summer 2007, PUB00258; John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB000287-019.

48 John FitzGerald, Research Affiliate, former Research Professor, ESRI, statement, CTX00022-013/014.

e) The Rating Agencies

Rating agencies assign credit ratings to debt issuers. The credit rating indicates the debtor's ability to repay debt and is also indicative of a likeliness of default. It thereby determines creditworthiness and consequently has direct influence on borrowing costs of debt issuers and the preparedness of investors to lend to the rated institution.

During the 2003–2008 period, the credit rating agencies saw the Irish banks in a generally positive light. Ratings of the large Irish banks were among the highest in Europe. In addition to the banks' strong profitability growth, ratings of the large banks were also supported by *"assessment of a high probability of systemic support in the event of a stress situation"*.[49]

In Part 2 of its Financial Stability Report 2006, the Central Bank includes the following quote from the Standard & Poor's rating agency (S&P):

"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".[50]

While the share prices of all Irish banks had reached their highest valuations in either the first or second quarters of 2007, their subsequent fall over the following months was not immediately seen as a problem that was peculiar to the Irish banks, but rather as a reflection of general liquidity problems across banks internationally.[51] This was also supported by the fact that the ratings of the Irish banks remained high until late 2008.[52]

On 1 January 2008, when property prices had been falling for almost a year and lack of liquidity in the interbank markets was already apparent, the Irish banks still enjoyed high long term credit ratings:

- AIB was rated Aa2/A+/AA- by Moody's/S&P/Fitch.
- BOI was rated Aa2/A+/AA- by Moody's/S&P/Fitch.
- Anglo was rated A1/A/A+ by Moody's/S&P/Fitch.
- IL&P was rated Aa3/A+/Not Rated by Moody's/S&P/Fitch.

The rating agencies and equity market analysts in general were slow to recognise the impending financial crash. The principal agencies, Moody's and S&P, reviewed the Irish banks in May/June 2008.[53]

49 Moody's Credit Opinion on Anglo Irish Banking Corporation, May 2008, IBRC03516-002.

50 2006 Financial Stability Report, Part 2, page 63, PUB00034-003; Liam Barron, former Director General, Central Bank, statement, LBA00001-016.

51 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, transcript, INQ00130-019.

52 Presentation to Irish Department of Finance Discussion materials, 24 November 2008, DOF02265-107.

53 Moodys' Investor Service, Credit Opinion Anglo Irish Bank Corporation PLC 2 May 2008, IBRC03516-001-008; Department of Finance correspondence on S & P Rating action on 6 Irish banks 30 June 2008, DOF03269.

Despite highlighting Anglo's *"apparently aggressive growth rates in recent years"*[54], a *"sizable degree of exposure to the commercial investment property market"*[55] and *"the institution's wholesale funding reliance"*[56], Moody's maintained its A1 rating for Anglo in its 2008 Review, citing its *"sound profitability"* and *"good credit quality supported by a rigorous lending approach"*. Meanwhile, S&P maintained ratings for AIB and BOI at A+ and Anglo at A, while IL&P was lowered from A+ to A.[57]

The rating agencies' *"outlooks"* on AIB, BOI and Anglo Irish Bank were adjusted for all three banks in June 2008 but they were not downgraded until November 2008, when the rating of Anglo was taken from A to A- by S&P.

The IL&P rating had been downgraded by S&P twice in 2008: from A+ to A in June, 2008 and from A to A- in November 2008.

In summary, therefore, it would appear that the rating agencies provided little indication of the problems which would befall the banks very shortly afterwards. This was also confirmed by Con Horan, former Prudential Director and Financial Regulator, who mentioned the rating affirmations around July 2008 and *"a view at that time, I think, even from international rating agencies, that the Irish banks were able to ride out the problems at the time."*[58]

Reliance on each other – National and International Economic Forecasters v National Regulatory Authorities and Government Authorities

The Joint Committee heard that there was a high level of trust placed from external national and international economic forecasters, namely the IMF, OECD and ECOFIN/European Commission on correct data and other input from both the regulatory authorities (i.e. the Central Bank/Financial Regulator) and the Department of Finance. This input from the Irish regulatory authorities was an important factor for the production of their forecasts. Equally, national authorities and Government sources often quoted the views of the external forecasters as an important factor for their own economic views.

Michael McGrath, Assistant Secretary with the Department of Finance, described the level of engagement between the Department of Finance, the Central Bank and the ESRI as cooperative and business-like. He said that the Department had regard to the Central Bank's independence and took very seriously the opportunity to comment on draft reports of the Central Bank and ESRI, supplying technical and policy-related comment for the institutions to consider. He noted that the Department took into account the reports of a range of bodies, such as the European Commission, the ECB, the IMF, the OECD and various international think-tanks, but that such external advice did not predict the crisis until it was too late.[59]

---

54 Moodys' Investor Service, Credit Opinion Anglo Irish Bank Corporation PLC 2 May 2008, IBRC03516-002.

55 Moodys' Investor Service, Credit Opinion Anglo Irish Bank Corporation PLC 2 May 2008, IBRC03516-002.

56 Moodys' Investor Service, Credit Opinion Anglo Irish Bank Corporation PLC 2 May 2008, IBRC03516-002/004.

57 Department of Finance correspondence on S & P Rating action on 6 Irish banks 30 June 2008, DOF03269.

58 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, transcript, INQ00130-019.

59 Michael McGrath, former Assistant Secretary, Department of Finance, statement, MMG00006-014.

Derek Moran, then Assistant Secretary in the Department of Finance, stated that engagements with international bodies such as the European Commission, the IMF and the OECD were *"challenging"* and covered the full range of macro-economic and fiscal issues. He noted that external institutional commentators noted vulnerabilities in the public finances and suggested tighter fiscal policy but simultaneously praised Irish economic performance. He believed their views largely coincided with that of the Department of Finance.[60] Derek Moran said that bodies such as the IMF warned of risks but *"the narrative tended to soften"* over time.[61] He described the compilation of the OECD Country Reports as an inclusive process, during which the OECD would engage with the Department, the Central Bank, independent economists and journalists, taking *"a very holistic view"* before generating a report. The report was then made the subject of detailed examination by a large OECD committee.[62]

Tom Considine, former Secretary General, Department of Finance, in assessing fiscal policy during his tenure, noted the consensus view of economic commentators including the European Commission, the IMF and the OECD that the domestic and international outlook was broadly favourable.[63]

Notwithstanding the consensus view, it is notable that individual contrarian voices warned about strong credit growth and property price bubbles as early as 1998. Some commentators were sufficiently prominent to receive attention in the wider media area or in financial circles. Specific examples of these early warnings are articles by David McWilliams in January 1998[64], William Slattery in February 2000[65] and Morgan Kelly in 2007.[66]

Section 2: Central Bank, Financial Regulator

A review of the framework that the Central Bank and Financial Regulator operated in and the actions taken by these regulatory authorities over the relevant period, are critical in understanding the contribution of the regulatory authorities to the crisis.

The Need for Regulation

The need for regulation stems primarily from the fact that most financial services businesses require customers to trust them with their money. This often involves long periods of time.[67] Customer trust maintains confidence in financial institutions and stability in the financial system allows them to operate effectively. Regulation is used as a tool to create or enhance customer trust.

60 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, statement, DMO00001-005.

61 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-004.

62 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-024/025.

63 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-006.

64 'Irish economy mirrors Asia's before the bust', Irish Times, 16 Jan, 1998, PUB00406-001. The article is also referred to in McWilliams' transcript to the Inquiry, CTX00068-016/017.

65 'Property price fall of 30-50 p.c. possible if credit growth not curbed', Finance Ireland, William Slattery, 02/2000, WSL00001-001.

66 Morgan Kelly, "On the likely extent of falls in Irish House Prices" ESRI Quarterly Economic Commentary Summer 2007, PUB00258; See also John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-019.

67 Other than banks financial services include also insurance companies, stockbrokers and money transmission companies.

There is often an unequal relationship between banks and their customers in relation to information and expertise. Consumers therefore need to rely upon and trust banks and the Financial Regulator plays a key role here.

The principal elements of financial regulation may be categorised as:

- Macro prudential Regulation: The use of prudential tools with the explicit objective of promoting the stability of the financial system as a whole, not necessarily of the individual institutions within it.[68]
- Micro prudential Regulation: Prudential measures primarily concerned with sound banking and the protection of depositors at the level of the individual bank.[69]
- Consumer Protection: The protection, especially by legal means, of the consumer. It is the policy of using legislation to protect consumers against unfair contract terms.[70] Consumer Protection is particularly important in the regulation of the financial services industry, due to the general imbalance of knowledge and powers between individuals and financial institutions and the often long-term nature of the agreements concluded between them.

Some other key terms relevant to financial regulation are:

- Financial Stability: This term refers to a situation where the components of the financial system (financial markets, payments and settlements systems, and financial institutions) function smoothly and without interruption, with each component being resilient to shock.[71] Financial stability may therefore be regarded as the desired "normal" state of affairs which regulation seeks to achieve and maintain.
- Systemic Risk: Systemic risk refers to the risk of a breakdown of an entire system, rather than simply the failure of individual parts. In a financial context, it captures the risk of a cascading failure in the financial sector, caused by interlinkages within the financial system, resulting in a severe economic downturn.[72]
- Non-Systemic (Idiosyncratic) Risk: By contrast, a non-systemic or idiosyncratic risk affects only a single institution or asset and does not affect the system as a whole.[73]

Risks to financial stability include both systemic and non-systemic risks. These risks have become more complex with time, as financial institutions have grown larger and increasingly interdependent upon one another. In many countries, including Ireland, the banking sector was, and continues to be, dominated by a relatively small number of large institutions.

Increased reliance on wholesale funding (outlined in Chapter 1) also resulted in significant interdependency between financial institutions. The failure of any one bank may therefore have unforeseen knock-on effects, as other creditor banks are forced to absorb losses, thus creating a wider contagion risk.

---

68 As defined by Bank for International Settlements (BIS) Quarterly Review, March 2010.

69 As defined by Bank for International Settlements (BIS) Quarterly Review, March 2010.

70 As defined by Oxford Dictionary of Business and Management, fifth edition, 2009.

71 Department of Finance, Memorandum of Understanding on Fiscal Stability between the Governor and Board of the CBFSAI and IFRSA, DOF03976-001.

72 As defined by the Systemic Risk Centre based at the London School of Economics and Political Science (LSE), www.systemicrisk.ac.uk/systemic-risk.

73 Systemic Risk Centre based at the London School of Economics and Political Science (LSE), www.systemicrisk.ac.uk/systemic-risk.

Reference will be made throughout this report to the fact that Ireland adopted a *"principles- based"* approach to regulation. This contrasts with the *"rules based"* approach, which is used in some jurisdictions, most notably the United States. The difference between the two approaches can be compared to compliance with the spirit of the law (principles-based approach) or the letter of the law (rules-based approach).

The success or failure of either regulatory approach is dependent upon ensuring proper adherence to and enforcement of the principles or rules applicable to the approach adopted. An intrusive style of regulation can and should be a key part of both regimes.

Regarding the Irish regulatory system in the decade before the financial crisis, former CEO of IFSRA, Liam O'Reilly said:

"The approach of the Financial Regulator was that of a principles-based regime. Such a regime was also the standard approach throughout Europe and was in line with the Basel capital requirements. The approach was well known and enunciated by the Financial Regulator, and by Government, and publicly accepted."[74]

Regulatory Structure Prior to 2003 and Reasons for Reform

Financial regulation both pre and post-crisis was subject to both European and domestic legislation. EU policy towards regulation in the years prior to the financial crisis was outlined by Marco Buti who made the following key points to the Joint Committee:

- Within the EU, it had been assumed that macroeconomic stability could be ensured through two main policy instruments. These were the control of inflation and the maintenance of a prudent and sustainable fiscal policy.
- The objective of controlling inflation was mandated to the ECB. The focus of the European Commission was to ensure that countries complied with the terms of the Stability and Growth Pact.[75] Consequently, little consideration was given to other macroeconomic policy areas, including the financial sector and national fiscal imbalances.
- Financial stability risks were mainly treated as relating to individual banks and not the economy as a whole. The EU had, therefore, adopted a principles-based approach to regulation based on minimum harmonisation.
- The working assumption was that the supervisory authorities in each jurisdiction would be capable of enforcing the minimum requirements and addressing any stability risks within their own banking sectors. [76]

The European framework therefore provided a minimum set of requirements which had to be complied with across all Member States. Provided those minimum requirements were met, Member States were able to impose additional requirements according to their own needs.

74 Liam O'Reilly, former CEO, IFSRA, transcript, INQ00065-003.

75 See Glossary of Terms for a definition of the The Stability and Growth Pact.

76 Marco Buti, Director General for Economic and Financial Affairs, European Commission, CTX00057-005/008.

Domestically, prior to 2003, banking regulation had been undertaken by the Central Bank of Ireland. Its two specific objectives were the protection of the banking and financial system as a whole and the protection of depositors and clients of banks and investment firms.

The Central Bank's longstanding approach to regulation comprised of a process termed *"moral suasion"*,[77] described by Patrick Honohan, the Governor of the Central Bank as being:

"…. non-legally binding requests whereby one says, "Please stop doing this, please stop doing that" and if the banks know what is good for them, they say, "Okay, yes, let's behave differently". However, if they do not respond, it has to be followed up with enforcement, strict directives and rules."[78]

The ability or otherwise of the Central Bank to enforce such requests was essential. Former CEO of the IFSRA, Patrick Neary, said that a key tenet of the approach is that it *"essentially placed boards and management of banks at the centre of responsibility for the prudent conduct of business."*[79]

Although the Central Bank was responsible for banking regulation, other financial institutions were regulated by a number of different Government departments and agencies, including the Department of Enterprise, Trade and Employment, the Director of Consumer Affairs, the Registrar of Friendly Societies and the Pensions Board. [80]

Reform of the Regulatory Structure 2003

During the 1990s there was an acknowledgement of the need to better regulate financial services to police both prudential and consumer protection. The existing legislative structures were considered disjointed, with unclear responsibilities and little offered by way of consumer protection.[81] Many financial scandals, including the DIRT Inquiry and Ansbacher accounts scandal, further undermined public confidence in the financial sector and added impetus for reform.

A key milestone for reform arrived with the publication of a report by the Oireachtas Joint Committee on Finance and the Public Service in July 1998. The report recommended establishment of a new Single Regulatory Authority (SRA) to oversee financial regulation, enforcement, and consumer protection.[82] This proposal would have removed responsibility for banking regulation from the Central Bank with the creation of an independent *"greenfield"* structure. The alternative was to consolidate all financial regulation and consumer protection matters within the Central Bank.

77 The Central Bank's approach to enforcement over this period is described in a document prepared for the Banking Inquiry by the Central Bank entitled "Item 13", CB05464.

78 Patrick Honohan, Governor Central Bank, transcript, PUB00273-036.

79 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-005.

80 Range of financial service providers to be overseen by the Single Financial Regulator, DOF03785-002/005/009.

81 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-040/041.

82 Presentation on the Report of the Implementation Group on the Establishment of a Single Regulatory Authority for the Financial Services Sector by Tom Considine, Assistant Secretary, Department of Finance, to the Joint Committee on Finance and the Public Service, 13 October 1999, DOF06854.

The Government established a working party under the Chair of Michael McDowell to examine and report on the various options for an SRA. Charlie McCreevy, the then Minister for Finance, presented and sponsored the changes in the Dáil and the Central Bank and Financial Services Authority of Ireland Act 2003 (CBFSAI Act 2003)[83] was passed by the Oireachtas. The CBFSAI Act 2003, as passed, reflected the Government's choice to proceed with a compromise approach to the restructure based on a minority recommendation made in the McDowell Report, crafted by Dermot McCarthy, then Assistant Secretary in the Department of the Taoiseach.[84]

The new structure comprised a separate Single Regulatory Authority (SRA), known as the Irish Financial Services Regulatory Authority (IFSRA), with its own board and which was to sit within a restructured organisation to be called the Central Bank and Financial Services Authority of Ireland (CBFSAI). Factors which influenced the Government's compromise decision included:

1. Charlie McCreevy was of the view that the *"greenfield"* option carried too many risks and that the establishment of the SRA as a distinct pillar of a reconstituted Central Bank was a more appropriate way forward.[85]
2. The European Central Bank influenced the final configuration of the new structure to ensure that financial stability issues were *"dealt with in a coordinated fashion."*[86]

By the time the new structure was agreed and implemented, the banking sector was in the middle of a period of rapid growth and change.[87]

CBFSAI and IFSRA: The Structure

The new structure created by the CBFSAI Act 2003 was relatively complex in nature, and comprised three decision-making bodies: [88]

1. The Governor of the Central Bank was to decide on European System of Central Bank (ESCB) tasks, including financial stability.
2. The Irish Financial Services Regulatory Authority (IFSRA) was to be responsible for licensing firms and the prudential and consumer regulation of financial service providers.
3. The CBFSAI Board (chaired by the Governor of the Central Bank) was to be the decision-making body for all remaining tasks, including the efficient co-ordination of the organisation as a whole.[89]

Prior to the separation of duties arising from the CBFSAI Act 2003, both micro-prudential regulation of the banking sector and oversight of macro-prudential (financial stability) issues fell within the remit of the Central Bank. From 2003, the delegation of responsibilities for these areas was governed by a Memorandum of Understanding (the Memorandum) between the Central Bank

83 Central Bank and Financial Services Authority of Ireland Act 2003, PUB00255.

84 Speaking Notes on Single Regulatory Authority, DOF06992.

85 Charlie McCreevy, former Minister for Finance, Letter to former Tánaiste Mary Harney, June 1999, DOF07055.

86 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-043.

87 See Chapter 1.

88 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-010; Patrick Honohan, Governor, Central Bank, transcript, PUB00352-089/090.

89 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-042.

and the Financial Regulator.[90] The Memorandum sought to set out the division of responsibilities between the two entities and provided that the Central Bank would address overall financial stability, while the Financial Regulator would deal with the regulation of individual institutions. The Memorandum focused on monitoring but did not address the taking of actions. For example, it stated that the Central Bank's role was to *"…identify and advise… relevant parties"*.[91]

Paragraph 4 of the Memorandum also clearly stated that the Central Bank was to be responsible for monitoring both micro-economic and macro-economic issues:

"the Governor and the Board's responsibilities therefore involve: ….analysis of the micro-prudential -where appropriate -as well as macro-prudential health of the financial sector."[92]

The language used in the CBFSAI Act 2003 listed among the objectives of the Central Bank *"contributing to the stability of the financial system."*[93]

The division of responsibilities within the Memorandum and the CBFSAI Act 2003 gave rise to concern expressed by some commentators and witnesses that lines of responsibility may have become blurred. The Honohan Report stated:

"The division of responsibilities between the Governor, the CBFSAI and IFSRA was novel and contained the hazard of ambiguous lines of responsibility especially in the event of a systemic crisis."[94]

John Hurley also referred to the timing for implementation of the new structure: *"the difficulty is that you separated at the wrong time the two functions and when you look back at it, the house was divided at a time when the bubble was inflating."*[95]

In explaining the role of the Central Bank in the lead up to the financial crisis, John Hurley said that, in line with the Memorandum, the Central Bank was responsible for providing "guidance" on financial stability and this guidance was given principally by way of its annual Financial Stability Reports. He said that confusion over the issue of financial stability may have been attributable to the power granted to the Central Bank to issue formal guidelines to the Financial Regulator under section 33D of the CBSFAI Act 2003. [96] However, he said, such a situation never arose and that section 33D was not used, as the Financial Regulator had never disputed the findings of the Financial Stability Reports:[97]

"In hindsight, these assessments, as I have indicated, were not adequate. I fully accept the role of the Central Bank and my role as Governor in underestimating the risks to the Irish financial system." [98]

90 Memorandum of Understanding on Financial Stability, DOF03976-003.
91 Memorandum of Understanding on Financial Stability, DOF03976-003.
92 Memorandum of Understanding on Financial Stability, DOF03976-003.
93 Section 5A (1)(b), Central Bank and Financial Services Authority of Ireland Act 2003, PUB00255-009.
94 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-023.
95 John Hurley, former Governor, Central Bank, transcript, INQ00047-042.
96 Section 33D, Central Bank and Financial Services Authority of Ireland Act 2003, PUB00255-031.
97 John Hurley, former Governor, Central Bank, transcript, INQ00047-003.
98 John Hurley, former Governor, Central Bank, transcript, INQ00047-008.

Apart from the division of responsibilities relating to financial stability, the Joint Committee heard evidence of concerns relating to the division of duties between the Central Bank and IFSRA. Concerns with the legislation included the following:

a) The CEOs of the Financial Regulator (Liam O'Reilly/Patrick Neary) had to consult with the Governor of the Central Bank (John Hurley) on matters relating to financial stability and could only act with the Governor of the Central Bank's agreement. For example, John Hurley approved the changes in capital ratios in December 2006, this additional requirement appeared to have an impact on decisions to take action.[99]

b) The Governor was not a member of the IFSRA Board even though, under the Memorandum of Understanding between the CBFSAI and IFSRA, the Governor and Board of the Central Bank had a responsibility for overview of the domestic financial system as a whole.[100]

c) The IFSRA board included its Consumer Director but did not include its Head of Prudential Regulation.[101] This supports the view of a number of the Inquiry witnesses that consumer matters were given more attention than prudential matters.[102]

d) Former Chairman of the IFSRA Board, Brian Patterson said that the ability of IFSRA to act on its own accord was also limited in a number of other ways:

   "[IFSRA] had a degree of independence but operated within the overall framework of the Central Bank…..The regulator inherited most of its staff from the Central Bank and so also inherited, and was effectively constrained by, the Central Bank's HR policies, systems, and culture…which, in my view, was generally hierarchical, deferential, cautious and secretive…. this did slow down our banking regulators from coping with change, of which there was a lot during the period, and in developing their crucial data analytics capability." [103]

Powers and Sanctions Available to the Central Bank and Financial Regulator

Illustrated below are the key supervisory powers that were available to the Central Bank and Financial Regulator.[104]

99 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, transcript, INQ00130-012/013.

100 Memorandum of Understanding on Financial Stability, DOF03976-003.

101 In practice, the Head of Prudential Regulation did attend IFSRA board meetings - Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-005.

102 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-005; Patrick Honohan, Governor, Central Bank, transcript, PUB00273-022.

103 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-004/005.

104 Central Bank Act 1971, Building Societies Act 1989, Central Bank and Financial Services Act 2003, Part 3 of the Central Bank Reform Act 2010, The Central Bank (Supervision and Enforcement) Act 2013.

Key Supervisory Powers available to the Central Bank and/or Financial Regulator 1992 to 2013

1992 to 2003

The Central Bank could:

- impose conditions on a banking licence
- revoke a banking licence
- suspend the carrying on of banking business
- prohibit the continuance of contraventions of 1971 Act
- petition for winding up
- regulate ratios and the composition of assets and liabilities

Central Bank Act 1971
Building Societies Act 1989

2003 to 2010

The Central Bank could:

- issue guidelines to IFSRA that it is required to implement
- regulate ratios and the composition of assets and liabilities

The Financial Regulator (IFSRA) could:

- *impose administrative sanctions for regulatory breaches
- impose conditions on a banking license
- revoke a banking license
- suspend the carrying on of banking business
- prohibit the continuance of contraventions of 1971 Act
- petition for winding up

** Central Bank and Financial Services Act 2003*

2010 to 2013

The Central Bank could:

- impose administrative sanctions for regulatory breaches
- impose conditions on a banking license
- revoke a banking license
- suspend the carrying on of banking business
- prohibit the continuance of contraventions of 1971 Act
- petition for winding up
- regulate ratios and the composition of assets and liabilities
- *approve/or not key appointments, suspend individuals
- **impose larger fines, impose customer redress and make orders, under Enforcement Powers

**Part 3 of the Central Bank Reform Act 2010*
***The Central Bank (Supervision and Enforcement) Act 2013*

- The Central Bank / Regulator had powers to intervene in the Banking Institutions through 1992 – 2013
- These increased over the period
- Some of the provisions were untested constitutionally
- The accountable organisation was the Central Bank but for the period 2003 – 2010, specific powers were given to the Financial Regulatory Authority (IFRSA).

A range of opinions were voiced by the witnesses to the Inquiry as to the availability and use of powers by the Central Bank and the Financial Regulator.

A number of banking witnesses described prudential regulation as *"light touch"*. Michael Fingleton, former Chief Executive of the INBS, noted that *"harsh experience has taught us that light touch regulation can have enormous and disastrous market distortions"* but suggested that, if the Financial Regulator had adopted a *"more interventionist"* approach, it would have been out of step with the international regulatory consensus.[105]

105 Michael Fingleton, former CEO, INBS, statement, MFI00001-023.

Former Chairman of AIB, Dermot Gleeson, described the Financial Regulator as taking a *"relatively hands off approach on prudential and competition matters"* allowing the most aggressive lenders to prosper.[106] Former CEO of Bank of Ireland, Brian Goggin, commenting on 100% mortgages, *"saw no reason why the regulator wouldn't intervene in an environment where the market was just getting out of hand"*. [107]

In his evidence, Patrick Honohan confirmed that the Governor of the Central Bank had powers either directly or by issuing appropriate guidelines to the Financial Regulator to require banks to maintain specific ratios, issue guidelines on the policies and principles the Financial Regulator was required to implement, attach conditions to banking licences and issue requirements on liquidity buffers and sectoral limits. He did also note that, while these powers were available, the normal operation of the Central Bank did not at the time utilise the powers to instruct the Financial Regulator, which had its own specific powers available.[108] When this was put to John Hurley, he stated his belief that the powers of the Governor of the Central Bank and the Central bank were *"theoretical"* and that the only power that he could have used was one of *"guidance"*. John Hurley was of the view that *"the detailed powers were actually with the Financial Regulator"*.[109]

Brian Patterson, the then Chairman of IFRSA, stated that the Financial Regulator could have attached conditions to licenses and *"done more"* in imposing capital requirements. He noted that the Financial Regulator could *"in extremis"* have sought emergency legislation from the Government.[110] Patrick Neary accepted that *"there were tools available to us"*, and noted *"if we had…considered them in the context of needing to do something, we would have found a way."*[111]

Liam Barron, former Director General of Central Bank and Director of CBFSAI, said that it was his understanding that the Financial Regulator had *"sufficient statutory powers to discharge its regulatory functions."*[112] Former Head of Banking Supervision in the Financial Regulator, Mary Burke (May 2006-October 2008), noted that *"the regulatory powers available to IFSRA and the bank before it, were broadly sufficient, aside from those with respect to crisis management and resolution"*. She stated that in the period 2003 to the end of 2008 *"even where regulations were sanctionable under the administrative sanctions process….no prudential enforcement cases were pursued against credit institutions"*. Regarding the question of whether the Financial Regulator had the power to halt the amount of lending by the banks to the property and construction sector, Mary Burke said:

"My view is we had a number of powers. We could have set ratios, we could have set requirements regarding the composition of assets and liabilities; we could have imposed conditions on bank licenses".[113]

---

106 Dermot Gleeson, former Chairman, AIB, statement, DGL00003-013.

107 Brian Goggin, former CEO, BOI, transcript, INQ00139-051.

108 Letter from Patrick Honohan to the Joint Committee dated 12th February 2015, CB07423.

109 John Hurley, former Governor Central Bank, INQ00047-026/027.

110 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-016.

111 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-017.

112 Liam Barron, former Director General, Central Bank and Director, CBFSAI, statement, LBA00001-004.

113 Mary Burke, former Head of Banking Supervision, Financial Regulator, (May 2006 to October 2008), transcript, INQ00131-005/037.

Frank Browne, former Head of Financial Stability Department of the Central Bank, stated:

"It is my belief that the FR had sufficient powers to take direct actions against the banks."[114]

Adrian Byrne, former Head of the Banking Supervision Department of the Central Bank, suggested in his witness statement that the IFSRA Board *"had sufficient powers to take direct action against banks in order to avoid a financial stability crisis."*[115]

Deirdre Purcell, non-executive Board member of IFSRA and of the Central Bank, stated in her witness statement that, when granted direct sanctioning powers *"there was caution within the FR before acting…in order to cut off recourse to the courts."*[116]

Gerard Danaher, member of the board of the Central Bank from 1998 to 2010 and of the Financial Regulatory Authority from 2003 to 2010 commented:

"The Financial Regulator did not seek significant additional powers in relation to the banks and never fully availed of the powers it had."

In his opinion, in the context of increases to capital ratio requirements and the imposition of heavier capital weights on certain mortgages, it was *"not a lack of power…but excessive caution which…led to the steps in question being too little and too late."*[117]

CBFSAI Board and IFSRA Board

The boards of the CBFSAI and IFSRA and their members formed part of the regulatory and Supervisory regime. It appears, however, that there was an absence of relevant experience on the part of members of both Central Bank and IFSRA in the years preceding the crisis. Appointees to the boards did not seem to require regulatory experience and this was highlighted by Brian Patterson with regard to the selection of the IFSRA board:

"I tried to make the point that the board needed to have regulatory experience. There were people with banking experience on it."[118]

Members of the Central Bank board also had a range of business backgrounds and experience but did not necessarily hold regulatory or banking experience. Former Non-Executive Director of CBFSAI and Central Bank board member, David Begg, highlighted the absence of specific training for the Central Bank board, once appointed: *"….. I don't think anybody received any training. I'm not aware of anybody else who did, at least."*[119]

Former Chairman of the IFSRA Board, Jim Farrell, in his witness statement responded to questions of the knowledge and skill set of the board and their ability to challenge as follows:

"While board members seemed to have a clear understanding of the issues, there was much reliance placed on the economists to deal with the many technical and interrelated economic issues.

---

114 Frank Browne, former Head of Financial Stability Department, Central Bank, statement, FBR00003-005.

115 Adrian Byrne, former Head of the Banking Supervision Department, Central Bank and former Personal advisor to Assistant Director General, statement, ABY00001-004.

116 Deirdre Purcell, former Non Executive Director of CBFSAI and IFRSA Boards, statement, DPU00001-011.

117 Gerard Danaher, former Non Executive Director of CBFSAI and IFRSA Boards, statement, GDA00001-005.

118 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-012.

119 David Begg, former Non Executive Director of CBFSAI Board, transcript, INQ00118-015.

In hindsight, having an economist(s) on the board to argue the finer points might have made a difference. Having said that, there were not many economists outside the Central Bank giving contrarian views."[120]

In response to the same question Gerard Danaher said:

"As for the members of the Board and the Authority, they came from many different backgrounds. Some had a greater knowledge of the technical aspects of banking and economics than others. They seemed to me to have sufficient knowledge and expertise to be able to draw their own conclusions on financial stability aspects. I believe the reason why incorrect conclusions were drawn arose more from an overreliance on external and internal assurances regarding financial stability rather than any inherent lack of knowledge or expertise. In that regard, I do not believe that there was any particular correlation between the degree of professional knowledge of banking or economics and the level of perspicacity demonstrated by members."[121]

The failure to act may be further attributed to the fact that warnings, in the early stages of the boom, were ignored. When the economy continued to grow strongly, there was a tendency to ignore warnings contained in the Financial Stability Reports and elsewhere.

Whilst there was much debate amongst regulatory policy-makers and academics about the design aspect of the CBFSAI, no review of the quality of supervision policy, practice or execution of CBFSAI appears to have been carried out by either the Department of Finance or the Minister for Finance. This was something that was highlighted by a number of the witnesses during the Inquiry hearings. While it must be noted that there is no statutory legal role for either the Minister for Finance or the Department in this regard, such a review after the introduction of the CBFSAI could have uncovered its structural shortcomings.

A review of the CBFSAI structure was undertaken by the OECD and IMF against Basel Core Principles for Effective Banking Supervision. According to Patrick Neary, *"the conclusions of all these assessments by these independent expert bodies in relation to the Authority were very favourable"*[122] This evidence, again, highlights the reliance placed by the regulatory authorities on international organisations.

Despite the degree of change and reliance placed on the work of the Central Bank and Financial Regulator, the Department of Finance or Minister for Finance never carried out a review of the performance, effectiveness or impact once the CBFSAI was implemented. In this regard, a number of witnesses said the following:

Richard Bruton, Minister for Jobs, Enterprise and Innovation said:

"…I think the biggest objection I had was that we hadn't stress tested the actual powers, the capabilities, the method of overseeing the financial institutions."[123]

---

120 Jim Farrell, former Chairman, IFSRA, statement, JFA00001-004.

121 Gerard Danaher, former Non Executive Director of CBFSAI and IFRSA Boards, statement, GDA00001-009.

122 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-003.

123 Richard Bruton, Minister for Jobs, Enterprise and Innovation, transcript, INQ00124-038; See also Mary Harney, former Tánaiste, transcript, INQ00136-009.

Brian Cowen commented: *"I mean there was a review, I understand from Mr. Considine who was the Secretary General, where I think either the OECD and IMF did a peer review study of how this CB and IFSRA was working, sort of, came out okay…It just tells you that the Government's mechanisms that were in place seemed to be working well"*.[124]

We asked Charlie McCreevy about appointments to the boards of the Central Bank and IFSRA. When asked about the backgrounds of the State appointees, Charlie McCreevy defended the appointments made during his tenure as Minister as follows:

"…in setting up the new structure, you can look at all of the Dáil debates and all of the Seanad debates and all of the commentary and you'll see all this concentration on consumer issues to the exclusion of nearly everything else….

"most of those people that I appointed, we did it in a small process. We put forward a few names, we put a journalist on that … to really give an emphasis on, say, really talking about consumer, so that other people had been, in all walks of life, had different experiences. And when you're appointing a board, you appoint people to a board that you think bring different experiences to the area…..

"I don't know what people were around…with regulatory experience that we would've picked from but, in any event … the board of a central bank, you'll need a broad range of experiences…." [125]

The former board members who provided witness statements to the Inquiry gave their views on the skills, experience and political composition of the Central Bank and IFSRA boards. The response of one former non-executive director of the Central Bank and IFSRA, Deirdre Purcell, provides an interesting insight in this regard:

"I was surprised when I got the phone call from the appointing Minister asking me to join the new Board and I responded by telling him I had no academic or professional qualifications in banking….. He explained the consumer protection function of the Financial Regulator and said he envisaged my role on its Board to be that of the 'ordinary' citizen who would aim to represent the 'ordinary' customer of financial institution …. as for the 'political composition of the Central Bank Board' …in truth, matters having been discussed around the table, I did not detect political bias in any decision of the Board."[126]

Gerard Danaher said that he believed that his appointment may well have been a consequence of his political background:

"In my own case, by profession I was a Senior Counsel. As such, I was in a position to contribute at the Board on such legal issues as arose. While I was not a specialist in banking law, I did have an interest in statutory interpretation which was useful……Obviously, when very technical aspects of economics or banking arose, I deferred to the experts. I assume that my political orientation …. was a factor in my being appointed."[127]

124 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-115.

125 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-018.

126 Deirdre Purcell, former Non Executive Director of CBFSAI and IFRSA Boards, statement, DPU00001-003/008.

127 Gerard Danaher, former Non Executive Director of CBFSAI and IFRSA Boards, statement, GDA00001-014.

The Joint Inquiry questioned why more emphasis was not placed on regulatory or banking capability in the appointment to key financial state boards and in the process for identifying candidates, but this matter remains unclear.

Regulation in Action: What was known and what was done

The preceding sections have outlined some of the weaknesses and limitations of the CBFSAI Act 2003. The Joint Committee reviewed the key work done and actions taken by the CBFSAI and IFSRA during the years leading up to the crisis and found that these actions and inactions had a critical impact on the financial crisis.

Key areas reviewed include:

- General Review of Mortgage Lending Practices
- Governance Concerns
- 100% Mortgages
- Licensing and Supervision Requirements and Standards
- Sectoral Lending Limits
- Commercial Loan Exposure
- Liquidity
- Attempts to introduce new Legislative Powers
- Credit Growth
- Pre Budget letters from the Governor to the Minister for Finance
- Stress Tests
- Financial Stability Reports
- Response to Financial Stability Reports

General Review of Mortgage Lending Practices:

The CBFSAI conducted a survey of mortgage lending practices in 2003.[128] The survey indicated that mortgage lending had grown at very high rates. For instance, it showed that between 1999 and 2002, mortgage lending increased by 77% from €24.7 billion to €43.8 billion. Three institutions were found to have granted mortgages with loan to value (LTV) ratios of above 95% and 100% in certain circumstances. Problems were also identified regarding income verification procedures and procedures for calculation of repayment capacity, amongst others.

Although the majority of banks had amended their credit policies, there was a high average level of exceptions to stated lending policies of over 20%. The survey findings identified that the level of adherence to the guidance issued by the Central Bank on prudent lending practices was unacceptably low.

128 CBFSAI Survey of Mortgage Lending Practices, Q3 2003 - CB Narrative, INQ00169.

The survey report findings stated:

"A second possible element would be to move beyond moral suasion and take direct action in the form of imposing requirements on institutions. However, the FSR must be mindful that aggressive action taken to force prudent behaviour on mortgage lenders may restrict the growth in mortgage lending and create a shock to the system that could negatively impact on a fragile property market."[129]

When questioned by the Joint Committee, Patrick Neary was asked to confirm whether *"The banks could effectively breach the limits without fear of any consequence from the regulator"*, Patrick Neary responded as follows:[130]

"The sectoral concentration…limit that we're talking about…yes"

The report concluded with a detailed action plan and follow-up programme for dealing with the individual banks. The programme stated that all inspection findings were to be issued to the chairman of each of the credit institutions and had to be considered by the respective boards. Each board was to review the compliance policy monthly. Stress tests were to be carried out to assess the institutions' resilience in the face of an economic shock.

CBFSAI board members and the Central Bank, as reflected in a discussion at the Financial Stability Co-ordination Committee in April 2004, remained concerned about the strong lending growth.[131] The minutes of the meeting noted that board members had concern about *"a degree of euphoria in the property lending markets and that the boards and management of banks are being myopic about the potential risks."*[132] In the same meeting, results of a 'stress test' exercise with the banks were presented and *"It was noted that the exercise suggested that the financial system could withstand the type of adverse shocks set out."*[133]

The 2003 CBFSAI survey, together with the minutes from the Financial Stability Coordination Committee referred to above, and subsequent correspondence from the Financial Regulator to the CEOs of large lending institutions[134] all indicate that both Central Bank and Financial Regulator were aware of the relaxation of lending rules and practices across the banks as early as 2003.

Governance concerns:

In addition to its concerns across the general industry, the Joint Committee also obtained evidence which showed that the Financial Regulator highlighted concerns that it had relating to governance arrangements at INBS. Letters written by IFSRA[135] and its predecessor, the Central Bank, to INBS in 2002, 2004[136], 2006[137] and 2008[138], cited concerns relating *inter alia* to corporate governance,

129 CBFSAI Survey of Mortgage Lending Practices, Q3 2003 - CB Narrative, INQ00169.

130 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-031.

131 The Financial Stability Co-ordination Committee comprised representatives from both the Central Bank and Financial Regulator.

132 Financial Stability Co-ordination Committee Minutes on 5 April 2004 - CB Narrative, INQ00039-001 to 003.

133 Financial Stability Co-ordination Committee Minutes on 5 April 2004 - CB Narrative, INQ00039-001.

134 Two letters from Financial Regulator to the CEO of large lending institutions - CB Narrative, INQ00039-001/002

135 Michael Fingleton, former CEO, INBS, transcript, INQ00077-033.

136 Michael Fingleton, former CEO, INBS, transcript, INQ00077-020.

137 Michael Fingleton, former CEO, INBS, transcript, INQ00077-026.

138 Michael Fingleton, former CEO, INBS, transcript, INQ00077-008/009.

strength of management expertise and the changing risk profile at INBS. The 2002 letter referred to above, also referred to issues raised in 1999 and 2000 which had still not been fully addressed. This series of letters reflects that the Financial Regulator was unable to progress changes at INBS over a period of years, notwithstanding the concerns expressed and repeat correspondence. Witnesses outlined some reasons why more robust action was not taken against INBS; but the fact remains that the situation, which had given rise to the concerns, was allowed to continue.[139]

Weakness in governance structures, procedures and risk controls were also subject to an ongoing dialogue between the Financial Regulator and Anglo over several years. [140]

100% Mortgages:

Ulster Bank (through First Active) was one of the first banks to make 100% mortgages widely available in Ireland.[141] In his evidence to the Inquiry, Cormac McCarthy, former Group Chief Executive and Director of Ulster Bank said that there was dialogue between Ulster Bank and the Financial Regulator *"about aspects of the product"* but that *"the Financial Regulator did not object"*.[142]

Patrick Neary, the then Prudential Director, said that *"…the then chief executive was quite emphatic that it was not the role of the regulator to be banning products; that it was in conflict with the … the view of the regulator, that a full choice should be given to people and that the emphasis should be on the way in which they were sold to people rather than banning the choice."*[143]

The evidence of Brian Goggin, former Group Chief Executive of BOI, was that BOI entered the 100% mortgage market only reluctantly *"to protect our franchise"*.[144] He said that the Financial Regulator expressed concern about 100% mortgages during a meeting in 2006 and that the Financial Regulator's reaction to their introduction was to propose the application of a higher capital weighting to the 100% mortgages, which Brian Goggin said he himself considered to be pointless.[145] Brian Goggin said that he proposed that the Financial Regulator should ban the provision of mortgages greater than 90%, but their response was that it was not the Financial Regulator's role to interfere in the market.[146]

Patrick Neary expressly contradicted Brian Goggin's evidence and said that that the meeting had been held to inform him of higher risk weightings for high-LTV loans: *"I certainly don't recall any strong argument from Mr. Goggin to have … the product withdrawn."*[147]

---

139 One example was the breach by INBS of the regulatory sectoral concentration limit on construction and real estate lending (combined maximum: 250% of own funds). Another was material errors in INBS regulatory reporting to the Financial Regulator relating to their large exposures. Respective letters from IFSRA to INBS have been seen by the Inquiry but fall under s33AK and cannot, therefore, be referenced.

140 Fintan Drury, former Non Executive Director, Anglo Irish Bank, transcript, INQ00142-018/019/027; Gary McCann, former Non Executive Director, Anglo Irish Bank, transcript, INQ00082-010.

141 Ulster Bank announced the extension of 100% mortgages to First Time Buyers in July 2005.

142 Cormac McCarthy, former Group CEO and Director, UB, transcript, INQ00086-020.

143 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-049/050.

144 Brian Goggin, CEO, BOI, transcript, INQ00139-019.

145 Brian Goggin, CEO, BOI, transcript, INQ00139-019.

146 Brian Goggin, CEO, BOI, transcript, INQ00139-019.

147 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-049/050.

Michael Buckley, former Group Chief Executive of AIB, said that the Financial Regulator had expressed *"generalised concerns"* to the bank concerning the mortgage market and the increase in LTV ratios.[148] Liam O'Reilly stated that the Financial Regulator considered the issue of 100% mortgages in the context of consumer protection.[149]

Although IFSRA did not believe its role was to interfere in the markets, in July 2005 it issued a general warning concerning 100% mortgages. IFSRA recommended that the banks consider the repayment capacity of customers and the suitability of such products for first-time buyers.[150]

Con Horan, former Prudential Director said that he had become increasingly concerned about the direction of property-based lending from the end of 2004 or early 2005 but that a proposal made in mid-2005 to increase the bank's capital requirements on high LTV mortgages was not accepted:

"My understanding was that senior management in the Financial Regulator and the Central Bank had considered the matter but did not believe the action was necessary. Macro-prudential analysis on mortgage growth suggested developments could be explained by economic fundamentals." [151]

Liam O'Reilly stated that he, as the then Chief Executive of IFSRA, had brought the proposal to the attention of the director General of the Central Bank but it was not applied because *"house prices were stabilising, interest rates were set to rise and property prices were stabilising."* [152]

However, Con Horan made a further attempt the following year to have the measure introduced, and this time was successful. In his evidence, Con Horan said that: *"This was the first time in almost a decade of an exceptional property market that the regulatory intervention was instigated."*[153] He noted that there were concerns within the CBFSAI, both that this intervention would jeopardise financial stability and that it was inconsistent with principles-based supervision. The Honohan Report noted that this *"belated and relatively modest"* action was only taken after *"a prolonged and agonised debate."* [154]

In its *"Licensing and Supervision Requirements and Standards for Credit Institutions"*, the Central Bank had set out *"requirements and standards which it uses to guide it in the assessment of applications for licences and in the supervision of the business carried on by credit institutions."*[155]

The requirements and standards are non-statutory, but the banks were required to comply with the Central Banks supervision requirements *"at all times."*[156] The most widely referenced requirements for the banks' lending business were those relating to *"large exposure limits"* and *'sectoral concentration limits'*. The sectoral concentration limits were non-statutory guidance as contained in the Licensing and Supervision Requirements documents.

148 Michael Buckley, former Group CEO, AIB, transcript, INQ00133-027.
149 Liam O'Reilly, former CEO, IFSRA, transcript, INQ00065-005.
150 Liam O'Reilly, former CEO, IFSRA, transcript, INQ00065-005.
151 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, transcript, INQ00130-004/005.
152 Liam O'Reilly, former CEO, IFSRA, transcript, INQ00065-015.
153 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, transcript, INQ00130-005.
154 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-018.
155 Licensing and Supervision Requirements and Standards for Credit Institutions, CB05442-003.
156 Licensing and Supervision Requirements and Standards for Credit Institutions, CB05442-004.

Sectoral Lending Limits:

- **Large Exposure Limits:**

  These regulatory limits were designed to limit risk by restricting the total lending or *"exposure"* of any bank to a client or group of connected clients which exceeds 10% of *'Own Funds'*.[157] The banks also had their own internal limits for large exposures to clients. The amounts of these internal limits were usually a function of the internal credit grading applied to the individual client, based on the bank's assessment of the risk. Patrick Neary said that he did not believe that the large exposure limits were breached by any of the banks in the run up to the crisis.[158]

  Notwithstanding the statement that these prudential limits were not, in fact, breached during the period, the scale of loans to individual borrowers increased dramatically in the years preceding the crisis. Commenting on the large exposures to individual property debtors which were eventually transferred to NAMA, Brendan McDonagh, CEO of NAMA, remarked *"when you looked at the top 29 debtors they had €34 billion of borrowings, so €34 billion of the €74 billion that came to NAMA was borrowed by 29 people."*[159]

  Although these large exposures did not breach regulatory limits, breaches of the sectoral concentration limits were identified, as described below.

- **Sectoral Lending Limits:**

  Intended to limit risk in financial institutions, these limits prescribe the percentage of *'Own Funds'* (equity) which each bank can lend to any single sector or connected sectors. The Joint Committee found that these limits were breached and appeared to have fallen into abeyance.[160] Evidence provided to the Joint Committee indicates that the sectoral lending limits were actually treated as guidelines by both the banks and the Financial Regulator.[161] In his evidence to the Inquiry, Patrick Neary said that the Financial Regulator understood the sectoral lending limits to be guidelines but he acknowledged that it was *"very easy to game it"*, by which we understand he meant that the guidelines were open to manipulation and were manipulated.[162]

- **Non-Adherence to Limits:**

  When questioned, Patrick Neary went on to acknowledge that it was correct to say that the banks were effectively able to breach the limits without fear of any consequence.[163] He accepted that IFSRA should have examined sectoral lending limits more carefully and should have considered whether there was an alternative way for the Financial Regulator to deal with

157 Licensing and Supervision Requirements and Standards for Credit Institutions, CB05442-014/015.
158 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-015.
159 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-023.
160 Letter from Bank of Ireland to the Financial Regulator 27 March 2007, BOI01640-001.
161 Michael Fingleton, former CEO, INBS, transcript INQ00077.
162 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-012.
163 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-033.

the associated risk.[164] He said: *"I think the sectoral concentration limit was allowed fall into abeyance too easily, and I accept that, and I regret that…"* [165]

Gerard Danaher and Liam O'Reilly also confirmed their view that the sectoral lending limits were only guidelines and that their importance had been reduced. Gerard Danaher suggested that their importance had been reduced during the late 1990s and Liam O'Reilly pointed to around 2004, due to the forthcoming implementation of Basel II.[166]

The effect of Basel II implementation was also confirmed by Con Horan, who stated that the view within IFSRA was that sectoral concentration limits did not form part of the Basel Process.[167] He confirmed that, where banks exceeded their limits, a process of engagement occurred between the banks and IFSRA but that IFSRA adopted a non- interventionist approach: *"The Banks must make their own adjudication on their sectoral concentrations."* [168]

Rather than focusing on sectoral concentration limits, the Financial Regulator placed more emphasis on capital measures as the method for controlling the banks.[169] However, both Liam O'Reilly and Brian Patterson said in their evidence that enforcement of capital limits was constrained by an awareness that increased capital charges for the Irish banks could leave them at a competitive disadvantage to the *"passported"* EU banks, over which the Central Bank had no control.[170]

With regard to the monitoring of these limits and exposures, there appears to have been inconsistency in terms of the speed and nature of response from the Financial Regulator. Evidence from some banks to the Inquiry was that the Financial Regulator often appeared slow to respond to notifications from the banks or, where a response was received, no meaningful answers were provided.

In this regard, we received evidence in relation to a response received by Ulster Bank from the Financial Regulator in 2007 regarding a sectoral concentration 250% CAP limit notification made by the bank. This response expressed the view that the Financial Regulator was *"not objecting."* The notification letter was initially submitted by Ulster Bank on 26 February 2007, with a subsequent letter on 28 May 2007, while the less than definitive written response was not received from the Financial Regulator until June 2007.[171] Patrick Neary accepted there was *"a lot of correspondence"* on this particular issue.[172]

164 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-031.

165 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-031.

166 Gerard Danaher, former Non Executive Director of CBFSAI and IFRSA Boards, statement, GDA00001-011; Liam O'Reilly, former CEO, IFSRA, transcript, INQ00065-021/022.

167 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, transcript, INQ00130-025.

168 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, transcript, INQ00130-040.

169 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-013/032.

170 *"Passported"* banks were banks operating in Ireland but incorporated and regulated in another EU state. Thus, any regulatory changes made by IFSRA would apply only to banks registered in Ireland; Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-006; Liam O'Reilly, former CEO, IFSRA, transcript, INQ00065-020.

171 Financial Regulator Letter to Ulster Bank re Sectoral Concentration Limits, June 2007, INQ00026-003.

172 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-018.

As outlined above, breaches of sectoral limits were not enforced and this lack of enforcement enabled the banks to continue to increase the concentration of property-related loan exposures in their balance sheets. In the context of AIB's non-compliance, this point was acknowledged by Dermot Gleeson, when he said: *"Now let me say to you; we would have been very well off not to have exceeded that sectoral limit. It's a great shame that we didn't [comply]…."*[173]

The failure to take more vigorous action against the banks was also acknowledged by Jim Farrell, former Chairman of IFSRA, in his statement:

"Having identified the key risks in those institutions, there was no excuse for not insisting that management take more forceful action. All board members, including myself, have to take responsibility for not pursuing those issues more vigorously with the management of the Regulator."[174]

When we asked Richie Boucher, Group Chief Executive of Bank of Ireland, about delays in receiving a formal response from the regulatory authorities, he said: *"They would be back to us today in a nanosecond. I don't think that timescale was evident in that period"*[175]

Gerard Danaher stated, on the operation and implementation of the sectoral limits, that they: *"…were effectively dropped by the Bank prior to the establishment of the Financial Regulator. Such limits were not applied to the IFSC banks"*[176]

Liam O'Reilly said, in respect of the non-enforcement that, in the years leading up to full implementation of Basel II in January 2008, less emphasis was being placed on sectoral limits. He also maintained that the limits were no more than guidelines.[177]

"In 2004 I think it was, there was a move towards the Basel II limits and there seemed to be a crossover between which system should be used, but at no stage were there mandatory limits."[178]

Commercial Loan Exposure:

A Speaking Note prepared for Charlie McCreevy for an Informal ECOFIN on 13 September 2003 stated the following:

"The concentration of risk exposures in the housing and commercial property markets merits close attention and is being monitored by on-site visits by the Supervisory Authorities to credit institutions."[179]

Notwithstanding this early recognition of risk in the domestic construction sector by Charlie McCreevy, commercial property concentration levels and the associated risk only publicly emerged

173 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-018.

174 Jim Farrell, former Chairman, IFSRA, statement, JFA00001-005.

175 Richie Boucher, Group CEO, BOI, transcript, INQ00085-033.

176 Gerard Danaher, former Non Executive Director of CBFSAI and IFRSA Boards, statement, GDA00001-011.

177 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-057/058 also provides an explanation for the relaxation of sectoral limits dating back to the mid 1990's; A discussion of the Financial Regulator's agreement to increase Ulster Bank's property sectoral limit from 250% to 500% is evidenced in the hearing transcript of Robert Gallagher, UB, INQ00088-010/011.

178 Liam O'Reilly, former CEO, IFSRA, transcript, INQ00065-022.

179 Speaking Note - for former Minister for Finance, Charlie McCreevy, Informal ECOFIN, 13th September 2003, DOF06749-003.

as a major concern for the Central Bank and Financial Regulator when they were identified as such in the 2007 Financial Stability Report.

In 2006, the CBFSAI board considered an internal report entitled *"Is there a homogenous Irish Property Market?"*[180] The question addressed in the report was whether, based on historical experience of the property market, any fall in Irish property prices could be expected to occur across all segments of the market simultaneously.

Key conclusions were that:

- a high degree of correlation between all residential property types and residential locations.
- the retail sector had grown at a relatively stronger pace in recent years by comparison with the office and industrial sectors.
- while the correlation between retail and commercial property was smaller, statistics showed that significant correlation existed.

On the question of publication of the report, it was agreed that it was important to convey the messages contained in the report to lending institutions. However, consideration was given as to how this should be done as the Central Bank wished to avoid provoking an *"over-reaction"* to the report's findings. It was agreed therefore that the message should be communicated in the Financial Stability Report.[181]

The Interim Financial Stability Report published in the first quarter of 2007, entitled *"Update on Risks and Vulnerabilities"*, noted three major vulnerabilities for financial stability but also noted a concern that credit growth rates to the commercial property sector remained high. The divergence between growth in capital and rental values was substantial and was noted as an emerging vulnerability. The report noted that:

"While the overall health of the banking system is robust when measured by the asset quality, solvency and liquidity of the Irish banks, the concerns identified in the Financial Stability Report 2006 remain, namely:

- *the continuing high rate of credit growth…*
- *the concentration of the loan book…*
- *the funding gap of the Irish banking system…*
- *net interest margins…*
- *a further reduction in the level of impairment charges (i.e., provisions) to historically low levels…"*[182]

180 Frank Browne, former Head of Financial Stability Department, Central Bank, statement, FBR00003-053; CB Narrative INQ00002-014.

181 Is there a homogenous Irish Property Market? - CB Narrative, INQ00067-010/011.

182 Interim Financial Stability Report – Update on Risks and Vulnerabilities - CB Narrative, INQ00058-015.

The 2007 Interim Financial Stability Report included a paper entitled *"A Financial Stability Analysis of the Commercial property sector"* which was aimed at investigating *"…empirically the recent performance of the Irish commercial property sector, to better inform the risk assessment relating to the large increase in capital values and decline in yields."*[183]

In late 2007, within IFSRA, the Banking Supervision teams completed an inspection in five different banks within a ten day period. The focus of the inspections was on *'the ongoing credit management of a sample of Commercial property exposures'* from the top 20 exposures of the respective banks reported to the Financial Regulator earlier that year.[184]

In the first quarter of 2008, letters were sent out to the five banks, with general findings that applied to all of them, and specific findings for each of the banks. The general findings included recognition that banks relied on confirmation from legal firms that security for loans was perfected. Given gaps in information on the overall indebtedness of borrowers i.e. details of loans with banks or other lenders, banks were asked to satisfy themselves that there could be no other claims on the same security.

The Financial Regulator also invited views on the perception of the banks that *"a slowdown in residential development will not unduly affect large developers, as they have the financial capacity to postpone developments until the markets improved."*[185]

In an assessment of financial market developments on 8 February 2008, the CBFSAI reported concerns about defaults in the commercial property sector that might arise in loans with moratorium or bullet repayments, where no payments were made until developments were completed. [186] Issues would arise if the value of the completed development turned out at less than the required repayment. The report also noted that the Irish banks were generally satisfied with the bigger property developers, though concerns were expressed over the ability of small developers to sell developments.[187]

Liquidity:

In late summer 2007, the Financial Stability Committee of CBFSAI noted the first indications of potential liquidity stresses in Irish banking system after the disturbances in the international liquidity situation. By September 2007, Committee meeting minutes indicate that the Financial Regulator had instituted weekly liquidity reporting requirements for the banks.[188]

Liquidity turbulences were also discussed at the CBFSAI board meeting in the third quarter of 2007. At this meeting, the board noted that the Central Bank had confirmed with the Irish banks that the banks had no shortage of collateral eligible for the ECB tenders. Accordingly, there was no reason for the Central Bank to anticipate any requirement for emergency liquidity assistance.[189]

183 Interim Financial Stability Report – Update on Risks and Vulnerabilities - CB Narrative, INQ00058-017.

184 IFSRA Board Meetings - CB Narrative, INQ00044-002/003.

185 IFSRA Board Meetings - CB Narrative, INQ00044-002/003.

186 CBFSAI assessment of Financial market developments 8th February 2008, DOF02007-002/003; Report of the Domestic Standing Group February 2008, DOF02007.

187 CBFSAI assessment of Financial market developments 8th February 2008, DOF02007-002/003.

188 Financial Stability Committee minutes - CB narrative, INQ00057-002.

189 Central Bank Board Meeting Q3 2007 - CB narrative, INQ00067-016.

Mary Burke stated in her evidence that the IFSRA introduced new liquidity requirements from 1 July 2007 which involved quarterly reporting on liquidity. She said that there were concerns at the time that the Authority needed to be aware of what was happening in terms of bank liquidity. IFSRA moved to weekly reporting by late 2007 and in April 2008 the IFSRA felt that the monitoring of liquidity was *"more urgent."*[190]

In January 2008, the four main audit firms were invited to a meeting with the Financial Regulator. In his evidence, KPMG Partner, Paul Dobey said:

"In 2008, we took steps to obtain assurances from the Financial Regulator… make sure they were aware of what the Financial Regulator was aware of. We spoke to the Central Bank because we wanted to understand ELA and the information … what dialogue was going on between the Central Bank and the euro system. And we did that in 2008 and we got the assurances we need from the deputy governor of the Central Bank of Ireland and we also spoke to the Department in relation to capital. Now, when we came along … and we, therefore, concluded that those banks were going concerns …"[191]

"We also had a responsibility to assess whether the going concern based on preparation of financial statements was appropriate… we had to go and make an assessment and get assurances from the system if I put it that way – the Department, the Regulator, the Central Bank, around the going concern based on preparation…" [It was the first time they engaged with so many other outside institutions] "…and it wasn't done lightly … we had a dialogue with the regulator which was teeing up in November … it was unprecedented… we had a meeting with the Financial Regulator in early 2008 – it was meeting of the four firms with the regulator."[192]

The evolution of liquidity monitoring and actions by the Financial Regulator is discussed in Chapter 6.

Attempts to impose new requirements:

In 2005, IFSRA attempted to introduce new controls, including a Compliance Statement regime for Directors. However, Brian Patterson confirmed that the proposed implementation did not proceed due to a combination of intense lobbying from the financial sector, coupled with what he believed to be a lack of willingness by the Department of Finance to implement the changes:

"…in November 2004 the authority set out to use its discretionary powers under the Central Bank Acts to require compliance statements of directors in financial institutions. The consequential consultation process ran into a barrage of resistance from the industry…. Following extensive lobbying and discussion, the Department of Finance wrote to the authority in November 2006 asking it not to proceed with the necessary consultation process, "without first consulting the Department" – a clear signal to us that this did not have Government support."[193]

190 Mary Burke, former Head of Banking Supervision, IFSRA (May 2006 to October 2008) and other senior roles at the Central Bank / IFSRA, transcript, INQ00131-006/007.

191 Paul Dobey, KPMG Audit Partner, transcript, INQ001054-023.

192 Paul Dobey, KPMG Audit Partner, transcript, INQ001054-059.

193 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-008.

The purpose and importance of the proposed regime was outlined in the statement of Con Horan:

"[The] proposal was to impose a formal condition on the licences of all credit institutions, thereby laying a strong foundation for the taking of enforcement actions under the administrative sanction regime that was being developed at that time. However, the proposal was not implemented as the belief was that the industry was overburdened with the changes brought about by the Financial Services Action Plan."[194]

When questioned on the issue of Directors' Compliance Statements, Brian Cowen accepted that he had written a letter to the Financial Regulator on the matter, but asserted the decision remained with the Financial Regulator: *"We didn't tell the regulator what to do in this situation."* Brian Cowen noted that the Financial Regulator had decided to defer proceeding with the proposal until consultation with the industry was complete. He also noted that the industry *"were raising some issues about it"* but said that *"we weren't involved in influencing the decision."*[195]

A Department of Finance Memorandum to the Minister, dated 11 April 2007, confirmed that the Financial Regulator decided to postpone implementation of the Directors' Compliance Statements after *"industry and other interested parties"* raised *"serious concerns"* in response to an informal consultation. The Financial Regulator put forward instead that the proposed Compliance Statement provisions should be reviewed as part of a project for the consolidation and modernisation of financial services legislation and that no powers would be exercised in this regard pending the outcome of the review. [196]

IFSRA therefore did not proceed to introduce Directors' Compliance Statements. From the evidence presented to the Joint Committee and as outlined above, this failure appears to have been due to general industry pressure. The situation was also referred to by Gerard Danaher, who made the following observation:

"As regards Corporate Governance Guidelines, this initiative also stalled and was ultimately 'delayed' pending developments at EU level. Again there was industry 'blowback' during the course of the consultative process. I do not recall Department of Finance involvement."[197]

In the Joint Committee's review of some of the actions taken by IFSRA in the years preceding the crisis, a number of areas have been identified where more forceful actions may have had some ameliorating impact on the size or scale of the eventual crisis. The failure to introduce the new legislative powers and controls described above appears to be one of those areas. Mary Burke, Brian Patterson and Gerard Danaher, provided their personal views of events surrounding the IFSRA's withdrawal of Directors Compliance Statements.

194 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, statement, CHO00013-003. The Central Bank also prepared a document for the Inquiry more fully detailing its efforts in having directors' compliance statements and other standards introduced which can be viewed at CB00069. The Central Bank's Policy Efforts during the Period 2003 – 2010.

195 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-041/042.

196 Department of Finance Memorandum to the Minister 11 April 2007, DOF06807-002.

197 Gerard Danaher, former Non Executive Director of CBFSAI and IFRSA Boards, statement, GDA00001-004.

In her witness statement, Mary Burke provided a summary of the overall approach and actions of IFSRA:

"… the issues were the strategic approach, and the willingness (or lack thereof), as well as the logistical wherewithal (or lack thereof), to use those powers to prescribe detailed rules/ requirements, or to challenge and intervene in a manner which would impact banks' business models. In the case of IFSRA and the [Central] Bank, this was I believe influenced by a number of external factors including the international approaches to regulation/supervision, government strategy/policy, promotion of Ireland as a financial services centre, industry influence on the shape of regulatory policy, costs, and, in the run-up to the crisis, an overoptimistic macro-economic view."[198]

Gerard Danaher said:

"All in all, the Authority of which I was part should have much more forceful, should have ensured that these initiatives were seen through expeditiously and should not have been diverted or fobbed off by management reluctance, by drawn out consultative processes or by the promise of statutory review or pending EU developments."[199]

In order to avoid similar failings in the future, Brian Patterson, offered the benefit of his experience to provide a suitable benchmark for future regulation:

"A modern Financial Regulator needs a board with regulatory experience and skills. It needs an enabling legal framework with strength to counter the naturally powerful influence of the banking sector. It needs to be well resourced, to have a fast-moving capacity to develop its IT capability and to recruit expert staff. It needs freedom of action and clarity in its legislative mandate that it's single-mindedly to prioritise the stability of the banking sector over other competing public policy goals."[200]

Credit Growth:

As documented in the Central Bank's annual Financial Stability Reports, the regulatory authorities were aware of the explosive year-on-year growth in debt levels.[201] In the build up to the financial crisis, the Central Bank or the Financial Regulator did not see sufficient specific threats to warrant more significant action to restrict or contain this growth. However, the Financial Regulator did introduce new capital requirements in 2006, but these measures were *"too little too late."*[202] This inaction can probably best be illustrated by reference to the growth in credit between 2000 and 2008.[203]

198 Mary Burke, former Head of Banking Supervision IFSRA (May 2006 to October 2008), statement, MBK00001-004.

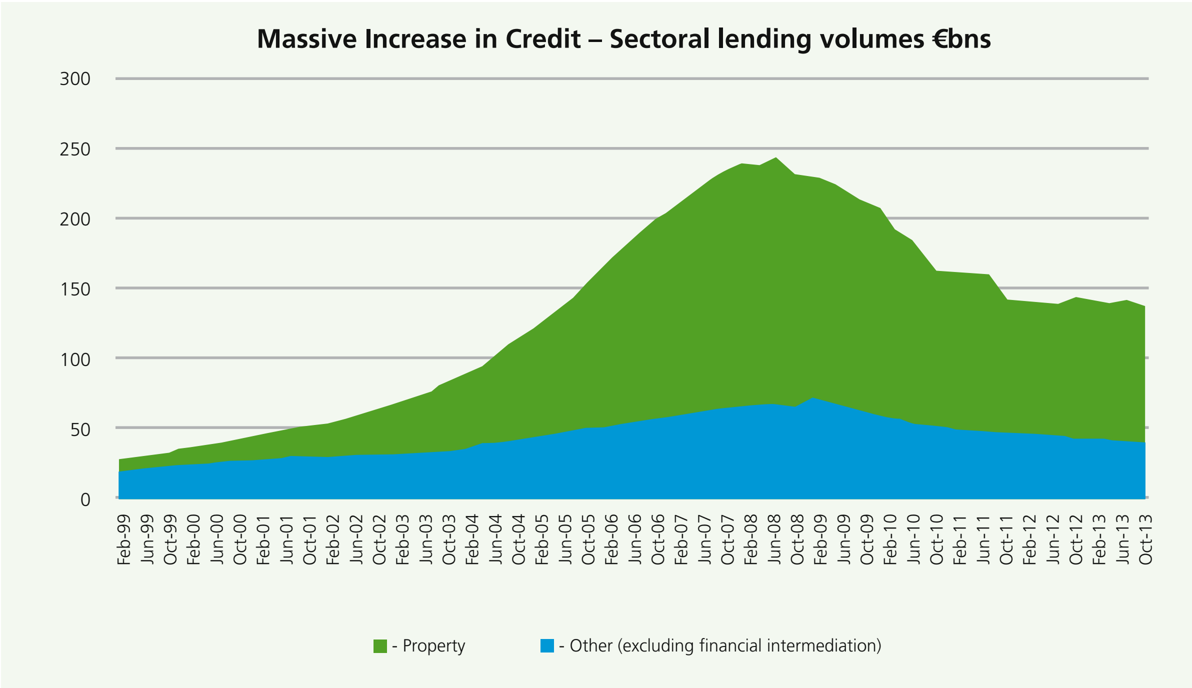
199 Gerard Danaher, former Non Executive Director of CBFSAI and IFRSA Boards, statement, GDA00001-007.

200 Brian Patterson, former Chairman IFSRA, transcript, INQ00063-007.

201 Central Bank paper; Survey of Mortgage Lending Practices 18 July 2003 - CB Narrative, INQ00169; Tom O'Connell, former Assistant Director General and Chief Economist, Central Bank, transcript, INQ00068-005/006/040/041; John Hurley, former Governor, Central Bank, transcript INQ00047-004/011/045/046; Narrative of Central Bank discussions on house price and credit growth, INQ00009; Department of Finance - Comments on CB Quarterly Bulletin July 2005, DOF00951-001; Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-061.

202 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-108.

203 "The Irish Financial Assistance Programme – Entry, Exit and Lessons Learned", John McCarthy, Chief Economist, Department of Finance, DOF07710-004.



Source: Department of Finance[204]

Pre Budget Letters from the Central Bank to the Minister for Finance:

The pre-budget letters to the Minister(s) for Finance from 1999 to 2008 highlighted key risks identified by the Central Bank. These pre-budget letters were broadly in line with the Financial Stability Reports and were intended to be used as a further additional guidance for the Minister for Finance in the development of his fiscal policy. Examples of pre-budget letters which highlighted particular risk were as follows:

- September 1999, the pre-budget letter stressed that a restrictive approach to the budget was highly desirable due to economic risks from credit growth and house price rises.
- September 2000, the pre-budget letter cited a *"convincing"* case against an expansionary budget as this would heighten the risk of a hard landing. (It is notable that subsequent letters shifted emphasis from restrictive budget requirements to a *'broadly neutral'* budget stance, notwithstanding the ongoing expansionary policies pursued by the Government).
- The 2005 pre-budget letter commented on the macro-economic situation, outlining the high level and rapid increase in the private sector credit and an expectation of a gradual decline in housing output. The letter also flagged that *"however, a more abrupt adjustment cannot be ruled out."* There was a recommendation contained in the letter for a limitation in any indirect tax changes in the 2006 Budget and it called for a prudent approach to the fiscal stance in the next year (an assessment paper of the budget measures announced later in the year mentioned in its conclusion that it pointed to relaxation of budgetary policy in 2006).[205]

---

204 Graph showing Sectoral Lending Volumes prepared by Department of Finance in presentation entitled "The Irish Assistance Programme – entry, exit and lessons learned", DOF07710-004.

205 Pre-budget Letter to Minister for Finance from the Governor - CB Narrative, INQ00067-008.

- The 2006 the pre-budget letter pointed out a number of specific risks and recommended a *"broadly neutral Budget for 2007."* Domestic risks were highlighted as follows: *"There are also a number of domestic risks, principally surrounding the housing market and the construction sector generally. The re-acceleration in house prices this year is a particular concern, as this upturn does not appear to have been driven by fundamental factors. It seems that a gap may now be opening up between actual prices and prices warranted by fundamentals. International observers such as the IMF and OECD have produced estimates of an overvaluation in the range of 15 to 20 per cent …. this points to the need for fiscal policy to avoid incorporating too optimistic a scenario for the construction sector and to target a sufficiently comfortable budgetary position to absorb any sudden downturn."*[206]
- The 2007 the pre-budget letter noted that *"there is a risk, however, that an unduly large downturn in the housing market and the construction sector in general could have serious ramifications for the overall General Government position given the importance of property related tax revenues … In light of this and your recent statements, it would be appropriate that the rate of increase in current spending next year is kept in line with nominal GDP growth, a point that was also emphasised by the IMF in its recent Article IV report on Ireland."*[207]

The Joint Committee notes that while key risks were identified there was however no specific warning of a building crisis or systemic risks in either the fiscal policy or the banking sector. In a similar manner to the Financial Stability Reports the overall tone is reassuring. The guidance regarding unspecific risks contained in these pre-budget letters does not appear to be reflected in the eventual Budget policies adopted by Government.

Stress Tests:

Apart from the banks' standard regulatory reporting and inspections, periodic stress tests were the main tool used by the CBFSAI to assess risk within individual banks. Stress tests were principally designed to inform the CBFSAI of the robustness of the financial system and of its ability to withstand a sharp and significant downturn. They were organised by the Central Bank with IFSRA's assistance.[208]

The stress tests carried out in 2006[209] (those completed closest to the crisis) were the latest in a series which began in 1999 and which were completed every two to three years. The primary approach adopted by the CBFSAI in its stress testing framework was scenario analysis. This involved assessing the impacts of an economic downturn on key aspects of the banks' financial positions. Standard stress testing was supplemented with testing on topical issues which, in 2006, included a sensitivity analysis on banks' inter-bank exposures and on the structure of their residential mortgage loan books.[210]

206 Pre-budget Letter to Minister for Finance from the Governor - CB Narrative, INQ00067-012.
207 Pre-budget Letter to Minister for Finance from the Governor - CB Narrative, INQ00067-016/017.
208 Financial Stability Report 2006, PUB00032-004.
209 Financial Stability Report 2006, PUB00032-004.
210 Financial Stability Report 2006, PUB00036-001.

These stress tests, as with those conducted in previous years, delivered positive results in demonstrating the apparent ability of the banks to withstand a forecasted downturn.[211] Much reliance was placed by the Central Bank and the banking institutions on the stress test results in confirming that the rapid lending growth was manageable. The results of the stress tests were considered to confirm the banks' internal assessment of their vulnerabilities to external events.

The results of a *"bottom-up"* exercise was supported by the results of an additional *'top-down'* stress test also undertaken in 2006. The *"bottom-up"* stress tests evaluated the impact of hypothetical economic downturn scenarios, while the *"top-down"* stress tests informed the CBFSAI's assessment of the robustness of the financial system, based on aggregating the results of individual banks. These tests were carried out in conjunction with the Financial Services Assessment Programme (FSAP) that the IMF was conducting on Ireland in 2006. For some witnesses, the involvement of the IMF appeared to underline the tests' credibility.[212] The Joint Committee also notes that there was no dissent expressed at the Financial Stability Committee meetings regarding the adverse scenarios employed in the stress tests.[213]

It is now clear that the stress tests were not, in fact, able to accurately predict the banks' abilities to withstand shocks (their *"shock absorption capacity"*). The main problems identified with the 2006 stress test were that:

- The model used for the stress test, as well as the scenarios tested, did not reflect the events that occurred in 2008. Both the model and the assumptions used in the stress test scenarios reflected a *'soft landing'* of the economy over the tested 2006-2008 period and were not nearly severe enough.[214] In particular, the 2006 test showed that a 25% fall in residential property prices and up to 10% default rates on mortgages in negative equity, would amount to a loss of 3% of the value of total reserves, which the CBFSAI concluded was manageable.[215]
- The inherent limitations of the stress tests were not sufficiently recognised: the tests took into account direct loan losses only but no subsequent impacts on the economy or a reduction in availability of credit.
- The stress tests did not address the high degree of reliance by Irish banks on international wholesale funding: This source of funding subsequently proved to be very vulnerable during the crisis.

---

211 Financial Stability Report 2006, PUB00036-001.

212 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-007 and David Begg, former member of the Central Bank Board, transcript, INQ00118-016/017.

213 Liam Barron, former Deputy Governor, Central Bank, statement, LBA00001-014.

214 Liam O'Reilly, former CEO, IFSRA, transcript, INQ00065-046.

215 Financial Stability Report 2006, PUB00036-009.

Financial Stability Reports:

During the lead into the financial crisis, the key area of public activity for the Central Bank was the production and publication of the annual Financial Stability Report, setting out its view of the economy and the risks to financial stability at that point in time. The reports were published annually each November from 2004 to 2007 and provided the Government and the banking sector with the Central Bank's analysis and assessment of the financial stability risks and the health of the financial system. Key areas covered each year in the Financial Stability Reports included:

- Overall assessment of Financial Stability.
- Analysis of the relevant domestic and international economic and financial issues.
- A thematic summary of a key financial stability sector or area.
- Financial stability key risks and the change from the previous reports.

The reports provided additional research papers on key topics. Key risks were highlighted but the overall impact of the report was influenced by the Executive Summary, which provided a balancing assessment of all factors. The Executive Summary needed to balance both the risks identified and manage the market reaction to the report.

The Central Bank was aware of the changing financial landscape and of the many key risks emerging. However, John Hurley commented that he saw these reports as *"guidance"*[216] and did not appear to follow up with any specific actions with either the Financial Regulator or the Minister for Finance. John Hurley said that, under the legislation, the prudential powers of the Central Bank over the banks were transferred to the Financial Regulator, and the role of the Central Bank was to contribute towards financial stability. This involved the identification of risks and vulnerabilities in the financial system, and communicating these to a wide range of stakeholders. This role was discharged *inter alia* through the publication of the Central Bank's annual Financial Stability Reports. Some key messages and elements identified in the Executive Summaries contained in the reports for these critical years were stated as follows:

1. **2004:** It was unlikely that the current robust state of the banking system would be compromised in the medium term even though the growth rate was four times the Euro banking system average, private sector indebtedness was at historically high levels – significantly higher than the euro area, real estate and construction had annual growth rates of 39.8% and 37.8% and the results of stress tests were dependent on institutions placing considerable reliance on the reliability of collateral.[217]
2. **2005:** risks of a sudden fall in prices reduced, primary risk was of a significant growth in credit and indebtedness levels – debt to income ratios were the highest in Europe, stability of the banking system was generally sound, the share of the banking loan book in property related sectors continued to increase very rapidly and now constitutes over half of the total loans outstanding, risks to the economy were mainly international, including fluctuations in the US economy and in particular the value of the euro against the dollar and provisioning

216 John Hurley, former Governor, Central Bank, transcript, INQ00047-014.

217 Financial Stability Report 2004, PUB00009-008.

levels on capital were already low by historical standards and the adoption of International Financial Reporting Standards would see these provisioning values fall further. The Report also noted that credit growth to construction and real estate exceeded 45%, and that commercial property related lending was now the largest component of loans to the non-financial construction sector. However it stated that there was no medium term risk to financial stability arising from the corporate sector.[218]

3. **2006:** Increase in financial stability risks in the last 12 months, the increase in house prices had accelerated again following the moderation noted in the previous year's report, stress testing performed during the year suggested that the shock-absorption capacity of the Irish banking system was strong, and that the sector was well placed to withstand problems, household indebtedness continued to increase rapidly as a percentage of disposable income and a soft landing was seen as the most likely outcome in the residential property market. For commercial property, it noted a further significant increase in capital values across all sectors, averaging 26.7%. Growth in commercial property lending accounted for 84% of total lending growth to non financial corporations, and now represented 60.5% of total lending to this sector. However, credit risk to the corporate sector remained low by historical comparisons.[219]

4. **2007:** Financial stability risks had increased but overall analysis is that the Irish banking system remained robust and well placed to cope with emerging issues, International financial market turbulence had arisen, reduction in rate of house price increases was seen as a positive development, the rate of credit growth has eased, ECB provided substantial liquidity injections to alleviate banks' funding problems and in contrast to the residential market, commercial property prices continued to increase at relatively high rates. Concern was noted about the continuing high share of the construction sector in economic activity. Growth in commercial property values continued at the "relatively high rate" of 11%, while rental growth across office, industrial and retail averaged 6.5%, 1.4% and 7.9% respectively. For the first time, concern was noted about increases in lending to the commercial property related sector, albeit risks were mitigated by continuing low rates of default. [220]

The overall message of the 2007 Financial Stability Report was generally positive and did not appear to reflect the growing financial stability risks. The Central Bank was clearly aware of key and escalating risks but did not deal with them in the report. When questioned about the tone and message contained in the Financial Stability Reports, John Hurley said: *"…the warnings by the Central Bank should have been stronger in hindsight but we didn't know that at the time."*[221]

218 Financial Stability Report 2005, PUB00020.

219 Financial Stability Report 2006, PUB00032.

220 Financial Stability Report 2007, PUB00044.

221 John Hurley, former Governor, Central Bank, transcript, INQ00047-062.

Regarding the 2007 Report, John Hurley said that no action was required as: *"In 2007, all of the aggregates were reducing. We had already started an easing of property prices and an easing of credit growth. So, what's a Central Bank to do in that situation, particularly, where it has an interest in a gradual or soft landing, and it would like overvaluation to dissipate in an orderly way. What it doesn't do - and I think someone else has said before this Committee - it doesn't frighten the horses. What it does is it tries to be balanced in its assessment and tries not to bring about the risks that it is trying to avoid…."*[222]

Response to the Financial Stability Reports:

It appears that there was limited review or action on the part of the Central Bank in evaluating the impact of the Financial Stability Reports and pre-budget letters on government fiscal policy:

"…We were responsible for contributing to financial stability overall. there is no way the Central Bank itself can ensure financial stability …"

"…we gave the advices and recommendations and our view on financial stability was the view we outlined. But financial regulation was something that was carved out from the Central Bank."[223]

Despite prolonged questioning on his accountabilities, John Hurley did not accept that his role generally required appropriate intervention in the market and with the Financial Regulator.

With the benefit of hindsight, it is difficult to comprehend the failure to recognise and react to the multitude of risks that were building in the economy, particularly from 2003 onwards.

Brian Patterson, said:

"We had regular interaction with each other and there were ample opportunities for executives and, indeed, board members to communicate to each other, to sit down and say "Look, I'm really concerned about this." And that's what didn't happen. Because out of the ongoing interaction between the regulator and all its people and the Central Bank, no proposals or recommendations for actions which were stronger or more urgent emerged, other than the ones that were in any case taken … because, collectively, the two organisations just didn't see the size of the risk that the banks were taking or the calamity which was going to overwhelm them in due course."[224]

In his evidence, David Doyle, former Secretary General of the Department of Finance, attributed the Department's lack of action on the risks to the Department's over reliance on the Central Bank's Financial Stability Reports which, in his view, did not contain sufficient warnings of a threat to financial stability:

"The Central Bank would have been largely reliant on the view of the banks and the Financial Regulator. You had people doing their stability report who said there are risks, but there's no fundamental issues arising, and there's no threat to financial stability. So the Department didn't, on foot of that, take action. What it did do in relation to the brief the Department had on the fiscal front was to urge caution and moderation on spending and taxation."[225]

222 John Hurley, former Governor, Central Bank, transcript, INQ00047-061.

223 John Hurley, former Governor, Central Bank, transcript, INQ00047-010.

224 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-011.

225 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-056.

David Doyle said that the Department of Finance did not put enough emphasis on the expansion of credit highlighted in the Financial Stability Reports and instead concentrated on fiscal policy:

"….the accepted analysis after the establishment of the ECB and the transfer of monetary policy from Irish Central Bank was that the only tool available to Government to control economic activity in the economy was through taxes and spending. The Department of Finance placed too much store on this conclusion. Greater consideration should have been given to the impact of uncontrolled lending. The Department should have adopted a more critical stance on monetary and regulatory matters in the decade ending in 2008."[226]

Former Taoiseach, Bertie Ahern acknowledged in his evidence to the Inquiry that he read the Central Bank's Financial Stability reports *"most times"*.[227] He said that he did not believe the level of household indebtedness to be a particular risk. He did express concern about commercial debt, although his view was that no responsibility lay with the Government in this regard:

"… I've made this point many times before, that the fact that people had assets that were houses wasn't a bad … you know, it wasn't the end of the world, because you had a saleable asset, and in normal times was going up, but even if it wasn't going up … so your level of indebtedness if you were in property, you know, wasn't always the worst thing. … I mean, look what happened in the commercial property side. I mean, there was where the madness really took place, where it zoomed from nearly nothing to extraordinary increases… I think, that was a bigger issue. Now, who should have seen it? Well, the job … it was the job of the regulator. I mean, I have earlier on today taken my hit for the areas that would've been in my responsibility, but I'm damned if I'm going to take responsibility for something that wasn't."[228]

In their regular interactions and participation in international reviews including the IMF, there would also have been an opportunity for the Central Bank to enquire how other countries were adapting and managing their own risks. The Joint Committee did not hear anything in the course of the Inquiry which demonstrated that this was explored by the regulatory authorities as an additional benchmarking opportunity.

Other Constraints to Regulatory Action:

The sections above demonstrate that both IFSRA and the Central Bank had clear sight over the activities of the financial institutions and that IFSRA was engaged in monitoring their actions. It also highlights some of the specific activities undertaken or not by both regulatory authorities during the relevant period. This section examines why more was not done to constrain the activities of the financial institutions in the run up to the crisis.

IFSRA - Resourcing Issues and Competing Priorities:

This section reviews two of the main issues confronting IFSRA as it commenced operations during what was a period of rapid growth and change in the financial services industry. The Joint Committee heard that IFSRA:

---

226 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-007/008.

227 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-040.

228 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-041.

- generally continued with the staff and practices (including principles based regulation, founded on the process of moral suasion) inherited from its predecessor regulatory bodies.
- focused on and allocated its main resources to its consumer protection role.
- its prudential arm lacked appropriate resources in terms of staff numbers and expertise and had no dedicated enforcement division.
- the introduction of the new Basel II regulatory framework exacerbated IFSRA's resourcing issue.

In his opening remarks to the Inquiry, Brian Patterson referred to the scale of the task facing the new regulation and its prudential regulation department, stating that IFSRA's regulatory aspect covered more than 50 Irish banking entities, 30 banks from other EU countries operating on a *"passport"* basis,[229] 2 building societies, 180 insurance companies, 430 Credit Unions, 3,400 funds and 4,000 intermediaries. IFSRA's remit also included the stock exchange, stockbrokers and others. In total, IFSRA was responsible for over 8,000 entities whereas its staff resources numbered approximately 350, of whom only 45 were allocated to banking supervision. [230]

In this regard, Deirdre Purcell, former board member of the Central Bank said:

"In light of the extraordinary range of the FR's activities, throughout my tenure, I did believe that the organisation was under-resourced in human terms, I am aware that others disagree … executives told me repeatedly that, while there were vacancies in many Departments staff were coping, although under strain …. Nor do I remember staff shortages being presented as seriously urgent at the Board of the CB." [231]

In his evidence, Gerard Danaher also recounted his impression. Although he did not recall any particular difficulties on the consumer protection side, he did recall that the organisation was always short of its full budgeted complement of staff and this had an impact on its discharging of its functions, including prudential supervision. However, his biggest concern was:

"……the real issue seems to me to be not one of insufficient staff or resources to discharge prudential supervision via a principles based system, but rather the decision to continue with that system rather than one which would have been much more intrusive and rules based."[232]

Brian Patterson also outlined the range of issues faced and the difficulties in obtaining additional staff:

"Resourcing levels in banking supervision … were derived from the principles- based approach. It's worth noting that in the new, post-crash regulatory regime, a more intrusive, inspection-based approach required a 170% increase in staff resources …. resources at the time were under considerable pressure."[233]

He added *"The fact that we levied 50% of our costs on the industry was also a factor."*[234]

229 Banks prudentially regulated in an EU jurisdiction can operate on a *"passport"* basis in other EU countries. Although subject to prudential regulation by their home authority only, they must still comply with specific conduct of business rules in each country.

230 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-004.

231 Deirdre Purcell, Non Executive Director and Board Member, IFSRA, statement, DPU00001-013.

232 Gerard Danaher, former Non Executive Director of CBFSAI and IFRSA Boards, statement, GDA00001-008/009.

233 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-005/006.

234 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-025/026.

The impact of the lack of personnel on the prudential monitoring undertaken was made clear to the Joint Committee when Mary Burke commented that the pressure the team was under was so significant that, although a requirement, the ICAAP assessments for banks were not completed in 2007.[235]

Con Horan also pointed to the absence of a dedicated enforcement section as being illustrative of the lack of resources dedicated to prudential regulation.[236] This was a view that was reiterated by Mary Burke.[237] In referring to follow-up of a cross bank review which took place in 2007, she stated:

"No there was not any other action taken. I mean if the action you're considering is something like an administrative sanction procedure, for example, in terms of inadequate internal controls, I've already said in my statement that we didn't have the resources to do that."[238]

Other than achieving the right numbers of staff, there was also a challenge in recruiting and retaining staff with the appropriate skill sets to match the increasingly challenging regulatory environment and the significant evolution in the nature and type of financial products and services. On this topic, Mary Burke said:

"It means people who are experts in lending, in treasury, in risk management being able to sit across the table from the banks and deal with them on their own level, on their terms, on the issues"[239]

Evidence was also heard about resourcing issues and a lack of requisite skill sets within the CBFSAI to enable it to carry out its supervision accountabilities.[240] One witness drew particular attention to the challenges in resourcing the Financial Stability Team.[241] Whereas the question of what was specifically requested and what was actually provided by way of additional resources was not fully clarified in the evidence presented to the Joint Committee, most witnesses who gave evidence on this matter did generally agree that adequate staffing levels were never achieved.[242]

Resources and Competing Priorities:

During the years leading to the financial crisis, the range of competing demands for the supervision teams within the Financial Regulator increased significantly. Increasing European legislation placed additional requirements on the same team, as did growth in the number, size and complexity of the Irish banks. Further challenges in the governance and supervision of some financial institutions

---

235 ICAAP assessments were a requirement under the Capital Requirements Directives; Mary Burke, former Head of Banking Supervision, IFSRA (May 2006 to October 2008), transcript, INQ00131-005.

236 Con Horan, former Head of Banking Supervision, and Prudential Director, IFSRA, transcript, INQ00130-011.

237 Mary Burke, former Head of Banking Supervision, IFSRA (May 2006 to October 2008), transcript, INQ00131-021.

238 Mary Burke, former Head of Banking Supervision, IFSRA (May 2006 to October 2008), transcript, INQ00131-021.

239 Mary Burke, former Head of Banking Supervision, IFSRA (May 2006 to October 2008), transcript, INQ00131-008.

240 John Dunne, former Non Executive Director, IFSRA, statement, JDU00001-006; John Dunne, former Non Executive Director, IFSRA, transcript, INQ00118-019; Central Bank Audit Committee Minutes 2004 to 2008 (narrative), INQ00037-001/002; Brian Patterson, former Chairman IFSRA, transcript, INQ00063-005; Mary Burke, former Head of Banking Supervision, IFSRA, (May 2006 to October 2008), transcript, INQ00131-004; Patrick Honohan, Governor, Central Bank, transcript, PUB00352-022.

241 Frank Browne, former Head of Financial Stability Department, Central Bank, statement, FBR00003-025/068/077; clarification statement, FBR00129-009.

242 John Hurley, former Governor of the Central Bank, statement, JHU00006-007; John Dunne, former Non Executive Director, Central Bank, transcript, INQ00118-019; Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-025/005. John Dunne, former Non Executive Director, IFSRA, statement, JDU00001-006; Central Bank Audit Committee Minutes 2004 to 2008, INQ00037-001/002; Mary Burke, former Head of Banking Supervision IFSRA (May 2006 to October 2010), transcript, INQ00131-004; Patrick Honohan, Governor, Central Bank, transcript, PUB00352-022. Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-006; Liam O'Reilly, former CEO, IFSRA, transcript, INQ00065-025.

resulted in in a reduced ability to perform site visits and impacted on enforcement activity. As Mary Burke stated:

"In terms of any linkage between macro-economic and prudential policy, when working in BSD, I saw no evidence of a strong link in that regard. Given the demands placed on resources, as a result of the implementation of CRD, at some time prior to my arrival in BSD, a decision was taken that the department would cease to be actively involved in work relating to the financial stability review."[243]

The focus on consumer matters was reinforced, as the Consumer Director was a member of the IFSRA board, whereas the Prudential Director was not (albeit he did attend the board meetings). In relation to the emphasis on consumer protection, Brian Patterson said:

"the Financial Regulator had an overly complex structure with an extremely broad mandate, which emphasised consumer protection as the main priority, with constrained powers and limited resources devoted to banking supervision."[244]

Another priority which absorbed considerable resources was the adoption of the new international banking accord, Basel II. Patrick Neary said that IFSRA decided to prioritise implementation of Basel II over more intrusive interventions in banks, which was viewed as the less pressing of the two priorities. [245]

Bertie Ahern did not appear to be informed of the resourcing issues, his impression being that the combined CBFSAI was well resourced:

"there were 750 people in the Central Bank, or Central Bank-regulator …. I thought there were loads of these people and I thought they had loads of time to be checking this … and then I see that if you take the main five banks they've about 15 or 20 is all that was supervising I was horrified when I saw that, horrified."[246]

Mary Burke, Head of banking Supervision at IFSRA, said:

"However, importantly in my view, a more onerous or prescriptive regulatory framework would, in and of itself, not necessarily have delivered a significantly different outcome if, as was the case, the supervisory resources, both in terms of staff numbers and specialist expertise, were not in place to monitor, challenge and enforce where compliance was not delivered. … The level of resources, and the available specialist expertise, was not such as to be capable of delivering intrusive supervision, even in a business-as-usual mode of operation…."[247]

When asked if economists assisted the Financial Regulator in its activities, Patrick Neary said:

"… a more intrusive approach would have been desirable and I think economists would have had a great role is assisting the accountants and that, in that … in a more intrusive review of banks."[248]

243 Mary Burke, former Head of Banking Supervision, IFSRA (May 2006 to October 2010), transcript, INQ00131-005.

244 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-010.

245 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132 -015.

246 Bertie Ahern, former Taoiseach, transcript, INQ00109-041; Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, transcript, INQ00130-011.

247 Mary Burke, former Head of Banking Supervision, IFSRA, (May 2006 to October 2010), transcript, INQ00131-004.

248 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-129.

Gerard Danaher said that the banking supervision function:

"was always somewhat short of its full budgeted complement of staff and this had an impact on its discharging of its functions, including prudential supervision."[249]

Dual Mandate and the "Business Friendly" Agenda:

One area which attracted differing views from witnesses was whether or not the *"dual mandate"* given to the Central Bank by the CBFSAI Act 2003 resulted in it being more deferential on prudential matters.

While its mandate to promote financial services (a new provision in the 2003 Act)[250] was subordinate to its regulatory financial stability role, the view of some witnesses was that it had the potential to cause conflict. In his hearing, Patrick Neary said:

"… this thing of the promotion … was … a very difficult concept and it was irreconcilable with the role of a regulator and it shouldn't have been there."[251]

The potential for conflict, it would appear, was greatest in the case of the IFSC. It appears that any consideration of additional regulatory action on the part of the CBFSAI in respect of domestic banks may have been tempered by a fear of the adverse impact that any such action might have on the international banking sector. Brian Patterson said:

"…there was an effort to ensure that rules and regulatory practice did not have a disproportionate impact on the operation and development of the financial services sector, particularly in relation to the IFSC."[252]

There was a difference of view expressed by witnesses on whether the dual role was conflicting, although the majority of the witnesses expressed a concern about this mandate. John Hurley, Liam O'Reilly, Brian Patterson, Mary Coughlan and Deirdre Purcell[253] all expressed reservations. However, a number of witnesses including Bertie Ahern, Bernard Allen, Jim Farrell and Brian Cowen expressed the opposite view.[254]

Charlie McCreevy was one of those who did not consider that the role of the Central Bank was compromised:

"I couldn't see for a moment how it would've compromised the role of the regulator in terms of the prudential supervision of Irish bank… There are many reasons why financial services have come to locate in Dublin… but the main reason for so doing. … one of the primary reasons is to be located and regulated from a jurisdiction that's recognised as having good prudential rules."[255]

---

249 Gerard Danaher, former Non Executive Director of CBFSAI and IFRSA Boards, statement, GDA0001-008/009.

250 Central Bank and Financial Services Authority of Ireland Act 2003 s. 5A – (1) (b), PUB00255-009.

251 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-114.

252 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-005.

253 John Hurley, former Governor, Central Bank, transcript, INQ0047-032, Liam O'Reilly, former CEO, IFSRA, statement, INQ00065-020, Deirdre Purcell, former Non Executive Board Member, IFSRA, statement DPU00001-011 & Mary Coughlan, former Tánaiste, statement, MCO00001-010.

254 Jim Farrell, former Chairman of IFSRA, statement, JFA00001-003, Bertie Ahern, former Taoiseach, transcript, INQ00109-069, Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-013 & Bernard Allen, former Chairman, Oireachtas Committee of Public Accounts, statement, BAL00001-007.

255 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-016.

The promotion of financial services role appeared to be part of a wider agenda of *'business friendly'* regulation, as evidenced by the *"Regulating Better"* White Paper, published in January 2004 by the Department of the Taoiseach.[256] These policies contained in the White Paper reflected the Government's attitude towards regulation at the time and may have contributed to the continued preference for a moral suasion approach over a more interventionist approach. [257]

In response to questioning as to whether the White Paper was promoting *"light touch"* regulation, Bertie Ahern said:

"The document of 2004 was for good regulation, for better regulation, based on the OECD efforts at the time that countries should not be regulating in areas that were not necessary and that for poor regulation which was affecting economic progress and stability of economies."[258]

The Joint Committee asked Bertie Ahern about a trip which he made to New York with Patrick Neary, the then Financial Regulator, on 14 March 2007. The Joint Committee referred Bertie Ahern to a speech which he made at a breakfast meeting with the US financial services industry, in the course of which Bertie Ahern asked for investment in Ireland and said: *"International benchmarking studies show that Ireland is very lightly regulated compared to most of our European colleagues"*. In response to this question from the Joint Committee, Bertie Ahern said:

"Well, I don't … in that sense, you're, you're trying to put "lightly regulated" as something that's bad."[259]

Professor Gregory Connor, Professor of Finance at NUI Maynooth, gave evidence to the Joint Committee and in relation to so called *"light touch"* regulation said:

"You should not have your financial regulator simultaneously flying around the world telling people "Bring your financial services to Ireland and we will adopt a very light touch approach". That contributed to what was a very bad performance."[260]

Principles-based regulation was still the preferred regulatory principle when, in 2007 and 2008, the Advisory Forum on Financial Legislation[261] undertook the modernisation and consolidation of financial legislation.[262]

It is also noteworthy that the Central Bank Reform Act, 2010[263] removed the promotion of financial services as one of the Central Bank's objectives. This reform was considered necessary by the Governor of the Central Bank, Patrick Honohan, who said in his evidence that promotion of financial services was incompatible with financial regulation and ensuring financial stability: *"…I pressed very hard to ensure that promotion of the financial services sector was taken out of the legislation."* [264]

---

256 This was an agenda introduced by the Government in its white paper Regulating Better, published in January 2004. INQ00069-005.

257 Con Horan, former Head of Banking Supervision, INQ00130-041; Mary Burke, former Head of Banking Supervision IFSRA (May 2006 to October 2008), statement, MBK00001-002/003.

258 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-052.

259 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-066.

260 Gregory Connor, Professor at NUI Maynooth, transcript, CTX00061-012.

261 The Advisory Forum on Financial Legislation was established by the Government and Brian Cowen appointed the Chair, Pádraig O'Ríordáin in April 2007.

262 Advisory Forum of Financial Legislation Report of Meeting 12 December 2007, DOF05708-004.

263 Central Bank Reform Act (2010), PUB00260.

264 Patrick Honohan, Governor, Central Bank, transcript, PUB00273-044.

The IFSC

The IFSC was established by the Irish Government, with European Union approval, in 1987. The objective behind the IFSC was to attract a range of internationally traded financial services, including banking, to Ireland.

International banks, licenced by the Central Bank and established in the IFSC, were subject to the same banking regulations and restrictions as the domestic banks. However, passported banks were not subject to these regulations.

The regulatory framework included both international prudential rules (e.g. the Basel Framework) and domestic regulations over which the CBFSAI had sole discretion.

Due to their different operating models, domestic regulations suitable for retail banks operating in the domestic market were not always appropriate for the IFSC banks, which typically engaged in specialised, internationally focussed banking activities. Notwithstanding this position, the same regulations and rules were applied to both types of banks. The policy of treating the international and domestic banks in the same way meant that the relaxations in the context of the international banks e.g. relaxation of sectoral limits, impacted upon the CBFSAI and IFSRA treatment of the domestic banks.[265]

Brian Patterson said in his evidence that *"…my belief is that sector concentration limits were, in effect, relaxed in the 1990s in order to facilitate the development of the IFSC."* [266]

However, in his evidence to the Inquiry, Patrick Honohan expressed a more nuanced view on the issue of the relaxation of sectoral limits and the IFSC:

"I am not sure it would be the IFSC banks as I think it is the local banks that were more affected by this." [267]

The above approach, involving universal rules for the international and domestic banks, was criticised by William Slattery, Former Deputy Head Banking Supervision, CBFSAI, who expressed the view that additional measures could have been imposed on the domestic banks only, had there been willingness to do so.[268] In his witness statement he said:

"I do not believe that the IFSC regulation should have been regarded as a binding constraint in regard to any actions that would otherwise have been regarded as appropriate for the domestic sector nor do I believe that there was any significant barrier from that source, to any actions that were regarded as necessary in the domestic banking sector, if there was a will to impose such additional measures."[269]

Mary Burke also commented on the challenge of differentiating the IFSC institutions, she said:

"Other factors which I consider influenced the approach to regulation and supervision were IFSRA's mandate to promote the financial services industry and the existence of the International

265 The international banks were licenced by the Central Bank; Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-020.

266 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-020.

267 Patrick Honohan, Governor, Central Bank, transcript, PUB00273-039.

268 William Slattery, Chairman of Financial Services Ireland, statement, WSL00002-006/007.

269 William Slattery, Chairman of Financial Services Ireland, statement, WSL00002-006/007.

Financial Services Centre (IFSC). The desire to portray Ireland as business friendly led, I believe, to a reluctance to introduce prescriptive rules and a particular focus on keeping costs down in the context of industry funding of the regulatory authority. In addition, the strategic decision that there should not be two different regulatory regimes - one for domestic firms and another for those in the IFSC - meant that a different approach was not taken to the domestic financial services sector. This decision was driven by a concern that the IFSC might otherwise be categorised as an off-shore centre with associated negative connotations"[270]

Since the date of its establishment, consecutive governments' policy has been to promote the development of the IFSC. This policy was supported, at all relevant times considered in this report, by the Government and coordinated by the Department of the Taoiseach. For example, the Secretary General of the Department of the Taoiseach chaired the IFSC Clearing House Group, which included senior representatives from the financial services sector and public sector representatives.[271] This hands-on involvement of highest level Government officials points to the importance that was attached to promotion of the IFSC and the international banking sector.

Notwithstanding this high level of government support given to the IFSC, a potential risk of involvement with the international banking sector was illustrated by evidence received by the Joint Committee surrounding a request to have Depfa Bank and WestLB Covered Bond Bank included in the Government Bank Guarantee Scheme in October 2008.[272] The background to this was that a specialist international infrastructure lender with its origins in Germany, Depfa Bank was privatised in the early 1990s and moved its main operations to Dublin in 2002. In 2007, Depfa was sold to Hypo Real Estate (HRE), a German bank, for €5.2 billion. In September 2008, HRE faced a severe liquidity shortage when the interbank lending markets dried up in the aftermath of the Lehman Brothers bankruptcy.

In light of this difficulty, the Irish Banking Federation approached officials at both the Department of Finance and Department of the Taoiseach to request the inclusion of all ACS Covered Bond Banks (including Depfa and West LB Covered Bond Bank) in the Government Bank Guarantee Scheme. The inclusion of those banks was urged in order to demonstrate *"tangible Irish Government support and an endorsement of the robust nature of the Irish legislation"*.[273]

Although owned by HRE, the activities of Depfa Bank were based in Dublin's IFSC and, according to Pat Farrell, the then CEO of the Irish Banking Federation (IBF), it was initially unclear which country had supervisory responsibility to ensure that Depfa Bank remained solvent and able to fulfil all its financial obligations.[274] If Ireland had acted on the IBF request, the cost of the financial support ultimately provided by the German Government to HRE could have fallen to Ireland.

Subsequently, HRE benefitted from nearly €10 billion of capital from a German Federal Government institution. The German Government also provided liquidity guarantees of €145 billion, together

270 Mary Burke, former Head of Banking Supervision, IFSRA, (May 2006 to October 2008), statement, MBK00001-003.

271 IFSC Clearing House Group, DOT00334-001.

272 Email from Pat Farrell former CEO of the Irish Banking Federation to Dermot McCarthy, former Secretary General, Department of the Taoiseach, DOT00347-001.

273 Email from Paul O'Connor to Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, DOT00347-003.

274 Pat Farrell, former CEO of the Irish Banking Federation, transcript, INQ00107-012.

with an asset relief measure, with an aid element assessed by the European Commission at approximately €20 billion. Ultimately, HRE was nationalised by the German Government in 2009.[275]

Lack of Confidence in Ability to Enforce

It would appear that doubts with regard to its ability to enforce prudential sanctions before the courts also contributed to a reluctance within IFSRA to move beyond moral suasion. This position was exacerbated by the delay in implementation of the sanctioning regime which was provided for in the CBFSAI Act 2003.[276] Brian Patterson referred to this delay and to hesitation to enforce sanctions:

"the power to impose sanctions on the industry took a long time to materialise…. sanctions were not available to the authority until late 2005, more than two years after vesting…. when eventually enacted, the legislation gave the authority powers to sanction without having to access the courts. Internally, there were real concerns about legal and possible constitutional challenge. If, in the early stages, the authority's sanctioning powers were to be struck down by the courts, it would have far-reaching consequences, and these concerns fed into a Central Bank culture which had already had in-built cautiousness and hesitancy…."[277]

He went on to say:

"I met the Minister probably around twice a year, largely, I think, almost totally at our request and the purpose of that was, less to kind of report to the Minister, in some sort of supervisory capacity; it was more to keep the Minister informed with, for example, EU developments, directives and so on. And also, a recurring theme at the time was to ask the Government to strengthen the legislation in relation to credit unions which we were worried about at the time, something, incidentally, the Government was reluctant to do."[278]

Section 3: Department of Finance

The Role of the Department of Finance in the Pre-Crisis Years

The Department of Finance fulfils a critically important role in relation to:

a) economic analysis and forecasting;

b) its interaction with the Central Bank and Financial Regulator;

c) advising the Minister for Finance on:

- the domestic economy and the macroeconomic situation and financial stability, including sectoral analysis.
- the fiscal budgetary estimates and forecasts as well as on budgetary preparation;
- the views of external, domestic and international economic forecasting authorities on the domestic and international economic situation.

---

275 European Press Release 2011, PUB00431

276 The sanctioning regime was not implemented until 2005 as outlined by Con Horan in his evidence, transcript, INQ00130-011. The inability of the Financial Regulator to proceed with its intention to bring in directors' compliance statements is also set out in this chapter.

277 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-006.

278 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-019.

- the implementation of financial legislation in relation to Central Bank, the Financial Regulator and the Finance Industry in general.

During the relevant period that is the subject of this report, the Department had the ability to advise the Minister on policy options to:

- counter or offset the conditions that could lead to a crisis.
- increase, reduce or neutralise the effects of a crisis as it unfolded.

When formulating advice for the Minister for Finance on economic matters, the Department liaised with and relied on other key institutions including:

- the Central Bank and Financial Regulator.
- domestic and international economic forecasting institutes and advising/co-operating in relation to reports and reviews of those on the domestic economy.

The Department's Economic Forecasting

The Budget and Economic Division (BED) of the Department of Finance undertook forecasts on the economy and was also in charge of sectoral analysis.

In their evidence, former Secretary General, David Doyle and former Second Secretary, Donal McNally confirmed that the Department placed reliance on consensus forecasts and did not carry out its own independent economic analysis of the Financial Stability Reports of the Central Bank or reports from international organisations. The Department relied instead on analysis from sources such as the ESRI, Central Bank, and international forecasting organisations like the IMF and OECD.[279] In this regard, Donal McNally said:

"Well, there was … there would have been projections made within the economic side and they would have been compared with what others were saying, but, maybe, we were relying a bit much on each other and going round in a bit of a circle."[280]

Former Chief Economist of the Department of Finance, John McCarthy, described the economics function of the Budget and Economic Division as follows:

"I think it needs to be remembered that the economics function was very, very small in the overall Department. Our job was simply to produce the forecasts."[281]

Donal McNally confirmed that it was difficult to recruit and retain economists for the Budget and Economic Division.[282] Only 7% of the Department of Finance staff had a Masters in Economics. This meant there was only a small pool of people with the requisite skills to perform the analysis and challenge necessary on the variety of information inputs to the Department and was a factor in the reliance on international commentaries.

279 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-007/008; Donal McNally, former Second Secretary General, BED, Department of Finance, transcript, PUB00347-018.

280 Donal McNally, former Second Secretary General, BED, Department of Finance, transcript, PUB00347-018.

281 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-016.

282 Donal McNally, former Second Secretary General, BED, Department of Finance, transcript, PUB00347-007.

The Department, in forming its view on the economy, relied on external sources and was influenced by what can now be described as a consensus view. This was clearly expressed by David Doyle, when he gave evidence to the Inquiry in relation to the Department's view on the housing market:

"As I said in my statement, the Department placed its reliance on the consensus forecasts, including forecasts from the Central Bank, the ESRI, which all spoke about a gradual reduction to a more sustainable level…"[283]

Documents provided to the Inquiry by the Department of Finance showed an added positive tone to their reports. For instance, the Department's speaking notes to the Minister and other internal memoranda tended to emphasise the positive messages. Derek Moran, current Secretary-General and former Assistant Secretary in the Budget and Economic Division said: *"On housing, notwithstanding the warnings, we did not conceive a collapse to the magnitude that actually happened, and I think we have to say that upfront."*[284]

At the same time, Derek Moran said that the international forecasting institutes such as the IMF and OECD came to the Department of Finance and the Central Bank for advice and discussion on the domestic economy before they published their forecasts.

As well as consulting with the Department of Finance and the Central Bank for advice and discussion on the domestic economy, the majority of these forecasting institutes used identical statistics and data leading to what Brian Cowen called a *"convergence of opinion"*.[285]

The Department's views were influenced by forecasts that were generated after consultation with the Central Bank and which expressed predominantly similar opinions on the state of the Irish economy.[286] That was particularly so in the case of forecasting the strength and development of GDP, on which there was usually little difference between ESRI, the Central Bank, OECD, IMF and the Department of Finance.[287]

The OECD and IMF forecasters' reliance on information received from the Department of Finance at the consultation stage was demonstrated by the fact that the reports from the IMF and OECD were sent to the Department of Finance in draft form before they were published.[288] In his evidence to the Inquiry, Derek Moran said that the Department checked the draft reports for factual accuracy and clarifications and made proposed amendments.[289]

As part of the Inquiry's work, a number of draft IMF and OECD[290] reports were examined and compared with the final published reports. This comparison showed that amendments proposed by the Department were typically accepted by the forecasting institutes. In some cases, the acceptance

---

283 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-008.

284 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-004.

285 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-045.

286 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-007; John McCarthy, Chief Economist, Department of Finance, statement, JMC00005-006; Donal McNally, former Second Secretary General, Department of Finance, Budget & Economic Division 2000-2007, Sectoral Policy Division 2008 to 2011, transcript, PUB00347-018.

287 Comment on Central Bank Winter Bulletin 31 Jan 08, DOF00460; Comment on Central Bank Spring Bulletin 31 Jan 08, DOF00747; ESRI Spring 2007 Quarterly Economic Commentary, DOF00938; OECD Autumn 2005 Economic Forecasts, DOF01100.

288 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-027/028.

289 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-024/025.

290 Post EDRC amendments to OECD Survey Ireland 02 2008, DOF03325-019.

of the proposed amendments produced a considerably more benign or positive interpretation of the prevailing economic condition and outlook than that contained in the original draft report.

John McCarthy was questioned on interactions between the Department and the OECD. He noted that the Department could request changes to the report but he said that the OECD had no obligation to agree. This process was common to all IMF and OECD member states, he said. Some changes were minor, some were substantive. In response to being shown a document suggesting the Department had requested changes to what an Departmental official had described as *"sensationalist"* language in a report, John McCarthy suggested other countries' finance ministries sought to rewrite entire OECD reports and that the Department of Finance only sought factual clarifications and changes of *"nuance"*, without changing the message.[291]

A Departmental document received by the Joint Committee listed a number of changes to the language of the 2008 OECD report which were proposed by the Department and implemented.[292]These included a change in the following paragraph:

The paragraph pre-amendment read as follows:

"Prior to the weakening in the property market and the recent financial market turmoil, the Irish banks were highly profitable and well capitalised, which will help to absorb the shock. But it would also seem important to be prepared for the worst."

Following amendment, the paragraph was changed to:

"The Irish banks are highly profitable and well capitalised, so they should have considerable shock absorption capacity, but it would also seem important to be prepared to deal with downside risks" [293]

Other proposed changes to phraseology included the substitution of *"the housing market cycle has turned"* for *"the housing boom is over"*, the deletion of a recommendation on financial stability: *"Implement an insolvency procedure, specifically adapted to banks."* and the deletion of a recommendation related to provision for bank failure from the final OECD report. John McCarthy, while accepting some changes were significant, suggested most were matters of *"nuance"*. [294]

Similarly, a view was given by Tom O'Connell, former Chief Economist of the Central Bank, that anything of a negative nature was uniformly removed from OECD country reports:

"… we would be discussing or interacting with the IMF and the OECD, in particular with the OECD country reports, it was embarrassing. When I used to go to Paris … to look at the reports, almost every line was parsed, and… anything of a negative nature needed to be taken out…"[295]

291 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-007/008/010/012/013.

292 OECD Economic Survey of Ireland 2008 – Draft, DOF03196; OECD Economic Survey of Ireland 2008, PUB00162-015.

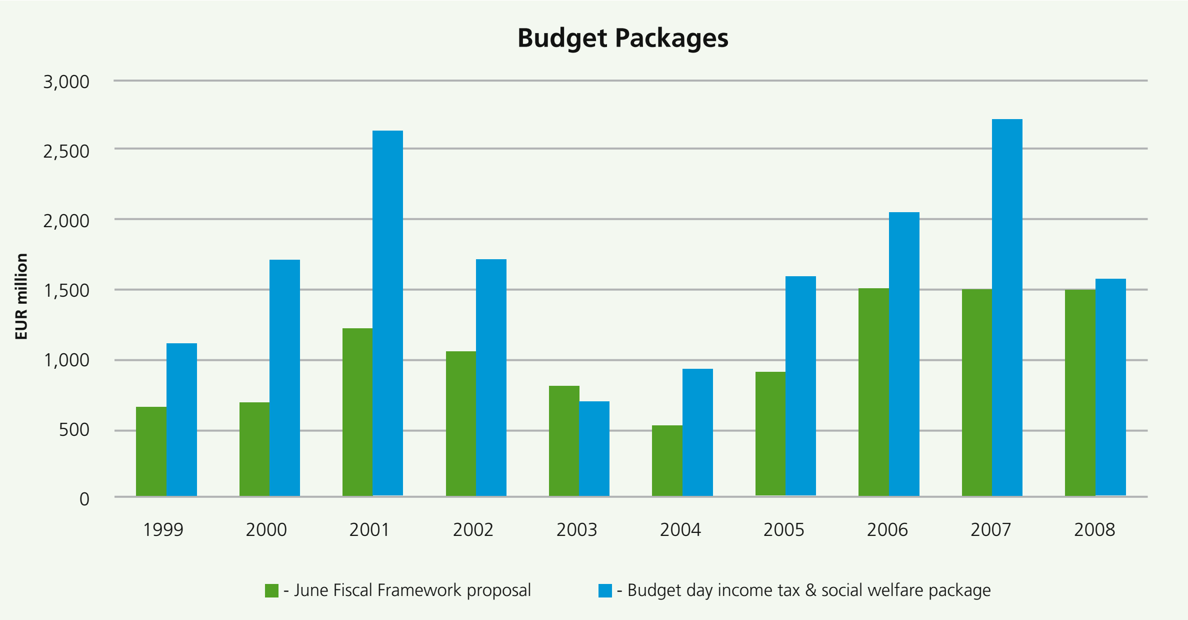
293 OECD Economic Survey of Ireland 2008 – Draft, DOF03196; OECD Economic Survey of Ireland 2008, PUB00162-015.

294 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-006/033/037.

295 Tom O'Connell, former Chief Economist of the Central Bank of Ireland, transcript, INQ00068-011.

The Advice from the Department of Finance on Budgetary and Tax Matters:

In the years leading up to 2008, the budgetary planning process was an annual exercise, with the starting point for the Government being the annual Budget Strategy Memorandum. This Memorandum was based on exchequer figures from the previous year and set a target for the planned fiscal surplus or deficit. From 2004 to 2008, when the economy was booming, the Memorandum was prepared almost six months before the Budget Day announcements. This meant that higher tax revenues than those planned for in the Memorandum were available on Budget Day.



Source: Wright Report[296]

The fact that no medium-term budgetary plan was in place made it possible for the original nominal spending targets to be exceeded while, at the same time, the original fiscal surplus or deficit was complied with. The introduction of medium-term budgetary planning was recommended in the Wright Report[297] as a means of counteracting the effect of spending additional revenue which arose during a particular year[298] and using it instead for reducing debt or saving for future contingencies.

A structural deficit develops when the amount of exchequer expenses is higher than the amount of sustainable and stable income. Structural deficits happen in situations where the exchequer spending is financed to a considerable extent by once-off, temporary or cyclical income components. The emergence of a structural deficit over the years leading up to the financial crisis in 2008 was not recognised by the Department, the Government or outside observers.[299]

296 Wright Report, 'Strengthening the Capacity of the Department of Finance', PUB00175-022.

297 Wright Report, "Strengthening the Capacity of the Department of Finance", PUB00175-033/034.

298 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-011.

299 Marco Buti, Director General European Commission, transcript, INQ00100-017 59; Alan Ahearne, former Special Advisor to former Minister for Finance, Brian Lenihan, transcript, CTX00048-010/011.

The Budget and Economy Division of the Department of Finance was in the best position to identify this deficit and deal with it, as it was directly responsible for both budgetary and tax advice and was also regularly involved in the analysis of tax revenues and expenses. The Business Planning Reviews produced by the Budget and Economic Division provided a basis upon which to prepare the annual budget.[300] The Business Planning Reviews in 2004, 2005 and 2006 included warnings on the dependence on the residential construction sector. They also pointed to the fact that, in spite of data being limited, more analysis of non-residential construction was important as that type of construction amounted to about half of overall construction output.[301]

In the period from 1999 to 2007, the Department had advised the Government on risks of pro-cyclical fiscal action.[302] When it came to Budget Day, with very few exceptions, the Department's cautionary advice was not followed. This was confirmed through evidence provided by former Second Secretary General Donal McNally and former Secretary General Tom Considine.[303]

David Doyle said:

"The outcome was that from 1998 to 2008, total Government current and capital spending, excluding the Central Fund, increased from €20 billion to about €60 billion. Total current spending increased from €18 billion in 1997 to €53 billion by 2008, an average increase of 11%. That was clearly an excessive increase. The Department did recommend a much tighter control of current spending."[304]

The Government's treatment of the Department's advice was further explored during the Inquiry hearings. Evidence provided to the Inquiry indicated that, while the Department's overall advice was respected, the credibility of the Department's budgetary advice in the years from 1998 to 2008 was weakened by the consistent occurrence of better-than-forecasted economic developments.[305] Charlie McCreevy said that the provision of consistently conservative advice by the Department led to the Government often ignoring it.[306]

The evidence of Donal McNally and Tom Considine was that Department officials were conscious that decision making was not the responsibility of the Department but for the Government. Donal McNally said: *"Well, I mean, they were highlighted in the budget strategy memorandums, as far as I recall, but it was Government decisions on the level of public spending."*[307]

Tom Considine said:

"Well it wasn't for civil servants to make those decisions. I mean, the reality of government is that these are decisions that are made by Ministers and eventually, you know, approved by the Government."[308]

300 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, statement, DMO00001-007/008.

301 Issue Notes BED 19 Nov 2004, DOF07889; Issue Notes BED 6 May 2005, DOF07891; Issue Notes BED 3 March 2006, DOF07890.

302 Wright Report, 'Strengthening the capacity of the Department of Finance', PUB00175-005.

303 Donal McNally, former Second Secretary General, Department of Finance, transcript, PUB00347-003 and Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-004/014.

304 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-007.

305 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-010, William Beausang, former Assistant Secretary, Department of Finance, transcript, INQ00127-013.

306 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-004/005.

307 Donal McNally, former Second Secretary, Department of Finance, transcript, PUB00347-011.

308 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-032.

John McCarthy gave the following view:

"I mean, there was a kind of departmental view that policy was moving in the right direction. Most people bought into that. Some were more vocal than others. So I think there was a consensus within the Department that there … there were problems but we simply weren't being listened to. There was … it was a case of the … the boy who cried wolf, really. We were talking about risks, these risks never materialised so we could almost be ignored."[309]

Brian Cowen said:

"And the question of the Department of Finance advice is obviously you take advices from everywhere, you take … and you'd obviously take it from your Department. But at the end of the day, Government makes decisions, ultimately, based on not just technocratic advice but where they see identified need."[310]

Chapter 5 provides more detail on the decision making process.

The Advice from the Department of Finance on the Property and Housing Market

The direct effect of a construction industry collapse on the fiscal balance was potentially significant and should have been factored in as a real risk. However, with the exception of some cautiously worded warnings,[311] the Joint Committee was unable to find evidence of an assessment by the Department of Finance of the potential fiscal effects of a property market crash on the Irish economy. In his evidence, Donal McNally said:

"I'm not quite sure how we got it so wrong; we just did get it wrong. We relied on external advice and on our own assessment but it turned out much worse."[312]

Neither did the Department of Finance consider the related and follow-up effects which would have a secondary impact on the fiscal situation.[313] Although the Department recognised the dependence on property related taxes and identified this in their Business Planning Reviews in 2004, 2005 and 2006, a detailed review of the full effects of a property downturn beyond the expectation of a *'soft landing'* and the related fiscal impact was not carried out.[314]

John McCarthy said that they *"did not shock"* the only research done on *'hard landing'*.[315] This absence, appropriate challenge or analysis on the *"soft landing"* theory was further commented on by Derek Moran, who qualified this view, saying that it was questionable whether *"it would have changed the policy outlook, but at least we should have been conceiving that as a possibility."*[316]

309 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-018.

310 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-013.

311 Business Planning Review 19 Nov 2004, DOF07889-003/004.

312 Donal McNally, former Second Secretary General, Department of Finance, transcript, PUB00347-019.

313 Donal McNally, former Second Secretary General, Department of Finance, transcript, PUB00347-019.

314 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-013/014; David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-003/004; Donal McNally, former Second Secretary General, transcript, PUB00347-017.

315 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-013/014.

316 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-014/015.

The emergence of significant house price inflation was recognised by the Department and also by the ESRI, OECD, IMF and rating agencies in the period up to 2008 in their regular economic reports. While economic and fiscal risks were outlined in the majority of these reports, the economic forecasts remained positive until into 2008.

In its Quarterly Economic Commentary in December 2004, the ESRI predicted that housing supply would, at some point, fall from 80,000[317] to an estimated 30,000 units. For illustrative purposes, the ERSI estimated that a fall from 80,000 to 40,000 units would lead to a GNP reduction of 3%. Simultaneously, the ERSI emphasised that this was unlikely to happen and that they expected only a 5% reduction of housing output for 2005. In a memorandum and speaking note prepared for the Minister, the Department stressed the latter aspect of the ESRI's commentary and, in the process, diluted the effect of the ERSI message:

"I note the ESRI's modelled 5 per cent fall in housing output. It is important to emphasise that this is not the ESRI's forecast for housing nor do they view it as likely to happen. It is simply an illustration of the importance of housing output on the economy. It is illustrative and doesn't take account of potential dynamic effects or policy responses." [318]

In his evidence, David Doyle said that the Department:

"….. accepted the consensus views of the Central Bank, the ESRI and others that the construction sector was facing a soft landing".

Asked whether there was any in-house examination carried out by the Department regarding the possibility of a *"soft landing"*, David Doyle said:

"… I don't recall such an examination … the Department placed its reliance on the consensus forecasts, including forecasts from the Central Bank, the ESRI, which all spoke about a gradual reduction to a more sustainable level…"[319]

Questioned on why the Central Bank Board and the Department accepted the *"soft landing"* theory, Tom Considine, former Secretary General, did not recall any internal analysis by the Department grounding the *"soft landing"* theory, but referred to the Central Bank Financial Stability Reports and the work of other external bodies such as the OECD.[320] He stated that in 2006 the public finances appeared strong enough to cope with any likely shock statement. [321]

John Moran, former Secretary General, Department of Finance believed that no one in the pre-crisis period was planning for the effects on fiscal revenues and employment levels of a substantial reduction in construction activity.[322]

317 Memorandum and speaking note to Minister on ESRI economic forecast 12/2004, DOF01134-001.

318 Memorandum and speaking note to the Minister on ESRI economic forecast 12/2004, DOF01134-003.

319 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-004.

320 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-042/058.

321 Tom Considine, former Secretary General, Department of Finance, statement, TCO00002-006.

322 John Moran, former Secretary General, Department of Finance, statement, JMO00001-002.

Briefings for the Minister for Finance on external reports and advice

The content summary and indeed tone of the briefings prepared for the Minister for Finance are key. Some relevant briefings in the lead into the financial crisis included the following:

- The 2004 Financial Stability Report expressed concerns over credit growth and household debt. A Departmental speaking note prepared for the Minister on the 2004 Financial Stability Report stressed that credit growth and household debt were occurring in a context of strong economic growth and increasing employment.[323]
- The ESRI Medium Term Review 2005-2012, prepared in December 2005, was positive but described a high growth scenario and a low growth scenario, emphasising the latter was more likely. The review referred to the risks in the housing market and the economy's dependence on construction. It recommended a policy of fiscal surplus and steps to reduce demand in the building sector, including the removal of tax incentives. The Medium Term Review suggested Ireland needed to reduce its dependence on the low Corporate Tax regime. Speaking notes prepared for the Minister by the Department described the Medium Term Review as a wholly positive assessment, acknowledged the risks in the construction sector but stated *"a soft landing is now in prospect"* and did not accept the ESRI views on the corporate tax regime.[324]
- The ESRI Spring 2006 Economic Commentary forecasted growth of 4.8% but expressed concern over the acceleration of house price inflation increasing the possibility of a sharp adjustment, the loss of competitiveness and stimulatory fiscal policy. However, it stated that a *"soft landing"* remained the most likely outcome. The Minister's speaking notes welcomed the growth forecast and accepted there were risks in the housing market but suggested the increase in housing supply would address them.[325]
- The ESRI Spring 2007 ESRI Economic Commentary forecasted growth of 5.4%, but warned that this was not sustainable in the long term and suggested house prices were over-valued by 15%. A Departmental speaking note on this Commentary prepared for the Minister emphasised the growth forecast, accepted the comments on the sustainability of growth but expressly disagreed with the comments on house price overvaluation. The Departmental Note instead suggested that house prices were grounded in demographics and economic growth and emphasised the moderation in growth in recent months, stating that a *"soft landing"* was the most likely scenario.[326]
- The ESRI Summer 2007 Economic Commentary included Morgan Kelly's paper which predicted a possible a drop in house prices of 40-60%. The Minister's speaking notes emphasised the necessity not to *'over-react'* to a recent decline in house price, stating the Minister shared *"the view of most commentators"* that house prices had been underpinned by a number of factors, including a strong economy, increases in employment and income and reductions in taxation.[327]

---

323 Speaking notes for Minister for Finance on Central Bank Annual Report, 2004, DOF0916.

324 The ESRI Medium Term Review prepared in 2005-2012, PUB00307; speaking notes, DOF01029.

325 ESRI Spring 2006 Economic Commentary, DOF00932.

326 ESRI Spring 2007 Economic Commentary, DOF00938.

327 ESRI Summer 2007 Economic Commentary, DOF00939.

The role of the Department of Finance in relation to supervision of the Central Bank and Financial Regulator

In his evidence, Tom Considine[328] outlined the Department's interaction with the Central Bank and the Financial Regulator prior to the implementation of the Domestic Standing Group (DSG)[329] as follows:

- generating and updating primary and secondary legislative proposals for the Minister for Finance in order to maintain an appropriate legal framework for regulating the financial services sector, including the Central Bank.
- representing the Government in the development of EU legislation governing the regulation of financial services and implementing EU legislation domestically.[330]

The Department's duties also involved:

- liaising with the Central Bank and the Financial Regulator.
- responsibility for overall macroeconomic analysis, primarily through cooperation with external advisers, including the Central Bank.

The responsibilities of the Department and Minister for Finance included ensuring that the structures for financial regulation were put in place and that they operated as required.[331] This included making the required resources available to the Central Bank and Financial Regulator.[332] The view put forward in the evidence presented to the Joint Committee is that the Department did not see itself as having a role in directly overseeing financial regulation and understood that the Central Bank and Financial Regulator were statutorily independent. The Department could have reviewed the quality of the CBFSAI's role which would have uncovered its structural shortcomings. In this regard, William Beausang, former Assistant Secretary, Department of Finance said:

"…we had no role in raising issues/concerns around the stability of the banks with the Central Bank because that was their job and they were an independent Central Bank. Once you get into a space where the Department is encroaching on the independence of a Central Bank, or the independence of the supervisor, you're getting into, sort of, potentially quite difficult territory so, I mean, the responsibilities are defined in legislation."[333]

Evidence from Charlie McCreevy to the Inquiry indicates that the Department saw its role as *"providing the legislative framework and dealing with the Governor on broad macro issues."*[334]

328 Tom Considine, former Secretary General, Department of Finance, statement, TCO00002-001.
329 The Domestic Standing Group (DSG) was introduced in 2007.
330 Tom Considine, former Secretary General, Department of Finance, statement, TCO00002-001.
331 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-008.
332 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-025.
333 William Beausang, former Assistant Secretary, Department of Finance, transcript, INQ00127-015.
334 Charlie McCreevy, former Minister for Finance, statement, CCR00001-002.

Brian Cowen said:

"The Department of Finance primarily saw its role as preparing any legislation that the Central Bank and Financial Regulator might seek. It did not see its role as one of second-guessing the work and assessments of the Central Bank and the regulator, which were independent, separate and had specific statutory responsibility within this area."[335]

William Beausang stated that, in the period up to 2008, the Department did not have the specialist expertise that it would have been required if it was to undertake an analysis of the banks' financial position and review the Financial Regulator's performance.[336]

David Doyle said: '*The Department was wrong to take, without challenge, the assessment of the Central Bank, the Financial Regulator and the banks' reassurance about the state of the financial sector. Such a reliance on consensus forecasts and the assessment of the Central Bank, the regulator and the banks was a mistake and I regret it"*.[337]

The Skillsets and Expertise in the Department of Finance in relation to Economic Forecasting and Banking:

The testimony of several witnesses to the Inquiry support the view that there was an ongoing lack of staff numbers and necessary skillsets in the Department of Finance in relation to the areas of economic forecasting and banking expertise. [338]

Regarding economic forecasting, Tom Considine commented as follows:

"…one of the difficulties that we had down through the years in Finance, was retaining people with financial expertise and, essentially, that's why the NTMA was set up in 1990."[339]

Former Secretary General, Department of Finance, Kevin Cardiff said:

"I know the economists are important but especially on the banking side. That is why we needed to rely so much on the NTMA. We didn't have in-house expertise. … they (NTMA) and the Central Bank handled our banking for us. We had to look to them immediately and even they then had to bring people in."[340]

Kevin Cardiff noted the *"gaps in technical proficiency"* identified by the Wright Report but stated that steps had been taken to address them.[341] He accepted the Department should have had more professional economists, but questioned the importance of this, suggesting that the views of external economists had not clearly conflicted with those of the Department.[342]

335 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-010/011.

336 William Beausang, former Assistant Secretary, Department of Finance, transcript, INQ00127-044/045.

337 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-004.

338 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-018; William Beausang, former Assistant Secretary, Department of Finance,transcript, INQ00127-013/045; David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-030; Wright Report, Strengthening the Capacity of the Department of Finance, PUB00175-006.

339 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-009.

340 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-034.

341 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-039.

342 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-034.

Robert Pye, Assistant Principal in the Strategic Management Unit of the Department from 1997 to 2010, believed the Department had *"all of the expertise, staff and experience that it needed to do its job property"* and attributed *"its failures"* to what he described as *"its inability"* to take a stance independent from Government.[343]

Meanwhile, Derek Moran described concerns within the Department over skills and *"economic capacity"* from 2003 and the difficulties attracting suitably qualified economists when pay rates were better in the private sector.[344] John Moran described the system as *"grossly under-resourced"* when he commenced work in the Department. [345]

Findings of the Joint Committee

1. The *'soft landing'* theory was cited frequently as the most likely outcome to the property boom from as early as 2000. No evidence was provided that this expectation was tested, let alone validated, through robust analysis or research. The failure to take action to slow house price and credit growth must be attributed, at least in part, to this shortcoming.
2. The Financial Regulator had sufficient powers to deliver their prudential supervision of the banking sector in a more intrusive manner through, for example, imposing conditions on banking licences, revoking a licence, suspension of banking business and (after late 2005) administrative sanctions for breaches, including lending limits.
3. While the recommendation of the European Commission to ECOFIN in 2001 to censure the Irish Government for their proposed fiscal strategy was withdrawn, this early warning about pro-cyclical fiscal strategy was a missed opportunity as the underlying message remained valid in the following years.
4. The Central Bank had sufficient powers to intervene in the banking sector to manage both the risk posed to the financial stability of the State by individual financial institutions and the banking sector as a whole, through the regulation of key ratios, the composition of assets and liabilities and the issue of guidance to the Financial Regulator that it was required to implement.
5. The Central Bank and Financial Regulator could have required banks to hold additional capital to absorb losses that could arise in the event of a financial crisis.
6. The new CBFSAI organisation created in 2003 was unnecessarily complex and led to a real or perceived ambiguity in the respective roles of the Central Bank and Financial Regulator. Once the new structure, which represented a material change in the delivery of financial supervision in Ireland, was in place, the Government should have carried out an independent review and assessment of its effectiveness and the delivery of its functions. However, it was the execution by the CBFSAI of their mandate and the absence of interventions that directly contributed to the Crisis.

343 Robert Pye, former Assistant Principal, Department of Finance, statement, RPY00002-005.

344 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-009.

345 John Moran, former Secretary General, Department of Finance, transcript, INQ00115-045/046.

7. The Financial Stability Reports monitored and provided analysis of the key risks to the financial system and financial stability. The reports did identify key risks. However, the overall assessment and tone of the reports were too reassuring and did not identify or warn of the systemic and macro prudential risks in the banking sector as well as the structural imbalances in the Irish economy despite specific, escalating and repeating risks.
8. The Central Bank and Financial Regulator were aware as early as 2003 that the Irish banking sector was placing increasing reliance on lending to the property sector, and that different lending practices were being adopted. Neither the Central Bank (at a macroprudential level) nor the Financial Regulator (at a microprudential level) intervened decisively at the time or in the years prior to the crisis.
9. Breaches of prudential limits and requirements, as well as other prudential weaknesses, were identified by the Financial Regulator. However, they relied on moral suasion and protracted correspondence, (sometimes for as long as a decade) rather than an escalation in the level of formal enforcement action. In the years 2000 – 2008, there was no enforcement action taken against any institution for prudential breaches. This reflected an aspect of regulatory capture.
10. In the years leading up to the crisis, the Financial Regulator did not identify the systemic risk that was building up in the banking sector, did not identify the emerging risk to the financial stability of the overall system and, therefore, did not escalate these issues to the Central Bank. There was poor assessment by the Central Bank of the build up of micro prudential systemic risk and they continued to believe and report that the banks and overall sector could withstand and manage the building risks in the system.
11. Banks in Ireland were allowed, through the inaction of the Financial Regulator, to breach sectoral lending limits on property, without fear of any consequence. The Financial Regulator could have used its powers to enforce those limits. In doing so, it may have controlled the scale of lending to the property and construction sector. This could potentially have reduced the impact of the eventual fall in asset values.
12. The Department of Finance relied on the Central Bank Financial Stability Reports as the basis for assessing risks or threats arising from the banks. The Department relied on the overall assessment in the reports rather than responding to the specific risks identified in the reports. The Department did not carry out adequate independent analysis of the risks.
13. The Department of Finance was too reliant on external agencies such as the IMF, OECD and European Commission (who all in turn relied, to some extent, on information sourced from the Department of Finance and Central Bank) for economic forecasting and did not do sufficient analysis to successfully challenge or form an independent review on some of the key risks identified in these reports. This included, in some instances, editing and reducing the risks highlighted in the international reports and in speaking notes for the Minister.

14. The International organisations (European Commission, IMF and OECD) and ESRI assumed that the high output levels of the Irish economy and the related boom in tax revenues were permanent structural features. They relied too much on Ireland's compliance with the limits set out in the Stability and Growth Pact in assessing the true fiscal positon of the Irish State before the fiscal and banking crisis emerged. The risk identification, while highlighting some key risks, was insufficient and too positive in overall assessment and conclusion.
15. The Joint Committee found that the CBFSAI stress tests of the banks in 2006 were inadequate. The model used in conjunction with the IMF for the stress tests as well as the scenarios tested did not reflect the emerging risks.

Recommendations of the Joint Committee

1. The membership of the Board of the Central Bank, appointed by Government, must include sufficient expertise and relevant direct experience in financial stability and prudential regulation.
2. While final decisions are matters for Government and often urgent, a formal process with clear procedures should be established (through legislation) in situations where there are conflicts between the advice provided by the Department of Finance on matters where exceptional risks are involved and the decision proposed by the Minister.
3. The Joint Oireachtas Committee on Finance, Public Expenditure and Reform, should be tasked with bringing forward proposals to ensure the Oireachtas can apply adequate oversight to the budgetary process, and to hold the Executive to account.
4. An Independent Budgetary Office, possibly as part of the Irish Fiscal Advisory Council, to provide independent costings of budgetary and pre-election proposals of political parties and members of the Oireachtas, should be established.
5. The Enforcement Division of the Central Bank should attend before the Joint Oireachtas Committee on Finance, Public Expenditure and Reform, on at least an annual basis, to give an account of the enforcement activity undertaken and advise of any further legislation or powers required to address emerging risks. The Enforcement Division should also report to the Committee on whether sectoral lending limits have been breached by any institution during the period, and if so, to summarise what actions have been taken to address these breaches.
6. The exemptions specified in the Freedom of Information Act 2014 should be reviewed by the Minister for Public Expenditure and Reform with a view to increasing public access to advice provided by civil servants and special advisors.
7. The banking division in the Department of Finance should be periodically subjected to a performance review by an independent third party to ensure fiscal, capital market, and banking expertise is adequate to challenge information and assumptions provided to it by the Central Bank of Ireland.
8. Clear guidelines should be developed on best practice on the recording, minuting and documentation management of meetings in the civil service. Monitoring of compliance with best practice should be the responsibility of the Information Commissioner.

Chapter 5: Government Policy and the Oireachtas

Introduction

In this chapter the Joint Committee will look at the critically important role of the Government. Together with the Department of Finance, Central Bank and Financial Regulator, it was believed to constitute the final line of defence against either an individual or systemic failure of financial institutions. Essentially, through policy actions, they had the ability to:

- create, augment or offset the conditions that lead to a crisis.
- increase, reduce or neutralise the effects of a crisis as it unfolded.

We will examine the factors that influenced the key decisions that the Government made in the period up to the crisis, the contribution of those decisions to the crisis, and the level of oversight which was applied to those decisions by the Oireachtas.

The Nyberg Report said the following in relation to responsibility for decision-making:

"People in a position to make decisions are and must be ultimately responsible for them regardless of what advice or suggestions they have received. The higher and more influential their position the greater their responsibility."[1]

In his opening statement Brian Cowen, Minister for Finance at the time, used this quote from the Nyberg Report and said:

"In relation to the actions I took, I want to make it clear from the beginning that nothing I have to say here should be interpreted by anyone in any way as an attempt by me to pass the buck to anyone else."[2]

He said:

"So regardless of what advice, you can't, as an exercise of accountability, pass on that responsibility to anyone else, and I … as it says, the higher and more influential their position, the greater their responsibility. I'm prepared to live by that principle on these issues"[3].

He also said:

"…we made those policy decisions in the full knowledge of … and that was a decision for politicians to make, not, however eminent a civil servant might be, you know? So, we …we made policy decisions with our eyes wide open."[4]

---

1 Nyberg Report, Misjudging Risk: Cause of the Systemic Banking Crisis In Ireland, March 2011, PUB00156-022.

2 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-141.

3 Brian Cowen, former Taoiseach and Minister for Finance, transcript PUB00345-003.

4 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-069.

Section 1: Government - Fiscal Policies

An underlying issue in the Government's fiscal policy in the period up to 2008 was the development of an imbalance in the fiscal policy strategy.

The Emergence of a Structural Deficit

A Structural Deficit develops when the amount of Exchequer expenses is higher than the amount of sustainable and stable income,[5] where the source of finance for exchequer spending is over-reliant on temporary or transitional income components, for example property related Capital Gains Tax (CGT) or Stamp Duty. These types of taxes are sensitive, in that they will grow quickly in a boom but will reduce rapidly when there is a downturn in the economy.

In contrast, more stable revenue sources include income taxes which are less impacted by a downturn in activity. Taxation policy choices made by the Government contributed to a Structural Deficit developing, which was realised in 2008 when the tax revenue, particularly from temporary sources, reduced dramatically while the expenditure commitments largely remained or continued to increase. Consequently, the large Structural Deficit, which had built up over a number of years, was left exposed.

From 1994 onwards, Irish Exchequer revenue became increasingly dependent on property or construction related income.[6] By 2006 - 2008, income from Stamp Duty and CGT collectively accounted for 15% of total revenues. A further 15% of revenues came from corporation taxes, which were strongly boosted by the activities of property development companies.[7] These sources were only sustainable in the longer term if property related transactions continued at a similar level.[8] However, this was not the case and when demand collapsed, so did the tax revenue that the Government relied upon to meet its commitments.

Tax Base Erosion was an important factor in the creation of the Structural Deficit. The Government made policy decisions which directly contributed to erosion of the Tax Base. These decisions are explored in more detail later in this Chapter.

The evidence given to us by former Taoisigh Bertie Ahern and Brian Cowen confirmed that the Government's focus was on the requirements of the Stability and Growth Pact and on GDP/GNP related ratios like expenditure/GDP, Debt/GDP and Government balance.[9] Bertie Ahern, Brian Cowen and Charlie McCreevy said that they had acted conservatively and balanced resources and demands responsibly during this period.[10] In relation to his approach to the budget, Brian Cowen said:

---

5 Glossary: Structural deficit.

6 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-006/007; John Moran, former Secretary General, Department of Finance, statement, JMO00002-002.

7 Statistics show that Capital Gains Tax income grew from €56m in 1995 to €3.099m in 2006. (dataset: Details of tax revenue Ireland) Stamp Duty rose from €279m in 1995 to €3.576m in 2006, PUB00402-001. This is considered below at Section 1.

8 John FitzGerald, Research Affiliate, former Research Professor, ESRI, statement CTX00022-013; Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, CTX00057-025.

9 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-004; Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-011.

10 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-004,022; Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-004; Charlie McCreevy, former Minister for Finance, transcript, PUB00346-008/027.

"the IMF came over to this country and did an exercise, which took account of the buoyancy effects that you're talking about in relation to the construction industry and came back and told us that there was a structural surplus - even when they took out the cyclical effect - that there was a structural surplus in the Irish economy of 2.8%."[11]

John McCarthy, Chief Economist at the Department of Finance, said:

"The contraction of the tax base and the ramping up of public expenditure on a permanent basis were clear policy mistakes and ultimately led to a very large structural deficit once the crisis kicked in. That the public finances were in broad compliance with the requirements of the Stability and Growth Pact during most of this period provides no comfort."[12]

The Drivers of Fiscal Policy that influenced Government Decisions

In this section, we will look at some of the macro-economic factors that impacted on decision making.

Fiscal policy from 1998 until early 2008 was discussed with key witnesses during hearings before the Joint Committee covering key points such as:

- the surge of GDP/GNP from 1995 to 2007.
- requirements under the European Stability and Growth Pact (SGP).
- strong population growth.
- expansion of the construction sector.
- commercial property.
- house price growth.
- vulnerability of construction sector.

The surge of GDP/GNP from 1995 to 2007:

GDP is an important measure of economic performance. Governments have historically relied on a measurement of expenditure as a percentage of GDP as a basis to assess what was affordable. GDP growth in Ireland over this period was substantially stronger than in most other EU member states, rising from €53 billion to almost €197 billion, or by 272%.[13] In contrast, growth of GDP over the same period was 27% in Germany, 131% in Spain and 129% in the UK.[14]

While the Debt/GDP ratio had improved dramatically, there was no reduction in the actual debt. Gross government debt remained almost unchanged at €44 billion during this period. It would appear that the strong revenues earned during the boom years were not generally used to reduce debt, but to increase expenditure. This suggested a priority on the short term rather than medium term management of fiscal risk.

This risk was realised when between 2007 and 2010, Ireland's GDP fell by 19%, which caused a deterioration in the ratio, regardless of any additional debt taken on.

11 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-023.

12 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-003.

13 GDP at market prices, PUB00400-001.

14 CSO-.Eurostat database, table [nama_10_gdp] Gross Domestic Product at market prices, updated 10 September 2015. PUB00400-001.

While the headline figures of total Government expenditure/GDP fell from 36.6% in 1997 to 33.3% of GDP in 2004, the actual amount of Government expenditure almost doubled from €26.7 billion to €51.8 billion in that period. By 2008, Government expenditure had tripled.[15] The substantial rise in expenditure was obscured by the strong rise of GDP. However the affordability of this increase in expenditure was reliant on a continuing stream of non-cyclical taxes.

There were differences of opinion expressed by witnesses. Charlie McCreevy said: *"No matter how these figures are interpreted, it is quite clear that there was no splurge over the period."*[16] However, this was not a view shared by all. Bertie Ahern accepted that Current Expenditure was too high by 2007.[17]

Brian Cowen regretted that current spending growth was not lower in his time as Minister for Finance and said that he should have had a less expansionary approach to his Budget for 2008.[18]

Agreeing high levels of current expenditure created a further problem, Tom Considine said:

"From a sustainability viewpoint, gross voted current expenditure is particularly important because of the difficulty in reversing welfare, pension and pay increases once granted."[19]

Requirements under the European Stability and Growth Pact (SGP):

These requirements came into force in 1998. The aim of the SGP was to keep each Member State within prescribed limits on Government deficit (limited to 3% of GDP) and debt (limited to 60% of GDP). Since Government debt was generally well below the prescribed threshold throughout the relevant period, the budget deficit was afforded more attention.[20]

Every year from 1998 to 2007 (with the exception of 2002), Exchequer revenues surpassed official forecasts, mainly due to strong rises in property-related income.[21] The 3% Government deficit limit under the SGP was generally easily achieved.[22] The Government Budget showed a surplus in each year from 1998 to 2007, bar a small deficit of 0.3% of GDP in 2002.[23]

Once the Government had a balanced or even slightly positive budget, the tendency was then to spend excess income on budget day rather than using some of this excess to reduce debt.[24]

When asked why, in the years 1999-2002, the income tax and welfare package announced on Budget Day dramatically exceeded the recommendation made by his Department the previous June, Charlie McCreevy said *"…because we were anticipating greater economic growth and greater*

15 Ireland and Europe Statistics on Debt/GDP deficit, PUB00400-001.

16 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-005/006.

17 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-024.

18 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-122.

19 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-004.

20 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, statement, DMO00001-010.

21 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-004/019/023.

22 A detailed account of the European commission's monitoring of Ireland's economic performance throughout this period provided by Marco Buti CTX00057-004 to 007.

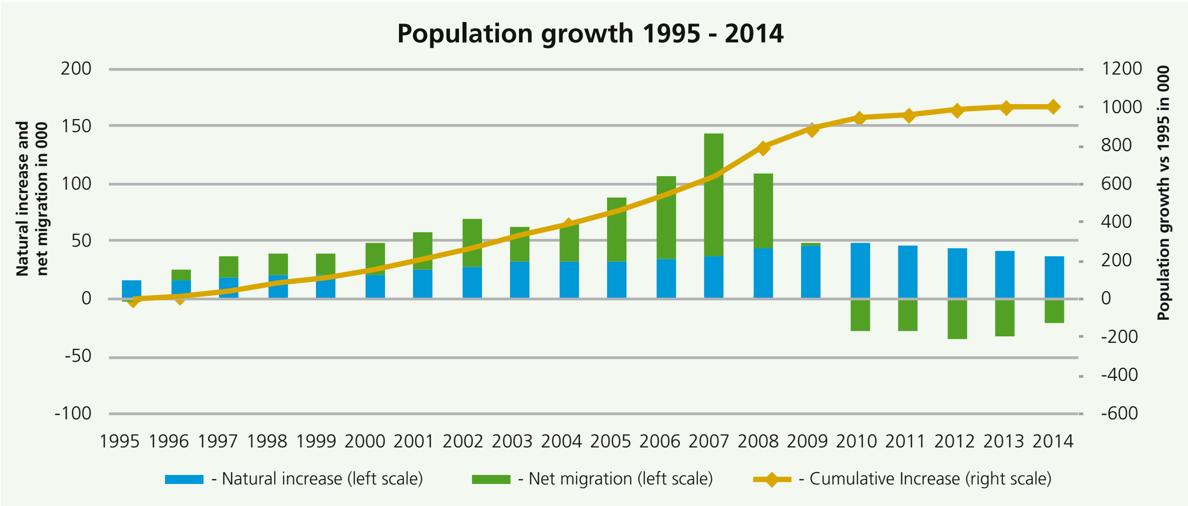
23 Eurostat national accounts database, Government deficit/surplus, debt and associated data [gov_10dd_edpt1] as per update on 17th June 2015, PUB00400-001.

24 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-006; Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-019.

economic growth was occurring."[25] This confidence in the ongoing growth funding the spending plans would prove to be incorrect.

Strong population growth:

Ireland's population grew from 3.6m in 1995 to 4.5m in 2008. Net immigration flows, along with a relatively young population, resulted in strong labour force growth, rising from 1.5m in 1998 to over 2.1m in 2008.[26] Accordingly, the Government needed to provide housing, education, transport and public infrastructure, and services as well as safeguard living conditions for a rapidly growing population.[27]



Source: CSO[28]

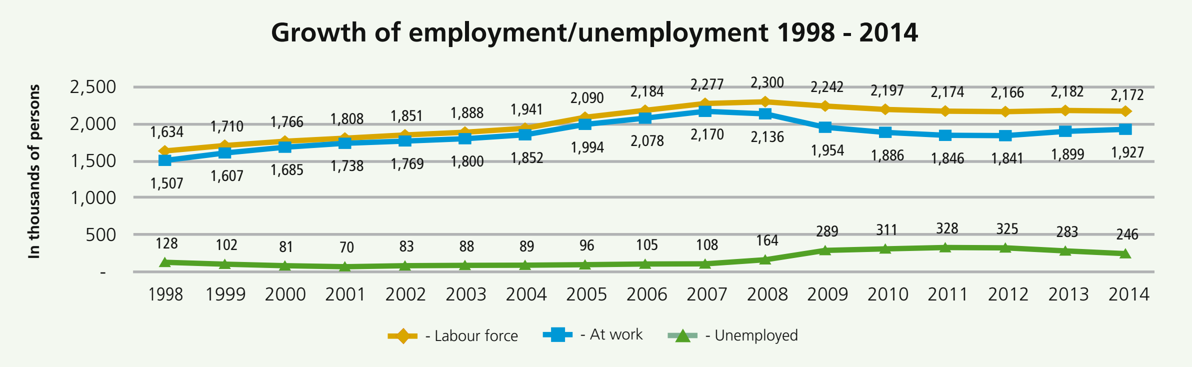
Population and employment growth, combined with substantial income gains and headline inflation, substantially contributed to the rise in GDP and also led to a rise in spending.

Brian Cowen and Charlie McCreevy said that the increase in expenditure on social protection was a deliberate Government policy.[29] Average social protection payments were increased significantly even though unemployment was below 5% for the first time in the history of the Irish State.

Brian Cowen spoke of having to make political and policy decisions when there was a budget surplus in order to address needs.[30] Charlie McCreevy spoke of the moral and political pressure he felt to spend the money which became available. He said: *"It is difficult to run a surplus in a democracy."*[31]

The need to house these workers added to demand in the property market. This further accelerated economic growth and resulted in increased property-related income and transactional tax revenues.

25 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-070.
26 CSO/StatBank Table QNQ24, PUB00398.
27 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-010.
28 CSO/Components of population change, PUB00401-001.
29 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-019/041; Charlie McCreevy, former Minister for Finance, transcript, PUB00346-006.
30 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-019.
31 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-006.



Source: CSO[32]

Expansion of the construction sector:

The commercial and residential construction sector expanded far beyond its historical trend line, generating a major increase in labour force supply and participation with one in every five persons working in the economy either directly or indirectly employed in construction. The primary and secondary effects of this expansion were significant.[33]

The Government's finances were becoming increasingly dependent on, and vulnerable to, maintaining stability in this sector.

Commercial Property:

Residential and commercial development had depended on acquiring land for future projects. The higher Stamp Duty and CGT followed rising property price levels generated the expectation of further capital gains in the property/construction sector.

House price growth:

While house price inflation was a key theme of many economic commentaries and featured prominently in the Central Bank's Financial Stability Reports, its impact on the Exchequer's finances was largely positive in the years leading up to the crisis. The expectation that house prices would continue to rise, in turn, supported the demand for more housing, both for residential and investment properties.[34]

Vulnerability of Construction Sector:

The substantial risk of a total collapse of construction activity and property activity was not contemplated.[35] Bertie Ahern said:

"I believed that that was about 55,000 houses and I believed we could get back to 55,000 houses without doing too much. That was the sustainable level, so … and we were getting there and I thought, if we got there, then … we were okay."[36]

---

32 CSO/StatBank Table QNQ24, PUB00398.

33 Annual Construction Industry Review, 2009, PUB00235-065.

34 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-004; John Moran, Managing Director, Jones Lang LaSalle Ireland, transcript, CTX00047-003.

35 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-058.

36 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-013.

The vulnerability of the commercial construction sector was illustrated by the PwC report on the banks in late 2008, which identified 'land and development' loans of €62bn.[37] The true value of the lands which secured these loans was significantly dependent on the construction projects being completed and a significant dependency on rezoning being granted by local authorities.

Discretionary Government Spending Programmes

As well as external factors which influenced Government decisions, there were discretionary decisions that the Government took which committed it to higher long-term expenditure. In this section, we will look at the role of Social Partnership and Programmes for Government.

Social Partnership:

Six Social Partnership Agreements were entered into from 1987 to 2005, covering three year periods, between:

- the Government
- main employer representative bodies
- trade unions
- farming organisations
- community
- voluntary organisations (joined in late-1990s)

From their inception in 1987 into the mid-1990s, Social Partnership Agreements assisted in delivering moderate wage developments and good industrial relations during times of substantial economic growth. These Agreements kept wage inflation in check over a prolonged period, thereby enhancing competitiveness and stimulating investment.[38]

From the late 1990s to 2007, the economy was operating at full capacity.[39] Labour shortages and high wages demands followed and a loss of competitiveness became evident.[40] As a result, the pay determination element of Social Partnership had by 2000, according to Dermot McCarthy become *"an inflation-based bargaining process."*[41]

Early concerns on loss of competitiveness voiced by some commentators[42] were outweighed by the strong growth of the domestic labour market. The construction sector accounted for a large part of the increase in employment numbers until early 2007.[43]

37 Ann Nolan, Second Secretary General, Department of Finance, statement, ANO00002-001.

38 Rob Wright, former Canadian Deputy Minister, author of the report 'Strengthening the capacity of the Department of Finance', CTX00058-005; PUB00175-024; IMF Country Report Ireland, No 04/348, PUB00138-049.

39 John McCarthy, Chief Economist, Department of Finance, transcript, INQ00128-003.

40 'Strengthening the capacity of the Department of Finance, Report of the Independent Review Panel', December 2010, PUB00175-025; Pre-Budget Letter from John Hurley to Charlie McCreevy 30th September 2003, INQ00070.

41 Dermot McCarthy, Secretary General, Department of the Taoiseach, transcript, INQ00108-041.

42 Department of Finance, Summary of the Central Bank Autumn Bulletin – 3rd October 2002, DOF01034-002; Department of Finance Summary OECD Autumn 2002 Economic Forecasts, DOF01066-001.

43 CSO, Ireland, StatBank table QNQ03 shows that total number of employed increased from 1.71mln in Q1 2001, to 2.17mln in Q3 2007. Number employed in construction increased from 0.17mln to 0.27mln, PUB00398-001.

The benchmarking process for the public sector pay structures resulted from commitments made under the social partnership agreements. Benchmarking placed additional pressure on the Government as private sector wage growth had risen robustly. Once benchmarking had been carried out, it was agreed for a period of three years and so could not be easily reversed.[44]

Programmes for Government:

The Programmes for Government in 1997, 2002 and 2007 set high-level goals for the Government in relation to spending and tax level commitments. Policies, such as the Government's Decentralisation Programme, were introduced by Charlie McCreevy with little analysis.[45] When questioned as to whether he believed that his announcement of decentralisation was a failure, Charlie McCreevy said:

"No, I don't…..I see many great offices all over the country with decentralised civil servants from Dublin there and they're doing very well and people … it's rejuvenated some areas, people are very happy. I think the … the system and efficiency hasn't deteriorated at all. I'm very … I'd be very sad that the total decentralisation wasn't completed as we, as we had envisaged."[46]

In examining the spending decisions, Rob Wright, former Canadian Deputy Minister of Finance, referred to findings he had made in the Wright Report, that the programmes for Government and Social Partnership Process helped overwhelm the Budget process.[47]

When this was put to Brian Cowen, he said *"That's their view."* He agreed that the Programmes were an influence, but he said it was the job of Government to implement the Programmes that it had brought in.[48]

The Budgetary Process

A key responsibility of any Government is to produce an annual budget. As part of the process, a Budget Strategy Memorandum was prepared by the Economic Division of the Department of Finance each June or July. This was considered and reviewed by the Minister for Finance and brought to Cabinet with proposals where the spending levels were agreed.

However, by the time the Budget was introduced in the following December, the spending levels had invariably grown. Charlie McCreevy said that he viewed the June memorandum as *"not so much as the Department's advice…but as a starting point for negotiations"* and he believed that the Department of Finance treated it the same way.[49] When asked to comment on the process, Bertie Ahern noted *"…that document is used as the opening discussion of a long process …"*[50]

44 IMF Country Report Ireland, No 04/349, November 2004, PUB00138-048.

45 Organisational Review Programme – Third Report, PUB00353-180/181.

46 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-033.

47 Rob Wright, former Canadian Deputy Minister, author of the report 'Strengthening the capacity of the Department of Finance', transcript, CTX00058-004/006.

48 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-069.

49 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-071.

50 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-054.

Brian Cowen said that the proposals from the Department of Finance would have been considered the *"most conservative possible"* and there would have to be *"negotiations around that going forward."* He did accept that this was not best practice.[51]

Tom Considine was asked whether budgetary decisions were taken by the Government contrary to the advice of the Department of Finance, to which he replied:

"Not alone were they contrary to the advice of the Department but they were contrary to the advice of the Minister for Finance as well, as presented at mid-year when the strategy was set. So, as the year went on then … in the autumn, the pressures within the system meant that that advice was relaxed and the spending was greater for, as you saw there, for most years, apart from 2003."[52]

When Charlie McCreevy was asked about advice, he responded:

"Democratically elected governments must, at all times, with their freedom, do what they consider best, in the interests of their people. Yes, this means the ignoring of some advice and the taking of others."[53]

Tom Considine said that the Department *"engaged"* with the Minister to prepare a budgetary strategy memorandum submitted to cabinet in mid-year; the government decision was based on the memorandum and formed the basis of spending and taxation frameworks prepared for the next year. Other departments submitted spending proposals in autumn based on this decision.

The Department also prepared cost estimates for funding existing public services, used in pre-budget discussions with other departments. Reductions in funding below existing service levels in the 2003 and 2004 budgets were opposed by other departments, leading to pressures to increase spending in 2005, when the targets in the budget strategy memorandum were exceeded by €1 billion. He described a memorandum prepared in 2005 recommending targeted increases in expenditure for the 2006 budget. These targets were exceeded by a significant margin.[54]

When questioned about these spending pressures and asked why they could not have been resisted in the established budget process, he said: *"it wasn't for civil servants to make those decisions"*[55], which were made by the Minister and ultimately approved by Government.

Asked whether the post-2003 budgets were decided *"contrary to the advice of the Department"*, Tom Considine stated that *"the Department set out its stall"* and the *"advice was signed off by the Minister"* but *"it wasn't possible to hold that line."* He stated that *"the political pressure to spend"* was too great.[56]

51 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-138/139.

52 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-033.

53 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-004.

54 Tom Considine, former Secretary General, Department of Finance, statement and transcript, TCO00002-008; INQ00112-004/027.

55 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112/032.

56 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-014/033.

David Doyle, former Secretary General, Department of Finance, stated that general advice to government was set out in the budgetary strategy memoranda but accepted that fiscal policy as decided by Government was generally pro-cyclical in this period with expenditure increases and tax concessions adding to demand in the economy. He commented that prior to 2008, Budget Day packages in general ended up significantly higher than those recommended by the Department *"as a result of the pressures exerted by the social partners, individual Ministers and the Cabinet."*[57]

Derek Moran listed a range of warnings included in the Budgetary Strategy Memoranda in relation to inflation, wage pressures, public spending, an overheating economy and increasing house prices and construction costs, noting that the Department had consistently advocated a tighter fiscal policy. He said that the Budgetary Strategy Memoranda *"became an opening for policy discussion rather than a fixed fiscal framework, a floor rather than a ceiling."*[58]

Donal McNally said it was:

"a matter for political decision what the level of public spending should be and what the tax to fund that should be…as a civil servant, you do what the Government decides."

Questioned on how the Department responded to calls from the IMF, the OECD and ECOFIN for a tighter fiscal policy, he said that such recommendations were highlighted in the Memoranda but the decision was left to the Government.[59]

The Government's consideration of the Department's advice was further explored during public hearings. Tom Considine and William Beausang said that while the Department's overall advice was respected, the credibility of the Department's budgetary advice in the years from 1998 to 2008 was weakened by the consistent occurrence of better-than-forecasted economic developments.[60] Charlie McCreevy said that the provision of consistently conservative advice by the Department led to the Government often ignoring it.[61]

Brian Cowen's view was:

"And the question of the Department of Finance advice is obviously you take advices from everywhere, you take … and you'd obviously take it from your Department. But at the end of the day, Government makes decisions, ultimately, based on not just technocratic advice but where they see identified need."[62]

The budgetary process culminated in the annual announcements of fiscal measures on Budget Day. Professor Niamh Hardiman, UCD, had given evidence to the Joint Committee on corporate governance. However, she also said: *"Irish Ministers for Finance have a tremendous amount of discretion when it comes to devising and implementing fiscal policy."*[63]

57 David Doyle, former Secretary General, Department of Finance, statement, DDO00001-017/022.

58 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, statement, DMO00001-008/009.

59 Donal McNally, former Second Secretary General, Department of Finance, statement, DMN00002-003 to 006, transcript, PUB00347-005/011.

60 Tom Considine, former Secretary General, Department of Finance, transcript, INQ00112-009; William Beausang, former Assistant Secretary, Department of Finance, transcript, INQ00127-013.

61 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-004/005.

62 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-013.

63 Niamh Hardiman, Professor UCD, transcript, CTX00053-009.

Charlie McCreevy outlined how Budget Day announcements included measures that were introduced by the Minister for Finance which were not previously known to or discussed with the Cabinet or with the Department of Finance.[64] An example of those types of measures which avoided the scrutiny of the Department of Finance was decentralisation[65].

"When I was Minister, I made the final decisions on certain matters. You'd obviously do the courtesy of speaking with the Tánaiste and the Taoiseach beforehand and then on the morning of the budget you would outline what your full budget was to your Cabinet colleagues."[66]

Charlie McCreevy, Brian Cowen and Bertie Ahern spoke about the impact of an upcoming election year on the Budget. Both Charlie McCreevy and Brian Cowen said that elections were an influencing factor on Government spending. They also accepted that Government decisions were made in pre-election years which led to increased spending.[67] Charlie McCreevy said:

"…the upcoming election has always influenced measures which the Government do at election time. We are politicians, don't forget, and we actually like to be re-elected."[68]

When Bertie Ahern was questioned on the impact of impending elections on budgetary decision making, he said that he didn't think that he had done anything irresponsible and *"…to be honest with you, I hadn't much competition in 2002[election]."*[69] When Charlie McCreevy was asked whether this was *"a responsible way to run the national finances"*, he said that the governments in which he served *"reduced the national debt and still had budget surpluses."*[70] This perspective was not shared by all witnesses.

David Doyle described political pressures for increased spending prior to the 2007 election when the Department was concerned that the construction industry was contracting and arguing for *"a much lighter approach"* but it never envisaged a depression.[71]

Derek Moran noted that the Department's Stability Programme Updates had identified the risks stemming from the economy's over-reliance on the property sector in 2005-2007. He believed that the Department did give appropriate advice on pro-cyclical policy, but accepted the criticism of the Wright Report that advice was given orally to the Minister without a record being kept. He stated that the failure to run tighter budgetary policies had *"profound"* consequences for the public finances; the adoption of such policies in the middle of the last decade would have significantly reduced the need for expenditure cuts and tax increases during the crisis resolution period.[72]

64 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-085.

65 Richard Bruton, former Finance spokesperson for Fine Gael, statement, RBR00001-007; Donal McNally, former Second Secretary General, Department of Finance, transcript, PUB00347-006.

66 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-101.

67 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-027; Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-052/053.

68 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-027.

69 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-023.

70 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-027.

71 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-052.

72 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-007.

Permanent expenditure increases were being based on the *"windfall"* that came each November from transactional taxes. Derek Moran said that the Department was highlighting these risks sufficiently *"at a macro-level"* but not at the *"micro level of tax head."*[73]

John FitzGerald commented on the fiscal policy, deeming it *"most unwise"* and he said that it *"fuelled the problem … if we had a sensible fiscal policy, we would not be where we are now."*[74]

When questioned as to whether the reason for the difference in Budget forecasts from the Department of Finance recommendation to what was agreed by Cabinet in 2007 was because it was an election year, Bertie Ahern said; *"I'm not going to deny it, but I don't think that it was a huge part of the budget."*[75]

Brian Cowen was questioned on the role played by pre-budget submissions, follow-up meetings with industry organisations and the imminent budget in the approach to the 2007 budget. He could not say that it was never a consideration but said *"…By the same token I believe what we did was responsible and was required and warranted."* [76]

There were a number of considerations that should have been considered in setting fiscal policy through the budget process, including ongoing affordability and medium term management of the state debt and spending commitments.

GDP and debt – Ireland from 1980 to 2014 and the legacy left

From the mid-1990s to 2007, Ireland experienced substantial GDP growth.[77] At the same time, Government gross debt[78] was maintained at a low level and reduced to less than 25% of GDP in 2006 and 2007. Ireland's fiscal state appeared robust and healthy.[79]

The financial crisis highlighted the underlying structural deficit in a reversal of fortunes in the period from 2008 to 2012. For example, from 2008 to 2011, GDP fell by over 15%, while Government debt increased to in excess of 120% of GDP in 2012.[80]

73 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ0014-007.

74 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-012.

75 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-055/056.

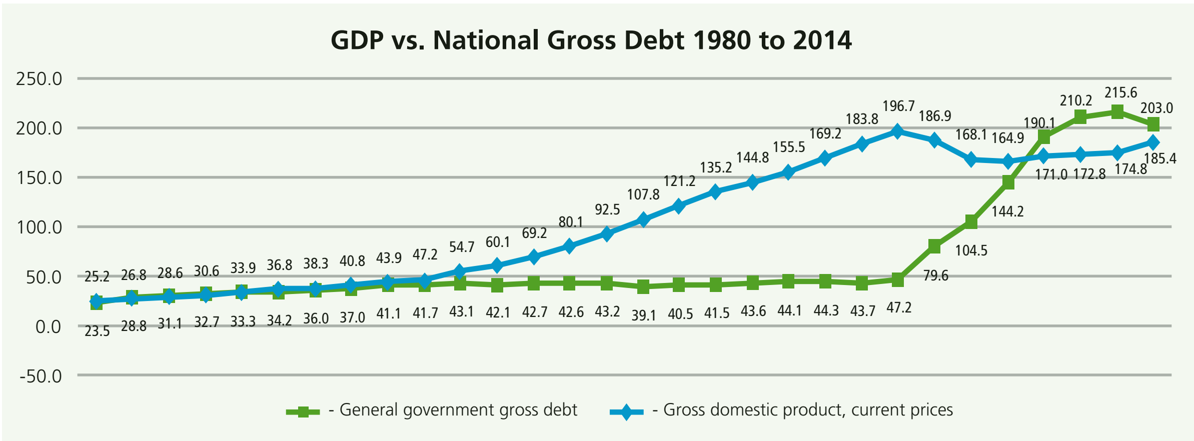
76 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-053.

77 Eurostat - GDP and main components (output, expenditure and income) dataset: [nama_10_gdp], PUB00400-001.

78 General government gross debt according to the convergence criteria set out in the Maastricht Treaty comprises currency, bills and short-term bonds, other short- term loans and other medium- and long- term loans and bonds, defined according to ESA 95. - ESA95: European system of national and regional accounts abbreviated as ESA95 or sometimes 1995 ESA, collects comparable, up-to-date and reliable information on the structure and developments of the economy of the Member States of the European Union and their respective regions.

79 Brian Cowen, former Taoiseach and Minister for Finance, transcript, quoting from a pre-budget letter from the Governor of the Central Bank in 2006 PUB00345-064/065; Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-003.

80 Eurostat, National accounts database, PUB00400-001.



Source: Eurostat[81]

Ireland's headline positive financial status, which had been incrementally secured over the previous 25 years, deteriorated between 2008 and 2012. Significant austerity measures and a determined bank asset sale programme were implemented in order to prevent an even greater deterioration in financial conditions.

Ireland is now a severely indebted State, exhibiting one of the highest Debt/GDP ratios in the EU. A number of factors contributed to the sudden and dramatic downturn in Ireland's financial status, two of which are:

- the development of a large Structural Deficit.
- the cost of rescuing the Irish banks.

Approximately €92 billion of new Government borrowing over the years 2008 to 2014 resulted from tax shortfalls due to the Structural Deficit[81] - considerably more than the amount of approximately € 64 billion[82] borrowed for bank rescue operations.

The General Government Debt as at 30 November 2015 stood at just over €201 billion.[83]

Taxation Policy and its Impact

Choices made by Government in deciding on the taxation policy required for their expenditure plans in both current and future years, and on the impact of those choices. A Structural Deficit gradually developed over the years leading up to the crisis. The steady increase in revenues from Capital Gains Tax (CGT) and Stamp Duty enabled reductions to be made to previously stable tax revenue segments, most notably Income Tax.[84] This meant that some traditionally robust and stable revenue sources were incrementally replaced by more cyclical and volatile tax intakes.[85]

81 Eurostat figures as published 30 July 2015 (code tsdde410) show an increase of General Government Gross Debt by approximately €1561bn, from €47.2bn in 2007 to €203.3bn in 2014. After deducting an amount of approximately €65bln for bank rescue operations, the new Gross Debt excluding costs for the banks amounts to approximately €91bln, PUB00400.

82 Department of Finance, Banking Inquiry team, Information Memorandum for the Joint Banking Inquiry Committee, 13 April 2015 DOF07852-003.

83 http://www.ntma.ie/business-areas/funding-and-debt-management/debt-profile/.

84 Capital Gains Tax increased from €245m in 1998 to over €3.0 bn in 2006 and 2007 while Stamp Duty increased from €622m in 1998 to over €3.5 billion in 2006 OECD statistics – Dataset: Details of Tax Revenue Ireland, PUB00402-001.

85 Klaus Regling, former Director General for Economic and Financial Affairs, European Commission, transcript, CTX00060-004.

Section 2: Tax Base Erosion

Tax Base Erosion

The erosion of the tax base during the period from the mid-1990s to 2008 will be examined in the following contexts:

- Reduction in Income Tax
- Rise in CGT and Stamp Duty
- Developments in other tax revenues, notably VAT and Motor Vehicle Tax

The rationale behind the change in tax policy, introduced by the Government, was outlined by Brian Cowen who said: *"But the reason why, by the way, we had this move to, to capital taxes…because it takes down the burden on direct tax, on working people."*[86]

Reduction in Income Tax

The strong and sustained increases in the overall tax-take over the ten year period from the mid-1990s onwards facilitated Income Tax rate reductions and a considerable widening of personal tax bands.[87]

Between 1997 and 2001, the Government decided to reduce the standard rate of personal Income Tax from 26% to 20%, while the higher rate was reduced from 48% to 42%.

In 1994, the share of Income Tax as a proportion of total tax revenues was 39%. This reduced to below 30% over the period 2002 to 2007.[88]

Against this background, Social Partnership agreements had been trading wage moderation for cuts in Income Tax in order to bring about real net income gains.[89] Sustainable tax revenues rely on consistent non-cyclical revenue streams, of which Income Tax is a critical factor. There is an increased risk on the exchequer purse when total revenue raised has a reducing reliance on non-cyclical taxes.

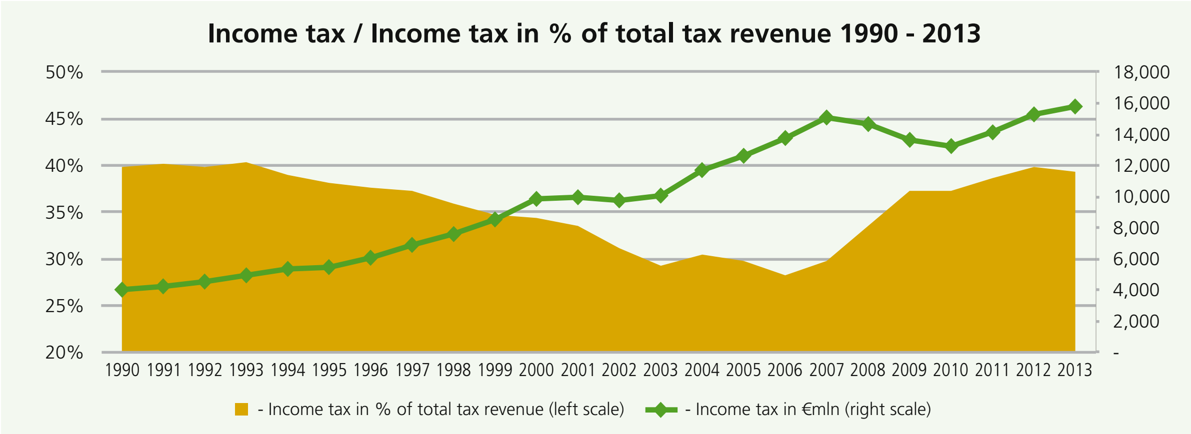
86 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-020.

87 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-046.

88 Cumulative income taxes 1980 to 1994 divided by cumulative total tax revenue over the same period (OECD stats) OECD Statistics – Dataset: Details of Tax Revenue Ireland, PUB00402-001.

89 Terence McDonagh, Professor of Economics, NUIG, transcript, CTX00069-005.

The graph below shows the very strong growth in the nominal value of total Income Tax from the late 1990s onwards almost masked its declining contribution to the total tax take.



Source: Tax base erosion Ireland based on OECD stats[90]

Total Income Tax revenue continued to climb strongly until 2007. This was a consequence of expanding employment and rising incomes.

The large cuts in Income Taxes were considered affordable by the Government due to the considerable increases from other sources, notably Stamp Duty, CGT and VAT, all of which are heavily transactional in nature.[91] Charlie McCreevy was questioned about narrowing the tax base. He did not accept that reducing capital gains, transaction and income taxes was narrowing the tax base; he believed that he had *"reduced an unfair burden."* [92]

Brian Cowen said: *"…that ten of the eleven budgets were in surplus, even though I had minor deficits budgeted for…"*. He went on to state that the IMF had confirmed that Ireland had a structural surplus in both 2005 and 2006. [93]

When questioned about the sustainability of relying on property related taxes, Brian Cowen said:

"if you had reduced housing output, you were going to have reduced taxes coming from that source and you would have to either find cuts in other areas of activity or provide for greater spend."[94]

Rise in Capital Gains Tax (CGT) and Stamp Duty

In 1998, the rate for CGT, including that in respect of gains made from the sale of development land, was cut from 40% to 20%. This increased to 60% in respect of development land if it was not developed within five years.[95] The measure was designed to stimulate activity by increasing housing output which, in turn, it was anticipated would lead to price moderation in the short to medium-term.

90 Tax base erosion Ireland based on OECD stats.pdf, PUB00402-001 Source: https://stats.oecd.org/Index.aspx?DataSetCode=REV.

91 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-056; Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-020.

92 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-046.

93 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-023.

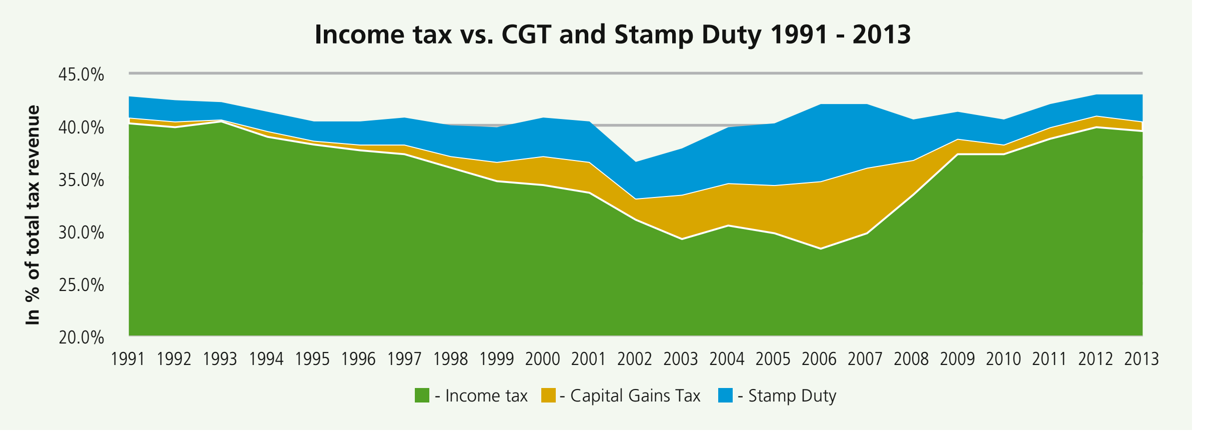
94 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-020.

95 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-013.

While the reduction in CGT appeared to stimulate construction output, the increased supply did not lead to the expected slowdown in house price growth[96] as house price inflation accelerated from 2002. The amount of CGT received by the Exchequer increased strongly with more new developments coming onto the market and sales volumes increasing.[97] From an average of less than 0.5% of total revenues between 1991 and 1995, CGT income gradually increased as a proportion of total revenue to over 2% in 2002, peaking at almost 7%, or approximately €3.1bn in 2006.[98]

Between 1991 and 1995, Stamp Duty contributed 2% to the total annual tax take. With the increasing number and value of property transactions and, notwithstanding some reductions in the rates, the contribution of Stamp Duty taxes to total tax revenue rose to over 3% in 1998, and reached 7.4% or €3.6bn in 2006.

The graph below illustrates how increasing revenues from Stamp Duty and CGT enabled reliance on personal Income Tax to diminish proportionately from 1997 to 2007.



Source: Tax bae erosion Ireland based on OECD stats[99]

Developments in other tax revenues, notably VAT and Motor Vehicle Tax:

Higher consumer spending was an indirect effect of rising house prices, as equity release loans on properties and a *'feel-good-factor'* or "wealth effect" generated demand for consumables such as household goods and new cars. As a result of this uplift in personal spending, income from VAT increased by over 45% to more than €14.3 billion between 2003 and 2007.

Between 2007 and 2009, total tax revenue fell by 28%, reflecting the sharp economic downturn. This downturn was most noticeable in the contribution of cyclical taxes to total revenue, which reduced from a peak of almost 30% in 2006 to 16% in 2009; a level it remained at for the following 4 years.[100]

96 Tom Parlon, Director General of the Construction Industry Federation, submission, "Housing demand far exceeds supply", TPA00013-018; Charlie McCreevy, former Minister for Finance, transcript, PUB00346-012.

97 Graph: Sectoral (property and other) lending volumes, 1999 to October 2013/Graph: House completions and construction employment, 1995 to 2013, DOF07710-004.006. FTI Data Repository, INQ00050-012.

98 Tax base erosion Ireland based on OECD stats.pdf, PUB00402-001, Source: https://stats.oecd.org/Index.aspx?DataSetCode=REV.

99 Tax base erosion Ireland based on OECD stats.pdf, PUB00402-001, Source: https://stats.oecd.org/Index.aspx?DataSetCode=REV.

100 "Cyclical taxes as a percentage of revenue (1992-2013)"; "Nominal total tax revenue (1992-2013)", INQ00050-012.

Section 3: Role of Property Tax Incentives and Pro-Cyclical Policy

Property tax incentives have always played a part in Government strategy to stimulate development, either in designated geographic areas or specific sectors of the economy.

Mortgage interest relief and low stamp duty rates for private borrowers supported not only residential house building for owner-occupiers, but also for investment purposes in times when demand for houses exceeded all long term estimates of requirement.

During the 1990s until their eventual phasing out from 2006, tax incentives served both to stimulate investment and to reduce the tax base.[101]

Tax Incentive Schemes

'Section 23' type property tax incentives were introduced in 1986 and continued for many years, through both area-based tax schemes and property-related incentives. This section describes these schemes in more detail.

Urban Renewal Scheme

This particularly significant area-based tax incentive scheme was introduced in 1986 and was targeted at areas of dereliction in 5 cities, following population declines in preceding decades. In the late 1980s, the construction industry was in difficulty and this scheme helped to both modernise derelict areas and support the construction industry. Over its duration the Urban Renewal Scheme was extended twice, to 49 areas in over 40 towns, and it was in place until 2006.[102]

Rural Renewal Scheme

This area-based scheme was introduced in 1998 to help develop the upper Shannon region, including counties Cavan, Leitrim, Roscommon, Longford and Sligo. While this Scheme also had strong uptake and provided for employment and new housing in relatively underdeveloped areas, it had little demographic impact. New houses were mostly occupied by existing residents of the area or left vacant. The scheme covered vast areas without the requirement for feasibility studies into the need for specific new developments. The result was that projects were often carried out for short-term employment and tax purposes, rather than to meet a real demand for infrastructural projects.[103]

Town Renewal Scheme

First proposed in 2000 and introduced in April 2001, the uptake of tax incentives under this scheme was relatively low compared to the Urban and Rural Renewal Schemes.[104]

---

101 Regling and Watson "A Preliminary Report on The Sources of Ireland's Banking Crisis", PUB00168-026/027; Charlie McCreevy, former Minister for Finance, transcript, PUB00346-057 to 059.

102 Goodbody Review of Area-Based Tax Incentive Renewal Schemes, PUB00301-101.

103 Goodbody Review of Area-Based Tax Incentive Renewal Schemes, PUB00301-068.

104 Goodbody Review of Area-Based Tax Incentive Renewal Schemes, PUB00301-126.

Living over the Shop Schemes

First introduced in 2001 and extended from the original closing date of 31 December 2004 to a new end date of 31 July 2006, these schemes were aimed at tackling the problem of vacant upper storey space in certain targeted streets in Dublin, Cork, Galway, Limerick and Waterford.[105]

Property-based tax incentive schemes

Tax reliefs and capital allowances were also granted for a number of other types of property transactions considered important to economic development.[106]

The Extension of Tax Schemes during the Property Boom

Extension of schemes, 1998 – 2004

A report entitled *"An Economic Assessment of Recent House Price Developments"* was presented to the Minister for Housing and Urban Renewal in April 1998. This report proposed specific policy initiatives including the repeal of section 23 relief for investment in residential property.[107]

Peter Bacon, who gave evidence during the Context Phase of the Inquiry, referred to the acceleration in house prices from 1993 and the annual rate of increase which reached 25% in 1997.[108]

The Government commissioned three reports between 1998 and 2000 from Peter Bacon, commonly known as the *'Bacon Reports'*. The reports recommended the adoption of a series of measures aimed at curtailing the role of investors in the property market as well as encouraging supply and enhancing affordability for first-time buyers and owner-occupiers.[109] The sustained growth in property was attributed in the reports to real growth in disposable income per capita, falling interest rates and an increasing net inward flow of migrants. The main Bacon Report recommendations were subsequently implemented by the Government with the aim of curtailing investors and encouraging supply.[110]

In addition to these measures some section 23 tax reliefs were restricted.

When the Bacon Report recommendations were implemented, house price inflation started to come under control in 2001.[111] The majority of property tax incentives had originally been scheduled to be abolished in 2002. However, after representations from interested parties, some of the measures that had been put in place to abolish these tax incentives were reversed in 2001, after Charlie McCreevy announced that CGT would remain at 20% and stamp duty for investors would be reduced. Charlie McCreevy clarified:

105 Goodbody Review of Area-Based Tax Incentive Renewal Schemes, PUB00301-127.

106 Indecon review of property based Tax Schemes 2006, incentive schemes 2006, PUB00302.

107 Peter Bacon, Economist, transcript, PUB00334-029.

108 Peter Bacon, Economist, transcript, PUB00334-003.

109 Briefing Paper No 9, The Bacon Reports and Tax Treatment of Property, 24th February 2015, CTX00002-001; Goodbody Review of Area-Based Tax Incentive Renewal Schemes, PUB00301; Indecon Review of Property-based Tax Incentive Schemes, PUB00302.

110 Briefing Paper No 9, The Bacon Reports and Tax Treatment of Property, 24th February 2015, CTX00002-003 to 007.

111 Peter Bacon, Economist, transcript, PUB00334-003/004/008; Briefing Paper No 9, The Bacon Reports and Tax Treatment of Property, 24th February 2015, CTX00002-008.

"Finance Bills, as is common with other legislation, are the subject of a Memorandum for government and said Memorandum would rehearse the reasons and rationales for particular sections. Decisions are then taken collectively by the Cabinet. … In my Budget speech for Budget 2002. … I signalled the proposed change for the Finance Bill 2002;

I am also aware of the difficulties being encountered in completing projects under various tax relief schemes for property investment. Therefore, I am extending the deadlines for eligible programmes under the Urban and Rural Renewal Schemes, the capital reliefs for student housing and the park and ride and multi-story car park schemes, these deadlines are being extended by two years or so, that is, to end 2004 in most cases."[112]

When questioned as to why Charlie McCreevy rejected the Department of Finance's advice to end property tax reliefs, Donal McNally said: *"Well, I think the Minister was persuaded by representations that some of these schemes should continue, that they were a work in progress."* When asked from whom these representations came from he replied: *"Well, in general, they would be from people who are making use of the reliefs."* [113]

In December 2001, Charlie McCreevy also restored interest relief as a deductible tax expense.

Peter Bacon said that section 23 tax reliefs were not necessary because there was no need to incentivise activity in a market where demand was so buoyant and he said that he advised Charlie McCreevy of this view.[114] Charlie McCreevy said that the Government's view was that the continuation of these tax incentives was necessary to *"maintain"* the construction industry. Indeed, Charlie McCreevy suggested *"that the effect of what we (had) done in Bacon No. 1, in particular, was in danger of killing off the whole construction activity."*[115]

Instead of cutting tax incentives in the 2002 Budget, most of the tax reliefs were extended until the end of 2004. This was reconfirmed in Budget 2003, with the clear statement that no further time extensions would be given in respect of the tax schemes.[116] Despite this, in the Budget for 2004, Charlie McCreevy announced a further extension of all area-based tax incentives to the end of 2006, effectively leaving future decisions on such matters for the next Minister for Finance, Brian Cowen, who took that office in September 2004.

At the time, some commentators, such as Professor John FitzGerald, recommended a much earlier end to the Government's property related tax incentives:

"In addition to operating a much tighter fiscal policy in the 2001-07 period, I recommended using specific fiscal instruments to take the heat out of the building and construction sector. We recommended getting rid of all building incentives and, possibly, taxing mortgage interest payments."[117]

---

112 Charlie McCreevy, former Minister for Finance, clarification statement, CCR00002-003.

113 Donal McNally, former Second Secretary General, Department of Finance, transcript, PUB00347-021.

114 Peter Bacon, Economist, transcript, PUB00334-029.

115 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-014.

116 See 'Taxation measures' under 'Certain Tax Capital Allowances and Tax Incentive Schemes'; Budget 2003, http://budget.gov.ie/Budgets/2003/Summary.aspx Budget 2003 Extracts of taxation measures, PUB00393-001/002.

117 John FitzGerald, Research Affiliate, former Research Professor, ESRI, transcript, PUB00287-005.

It was argued by Charlie McCreevy, Brian Cowen and Bertie Ahern, that builders and investors had committed themselves to various schemes and needed reasonable transitional arrangements to unwind and/or complete projects.[118] We also heard that heavy lobbying was a factor in the extension of the incentives in the Budget of 2004.[119]

Alan Dukes, Director and Chairman of the Irish Bank Resolution Corporation said in relation to the construction sector:

"for many, many years the construction sector in Ireland has persuaded all political parties… on the basic proposition that they make that construction is good for the economy. I've always thought that that is the wrong causation. A strong economy is good for construction and I think that an over-reliance on construction as a motor of growth has turned out, in our case and indeed in other economies, to be a very bad idea."[120]

Donal McNally talked briefly about the use of tax incentives in construction for high net-worth individuals. He told us:

"…in 1996 and 1997… We did persuade [Revenue] to do a survey of the top 400 earners, trying to find out which reliefs were being used or not. And, you know, the conclusion was that these were favouring those with the money to invest and with the taxable income to offset it against and as a result … and those reviews are published each year, but there was a change made in 1998 Finance Act which limited the amount that could be set off by passive investors against other income. So, you know, it was known that these reliefs benefited high earners, yes."[121]

We asked Charlie McCreevy about the benefits of these tax incentives for high net-worth individuals. The following statement was put to him by the Joint Committee:

"of the 400 top earners in Ireland during 2002 and 2001 [which showed] the way that they were able to reduce their effective tax rate was through these schemes…For example, there were six individuals of the top 400 earners that paid no tax in 2002, which was an increase from 2001. There was 37 of the 400 that paid between 0% and 5% effective tax rate. That was an increase from 25 the year before."[122]

We said that these *"individuals were able to reduce their tax rate, in some cases, to a level of zero"* as a result of these property schemes and invited Charlie McCreevy to comment.

Charlie McCreevy responded:

"Successive Finance Ministers, pre my period and during my period, have introduced changes into the taxation code to ensure that everyone is trying to … that everyone is paying an adequate level of tax."[123]

---

118 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-005/006/017; Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-055; Charlie McCreevy, former Minister for Finance, transcript, PUB00346-014/015.

119 Donal McNally, former Second Secretary General, Department of Finance, transcript, PUB000347-021; Liam Kelleher, Director General Construction Industry Federation, transcript, INQ00064-025.

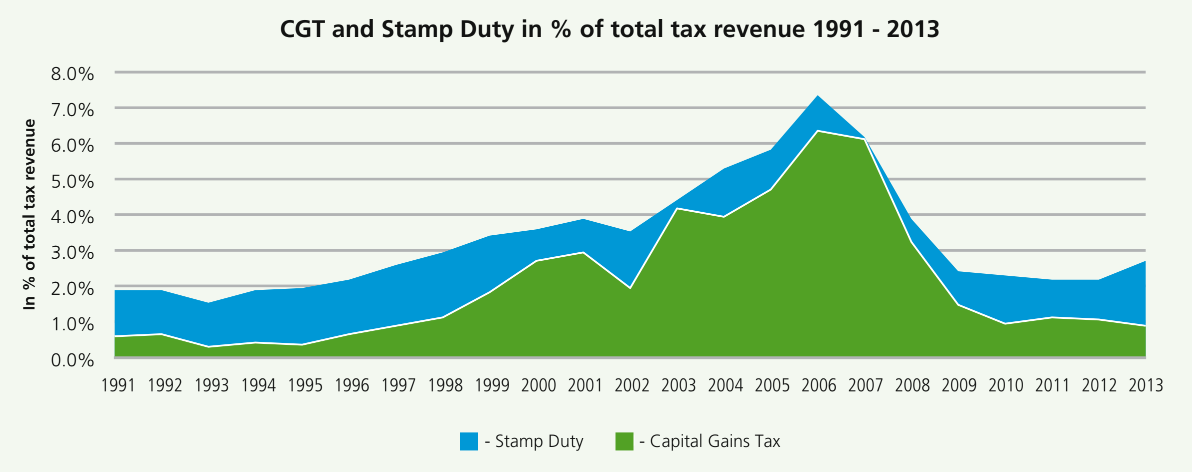
120 Alan Dukes, Director and Chairman of the Irish Bank Resolution Corporation, transcript, INQ00141-038.

121 Donal McNally, former Second Secretary General, Department of Finance, transcript PUB00347-022.

122 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-082.

123 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-082.

Another possible reason for the extension of tax incentives, or at least for the reluctance to cut off tax incentives immediately, was that revenue from CGT and Stamp Duty had risen strongly since 1998 as evident from the graph below. This was partly due to the fact that tax incentives led to the continuation of the strong activities in the property and real estate sector. An end to tax incentives would have resulted in a reduction in tax revenues from these two sources.[124] The resultant impact on the SGP and other benchmarks could have been significant.



Source of Statistics: OECD[125]

Extension of schemes, 2005-2008

On appointment as Minister for Finance, Brian Cowen commissioned a comprehensive review of property tax incentives in late 2004.[126] Arising from these reviews, two reports were completed in 2005 and they recommended the complete or partial elimination of the majority of tax schemes. The reports found that most tax schemes were too expensive for the Exchequer, relative to the benefits they produced. In some cases, even the benefits were doubtful. It was also found that, up to the end of 2006, the estimated cost of area-based schemes to the Exchequer was €1.93 billion. The overall cost for property-based incentives for the period 2005 to 2008 was in the region of €453 million.[127]

These reports also indicated that property incentives contributed to property price inflation, largely benefitting a small number of landowners and developers. Average house prices grew at a proportionately greater rate than the average industrial wage in six out of eight years from 1998-2006.[128] The Goodbody Report suggested that the schemes had a strong negative effect on income distribution.[129]

124 OECD Statistics – Dataset: Details of Tax Revenue Ireland, PUB00402-001.

125 Graph completed by Banking Inquiry using OECD Statistics – Dataset: Details of Tax Revenue Ireland, PUB00402-001.

126 Goodbody Review of Area-Based Tax Incentive Renewal Schemes, PUB00301; Indecon Review of Property-based Tax Incentive Schemes, PUB00302.

127 Indecon Review of Tax Schemes 2006, PUB00302.

128 CSO Database 'Average Industrial wage compared to house price inflation 1998-2006', PUB00392-001.

129 Goodbody Review of Area-Based Tax Incentive Renewal Schemes, PUB00301.

The Goodbody Report also provided Government with the quantification of the costs of the schemes to the Exchequer and highlighted that some 74% of the potential revenue lost by reason of the tax breaks came from a single incentive, the Urban Renewal Scheme.[130]

In his clarification statement, former Finance Minister and Taoiseach, Brian Cowen said that property-based tax incentive schemes, which were due to be phased out in July 2006 and closed to new projects, were extended to 2008. *"Two independent reviews were carried out in 2005, and published in February 2006 alongside Budget 2006"* he said. *"Goodbody Economic Consultants were retained in April 2005 to undertake a detailed review of the area-based tax incentive schemes: the Urban Renewal Scheme (URS), Rural Renewal Scheme (RRS), Town Renewal Scheme (TRS) and Living-Over-the-Shop Scheme (LOTS)"* while *"Indecon economic consultants were retained in April 2005 to undertake a detailed review of various sectoral property-based tax incentive schemes."* The reports, according to Brian Cowen, found:

"Following analysis of the reviews received from these consultants, it was recommended that the following property-based tax incentive schemes, which were closed to new projects but included applicable construction activity up to July 2006, should be allowed to expire, subject to an extended phasing-out period for existing pipeline projects out to 2008: the Area-based Renewal Schemes (Urban, Town and Rural Renewal); Several of the sectoral incentive schemes, namely reliefs for hotels, holiday cottages, student accommodation, third-level buildings, multi-storey carparks, developments associated with park-and-ride facilities."[131]

Impact of the Tax Schemes during the Property Boom

The extension of tax beyond the mid-1990s however, meant that the Government supported a large number of economically self-sufficient development projects with further monetary incentives.[132] On top of that, many residential developments were subsidised in areas where no real demand for housing existed[133] and for which realistic demand studies had not been carried out prior to their commencement.

The extent to which the oversupply of housing had been supported through tax incentives became clear in 2009, when completion of residential units reduced to 26,420, from over 93,000 in 2006, a fall of 72%.[134] However, in 2008, the Government had only budgeted for a drop in housing completions to 45,000.[135]

In evidence, Bertie Ahern acknowledged that the reliefs in relation to the construction sector had helped create and sustain the property bubble. He said that he came to that view in about 2009.[136]

130 Goodbody Review of Area-Based Tax Incentive Renewal Schemes, PUB00301-147.

131 Brian Cowen, former Taoiseach and Minister for Finance, clarifying statement, BCO00003-007.

132 Peter Bacon, Economist, transcript, PUB00334-029.

133 NIRSA & NIUM report, 'A Haunted Landscape; Housing & Ghost Estates in Post-Celtic Tiger Ireland', PUB00263-026.

134 NIRSA & NUIM report, 'A Haunted Landscape: Housing and Ghost Estates in Post-Celtic Tiger Ireland', PUB00263-018.

135 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-042.

136 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-012.

Impact of the SSIA Scheme on the Economy and Property Market

The tax incentive which was mostly widely taken up was the Special Savings Incentive Account (SSIA) scheme which attracted over 1.1 million savers when it was opened in 2001 and 2002. Overall, an amount of €10 - €12 billion was saved by individuals over a five year period up to 2007.

Charlie McCreevy was very clear that, despite the lack of analysis that was done prior to the launch of the SSIA Scheme, he was content with the results of the scheme. Indeed he said:

"…that was a counter-cyclical policy … it must have taken in the order, over the five years … if it cost €2.5 billion, it must have taken in the order of €10 or €11 billion out of the economy over the five years."[137]

However, a further consequence of the SSIA Scheme was that the money saved flowed back into the economy plus the 25% added on by the Government. SSIA plans expired between May 2006 and April 2007 with no Government plan or policy to deal with changed consumer habits or approach to best channel the maturing funds. The Central Bank's Financial Stability Report of 2006[138] referred to some estimates that approximately 33% of the total saved ended up being spent on cars and holidays together (up to €4 billion) and home improvement (up to €1 billion) in those two years.

Role of ECOFIN

The Economic and Financial Affairs (ECOFIN) Council is responsible for EU policy in three main areas:

1. Economic policy
2. Taxation issues
3. Regulation of financial services

The Government, through the Minister for Finance and senior officials, interacted on a regular basis with its peers in Europe via ECOFIN. It was there the Government's position could be discussed in more detail and commentary could be received from the ECOFIN Council on their view of Government performance and actions.

The ECOFIN Council coordinates Member States' economic policies, furthers the convergence of their economic performance and monitors their budgetary policies.

In What Way Does ECOFIN Impact on Ireland?

One significant impact which the ECOFIN Council had on all Member States, including Ireland, was the requirement to adhere to the terms of the Stability and Growth Pact (SGP) (see Chapter 3).

The European Commission is charged with enforcing the SGP terms and breaches are liable to economic sanction. As part of the SGP enforcement regime, Member States are obliged to present a SGP report in the form of a Stability Programme to the ECOFIN Council.

137 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-044.

138 Financial Stability Report 2006, PUB00032-017.

The Irish Government drew too much comfort from their budgetary strategy being in regular compliance with the terms of the SGP rather than upon analysis of the underlying correlated risks in the economy. However, this sense of security was ultimately misplaced as the existing Structural Deficit was unidentified in the period up to 2008.

Role of Informal ECOFIN

Participants at informal ECOFIN Council meetings include the Finance and Economy Ministers and Governors of the Central Banks of EU member states. These informal meetings usually served as a platform for new initiatives and discussions on topical issues in the field of economics and financial affairs.

Typically, the Minister for Finance receives a briefing on these meetings, which includes speaking notes on different subject matters.

Positivity in Minister for Finance's ECOFIN Speaking Notes

The speaking notes prepared for the Minister for Finance, by the Department of Finance, were constructed to give a positive public message, such as those relating to the September 2003 informal ECOFIN meeting which stated: *"While the banking sector has a high exposure to residential property, a steep decline in the Irish property market is unlikely."*[139]

Yet in the same speaking note, there was awareness of the risk associated with commercial property prices: *"…commercial property prices remain a potential source of vulnerability for the Irish banking system…"*[140]

This pattern of a reassuring tone is repeated in speaking notes in 2004 & 2005.

"Irish banks remain well capitalised with solvency ratios significantly in excess of the regulatory minimum."[141]

"The Irish banking sector is currently in a strong position, with good profitability and reserves well above minimum requirements."[142]

Further assurances were given by Brian Cowen regarding the stability of the financial sector at the 2005 informal ECOFIN meetings. At the meeting in May 2005, his speaking notes included the following statement:

"The national authorities in Ireland - the Department of Finance, the CBFSAI and IFSRA - are currently actively cooperating to put in place appropriate procedures and arrangements to ensure that the Irish authorities can respond speedily and effectively to any emerging or actual financial crisis in Ireland."[143]

---

139 Speaking Note, Informal ECOFIN, 13 September 2003, Department of Finance, DOF06749-004.

140 Speaking Note, Informal ECOFIN, 13 September 2003, Department of Finance, DOF06749-005.

141 Speaking Note, Informal ECOFIN, 11 September 2004, Department of Finance, DOF06501-004.

142 Speaking Note, Informal ECOFIN, 10 September 2005, Department of Finance, DOF06199-001.

143 Speaking Notes, Informal ECOFIN, 13-14 May 2005, prepared by the Department of Finance, DOF06492-010.

The Minister's briefing for the September 2005 meeting provided the following further reassurance: *"The available information suggests that the banking system remains in robust health."*[144]

Despite the continued emphasis on the need for appropriate monitoring of risk in the financial sector, Ireland continued to display confidence in its regulatory regime. For example, Brian Cowen's speaking note at the May 2005 informal ECOFIN Council meeting said: *"In short, we supervise banking and other financial activities to the highest European and International standards."*[145]

However, this sentiment changed when, at the April 2006 informal ECOFIN Council meeting, the Minister's speaking note noted that rising house prices had been highlighted as a potential source of instability, due to the possible over-exposure of the banks in this sector.[146]

The European Finance Committee, in its November 2007 report to the ECOFIN Council, stressed the need for prudence in the valuation and accounting treatment of assets *"…particularly of those assets where markets are potentially illiquid in time of stress…"*[147]

Section 4: Oversight by Government and the Oireachtas

Having examined how the macro-economic policies and decisions of Government helped create the conditions for both the boom and the crash, it is necessary to explore the effectiveness of oversight by the Oireachtas, its constituent parts, and its ability to influence unfolding events.

Given the change in circumstances that the State and its citizens have experienced, it is appropriate to look at the Oireachtas of the day and its role in this crisis and how decisions were made.

Background

The Oireachtas comprises two houses, the Dáil and the Seanad, which currently have 166 and 60 members respectively. The principal role of the Oireachtas is to enact legislation. The Dáil is responsible for nominating the Taoiseach, the head of the Government, by a simple majority. The Taoiseach (through the President) appoints the various Ministers who have control over their respective Departments. The Taoiseach and Ministers make up the Government. The Taoiseach generally requires the support of a majority of the members of the Dáil to govern. If it loses this support the Ministers are obliged to resign from office unless the Dáil is dissolved. Members of the Dáil who are not members of the parties which make up the Government constitute the Opposition. Under the Irish Constitution (Bunreacht na hÉireann), the Government is responsible to Dáil Éireann.

144 Speaking Notes, Informal ECOFIN, 9-10 September 2005, prepared by the Department of Finance, DOF06199-005.

145 Speaking Notes, Informal ECOFIN, 13-14 May 2005, DOF06492-004.

146 Speaking Notes, Informal ECOFIN, 7-8 April 2006, DOF06517-001.

147 Economic & Financial Committee, "Financial Market Situation", DOF01640-003.

Role and Effectiveness of the Oireachtas

The Committee heard evidence from Professor David Farrell, UCD, in relation to public policy in parliamentary democracies. He outlined 3 factors for an effective parliamentary democracy:[148]

1. Parliament should be organisationally and structurally suited to fulfilling its scrutiny role over Government.
2. A culture of effective parliamentary scrutiny.
3. A culture of open and transparent government.

His view was that the Oireachtas had

"…performed poorly … It lacked sufficient organisational and structural fire power to provide effective scrutiny. It lacked the political will to use what powers it did have, indicating what I call cultural shortcomings, and it was hindered by a governmental system that places great emphasis on secrecy, particularly in its dealings regarding budgetary matters. There is little evidence to this day that those matters have been resolved."[149]

The weaknesses in the Irish system have been noted at various times in the past, with different reports having called for changes to improve parliamentary scrutiny and increases in parliamentary support for members to assist them in their tasks. In his witness statement to the Inquiry, Pat Rabbitte, former Minister, drew attention to these limitations and also recommendations made in previous Parliamentary reports to address them, including the DIRT report, 19 July 1999, and a report prepared for the Public Accounts Committee in 2005.[150]

The key political leaders during the relevant period responded in different ways when questioned on their own degree of responsibility.

Brian Cowen accepted the responsibility that goes with his role as a decision maker but did not accept that that there was *"a mismanagement of the economy by us."*[151]

Bertie Ahern accepted that *"…the amount of taxation that was directly related to…property was too high."*[152] He accepted responsibility for the structure of regulation brought in by the Central Bank Act of 2003, but stated *"I take no responsibility… for what was happening in the Central Bank or in the Financial Regulator because I had no knowledge or control over it."*[153]

Charlie McCreevy, when asked whether he *"should take any share of the responsibility for the crisis that emerged"* four years after he left office, responded:

"… you would only apologise for things that you think you got very much wrong or you made a mistake, or a big mistake or a series of large mistakes. I don't believe that I did." [154]

148 David Farrell, Professor of Politics UCD, transcript, CTX00051-003.
149 David Farrell, Professor of Politics UCD, transcript, CTX00051-004/005.
150 Pat Rabbitte, TD, former Leader of the Labour Party, statement, PRA00001-006/010.
151 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-092.
152 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-026.
153 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-026/068/069.
154 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-068.

Communication between the CBFSAI and Government

A common theme amongst witnesses was that it was the responsibility of the Central Bank and Financial Regulator to monitor what was going on in the banks and senior Government figures would be unware of the financial condition the banking sector was in. Brian Cowen said:

"It is, however, important to note that no one in the independent authorities ever advised the Government that the capital adequacy was not sufficient or that higher capital adequacy ratios should be imposed."[155]

The regulatory system was significantly changed with the passage of the CBFSAI Bill in 2003. In anticipation of these changes, Brian Patterson was appointed Chairman of the Financial Regulator (initially in an interim capacity, from April 2002) by Charlie McCreevy. Brian Patterson stated in his evidence: *"the only person who could have set objectives and goals for me probably would have been the Minister and he didn't do that."*[156]

Charlie McCreevy was asked to respond to this statement. He stated: *"I went in September 2004. I wouldn't have had time to monitor what was being set there for the regulator because it was too early in the process."*[157]

Patrick Neary was questioned on whether there was any review of the new structure following its introduction to assess its effectiveness. He accepted that no review was carried out domestically (by the CBFSAI, the Government or the Department of Finance), but said:

"The Authority's approach, in the same way as that of other country's banking supervisors, was subject to ongoing best practice review and external assessment by international bodies such as the IMF and OECD. These agencies benchmarked, in detail, the Authority against a framework of principles entitled "Basel Core Principles for Effective Banking Supervision."[158]

The Financial Stability Reports and annual pre-budget letter from the Governor formed the basis for the Governor's discussion with the Minister(s) for Finance.[159] (See Chapter 3). Previously this information had been incorporated in the Annual Reports.[160] Brian Patterson, the Chairman of IFSRA from 2003 to 2008, described the reports as the main mechanism for the Central Bank and IFSRA to communicate the macroeconomic situation to the Government.[161] John Hurley was asked whether there were other mechanisms apart from the Financial Stability Reports and the Pre-Budget letters to ensure the Central Bank kept the Government informed about the current macroeconomic situation and the effects of macroeconomic developments on the financial stability of the banking sector. In response, he outlined the following actions: *" ... the risk assessment of the Central Bank on financial stability matters was communicated primarily by means of the Financial Stability reports published by the Central Bank, the introductory statements of the Governor at their launch and the press conferences themselves … They were addressed in the regular meetings*

155 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-008.

156 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-036.

157 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-069.

158 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-003.

159 John Hurley, former Governor, Central Bank, transcript, INQ00047-005.

160 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-027; Charlie McCreevy, former Minister for Finance, transcript, PUB00346-045; John Hurley, former Governor, Central Bank, transcript, INQ00047-050.

161 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-046/047.

between the Minister and Governor and in the pre-budget letters sent to the Minister for Finance. They were also communicated in meetings between the Taoiseach and Governor … In addition the Bank's views were communicated by means of its Quarterly bulletins and its Annual Reports which were submitted to the Government. These reports also received wide media coverage …"[162]

Describing contacts between the Minister for Finance and the Central Bank, Charlie McCreevy stated: *"I met formally with the Governor every two months approximately. Also, I met him on other occasions throughout the year."*[163] John Hurley confirmed that *"The financial stability reports were discussed by me with the Minister on many occasions."*[164]

Brian Cowen gave evidence of meeting with the Governor when the Financial Stability Reports and Pre-Budget letters were produced. He also referred to his meetings with the Financial Regulator as follows:

"I would have expected that any concerns would initially be escalated through the existing channels of the Central Bank and Financial Regulator through the Secretary General of the Department. Any briefings I received from the Governor of the Central Bank and through the financial stability reports were overall conclusively positive."[165]

Brian Cowen gave evidence that he met the Chairman of the Financial Regulator approximately twice a year. He stated:

"…if there was any issue at any time that the chairman of the Financial Services Authority wanted to bring to my attention, there was no problem bringing it to my attention."[166]

Brian Patterson, Chairman of the Financial Regulator from 2003 to 2008, stated that his meetings with the Minister for Finance were:

"…less to kind of report to the Minister, in some sort of supervisory capacity; it was more to keep the Minister informed with, for example, EU developments, directives and so on."[167]

Bertie Ahern stated, when questioned on whether he discussed the content of the Financial Stability Reports with the Minister for Finance: *"I met the Minister for Finance several times a week, so he would always be updating you and briefing you on issues that happened and meetings that happened."* [168]

The evidence would indicate that the Central Bank was providing the Government with information on the macroeconomic situation and financial stability on a frequent basis, through the medium of the Financial Stability Reports, the Quarterly Bulletins and the pre-budget letters. The Minister for Finance also met regularly throughout the year with the Governor of the Central Bank and on a more limited basis, with the Chairman of the Financial Regulator. There were clear channels of communication for the Minister and the Central Bank to discuss issues relating to financial stability

162 John Hurley, former Governor, Central Bank, statement, JHU0003-009.
163 Charlie McCreevy, former Minister for Finance, statement, CCR00001-003.
164 John Hurley, former Governor, Central Bank, transcript, INQ00047-016.
165 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-010.
166 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-026.
167 Brian Patterson, former Chairman, IFSRA, transcript, INQ00063-019.
168 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-065.

and macro-economic problems.[169] When asked whether he challenged the assertion that the risks highlighted in Financial Stability Reports could be managed strongly enough, Brian Cowen did accept that *"Clearly, it wasn't questioned sufficiently and I accepted the consensus view."*[170]

Role and Effectiveness of the Opposition

The Opposition, as well as being able to promote their own agenda, had a valuable role to play in a parliamentary democracy by scrutinising the work of the Government and holding it to account.

As well as contributing to debates, issues may be raised through Parliamentary Questions which must be addressed by the Taoiseach or relevant Minister. Several hundred such questions are typically tabled in a parliamentary session.

Enda Kenny, Taoiseach, and former Leader of the Opposition, was asked to explain why, during the 43 Fine Gael different private member *"slots"* in the Dáil between 2005 and 2007, he or his party did not choose to use those slots to address the system of regulating banks, lending related to property or excessive public spending. In response, he stated these questions were not the only opportunity to raise important issues:

"So…the Private Members' business is an opportunity for parties and, obviously, backbench Deputies and Front Bench Deputies want to raise issues that might be of more local than national importance."[171]

Brian Cowen summed up his view on the effectiveness of the Oireachtas in his opening statement. He said:

"…throughout my period as Minister for Finance the critique from the political Opposition was that we were not addressing economic issues quickly enough. There were constant demands for more spending. The capital adequacy, or otherwise, of banks, was not, to my knowledge, ever raised as a priority issue."[172]

Brian Cowen was asked to comment on why there was so little scrutiny in the Oireachtas, and he responded:

"I think that just there was a belief in good times that banks seemed to be a good business to be in and they seemed to be doing well and there was no indication that they were in trouble. And, as I say, this silently … this misjudgement of risk is what's behind all of these miscalculations from a whole slew of actors."[173]

On macroeconomic and fiscal policies, the most robust and sustained engagement between Opposition and Government took place around the introduction of Budgets, but this tended to focus more on spending and taxation choices rather than macroeconomic policy. Bertie Ahern was asked whether he was aware of concerns raised with the Minister for Finance by the Opposition TDs in the Dáil in 2007 and whether he paid attention to them. Bertie Ahern said:

---

169 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-010.
170 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-051.
171 Enda Kenny, Taoiseach and Leader of the Fine Gael Party, transcript, INQ00124-034.
172 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-009.
173 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-125/126.

"I've read the questions…but I'd have to say…do I think 2008 was too high in public spending, the answer is yes. Did I listen to the Opposition in the House, I would have spent three times more if I'd listened to them."[174]

A number of major fiscal issues were introduced by the Government during the pre-crisis years, which had major long-term budgetary impacts, but were not open to rigorous scrutiny by the Oireachtas. Amongst the most notable of these were the public sector benchmarking exercises of 2002 and 2007.

Then Finance Spokesperson for Fine Gael, Richard Bruton noted: *"Government did not even see the need to bring Social Partnership agreements to the Dáil for democratic approval."*[175]

Enda Kenny said:

"…the lack of opportunity for the Oireachtas to properly scrutinise and assess the tax and spending options available to the Government were a very sore point with us"; "…Our opposition to the Governments public sector benchmarking pay deal reflecting the lack of transparent…"[176]

Former Chair of the Public Accounts Committee, Bernard Allen stated that *"all negotiations with the social partners were conducted in secret and there was no role for the Oireachtas."*[177] He also noted that the Public Accounts Committee was prohibited from carrying out analysis of budgetary policy under Standing Order 163(7).

Former Tánaiste, Mary Harney noted in her statement to the Joint Committee: *"There were many positive outcomes from Partnership but the model became all-embracing and, to an extent, undermining of the role of the Oireachtas."*[178]

The Joint Committee noted limited engagement with senior management in key state bodies such as the Department of Finance, the Financial Regulator and the Central Bank. Enda Kenny confirmed to the Joint Committee that he had never had meetings with staff or officials from the Central Bank or the Financial Regulator in the period 2002-2007 though he never sought such meetings.[179]

Witnesses before the Joint Committee gave evidence as to how effectively they thought the Oireachtas discharged its duties. Mary Harney noted in her statement:

"In truth, the quality of Oireachtas oversight of banking and economic policy was very poor prior to the crisis. Oireachtas committees that could have had a role were low profile and in my opinion did little real analysis of economic policy and none at all on banking policy."[180]

Richard Bruton said: *"I think it wasn't well-equipped, neither in having access to the information nor the analytical armoury at its disposal."*[181]

174 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-025.

175 Richard Bruton, Minister for Jobs, Enterprise and Innovation and former Fine Gael Opposition Finance Spokesperson, statement, RBR00001-006.

176 Enda Kenny, Taoiseach and Leader of the Fine Gael Party, transcript, INQ00124-004.

177 Bernard Allen, former Chairman, Public Accounts Committee, statement, BAL00001-009.

178 Mary Harney, former Tánaiste and Leader of the Progressive Democrats, statement, MHA00001-008.

179 Enda Kenny, Taoiseach and Leader of the Fine Gael Party, transcript, INQ00124-027.

180 Mary Harney, former Tánaiste and Leader of the Progressive Democrats, statement, MHA00001-008.

181 Richard Bruton, Minister for Jobs, Enterprise and Innovation and former Fine Gael Opposition Finance Spokesperson, transcript, INQ00124-032.

Role and Effectiveness of Oireachtas Committees

For efficient working of the Oireachtas, tasks are delegated to Committees, who shadow Government Departments and examine legislation and spending. These committees are drawn from members of the Oireachtas, either Select (from one House) or Joint (from both Houses).

Membership of the Committees may be drawn from all members of the Oireachtas except Government Ministers.

The role of Committees within the Oireachtas has been expanded in recent years. An examination of the records of Committee hearings suggests that Joint Oireachtas Committees are structurally more amenable to conducting an inquiry than those restricted to TDs only.

We sought evidence from a number of former Chairs of Oireachtas Committees. They provided varying views and some constructive criticism on the effectiveness of the Committee system and suggested improvements.

Former Chair of the Joint Committee on Finance and the Public Sector, Michael Ahern said, in relation to the lack of experience and expertise on the Committee, *"However, what was an issue and a limitation was the resources the Committee had; how could 11 Deputies and 4 Senators oversee such a huge remit?"*[182]

Bernard Allen said:

"My own experience is that there is very little independent advice available to Oireachtas Members. For the most of my years in the Dáil, there was not the scope to get that independent expert advice."[183]

Former Chair of the Joint Committee on Finance & Public Service, Seán Fleming said:

"Essentially the Oireachtas Committees had little or no access to additional expert advice. They essentially relied on officials from the relevant Government Departments to provide information"[184]

Michael Ahern also spoke of the lack of available expertise and suggested, *"An Office like the Office for Budget Responsibility is necessary."*[185]

Former Leader of the Labour Party and Minister, Pat Rabbitte, spoke of the difficulty in finding specialisation amongst a Parliament of 158 Deputies and added: *"Individual Deputies being members of more than one or of several Committees compounds the problem."*[186]

Other witnesses were less critical. Former of the Chair Joint Committee on Economic Regulatory Affairs, Michael Moynihan in his statement said:

---

182 Michael Ahern, former Chairman, Joint Oireachtas Committee on Finance and the Public Service, statement, MAH00001-007.

183 Bernard Allen, former Chairman Public Accounts Committee, statement, BAL00001-008.

184 Seán Fleming TD, Member Public Accounts Committee and Finance, Public Expenditure & Reform Committee and former Chairman Finance & Public Service Committee, statement, SFL00001-009.

185 Michael Ahern, former Chairman, Oireachtas Joint Committee of Finance and the Public Service, statement, MAH00001-007/009/010.

186 Pat Rabbitte TD, former Leader of the Labour Party, statement, PRA00001-005.

"Our committee was given a specific remit in the context of annual reports and public interest statements. We fulfilled this remit but it is obvious in retrospect that the remit of the Committees should and could have been wider, and then expertise could be requested. I do not recollect being asked to bring in expert advice and I am quite confident if the need was there it would have been supplied."[187]

Bertie Ahern also said:

"I think the committees did their best. And, I think, one of the advantages of the committees is that they can call people in and they can discuss it but, as you recall, Deputy, there were very … there was very little debate on these issues in the Oireachtas." [188]

Former Tánaiste Mary Coughlan stated:

"Both as a back-bench Teachta Dála and as a Minister, it was my experience that committees were appropriately resourced to obtain such expert advice as any such committee deemed necessary to assist it with its enquiries."[189]

In the years preceding the crisis, the capacity of the Oireachtas Committees was restricted by a number of factors:

- The absence of powers to compel witnesses to attend, with the exception of the Public Accounts Committee who had such powers.
- Under the Terms of Reference establishing them, Committees may be required to refrain from enquiring into the merits of a policy or policies of the Government or a member of the Government or the merits of the objectives of such policies. This limitation was applied to a number of Committees up to the 30th Dáil and still applies to the Public Accounts Committee, limiting its effectiveness to address fiscal or budgetary matters.[190]
- Only Government Ministers can move legislation and amendments which involves a change in the public purse.[191]
- Government Ministers and senior officials did not appear before Committees on a regular basis.
- The size of the Committees - some were very large with up to 21 members. Additionally, some members were members of more than one Committee, which restricted their available time.
- The absence of an obligation on members to attend all Committee hearings, which operate on a quorum basis.
- The practice where Ministers appear before a Committee was generally that they were only questioned by Opposition members.[192] Votes were taken and passed on a majority basis, with the Government side ensuring that it had natural majorities on all Committees.

187 Michael Moynihan TD, former Chairman, Joint Committee on Economic Regulatory Affairs, statement, MMY00001-010.

188 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-051.

189 Mary Coughlan, former Tánaiste, statement, MCO00001-010.

190 Bernard Allen, former Chairman, Public Accounts Committee, statement, BAL00001-003.

191 Michael Ahern, former Chairman, Oireachtas Joint Committee of Finance and the Public Service, statement, MAH00001-011.

192 Mary Coughlan, former Tánaiste, statement, MCO00001-011.

- The level of skillsets of Members in the economics and finance areas.

These restrictions still exist. The Committee system has evolved and developed over a number of years to its current construct. This evolution did not include an objective review, and implementation of, recommendations in relation to improving its oversight and effectiveness.

Election Manifestos as a Basis for Policy

Each new Government, when elected, agrees a Programme for Government, which would have been influenced by the Election Manifestos of the participating parties. Pre-2008 party political election manifestos examined by us contained a variety of promises on taxation and spending.[193]

In 2002, the common focus was on increasing expenditure, but not raising taxes. This plan depended on expected economic growth materialising. The vulnerability of this approach of course would be agreeing increased expenditure plans based on anticipated income, which may not materialise.

In its 2002 manifesto, Fine Gael[194] had some limited costings done, which was absent from the manifesto of Fianna Fáil.[195] While there were different approaches in detail and emphasis, the underlying construct for all the 2007 manifestos was premised on cuts in taxation and increases in expenditure.[196]

The Fine Gael Manifesto promised to cut taxes for all taxpayers and increase current exchequer spending by an average of 6% per annum. Fianna Fáil's manifesto also promised 6% spending growth. Its spending plans assumed 7% nominal growth in the economy annually and employment growing by 2.5% per annum. This would deliver average budget surpluses over the following 5 years and a Net Debt/GDP ratio of 3% by 2012. The Labour Party approach was to detail the various additional services that would be funded but provide no costings. Tax cuts were also promised.[197]

When questioned at Committee on why the Fine Gael election manifesto also put forward proposals to reduce taxes in 2007, thus narrowing the tax base, Enda Kenny replied that the commitments on tax and spending were:

"… consistent on the basis of the growth forecasts that were available at the time, both from the ESRI and from the Department of Finance, which were forecasting growth average of about 4%, between the period 2008 to 2012."[198]

Joan Burton, Tánaiste and former Finance spokesperson for Labour, also referred to the ESRI and Department of Finance growth forecasts when questioned on the Labour Party 2007 election manifesto promises for taxation and spending.[199]

---

193 Fianna Fáil, Fine Gael, Labour Party and Progressive Democrats.

194 Fine Gael Manifesto 2002, PUB00309-004 to 020.

195 Fianna Fáil Manifesto 2002, PUB00149-027 to 029.

196 Fine Gael Manifesto 2007, PUB00310-004/005, 095 to 097; Labour Party Manifesto 2007, PUB00321-008 to 011; Fianna Fáil Manifesto 2007, PUB00150-149 to 152; Progressive Democrats Manifesto 2007, PUB00155-007 to 009.

197 Fine Gael Manifesto 2007, PUB00310-004/005, 095 to 097; Labour Party Manifesto 2007, PUB00321-008 to 011; Fianna Fáil Manifesto 2007, PUB00150-149 to 152.

198 Enda Kenny, Taoiseach and Leader of the Fine Gael Party, transcript, INQ00124-010.

199 Joan Burton, Tánaiste and former Labour Party Spokesperson for Finance, transcript, INQ00125-008.

Klaus Regling, former Director-General for Economic and Financial Affairs of the European Commission, summed up the position in his evidence when he noted several interacting factors:

"…weak financial supervision and bank governance combined with official policies to leave the economy vulnerable to a deep crisis."[200]

He also said:

"Ireland was a country where it seems no one was really in charge to prevent such a bubble from emerging over the previous four to five years that led to 2008."[201]

Findings of the Joint Committee

1. Taxation policy choices made by the Government contributed to the development of a Structural Deficit. The Structural Deficit which had been building in the years leading up to the crisis, had not been fully recognised until the crisis hit. Taxation policy reduced direct taxes (such as, income tax) and prompted the transfer of fiscal revenue sources to pro-cyclical taxes – this led to a vulnerable fiscal balance in the event of an economic downturn.
2. The Government's fiscal policy resulted in significant, long-term expenditure commitments being made on the back of cyclical, transaction-based revenue streams that ultimately proved to be unsustainable.
3. The erosion of the income tax base in the years leading up to the crisis did not give rise to sufficient concern at Government level at the time, primarily for two reasons:
   i) the significant increases in transaction taxes, such as stamp duty and capital gains tax, which compensated for the declining share of income tax as a proportion of total tax revenue.
   ii) the absolute increase in income tax revenue from approximately €4 billion in 1990 to €15 billion in 2007.
4. Fiscal policy after 2001 was not focused on mitigating and managing the property price increases. If steps had been taken, for example through reducing or abolishing property tax incentives, as originally planned from 2002 to 2004, the severe overheating from 2003 to 2007 could have been mitigated, at least to some degree. Tax incentives were introduced and extended without sufficient analysis of the costs, benefits and impacts. They fuelled an already strong construction industry during most years from the mid-1990s up to and including 2006.

200 Klaus Regling, former Director General for Economic and Financial Affairs, European Commission, transcript, CTX00060-003/004.

201 Klaus Regling, former Director General for Economic and Financial Affairs, European Commission, transcript, CTX00060-003.

5. The Budget Strategy Memorandum produced by the Department of Finance each June, and signed off and brought to Cabinet by the Minister for Finance, was exceeded, with the exception of one year, by the actual Budget package introduced by the Minister on Budget day. This Budget Strategy Memorandum did, in varying terms, frequently highlight the risks of pro-cyclical fiscal policy but this was not generally reflected in the Budget package agreed by Government. No evidence was provided that the Department of Finance cautioned on the ultimate fiscal impacts of the property downturn.
6. The oversight, challenge and effective scrutiny by the Oireachtas of the Government and its policy decisions in relation to fiscal policy, financial stability and the system of financial regulation was inadequate in the pre-crisis years.
7. The Constitution allows significant decision-making powers by Cabinet to make far-reaching decisions without any prior engagement with the Oireachtas. Members of the Oireachtas, including the Opposition are constrained, with the added issue of limited resources, in their ability to influence the decision-making process.
8. Government, including individual Ministers, made policy decisions, based on a range of considerations, including having regard to, but not always accepting the advice of the Department of Finance, Central Bank and International organisations, and ultimately accepted overall responsibility for decisions made.
9. All the main political parties, whether in opposition or in government, advocated pro-cyclical fiscal policies, including increasing expenditure and reducing taxation, in the years leading up to the crisis, as evidenced by their election manifestos in the 2002 general election and, especially, the 2007 general election.

Recommendations of the Joint Committee

1. Acceptable bands should be agreed with regard to the proportion of total State taxation revenue accounted for by defined cyclical, transaction-based taxes, including triggers for follow-up action when these limits are breached.
2. Members of Oireachtas committees should receive appropriate training and support in technical content, if they do not already possess the required skill set.
3. The Houses of the Oireachtas Commission should carry out a detailed analysis of the resources allocated to support Oireachtas Committees, and of its potential impact on the capacity of Committees, to carry out effective oversight.
4. The Public Service Oversight and Petitions Committee should review the most recent relevant reviews undertaken of the Irish parliamentary system and identify, along with an implementation plan, the key reforms necessary to improve accountability and oversight.

Chapter 6: Preparation for the Crisis: July 2007 – 29 September 2008

JULY 2007

The Formation of the Domestic Standing Group

The establishment of the Domestic Standing Group (DSG) in July 2007 by a Memorandum of Understanding between the Central Bank, the Financial Regulator and the Department of Finance was an EU requirement. Following a recommendation of the Economic and Financial Committee[1], the EU Financial Services Committee had required that all member states establish an emergency planning and management group in the form of a Domestic Standing Group.[2] Membership of the DSG was also effectively prescribed by the EU. The 2005 EU Memorandum of Understanding brought the principals from the Central Banks, Bank Supervisors and the Ministries for Finance together as a tripartite group to formulate an EU wide policy on crisis management.[3] This was followed by a domestic Memorandum of Understanding in 2007 which formed the Domestic Standing Group (DSG). The signatories to this Memorandum of Understanding were Kevin Cardiff, Second Secretary of the Department of Finance, Liam Barron, Director General (CBFSAI) and Patrick Neary (Financial Regulator).[4]

The primary representatives of each party comprising the DSG were Tom O'Connell (CBFSAI), Con Horan (Financial Regulator), and William Beausang (Department of Finance).[5]

The DSG met on a monthly basis from July 2007 – July 2008 and supplied much of the financial market information from the Central Bank and the Regulator to the Minister and Government during the period covered in this chapter.

AUGUST 2007

NTMA stops Placing Deposits with the Irish Banks

For some time the National Treasury Management Agency (NTMA) had been sceptical of the business models of INBS and Anglo. Michael Somers, who was CEO of the NTMA said: *"I always had a concern about Anglo…"*[6] Somers subsequently added in his clarification statement to the Joint Committee[7] that the Minister for Finance's guidelines prohibited the NTMA from placing

1 The Economic and Financial Committee is a committee of the European Union set up to promote policy coordination among the Member State.

2 EU structures for monitoring financial stability and managing financial crises, DOF06167; Crisis Management Exercise: lessons learned and possible follow-up, DOF06159; Next Steps in developing the EU framework for financial stability and crisis management, DOF06139-004; Next Steps in developing the EU arrangements for financial stability, DOF06204-005.

3 Memorandum of understanding on co-operation between the banking supervisors, central banks and finance ministries of the European Union in financial crisis situation, DOF06149.

4 Memorandum of Understanding the Department of Finance, the Central Bank and Financial Regulator, DOF02469-013.

5 See for instance minutes from October 2007, DOF01948; March 2008, DOF01983; July 2008, DOF02005.

6 Michael Somers, former CEO, NTMA, INQ00093, Para 1556.

7 Michael Somers, former CEO, NTMA, clarification statement, MSO00002-002.

deposits in counterparties with S&P[8] rating of less that A1, which included INBS."[9]

The NTMA's former Director of Finance and Risk, Brendan McDonagh, explained to the Inquiry how the agency was now growing increasingly concerned about the global financial markets:

"By August 2007, the NTMA had made the decision… to stop placing deposits with any bank. The NTMA policy was to move maturing deposits back to the Central Bank of Ireland – we referred to it internally as safe-harbouring deposits."[10]

He also said:

"we had concerns from August 2007 about banks globally, Deputy, because things ... strange things were beginning to happen. There was rumour after rumour in the market even about big banks like Wachovia, Wells Fargo, Washington Mutual, Citibank, BNP Paribas, Goldman Sachs ... Merrill Lynch … so like, it wasn't just confined to Ireland."[11]

John Corrigan, Chief Executive Officer NTMA, put this in the context of the NTMA's role:

"the NTMA's role is ... in that space is to fund the Exchequer and to make sure that the Exchequer has sufficient cash to meet its day-to-day requirements. We had a very conservative approach to risk. I don't think anybody would thank us if the money which had been garnered through borrowing or through tax receipts had been lost through some sort of placement with, with, dodgy counterparts."[12]

When asked by the Joint Committee *"Was it the first time that the NTMA had made that kind of decision in relation to putting deposit in the Irish banks?"*[13], John Corrigan responded: *"To the best of my knowledge, yes."*[14]

Brendan McDonagh stated:

"There could have been no ambiguity at any time during this period on the part of senior Department of Finance officials or the Minister for Finance as to the NTMA's position on global bank risk from August 2007 and our reluctance, given the increasing dislocation of financial markets, to put at risk any State money under our management by placing it on deposit with domestic or international financial institutions unless we were directed to do so by the Minister for Finance."[15]

31 August 2007 - DSG Update

Despite the fact that the NTMA, *"who had a strong market-facing role, had very fundamental concerns about the stability of the financial system"*[16] the Central Bank and Financial Regulator reported to the DSG that the *"domestic economy and banking system remained sound and there is*

8 Standard & Poors, is one of the three recognised major international statistical rating agencies, Moody's and Fitch's being the other two.
9 Michael Somers, former CEO, NTMA, statement, MSO00002-003.
10 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-006.
11 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-032.
12 John Corrigan, former Director of Funding and Debt Management, NTMA, transcript, INQ00106-008.
13 Question by the Joint Committee, INQ00106-008.
14 John Corrigan, former Director of Funding and Debt Management, NTMA transcript, INQ00106-008.
15 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-007.
16 John Corrigan, former Director of Funding and Debt Management, NTMA, transcript, INQ00106-007.

no cause for alarm."[17] They told the group that they were not aware of any liquidity difficulties for Irish banks.[18] *"However if there is a long term credit crunch globally this could impact on economic developments."* [19] For now, *"This is not an Irish problem, but a global one. The Regulator has put a lot of effort into minimising any reputational damage for Ireland, but there are risks there also."*

SEPTEMBER 2007

The September IMF Article IV Staff Report was largely positive about the fundamentals of the Irish economy, though it noted weaknesses both in the construction sector and the exposure to the banks. It said:

"Economic performance remains impressive but noted that in recent years economic growth had become increasingly reliant on house building. It also noted that banks have large exposures to the property market, but stress tests suggest that cushions are adequate to cover a range of shocks."[20]

7 September 2007

The Irish Times carried an article on 7 September 2007 entitled 'Banking on Very Shaky Foundations' written by Professor Morgan Kelly.[21]

12 September 2007 – Northern Rock

Northern Rock, a UK bank, sought and received liquidity support from the Bank of England due to a problem in the credit market. This led to panic among depositors *"in the first run on a British bank in more than a century."*[22] In Ireland *"there were queues on the street outside Northern Rock when it got into difficulty."*[23]

21 September 2007 – DSG Update

Less than a fortnight later, the Central Bank was reporting to the DSG that the Northern Rock crisis was still generating a significant negative effect on the market, but that there were tentative improvements.[24] However, some *"significant Irish financial institutions"* needed to renew substantial funding in early 2008. Access to ECB funding was regarded as a very important safeguard for Irish banks.[25]

---

17 Central Bank/Financial Regulator views on financial market development as conveyed to Department of Finance at meeting of 3lst August (summary report), DOF02018-004.

18 Central Bank/Financial Regulator views on financial market development as conveyed to Department of Finance at meeting of 3lst August (summary report), DOF02018.

19 Central Bank/Financial Regulator views on financial market development as conveyed to Department of Finance at meeting of 3lst August (summary report), DOF02018-004.

20 IMF Country Report No 07/035 September 2007, PUB00122-001.

21 Special Articles on the likely event of falls in Irish house prices by Morgan Kelly, PUB00258-002.

22 Simon Carswell, Irish Times journalist, statement, CTX00042-001.

23 Brian Goggin, former Group Chief Executive, BOI, transcript, INQ00139-009.

24 Central Bank Report on financial market conditions, DOF01859.

25 Central Bank Report on financial market conditions, DOF01859-001.

OCTOBER 2007

On 2 October 2007 a preparatory note for the DSG meeting raised several issues that needed attention.[26] According to the note, the Department was starting to consider what legal powers might be needed by the Minister for Finance to provide assistance to a financial institution in distress. Included in these options was nationalisation.[27] The legal position regarding *"the scope for the NTMA to place a deposit with a bank"* was also highlighted for examination. So too was the Deposit Guarantee Scheme, which protects depositors, following the UK government's decision to provide a temporary 100% guarantee of deposits with Northern Rock.

It is worth pointing out that three months after the DSG was formed and a month after Northern Rock, there was still a sense that the *"roles and responsibilities of the Department, the Central Bank, and the Financial Regulator"* needed clarification. [28]

9 October 2007 - DSG Update

In its October update to the DSG the CBFSAI reported that Irish banks had a *"good name"* although it noted that there was also a perception internationally that Irish banks were exposed to the property sector.[29] They reported a *"…return to more normal financial markets conditions…"*[30] But even with improved liquidity conditions, a tightening of lending behaviour was prevalent and the retail lending rates would remain under upward pressure *"for as long as disturbed credit market conditions persist."*[31] The report also noted that while market funding was available, it was increasingly over a shorter term. Irish bank shares continued to fall, having lost between 30% and 40% of their value since the start of 2007. This update also marked the first time in the period that the issue of Contracts for Difference (CFDs) was brought to the attention of the Department. Significant losses to high *'net worth'* individuals in relation to CFDs were highlighted.[32]

NOVEMBER 2007

13 November 2007

The pressures were building, as evidenced by an email from IL&P to the Regulator on the 13 November confirming the raising of €2 billion from the ECB but noting: *"The level of pressure on Irish Institutions continues at a pace in both the Credit and Equity Markets."* The email also passed on some feedback IL&P had received from their major shareholders: *"…One of our Canadian Holders said that she had been informed out of London that we in IL&P are the next Northern Rock, so once again, we are on red alert."*[33]

---

26 List of Issues/Questions for DSG meeting, 3 October 2007, DOF01948.

27 List of Issues/Questions for DSG meeting, 3 October 2007, DOF01948-005.

28 List of Issues/Questions for DSG meeting, 3 October 2007, DOF01948-002.

29 Update on Financial Issues – Government Meeting 9 October 2007, DOF01950-003/005.

30 Update on Financial Issues – Government Meeting 9 October 2007, DOF01950-002.

31 Update on Financial Issues – Government Meeting 9 October 2007, DOF01950-003.

32 Update on Financial Issues – Government Meeting 9 October 2007, DOF01950-003.

33 e-mail correspondence from IL&P to the Financial Regulator, PTSB01924-001.

DSG Update

An information note, known as an 'Aide Memoire' for Government, was sent to Brian Cowen, former Minister for Finance, on 13 November 2007. The subject of this information note was 'Financial Market Developments'. It summarised the information given by the DSG to the Central Bank and Regulator and it also provided a look ahead to the Central Bank's Financial Stability Report.[34]

The DSG update repeated concerns on the Irish economy and the exposure of banks to the property sector with bank share prices reported as being *"depressed."*[35] It also claimed that despite improvements in credit market conditions, the financial markets remained volatile. However it noted that: *"To date, these developments have not had any serious effects on the Irish domestic financial system…And stressed that the "Irish institutions are financially sound with good quality assets and are well regulated."*[36]

The update also included an overall assessment of the 2007 Financial Stability Report. It said that financial stability risks had increased on previous years, but that the upward momentum of residential property prices had slowed and house prices had lowered by 3.5% on a year to date basis. The assessment concluded that: *"The underlying fundamentals of the residential market continue to appear strong. The central scenario is, therefore, for a soft, rather than a hard, landing."*[37]

16 November 2007 - DSG Update

The Central Bank produced a paper for another DSG meeting in November. In the month that had passed since the last update, Irish bank share prices had continued to fall and had now lost between 30% and 50% of their value. According to the report the quality of assets secured on speculative development land was a particular focus of attention for financial institutions.

The update also provided more detail on negative sentiment on the interbank market toward Irish banks' exposure to the property markets:

"There are some indications that Irish banks are being subject to more refusals in the unsecured interbank market on account of negative international sentiment regarding the Irish banking sector and the Irish property market generally… there is a general discount in the value of Irish banks as there is a perception internationally that they are exposed to the property markets…"[38]

Two items were highlighted in the update. One was that *"If the present market conditions persist, as expected, into 2008 there is an increased risk of liquidity issues arising for Irish banks".* The other was the importance of *"highlighting the inherent strengths of the Irish financial system and economy."*[39]

The Central Bank and Financial Regulator reported to the DSG that they were continuing to monitor the position closely:

---

34 Department of Finance - Aide Memoire for the Government on Financial Market Developments, 13 November 2007, DOF04057-001.

35 Department of Finance - Aide Memoire for the Government on Financial Market Developments, DOF04057-004.

36 Department of Finance - Aide Memoire for the Government on Financial Market Developments, DOF04057-003.

37 Department of Finance - Aide Memoire for the Government on Financial Market Developments, DOF04057-004.

38 Central Bank Assessment of Financial Market Developments 16 November 2007, DOF01962-004-005.

39 Central Bank Assessment of Financial Market Developments 16 November 2007, DOF01962-002.

"The Central Bank and Financial Regulator continue to liaise with the Irish banks closely at CEO level and are monitoring the position very closely. The banks in turn are working intensively to implement contingency arrangements to meet their liquidity requirements."[40]

Legislation

Meanwhile, work was continuing to prepare legislation to provide the Minister for Finance with the necessary legal options to support a distressed financial institution, including nationalisation. This was confirmed by former Attorney General Paul Gallagher in his evidence:

"Between 30 November 2007 and 29 September 2008, the Department was in constant contact with my office, looking at possibilities, identifying different options."[41]

However bank resolution legislation, which would allow for the winding up of a financial institution and which would have given another legislative option on the night of the Guarantee, had not been requested from the Attorney General or the Office of the Attorney General.

DECEMBER 2007

The NTMA Under Pressure

Since the NTMA's decision to move its deposits away from the domestic banks, it had come under pressure to reverse that decision. Michael Somers said:

"the pressure then continued on us at every meeting we went to …we were only asked along because I think we had the money and they wanted us to part with …"

"We had a meeting of the NTMA advisory committee, I think it was about 6 December, when the pressure was extreme. And I went off and I said I'd have to get legal advice on this as to where do I stand. Because, I mean, the Minister for Finance was my boss and I wanted to see, well, what do I do? Because the legal power that we were using was to borrow money for the Exchequer. It wasn't to borrow money to bail out the banks … We were borrowing money to fund the Exchequer. Here we were being pushed to use that money, which was there to pay the bills at the end of the week, to instead prop up the banks, to provide liquidity for the banks." [42]

Michael Somers then sought a legal opinion as to how to proceed and Brendan McDonagh explained that:

"and the senior counsel's opinion came back, said, 'Legislation's very clear under the 1990 Act. If the Minister issues you a direction under section 4(4), you are obliged to comply with the Minister's direction.'"[43]

Brendan McDonagh explained in his evidence that the NTMA was invited to attend a DSG meeting on 12 December 2007. He said:

---

40 Central Bank Assessment of Financial Market Developments 16 November 2007, DOF01962-005.

41 Paul Gallagher, former Attorney General, transcript, INQ00110-005/006.

42 Michael Somers, former CEO, NTMA, transcript, INQ00093-015/016.

43 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-031.

"The NTMA was invited to the latter stages of a domestic standing group meeting with the Department of Finance and the Central Bank to discuss the placing of deposits within existing credit limits with; Bank of Ireland, €200 million; AIB, €200 million; Irish Life and Permanent, €50 million; and EBS, €50 million. An existing deposit of €40 million with Anglo Irish Bank, with a maturity of one year, had been in place before the NTMA made its decision to cease placing the deposits with the banks and to place them instead with the Central Bank. The NTMA's position at this meeting which took place I believe on 12 December 2007, was that in the absence of a written direction from the Minister, we did not intend reversing this policy of placing bank deposits in financial institutions. We made the point at the meeting that, if anything, the risks attaching to the banking system, internationally as well as domestically, had become even more pronounced since the original August 2007 decision."[44]

"Following that meeting, the Minister for Finance at the time, Brian Cowen, wrote to the chief executive of the NTMA, Michael Somers, on 19 December 2007, directing the NTMA to place deposits with the four main banks, namely, Bank of Ireland, AIB, Irish Life and Permanent and EBS."[45]

The position adopted by Brian Cowen was contrary to the position of the NTMA.

This direction was clarified to the NTMA on 21 December 2007.[46] Brian Cowen said in evidence:

"the NTMA chief executive, who ... they're very strong on their independence, they wanted a written letter that they were to continue providing funds into the Anglo Irish Bank. In terms of deposits, overnight deposits, it was felt that, if it were to emerge that they weren't doing that, that that might reflect badly on the banking system generally. So that direction was written for by me in January of 2008 for a six-month period."[47]

He also said:

"There was a letter of instruction, as I understand, because they said they required a direction on that and they were always very mindful of their own independence."[48]

Crisis Simulation

The EU requirement[49] to run a crisis simulation exercise was met in December 2007. It was the first of its type to include members of the DSG, and it was run over the course of an afternoon. The simulation focused on a distressed single borrower.[50] Feedback sought by the Central Bank from the exercise was largely positive; it was well planned organised and effectively executed.[51] Though the procedures in the crisis management manual used by the Central Bank known as the *'Black Book'*, were described in the Honohan Report as *"…excessively cumbersome…"*,[52] evidence to

44 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-006.
45 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-007.
46 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-007.
47 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-077.
48 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-087.
49 Informal meeting of FSC July 2006 - Crisis Management Exercise: lessons learned and possible follow-up, DOF06159.
50 Crisis Simulation feedback form, DOF06079-004.
51 Crisis Simulation feedback form, DOF06079-004.
52 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-122.

the Joint Committee from Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, was that the exercise was well formulated:

"…really well constructed in the sense of a lot of thought went into it over a period of weeks or months by the people concerned and there was a real attempt to make this a realistic thing that could happen…"[53]

As to whether or not this was a *"realistic thing that could happen,"* Con Horan, former Prudential Director of the Financial Regulator, said:

"Being absolutely frank, I've been involved in these at a European level and I've been involved in them at a domestic level. And they are largely simulations around a small group of facts that are conducted over an afternoon or a full day with papers prepared and people able to read documents in advance of that. So, the reality is they do ... you do learn lessons and you do pick up issues in relation to how it would happen in reality, but, in effect, having experienced crises in Ireland and in Europe in recent years, the reality is always an awful lot more complicated and different."[54]

JANUARY 2008

At the end of 2007 and into the start of 2008 the "big four"[55] auditing firms were becoming increasingly concerned about the stability of the banking sector and the consequences for their clients as going concerns. The four firms met with the Financial Regulator in early 2008. The purpose was to ensure a full understanding among the authorities of the risks now evident in the financial system, and to seek reassurance of the actions being taken by the Government, Regulator and Central Bank to address these risks.[56]

Paul Dobey, of KPMG, the auditor for AIB, said:

"We were concerned, generally, as a firm, in relation to the matters ... the financial stability matters in 2007, and in early ... on 10 January 2008 we met with the Financial Regulator… to have a discussion about the issues that the ... the issues that were arising in the environment at the time."[57]

"all the four firms went in and ... and talked to the ... to the regulator."[58]

In relation to further meetings held in late 2008 and early 2009, he said:

"and it wasn't done lightly. We had huge consultations in our firm… It was unprecedented"[59]

"We spoke to the Central Bank because we wanted to understand ELA and... what dialogue was going on between the Central Bank and the euro system… and we also spoke to the Department in relation to capital. Now, when we came along ... and we, therefore, concluded that those banks were going concerns."[60]

---

53 Kevin Cardiff, former Secretary General and Second Secretary General of the Department of Finance, transcript, PUB00350-055.

54 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, transcript, INQ00130-015.

55 Deloitte, Ernst & Young (EY), KPMG and Pricewaterhouse Coopers (PwC).

56 Paul Dobey, Partner, KPMG, transcript, INQ00105-041, John McDonnell, Partner, PwC, transcript, INQ00117-012 to 016.

57 Paul Dobey, Partner, KPMG, transcript, INQ00105-041.

58 Paul Dobey, Partner, KPMG, transcript, INQ00105-041.

59 Paul Dobey, Partner, KPMG, transcript, INQ00105-059.

60 Paul Dobey, Partner, KPMG, transcript, INQ00105-023.

"…we also had a responsibility to assess whether the going concern based on preparation of financial statements was appropriate. It was in the context of the going concern based on the financial statements which was a future looking thing and maybe that's not keeping the score, right? That's assessing what the score might be at the end of the game, right? And we're only at half-time. We had to go and make an assessment and get assurances from the system, if I put it that way, the Department, the Regulator, the Central Bank, around the going concern basis of preparation."[61]

John McDonnell, Partner of PwC described the meeting in the following terms:

"the meeting that the accounting firms had with the regulator in the context of accounting for financial instruments as a result of the liquidity crisis. And what happened at the time was that we had the subprime crisis in late 2007 and, as a result of that, there was a number of issues around how one would value securitisation vehicles, but, in particular, the credit aspect of financial ... of financial instruments."[62]

16 January 2008 - DSG Update

A further 'Memorandum for the Information of Government' was submitted to Brian Cowen.[63] As with the previous updates for Government, the memorandum was based on an assessment by the Central Bank and Financial Regulator presented to the DSG on 11 January 2008. It noted that a massive coordinated intervention by major central banks had provided liquidity for banks to meet their year-end financial needs. However markets were expected to remain disrupted for some time with reports of financial institutions estimating eventual losses ranging from €100 billion to €275 billion and major international banks seeking balance sheet investment from Middle Eastern and Asian investors. The memorandum also noted that the macroeconomic climate was a concern due to poor economic growth globally and the risk of a US recession.

The Memorandum also noted that some improvements in the market had allowed Irish banks to access their required liquidity but the maturity of funding continued to shorten, thereby increasing the pressure over time. There was an improvement in Ireland's rating by Fitch, however negative sentiment remained, given concerns regarding the property market, and the share prices of Irish banks continued to fall.[64]

Meanwhile, the DSG was reviewing its financial stability planning. Apart from the crisis simulation exercise, a review of the existing Deposit Guarantee Scheme was still being considered in light of the Northern Rock event. The memorandum also noted that the DSG was continuing to examine the powers available to the CBFSAI and the Minister to respond to a Northern Rock style event in Ireland.[65]

---

61 Paul Dobey, Partner KPMG, transcript, INQ00105-059.

62 John McDonnell, Partner PwC, transcript, INQ00117-012.

63 Memorandum for the Information of Government Financial Markets Developments, 16 January 2008, DOF03709.

64 Memorandum for the Information of Government Financial Markets Developments, 16 January 2008, DOF03709.

65 Memorandum for the Information of Government Financial Markets Developments, 16 January 2008, DOF03709.

The assessment in the Memorandum for the Information of the Government concluded:

"It is important to emphasis that the Irish banking system is strong, liquid and well capitalised. Notwithstanding the current turbulence, the Irish banks are accessing their required liquidity…"[66]

There was also a note that the next two big hurdles were the rollover of long-term funding arrangements early in the year and the publication of audited accounts. Highlighted for particular attention were *"fears in the market that a recession in the US could have a significant impact on financial markets globally."* The memorandum concluded that the Financial Regulator and the DSG were monitoring the situation closely.

Scoping Paper

In January the Department of Finance drafted a confidential 22 page document titled *"Financial Stability Issues – Scoping paper"*[67]. The Scoping Paper sought to identify:

"…the options available to the Irish Authorities in the case of a systemic threat to financial stability, as well as consider any issues regarding the structures currently in place to oversee financial stability planning arrangements and also to manage a financial crisis"[68]

William Beausang, former Assistant Secretary Department of Finance, was the originator of the project and he described it as an attempt to: *"try to develop an approach where there would be more up-to-date or more relevant information available to the authorities at the point that intervention might need to be taken."*[69]

The paper was drafted as a manual for the management of a financial crisis and detailed the roles of the Central Bank and the Minister for Finance in such a situation. It also effectively summarised the DSG discussions from the previous four months on the legal options available to the Minister, the Central Bank and the Regulator in managing a financial crisis.

Contained within the paper are brief discussions on several key aspects of Financial Regulation. Ideas such as:

- Constructive Ambiguity: *"A policy of constructive ambiguity towards financial stability planning involves not sharing full information about public authorities' likely actions in a financial crisis, in order to minimise moral hazard;"*[70]
- Emergency Liquidity Assistance (ELA): *"The view of the CBFSAI is that the requirement for the ELA provision to an Irish bank would signify the existence of a serious threat to the long-term sustainability of the financial institution in question because of the 'stigma' that would attach to it. It is important to highlight, therefore, that ELA provision would be an interim measure while urgent consideration was given by all parties to the available options for rescuing the bank;"*[71] and

66 Memorandum for the Information of Government Financial Markets Developments, 16 January 2008, DOF03709-002.

67 Department of Finance, Financial Stability Issues – Scoping paper, DOF03183.

68 Department of Finance, Financial Stability Issues – Scoping Paper, DOF03183.

69 William Beausang, former Assistant Secretary, Department of Finance, transcript, INQ00127-048.

70 Financial Stability Issues – Scoping Paper, DOF03183-001.

71 Financial Stability Issues – Scoping Paper, DOF03183-002.

- Illiquidity and Insolvency: *"If a period of illiquidity continues it is likely that an illiquidity institution will move closer to insolvency. In circumstances that liquidity is not freely available, any sustained poorly managed mismatch between the short-term liabilities and the longer-term asset can quickly lead to a situation whereby an institution becomes unable to meet its obligations as they fall due, i.e. it becomes insolvent because of its illiquidity."*[72]

Patrick Neary, former Chief Executive IFSRA, said:

"at some stage in 2007, a scoping paper was prepared by the Department of Finance […] and it covered a range of topics, including having a look at a deposit protection scheme, legislation for nationalisation, etc., the tools that might be needed in the event that there was a crisis."[73]

Among the tools covered in the Scoping Paper was the use of a government guarantee of a troubled institution's liabilities to enable it to continue to avail of ELA. The option of nationalisation was also outlined as a temporary measure. Another option was to create a "bad bank", in other words a State takeover of the part of the bank that it is in difficulty. The paper noted that in a case where a distressed institution is regarded as being systemically important to the economy (i.e. Too Big To Fail) state intervention should be taken on a case by case basis.[74] It also noted that: *"The costs of insolvency should not transfer to the State simply because the institution in question is a bank."*[75]

Under the heading *"Scenario 1 – An institution that is illiquid but solvent"* the paper said: *"Therefore the Minister and Government could quickly find itself in a situation where there was pressure to give assurances that the State was prepared to support the bank in difficulty or provide guarantees to its depositors. Other guarantees which the Minister might consider giving included guarantee to banks regarding interbank lending to pre-empt overall withdrawal of market liquidity…."*[76]

In their input into the Scoping Paper the Central Bank and Financial Regulator said that a reference to nationalisation should be included as an additional tool in crisis management. They also said that the issuing of guarantees appeared understated and needed sharper focus, that a letter of comfort (a written assurance as opposed to a full guarantee) from the Minister would not be sufficient to cover the risk to the CBFSAI and that Central Bank could not act on a promise of a guarantee as it was prohibited from lending to insolvent institutions.[77] This last aspect was confirmed by Tony Grimes who said: *"Well, it's absolutely clear that if the institution is insolvent the Central Bank could not lend without a formal guarantee of the Government."*[78]

John Hurley, former Governor, Central Bank, said: *"I think there was an adjustment made which was "Look, a broad guarantee might have to be considered in this systemic situation."*[79]

---

72 Financial Stability Issues – Scoping Paper, DOF03183-005.

73 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-072.

74 Financial Stability Issues – Scoping Paper, DOF03183-006.

75 Financial Stability Issues – Scoping Paper, DOF03183-006.

76 Financial Stability Issues – Scoping Paper, DOF03183-002.

77 Joint Central Bank/Financial Regulator response to Department of Finance Paper, "Financial Stability Issues – Scoping Paper (2nd Draft), INQ00170.

78 Tony Grimes, former Director General, Central Bank, transcript, INQ00129-005.

79 John Hurley, former Governor, Central Bank, transcript, INQ00047-100.

The input from the Central Bank and Financial Regulator also stated that it was likely to be very difficult to determine the solvency position of an institution. The response paper discussed the scenario in which it was unclear if an institution was insolvent or illiquid. It concluded that the risk involved in refusing to lend to a solvent institution was potentially much more serious than lending to an insolvent one as it may drive a sound bank into liquidation and insolvency.[80] This input was reflected in the Scoping Paper.

However, despite this level of input, work on the paper did not progress. The paper itself, as seen by the Committee, is an unfinished draft. In his opening statement, William Beausang said work never progressed because of: *"…important differences in emphasis with the Central Bank's assessment, as reflected in the Central Bank's comments on the Department's scoping paper, and its own paper on resolution options circulated in June 2008."*[81]

The paper was presented to the DSG for observations in January 2008, but saw limited attention outside of that. William Beausang subsequently provided a written statement which stated that:

"Key elements of the Department's assessment and conclusions set out in the Scoping Paper were not shared by the CBFSAI. Consequently, no agreement was reached at the DSG on the Scoping Paper and it was not submitted to the Minister nor the Secretary-General of the Department of Finance.…My recollection is that the work would have been advised to the Head of Banking Division."

When asked if he had seen a copy of the Scoping Paper, Brian Cowen said: *"Mr. Cardiff would have been the guy, my point man, on that."*[82]

Brian Cowen was asked if he had seen the Paper before. He said he had.[83] When then asked when he first saw the Scoping Paper, Brian Cowen said: *"When did I see it first? It was only around the time it was done up, I presume."*[84]

Kevin Cardiff was asked why, given the concerns laid out in the Scoping Paper, nobody went in to examine the banks more closely. He replied:

"…this was a failure. There, there ought to have been better information… And, we believed … were led to believe that the regulator had a good picture of the banks under its remit, that reasonable loan loss stress testing had been done, that the banks were regarded as solvent, resilient, capable of withstanding significant shocks and we accepted that."[85]

80 Joint Central Bank/Financial Regulator response to Department of Finance Paper, "Financial Stability Issues – Scoping Paper (2nd Draft), INQ00171.

81 William Beausang, former Assistant Secretary, Department of Finance, transcript, INQ00127-006.

82 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-093.

83 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-060/058.

84 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-060.

85 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-032.

FEBRUARY 2008

8 February 2008 - DSG Update

As well as a CBFSAI assessment of financial markets; items for discussion at the February meeting of the Domestic Standing Group included a review of the Deposit Guarantee Scheme, noting that it was coming up in Parliamentary Questions and it was *"important that we are in a position to, at a minimum, state that the issues raised are being examined."*[86]

The CBFSAI assessment[87] started by stating that the Irish banks were still able to access the liquidity they required. However negative sentiment towards Irish banks by international investment banks had resulted in Irish bank share prices remaining low. The assessment noted that there had been some stress testing of residential mortgages in the residential sector but no major issues were highlighted.

When it came to commercial property, the Central Bank was more concerned. The worry was that problems in the sector in the US and the UK were likely to have an impact in Ireland *"where difficulties in the commercial property sector are likely to arise during this year."*[88] Specifically, defaults in the commercial property sector may arise in loans with moratorium[89] or bullet repayments,[90] where no payments are made until developments are completed. If the value of the completed development turned out at less than the required repayment, it would lead to defaults. But the report noted that the current position was relatively strong, with low vacancy rates that should help reduce the impact of future problems. The CBFSAI concluded that section of the update by saying:

"The Irish banks are generally happy with the "big players" in property developments. There are some concerns about the next tier of developers e.g. small builders who have completed a development and cannot sell it – and the banks are watching these types of customers early."[91]

In February 2008 the Department of Finance also prepared a presentation entitled *"Overview of Financial Stability Resolutions Issues"* drawn in part from the Scoping Paper and in the midst of that presentation the following text was highlighted:

"As a matter of public policy to protect the interests of taxpayers any requirement to provide open-ended/legally binding State guarantees which would expose the Exchequer to the risk of very significant costs are not regarded as part of the toolkit for successful crisis management and resolution."[92]

When asked how it came about that a legally binding State guarantee could not be part of the tool kit in February and yet one could be introduced September, John Hurley said:

---

86 Report of the Domestic Standing Group February 2008, DOF02007-001.

87 Report of the Domestic Standing Group February 2008, DOF02007-002.

88 CBFSAI assessment of Financial market developments 8 February 2008, DOF02007-002.

89 A loan with a moratorium is one where agreement is given to either cease repayment of principal or interest, or both, for a certain period of time.

90 This refers to the final repayment of a loan, which consists of the whole sum borrowed at the start. Any interim repayments are interest-only.

91 CBFSAI assessment of Financial market developments 8 February 2008, DOF02007-003.

92 Department of Finance presentation, "Overview of Financial Stability Resolutions Issues", DOF03185-011.

"this situation changed absolutely dramatically within a short space of time and the options for the Government were quite limited and in the circumstances of the change."[93]

David Doyle, former Secretary General in the Department of Finance, said:

"In relation to that particular statement that you have there in that presentation - that State guarantees are not part of the toolkit - that was the view, that State guarantees should not be part of the toolkit … Now, by the time September arrived, you had the international financial meltdown taking place; you had Bradford and Bingley being nationalised; you had German banks being nationalised; you had Lehman's being let go to the wall; so towards the end of that month, the view down in Dame Street was that the financial markets had become so crisis bound that, as a last resort, a guarantee would have to be considered. That was the view that started to emerge the week before this down in Dame Street, because of the huge flows of liquidity and what was going on internationally, that it would have to be considered."[94]

MARCH 2008

10 March 2008

The Domestic Standing Group received an update on financial market conditions in advance of a Government meeting on 11 March 2008. The four key points of this CBFSAI update were:

- Market conditions had worsened; there was a perception that these difficulties would continue to persist for a significant period of time;
- Market sentiment towards Ireland was negative, based upon the Irish banks' level of exposure to the property sector and a perceived likelihood of defaults due to the worsening economic situation;
- Irish banks were accessing their required liquidity, but it had become increasingly difficult for them to access any longer term funding which left them more vulnerable to shocks in the market. Long term funding was becoming increasingly difficult to access and was only being made available for banks rated AA or AAA – Irish banks were generally rated A. Some Irish banks were falling back on ECB funding at that time; and
- Property market conditions remained difficult; no new developments were being undertaken and the banks were increasing pressure on developers to raise funds, either by renting property or selling it at a reduced price, to begin to repay outstanding loans. The report says:

  "If builders begin to default, and the banks are unable to refinance their exposures, this will have significant consequences, for the banks in terms of profits and credit provisions, as well as access to funding, and will have further negative impact on sentiment regarding the Irish market."[95]

The conclusion to the report was that conditions at that time were returning to those experienced at the end of 2007 - the worst point of the turmoil thus far. The key issue at that point was the

93 John Hurley, former Governor, Central Bank, transcript, INQ00047-122.

94 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-021.

95 Central Bank, Update on Financial Market Developments, CB05971-004.

"increasing realisation that markets are not going to improve soon and may even deteriorate further."[96]

St. Patrick's Day 2008

On St. Patrick's Day Anglo shares lost 15% of their value from the previous day close, with a maximum fall of 22% at one point that morning. That same day, AIB closed 6.1% down, IL&P closed 4.7% down and BOI closed 4.7% down.[97] A number of other factors unique to the Anglo share decline were identified by the Financial Regulator in its paper investigating trading in Anglo shares dated October 2008.[98]

Simon Carswell, Irish Times journalist said:

"…after what is known as the St. Patrick's Day massacre in 2008, when there was short-selling in two of the Irish banks in particular, but mostly in Anglo Irish Bank, a strong statement of confidence issued from the Central Bank and the Financial Regulator's office to counter that negative market comment."[99]

Fintan Drury, Non-Executive Director, Anglo Irish Bank, said:

"a few days after St. Patrick's Day 2008. I received a phone call from Seán Fitzpatrick, the chairman of the bank, asking me if he thought that Brian Cowen would take a call from him."[100]

Seán Fitzpatrick phoned Brian Cowen who was in Vietnam on Ministerial (St. Patrick's Day) business. Brian Cowen explained:

"The purpose of his phone call was to say to me that they ... that this had happened in relation to the share price and that they believed that there was a position being taken by Mr. Quinn in relation to their share and that's ... that the market had this information was out in the markets or whatever. And I said that these are regulatory matters, these are matters he needed to refer down to the Central Bank and to the Financial Regulator and have it dealt with there."[101]

Brian Cowen was asked if he had heard of Seán Quinn's[102] exposure to contracts for difference in Anglo: *"I think before I had ... before I left for that trip that time around St. Patrick's Day."*[103]

Shortly after his return to Ireland, Brian Cowen had a meeting with Bertie Ahern at his home. Bertie Ahern said:

"Obviously, market sentiment to Anglo, in particular, internationally was growing. And that was a big concern … I think he was coming back from the airport and came in to me. But we wouldn't normally ... again, I mean, he was concerned about the issue and I was concerned about the issue. We'd all been away for St. Patrick's Day and he updated me on it."[104]

---

96 Central Bank, Update on Financial Market Developments, INQ00151.
97 Irish Stock Exchange website – www.ise.ie - Official Record of the Irish Share Price Movement.
98 IFSRA report into Trading in Anglo Irish Bank Corporation PLC shares 17-20 March 2008, INQ00151.
99 Simon Carswell, Irish Times, transcript, PUB00179-013.
100 Fintan Drury, Non Executive Director, Anglo Irish Bank, transcript, INQ00142-005.
101 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-088.
102 Seán Quinn, former Chairman of the Quinn Group.
103 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-089.
104 Bertie Ahern, former Taoiseach and Minister for Finance, transcript, INQ00109-050.

In March 2008 John Hurley and Pat Neary began approaching individual banks to encourage them to place deposits with each other in what was referred to informally by the Joint Committee in the public hearings as the "Green Jersey" agenda. When asked about it, John Hurley said:

"There would have been a discussion when we met some of the major banks about the potential for their assisting smaller banks that came in to difficulty. That would have happened and you ... you would expect in a banking system that if a small bank was in difficulty, that the first port of call would be the main banks because private sector solutions would be the main vehicle at that stage."[105]

According to Patrick Neary:

"we did have a series of meetings essentially with the larger banks to see would they be prepared. And, in principle, yes, they felt there was merit in it but at the end of the day they were saying, 'Well, look, if we're going to commit to this we need them to have some form of backing from the Central Bank.' So it kind of ... it, it never really progressed."[106]

Tony Grimes, former Director General, Central Bank, told us:

"it wasn't really a policy decision, it was more something that you know emerged in the course of the frequent meetings that we would have had with all the individual institutions. And in the context of the exploration by them, and us, of what measures might be put ... be put in place to make the liquidity situation somewhat better."[107]

From the evidence presented to the Joint Committee, it is unclear if the DSG or the Government were made aware that the Regulator and Central Bank were pursuing this strategy.

APRIL 2008

OECD Economic Survey of Ireland

In April the OECD published their Economic Survey of Ireland.[108] In the introduction, it said that although productivity growth had slowed in recent years, the economic fundamentals remained strong.

It also said that housing investment had fallen sharply, but that the downswing in activity could soon be over. However, there was also a risk, highlighted in the report, that the slowdown in the housing market could be sharper and more protracted, with greater implications for employment and the wider economy.

On the financial sector it said that the CBFSAI had moved quickly on the global liquidity squeeze. The OECD report stated the Irish banks were highly profitable and well-capitalised, but also that it was important to be prepared to deal with downside risks.

105 John Hurley, former Governor, Central Bank, transcript, INQ00047-101.

106 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-117.

107 Tony Grimes, former Director General, Central Bank, transcript, INQ00129-025.

108 OECD Economic Survey Ireland, PUB00162.

10 April 2008

Brendan McDonagh told us:

"The NTMA had in fact been engaged in discussions with the Department of Finance from April 2008 about the provision of emergency liquidity in circumstances where the Irish banks could not meet their funding requirements from the wholesale markets. This was separate to the engagement we'd been having with the Department of Finance from the summer of 2007 in relation to the NTMA placement of bank deposits ..."[109]

21 April 2008 - DSG Update

A briefing note outlining financial market developments was prepared for the Tánaiste for a meeting of Government the next day. The note was based on the Central Bank's assessment of financial market developments. The key points were:

- There had been a "very negative shift" in US sentiment towards Irish banks. As before this was attributed to perceptions of the Irish economy and exposure to the property sector. This was important as the US was an important source of funding for Irish banks at this time when they were finding it difficult to access funding in Europe.[110]
- Confirmation that Irish banks were solvent, well capitalised with strong loan books.
- The Central Bank suggested that the Government continue to focus on the fundamental strengths of the Irish economy.
- An update on the Bank of England's move to help back access funding.
- A suggestion by the Central Bank that continued access by Irish banks to ECB funding was being seen as a negative signal to the markets: *"Relying on the ECB for funding could be seen as a sign of stress in the current climate."*[111]

Although it described the deteriorating market conditions, the continued access to ECB funding, the difficulty of accessing funds in Europe and the growing prospect of difficulty in the US, the briefing note highlighted that:

"The CBFSAI and industry are continuing to highlight the strength of the Irish banking sector and the quality of the financial regulatory system, Governmental and Ministerial comment on the fundamental strengths of the Irish economy will continue to be important."[112]

Legislation

On the 24 April 2008 an email was also sent between officials in the Department of Finance on the potential for amending the State Guarantee Act 1954 to allow the Minister to provide a guarantee to a financial institution should it be required.[113] It concluded that it may be easier and clearer to draft legislation.

109 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-005.
110 Note for the information of the Tánaiste for Government meeting, 22nd April 2008, DOF01978-003.
111 Note for the information of the Tánaiste for Government meeting, 22nd April 2008, DOF01978-003.
112 Note for the information of the Tánaiste for Government meeting, 22nd April 2008, DOF01978-001.
113 Department of Finance email dated 24/04/2001, DOF02849-001.

Whilst giving evidence to the Joint Committee, Brian Cowen was asked *"when is the first time that you became aware that there was a need to prepare legislation that would allow for the potential State guarantee of the institutions?"*[114] In response, Cowen answered *"April-May."*[115]

24 April 2008

Fintan Drury described to the Joint Committee how he had helped arrange for Brian Cowen to address a dinner event for the board of Anglo:

"I had undertaken to ask him to do the event and, indeed, the records in the Department should show that he had at least ... on at least two previous occasions been diaried to meet with us, but other priorities had got in his way. The event was completely unremarkable. I recollect a general introduction by Seán Fitzpatrick, as chairman, and then a broad discussion about all things other than banking…"[116]

Brian Cowen was asked about the meeting and whether he had brought a briefing document[117] prepared that day on *"banking sector issues"* with him. He said that he did not bring any briefing with him to the event.[118] He was also asked if David Drumm had spoken to him, to request that the NTMA place deposits in the bank:

"I think what he's referring to there is a conversation he says he had with me, and I was sort of saying "Well is that not done already", because I was thinking back to this question of the letter that was sent out in January, was that not going ahead or was that not happening. And I obviously misunderstood, because that's what I thought he was referring to. And that was it, essentially. Sin é."[119]

MAY 2008

Three weeks later Brian Cowen was Taoiseach and the new Minister for Finance, Brian Lenihan, received a briefing from his officials. The briefing included a breakdown of the 6 main financial institutions' most recent Annual Reports:

- AIB had posted profits of €2.5 billion, had a loan book of €128.76 billion (€46.41 billion in property and construction loans), and was noted as being exposed to the property market – especially commercial.
- Bank of Ireland had posted profits of €1.9658 billion, had a loan book of €125 billion (€26.382 in property and construction loans), and was also noted as being exposed to the Irish and UK property market.
- Anglo posted profits of €1.243 billion and had a loan book of €64.949 billion, 63% of its funding base was in deposits (a significant proportion of which were in larger, more mobile accounts), and the bank was exposed to the commercial property market. The report also said there was a *"Risk of short selling of shares by hedge funds- 12.78% of shares reported to be*

114 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-018.
115 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-018.
116 Fintan Drury, former Non Executive Director, Anglo Irish Bank, transcript, INQ00142-005.
117 Briefing on Banking Sector Issues, 24/04/2008, DOF03372-023.
118 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-107.
119 Brian Cowen, former Taoiseach and Minister for Finance, transcript, PUB00345-096.

held on loan" and the *"Financial Regulator currently investigating short selling of shares in March when shares prices fell 15% in one day."*[120]

- The key risk for IL&P was that it was currently accessing 20% of its funding from the ECB with no sign of improvement in the near future. It too was exposed to the Irish property market and was having difficulty accessing funding from commercial sources as a result. It had posted profits of €448 million but had a loan book of €39.2 billion.
- INBS had been seeking a buyer to enable it to convert from a building society to a bank, but with little interest from the international market. It had recently been downgraded by Fitch and was having difficulty accessing funding from commercial sources.
- EBS had posted profits of €66.6 million, had a loan book of €15.88 billion, was 52% funded from customer deposits and was also having difficulty accessing funding from commercial sources.

Elsewhere the Department of Finance was warning of a possible issue on the income side of the Exchequer as the *"end-April taxes were €736 million below profile - 45% of this shortfall is due to the poor performance of Capital Gains Tax. While it is very early to call an end-year position, we are now factoring in a €2 billion shortfall in taxes but have not publicised this as yet."* It further stated that in overall terms the general government balance was likely to be around -2.2% of GDP and that *"This represents a significant worsening of the position for this year with serious consequential impacts for next year."*[121]

Around the same time, the Central Bank contact with the banks had moved to daily calls.[122] When asked, Mary Burke, then Head of Banking Supervision at the Financial Regulator, what she remembered of the period from April to June, she replied:

"Now, I will say, in terms of the meetings and the planning that was going on at the time, it was particularly chaotic and, from where I sat, it felt chaotic in terms of the amount of work we were trying to do."[123]

In May the ESRI published its Mid-Term Review. John FitzGerald said in his written statement:

'This report came out at the beginning of the "great recession". It had an upbeat tone which, as subsequent events have shown, was wholly unwarranted. This was based on the assumption, adopted internationally, that the credit squeeze effects would be short lived, with world growth back at trend by 2010. There was a scenario on a credit crunch. However, even this shock was much too mild. The Review completely missed the possibility of a financial collapse'.[124]

JUNE 2008

With financial market conditions continuing to deteriorate throughout 2008, work continued on a draft Bill relating to the proposed powers of intervention. As of 6 June 2008, documentation shows

120 Briefing from the Department of Finance to Minister on financial sector, DOF03372.
121 Brief for Minister for Finance, May 2008, Main Policy Issues, DOF03151-001.
122 Mary Burke, former Head of Banking Supervision IFSRA (May 2006 to October 2008), transcript, INQ00131-007.
123 Mary Burke, former Head of Banking Supervision IFSRA (May 2006 to October 2008), transcript, INQ00131-007.
124 John FitzGerald, Research Affiliate and former Research Professor, ESRI, Statement, CTX00022-014.

that nationalisation legislation was being prepared.[125] According to the evidence of Paul Gallagher, the focus shifted in June to nationalisation of the banks and to the provision of a bank guarantee:

"I believe that it was on 16 June 2008 that there was a particular emphasis on producing the necessary legislation that would provide legal options that included… nationalisation legislation and also the provision of a legislative basis for any guarantee that might have to be offered in respect of any institution."[126]

"what happened on 16 June was they said go ahead and draft. It was still focused on a particular bank because that's what you would do with nationalisation legislation."[127]

Kevin Cardiff recalled:

"In the first half of 2008, there was absolutely no serious consideration, which I can now recall, being given in CB/FR, DoF or NTMA to a broad guarantee in respect of a wide range of institutions for a wide range of liabilities, as a discrete policy option, although of course, as I have just noted, there was ongoing work on legislative opt ions which included consideration of how to enable Government to give guarantees in appropriate cases. But at various points in time it seems that a broad Government guarantee did feature in discussions in other quarters. The Governor of the Central Bank, I believe, received approaches in March/April 2008 suggesting that the Government should announce a broad guarantee – though it is possible that what was in mind at this time was a general political undertaking rather than a formal guarantee."[128]

17 June 2008

"On 17 June 2008, the new Minister for Finance, Mr. Lenihan, in correspondence to Dr. Somers, directed the roll-over of Bank of Ireland and AIB deposits on an unsecured basis and an increase in deposit sizes with Irish Life and Permanent from €50 million to €250 million and EBS from €40 million to €100 million."[129]

"The NTMA chief executive also advised that the NTMA did not intend to renew a one-year unsecured deposit of €40 million with Anglo Irish Bank which fell due on 8 August 2008, as the deposit was not covered by the Minister's December 2007 direction… Mr. Cardiff wrote to me on behalf of the Minister directing the NTMA to place a €40 million one-year collateralised deposit with Anglo Irish Bank and to roll over the NTMA's €200 million deposits with Bank of Ireland and AIB on a six-month collateralised basis."[130]

NTMA now had a total of €790 million in Irish banks (BOI €200 million, AIB €200 million, IL&P €250 million, EBS €100 million, Anglo €40 million).[131]

---

125 Outline Heads of a Bill to provide for the Irish Authorities (Minister for Finance) to take action in relation to an Irish financial institution, DOF03209.

126 Paul Gallagher, former Attorney General, transcript, INQ00110-006.

127 Paul Gallagher, former Attorney General, transcript, INQ00110-016.

128 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-005/006.

129 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-007.

130 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-007.

131 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-007.

18 June 2008

Despite providing comprehensive feedback to the Scoping Paper, the Financial Stability Department of the Central Bank and the Banking Supervision Department of the Financial Regulator provided their own Crisis Resolution Options paper in June 2008.[132]

The Options paper raised a number of concerns regarding nationalisation. It ruled nationalisation out as an option if it would take a long time to enact the legislation or if the announcement of intent to nationalise would be insufficient to stop a run. It also proposed that a bank guarantee would be needed anyway and that the authorities would need to be cognisant of the long term reputational damage to Ireland as a financial centre if an institution were nationalised.[133]

23 June 2008 - DSG Update

A further briefing note[134] outlining market developments was prepared for the Government. The key points were:

- Market volatility led to a fall in the share price of Irish banks - on average by 25% since mid-March. This was seen as being due to the further decline in property values.
- Irish banks were seen to be highly exposed to property, with BOI cited as having 70% of its lending tied to *"bricks and mortar."*[135]
- Bank of Ireland had successfully issued a €1.2 billion bond, but at a significant premium, reflecting continued negative investor sentiment towards Ireland.
- A number of banks were reported to be on 'watch' by rating agencies, the consequence of which would be increased costs in funding, reduced share price and increased outflows of funds. Banks continued to tightly ration lending, the consequences of which are described in the Central Bank's assessment as follows:

  "The CBFSAI expects that this continuing tightening in credit availability and cost will likely increase bad debts. The issue of anticipated increase bad debts has already featured in brokers notes/briefing and has received some media comment."[136]
- Market knowledge of the exposure of Irish banks to the construction and property sector continued to complicate matters.

The briefing note for the Minister concluded with the following statement:

"Internationally the financial sector is out of favour. While the Irish financial sector should not expect to be immune to this, the widespread perception that Irish banks are very heavily dependent on property lending has exacerbated the position. As property prices continue to fall, the position of Irish banks is vulnerable to further deterioration."[137]

132 Paper from CB on Crisis resolution options, 18th June 2008, INQ00171.
133 Paper from CB on Crisis resolution options, 18th June 2008, INQ00171.
134 Note for the information of the Minister for Government meeting Financial market developments, DOF03287.
135 Note for the information of the Minister for Government meeting Financial market developments, DOF03287-003.
136 Note for the information of the Minister for Government meeting Financial market developments, DOF03287-004.
137 Note for the information of the Minister for Government meeting Financial market developments, DOF03287-004.

June 2008

Minutes of the meeting of the Irish Financial Services Regulatory Authority[138] recorded that senior management of the Financial Regulator reported on the discussions of the DSG on legislative issues and in that regard, on the preparation of a pro forma draft bill on nationalisation. The Authority asked for a further report at the next meeting on legal options for shortening the timetable of mergers.

JULY 2008

In July 2008 Brian Lenihan, then Minister for Finance, wrote to the Attorney General. He marked the letter *'secret.'* He asked the Attorney General to waive the normal requirement of obtaining the Government's authority prior to referring the drafting of legislation to the Office of Parliamentary Counsel. This waiver was sought on the basis of the exceptional sensitivity and urgent nature of the proposed legislation.[139]

"I write seeking your agreement for the priority drafting of primary legislation proposals relating to the maintenance of financial stability… given the exceptional sensitivity of the matters concerned and the urgent need to ensure an appropriate level of preparedness for a financial stability event, I would ask for your agreement that the normal conventions are set aside on this occasion."[140]

7 July 2008 – Memo for Government

On 7 July 2008, the Office of the Minister for Finance sent a secret Memorandum for Government. The memorandum said that the Live Register had increased from 201,800 at end May to 220,800 at end June. Budget estimates had been based on a figure of 170,000 so this increase would add *"some €500 million to expenditure in 2008"*[141] It was noted that there were also significant spending pressures in the HSE. As a result of these two factors *"combined with the tax shortfall of at least €3 billion"*[142] there was now *"a strong likelihood that we will be in breach in 2008 of our EU commitments arising under the Stability and Growth Pact and our membership of the Euro area."*[143]

8 July 2008 - DSG Update

The Domestic Standing Group met to prepare a report for a meeting of Government. Attendees at this meeting included more senior officials from the Department of Finance and the Central Bank than had previously attended Domestic Standing Group meetings. They included the Deputy Governor of the Central Bank and the Second Secretary of the Department of Finance.

138 Central Bank narrative on Minutes of meeting, June 2008, INQ00023-004.

139 Letter from Brian Lenihan, Minister for Finance to the Paul Gallagher, Attorney General dated July 2008, DOF04447-001.

140 Letter from Brian Lenihan, Minister for Finance to the Paul Gallagher, Attorney General dated July 2008, DOF04447-001.

141 Office of the Minister for Finance – Memorandum for the Government, Measures necessary for Budgetary Consolidation 2008, DOF07574-003.

142 Office of the Minister for Finance – Memorandum for the Government, Measures necessary for Budgetary Consolidation 2008, DOF07574-003.

143 Office of the Minister for Finance – Memorandum for the Government, Measures necessary for Budgetary Consolidation 2008, DOF07574-003.

The report confirmed that the Central Bank was *"staying in close touch with the Irish banks"*[144] and that the sharp decline in Irish bank share prices had not had an impact on the banks' deposit base.

Two financial institutions (IL&P and Anglo Irish Bank) had recently received a *"top up of liquidity."*[145]

A strong warning signal was included in the report:

"There were some indications that recent falls in share prices reflected share sales by long-term investor indicating that if the current unfavourable market environment persisted there was an increased risk of a general loss of confidence in the Irish banks. International investors believed that the sharp slow-down in the Irish economy and property market would give rise to significant loan losses for the Irish banks, a collapse in profitability and the need to raise significant capital…"[146]

However despite this assessment the Financial Regulator reported that:

"…a detailed line-by-line examination of its loan book by one of the major Irish banks which highlighted that even allowing for 'worst-case' loan losses, profitability would remain strong measured against objective market benchmarks."[147]

Con Horan attended this meeting of the DSG in his former role of Prudential Director of the Financial Regulator. He was asked by the Joint Committee how this information was sourced and how had it been verified. His response was:

"…they [banks] would have been doing their own analysis and contingency planning. I don't think that we went in to check that at that time, in July 2008… It would have been the feedback from the institutions in terms of their observations and their belief, in relation to their [loan] book."[148]

9 July 2008

On 9 July 2008 there was an email exchange[149] between the Department of Finance and the Central Bank on the subject of a Special Resolution Regime. Kevin Cardiff explained this as one in which *"you take control of the institution, you manage it out, you share the burden of the losses."*[150]

John Hurley was asked about this regime:

"It was discussed in the course of 2008 before I left the bank. It was an option that was being looked at. The matter was ... my ... the report to me when I came back was the matter had been discussed with the Department of Finance, and the Department of Finance, I think, were in touch with the Attorney General's office, and my understanding was this ran into legal and constitutional difficulties… I think the United Kingdom had similar problems with a special resolution regime after Northern Rock. This was not ... this was a very complicated issue."[151]

144 Report of Domestic Standing Group Meeting, 8 July 2008, DOF03304-005.
145 Report of Domestic Standing Group Meeting, 8 July 2008, DOF03304-005.
146 Report of Domestic Standing Group Meeting, 8 July 2008, DOF03304-005.
147 Report of Domestic Standing Group Meeting, 8 July 2008, DOF03304-005.
148 Con Horan, former Head of Banking Supervision and Prudential Director, IFSRA, and attendee at the DSG, transcript, INQ00130-018/019.
149 Department of Finance email to Central Bank, DOF03245.
150 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-068.
151 John Hurley, former Governor, Central Bank, transcript, INQ00047-116.

Kevin Cardiff explained the difficulty in introducing a special resolution mechanism by saying that:

"if you wanted to burn bondholders, then ... especially senior bondholders, then you have to talk about major constitutional issues that we didn't see a way around in sort of June 2008 and even in January 2009, even for subordinated bondholders, there were obstacles, both market and legal."[152]

John Hurley gave evidence that the regime was not progressed. When asked if it would have made a difference had it been available on the night of the guarantee he said:

"It strikes me that the decision is very likely to have been the same."[153]

28 July 2008

On 28 July, Brian Cowen met with Alan Gray, an independent economist and Non-Executive Director in the Central Bank, Seán Fitzpatrick of Anglo Irish Bank, Fintan Drury, a former director of Anglo Irish Bank and Gary McGann, Group Chief Executive of Smurfit Kappa Plc and a director of Anglo Irish Bank at Druids Glen. Brian Cowen described how the event was organised:

"I was talking to Fintan Drury one day and I said to him: 'Look, I'm going away, I'm going to try and get a couple of weeks off. I haven't had a break in a long time. But before I go away, could we get a few people together? I just want to talk about people about how they see the economy - how they see things going – because we're seeing here a slowdown.' …And he suggested that he'd get a few people together."[154]

Fintan Drury said: *"We met for about two hours, we went through an agenda that Alan Gray had prepared for the meeting and which did not have banking on it at all."*[155]

Alan Gray said:

"I was invited, on behalf of the Taoiseach, to attend the meeting to outline any views I had on unemployment and on the ... what was happening in the economy - which is something that many governments have done at different periods - and I put in a lot of effort in advance of the meeting, including talking to some international economists about their perspectives and ideas, and I turned up at the meeting with my detailed notes."[156]

Gary McGann said in his evidence that the meeting took place in Fintan Drury's house, not in the Druid's Glen golf club as had been previously understood.[157]

Fintan Drury said:

"Seán Fitzpatrick, Brian Cowen and I then went and played ... I don't even remember was it nine or six holes of golf and then we went to the bar and had some drinks… Later, Gary McGann and Alan Gray returned to join us for dinner."[158]

152 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-068.

153 John Hurley, former Governor, Central Bank, transcript, INQ00047-116.

154 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-020.

155 Fintan Drury, former Non Executive Director, Anglo Irish Bank, transcript, INQ00142-005.

156 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-009.

157 Gary McGann, former Non Executive Director, Anglo Irish Bank, transcript, INQ00082-001.

158 Fintan Drury, former Non Executive Director, Anglo Irish Bank, transcript, INQ00142-006.

Brian Cowen said: *"It was about economic issues - it was nothing to do with Anglo Irish Bank at all."* [159]

Alan Gray reflected on his decision to attend the meeting: *"I certainly believe, from where we are now and what I know now, that it was a mistake … but I have been so concerned about the issue of unemployment in the Irish economy that I have never not accepted any invitation by any Government Minister or Taoiseach when I have been invited to talk on this issue."*[160]

AUGUST 2008

The Joint Committee observes that there was very little documentation provided for the month of August 2008. Kevin Cardiff was asked why there appeared to be a gap. He replied:

"I don't think there was. I mean, August is a time when some people take holidays and so forth but actually there was a lot going on in August. From what I recall, for example, the ... the budget that would normally be in December was ... was going to be in October and ... was brought forward to October. And that decision was made, as I recall, at the very end of August so there were clearly people working on the figures and so forth during August. On the financial side, as I understand it, the ... around about the end of July there was a new iteration of legislation which would have been worked on through August. So it may have been that in the natural course of things that people weren't sending notes around as much but there was work going on, you can be sure."[161]

SEPTEMBER 2008

3 September 2008 – Update on Emerging Economic and Fiscal Position

A secret Memorandum was prepared by the Department of Finance for the first Government meeting since the July recess. The report it contained made for difficult reading. It reported that:

"it is now certain that the end-year tax shortfall will be substantially higher than previously expected. The Department of Finance is currently factoring in a shortfall of €5 billion in tax receipts for the year as a whole and it could be higher."[162]

Another note for the meeting on financial market development contained more bad news. The international difficulties and the initiatives in play to help stabilise the situation were outlined. With regard to the Irish Banks the note stated:

- *"As a small banking market significantly involved in property lending particularly in the commercial sector, Irish banks have been hit hard by negative investor sentiment.*
- *A further indicator of investors' negative sentiment towards Ireland is that the yield spread of Irish Government Bonds…now stands at 47bps…normally at the low end of a 5 to 10 bp range over Germany.*
- *The share prices of individual financial institutions have been highly volatile…*

159 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-021.

160 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-008.

161 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-012.

162 Office of the Minister for Finance – Update on the Emerging Economic and Fiscal Position 2008 - 2011, DOF07703-001.

- *Irish banks are under pressure to maintain dividends…*
- *Domestic Irish banks continue to state they are open for business and are interested in proposals that offer real opportunity for added value. However, there has been a decline in levels of lending…"*
- that it should be noted that:

  "In the context of international concerns of growth in dependence by banks on liquidity from Central Banks, it should be noted that while the overall level of ECB funding availed of by banks in Ireland has increased from €39.5 billion (Dec 2007) to €44 billion (July2008), domestic banks have reduced their dependence from €15 billion to €13 billion. [This figure fluctuates and it may be too strong to suggest that there is a downward trend]."[163]

In early September 2008, the Financial Regulator circulated a memorandum to members of IFSRA's financial stability committee on *'short selling*[164]*'* noting as follows:

"…The issue of short selling has received a lot of attention over the course of 2008. This is due to the fact that the practice of short selling is considered to exacerbate market turmoil adding to volatility and risk in the market. Short selling has therefore been seen as a contributory factor in the problems experienced by financial institutions in particular, on the back of extreme share price declines in recent months..."[165]

5 September – INBS is Downgraded

On Friday, 5 September 2008, Moody's[166] downgraded Irish Nationwide Building Society's (INBS) credit rating by 2 notches.[167] Moody's report stated the downgrade reflected INBS's increasing exposure to commercial property and development which accounted for 80% of the society's loan book.[168] It also cited the rapid deteriorations in land and property values in Ireland and the UK, which were exacerbating the already high loan-to-value ratios on the INBS commercial property and development loan book.[169] The agency expected INBS's asset quality to weaken as the economic environment in both Ireland and the UK worsened.[170]

7 September

The situation at INBS was exacerbated later on 5 September 2008 when, at 18:15, a report on the Reuters newswire erroneously claimed that INBS was to be liquidated.[171]

---

163 Note for the Minister's information on financial market developments for Government meeting of 3 September 2008, DOF03356-005.

164 See Glossary of Terms.

165 Memo from Financial Stability Dept to Financial Stability Committee on Short Selling INQ00155 (subject to S.33AK Central Bank Act 1942).

166 Moody's is one of the three recognised major international statistical rating agencies, Fitch's and Standard & Poor's being the other two. Moody's report had indicated the downgrade would probably be greater except they anticipate there is a moderate probability of systemic support to INBS in the event of financial crisis.

167 Moody's uses a global rating scale, ranging from AAA, being highest quality - lowest credit risk through to C being lowest rated - typically in default with little prospect of recovery. Within each rating classification, there is a 1,2 or 3 indicating higher or lower end of that generic rating. E.g. A3 to BAA2 is a 2 level (notch) drop.

168 Committee of Public Accounts Report on the crisis in the domestic banking sector: A preliminary analysis and a framework for a banking inquiry July 2012 (21 note to minister re Moody's downgrade of INBS), PUB00072-217.

169 Committee of Public Accounts Report, July 2012, (Document no. 21 note to minister re Moody's downgrade of INBS), PUB00072-217.

170 Committee of Public Accounts Report, July 2012, (Document no. 21 note to minister re Moody's downgrade of INBS), PUB00072-217.

171 This Reuters report was subsequently retracted and is no longer available.

In evidence, Michael Fingleton, former Chief Executive, INBS said that *"[on] the night the Reuters report was issued, on the lines, we contacted the regulator's office and we informed them that the report was totally erroneous."*[172]

Reuters subsequently edited the story at 20:30 with a denial as to the story's legitimacy from INBS, before removing the story from its networks at 22:45.

As a result of these two events, the Moody's downgrade and the Reuters story, a crisis meeting was arranged for 6-7 September between representatives from Department of Finance, the Central Bank and the Financial Regulator, AIB, Bank of Ireland, and INBS. It was to be held in Central Bank Headquarters on Dame Street and was aimed at determining how to deal with the possibility of INBS facing liquidity difficulties on the Monday.[173]

In explaining these developments, John Stanley Purcell, former Finance Director, INBS noted that:

"The Reuters report was utterly unhelpful. I mean, it created a sense of unease and it was going to result in withdrawals so I mean, the regulator was taking precautions and one of the precautions was to see could a standby facility be arranged."[174]

Michael Fingleton explained that:

"...from the regulator's point of view, they felt and believed that, following the Reuters report, there might be a run on the society or that there would be a run on the society the following Monday […] and that they wished to establish whether a major bank would supply, if the society needed it, some liquidity".[175]

As to whether INBS needed liquidity, this was challenged by Michael Fingleton, when he argued that: *"we didn't need to access wholesale funds at that time. We had €4 billion of cash or near cash on deposit with counterparty banks"*.[176]

Nonetheless, the meeting proceeded in order to determine whether AIB and Bank of Ireland would provide a *"backstop"* facility for INBS.[177]

When asked whether "*AIB and Bank of Ireland indicate[d] a willingness to provide such a backup at that meeting?"* John Stanley Purcell answered *"No, they didn't indicate a willingness"*, before elaborating *"Well, we had a discussion. I can't remember all the details, but there was three of us there and the meeting just petered out."*[178]

A minute note taken at the meeting noted that:

"The banks reiterated it was not a realistic proposition for either institution to provide unsecured funding for an entity that had a hole in its balance sheet which would exceed its reserves,"[179]

---

172 Michael Fingleton, former CEO, INBS, transcript, INQ00077-016.

173 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-014.

174 John Stanley Purcell, former Finance Director, INBS, transcript, INQ00078-020.

175 Michael Fingleton, former CEO, INBS, transcript, INQ00077-017.

176 Michael Fingleton, former CEO, INBS, transcript, INQ00077-017.

177 John Stanley Purcell, former Finance Director, INBS, transcript, INQ00078-021.

178 John Stanley Purcell, former Finance Director, INBS, transcript, INQ00078-021.

179 Dermot Gleeson, file note of meeting with CB/FR, 7 September 2008, AIB02136.

Dermot Gleeson, Chairman of AIB, commenting on a meeting held on 7 September 2008 which AIB and Bank of Ireland attended at the request of the Regulator with the Senior Management of Irish Nationwide, said that an assessment was done by AIB itself and the report came back: *'"Don't touch it" in effect.'*[180]

Richie Boucher, then Chief Executive Retail Financial Services at Bank of Ireland, was also at this meeting and in his evidence to the Joint Committee, he explained that:

"There was no coherent position ... of the problem we were being asked to solve at that moment or the extent of the problem going forward. I have to admit at some stage I said to my colleague, "We should leave this meeting." We said, "We can't carry on this discussion."[181]

He recalled in evidence: *"to be honest, I felt we should get out of the building."*[182]

The two banks appeared clear in their views that the problems at INBS were not only hard to fully discern but not ones that they wished to take on. Other witnesses gave differing versions of these events.

The view of the Regulator on the meeting was expressed by Patrick Neary in his evidence to the Inquiry as follows:

"Richie Boucher would not have known what information we had on the... on the liquidity of Nationwide because we wouldn't have been in a position to share it with him because that would be absolutely subject to section 33AK, so he got no information about liquidity about Nationwide from us. A meeting was arranged, attended by the two large banks and Irish Nationwide. If Irish Nationwide chose to be, how would you say, coy or restrictive about the information they provided, look, I mean, that ... that may have happened."[183]

John Stanley Purcell commented on this same meeting in his evidence to the Joint Committee as follows:

"information was provided to the meeting at short notice on liquidity, funding liabilities and the maturity of funding liabilities. The meeting concluded without any agreement to progress the provision of a standby facility. Had the matter progressed, any additional information required not brought to the "at short notice meeting" would have been provided."[184]

Four Options for INBS

Michael Walsh said:

"On the Sunday evening of 7 September I got a phone call from Con Horan... they had been looking at a contingency plan, as you know, with AIB and Bank of Ireland that hadn't operated. Apparently, Anglo had contacted the regulator to say that they might represent a solution. I was slightly surprised, but nonetheless the regulator wanted me to meet them. I accordingly organised

180 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-039.

181 Richie Boucher, Group CEO, BOI, transcript, INQ00085-017.

182 Richie Boucher, Group CEO, BOI, transcript, INQ00085-036.

183 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-079.

184 John Stanley Purcell, former Finance Director, INBS, transcript, INQ00078-003.

to meet them the next morning. Having met them, I did a briefing paper for the regulator setting out the options as I saw them at that point in time. I met the regulator, discussed that options paper. I then revised and adjusted that at the regulator's request and submitted it to the Department of Finance. That paper is in the public domain."[185]

The paper[186] contained four options for INBS as follows:

- do nothing
- ensure an orderly run-off of INBS
- breakup INBS
- merge with another institution

Legislation

In early September 2008, the draft legislation was modified to allow the Minister for Finance to take a Building Society into public ownership if required.[187] William Beausang said:

"In early September 2008, this work was reorientated to taking a building society into public ownership on the basis of a major contribution from the office of the Attorney General, and, at a late stage, the Department's commercial legal advisers." [188]

Kevin Cardiff said that this modification was sought by the Department of Finance on the basis of a potential run on INBS. He described the publication of the Reuters report as a trigger event:

"…Reuters ran a story and their story was…Irish Nationwide about to be liquidated. This was a trigger point because that could cause a run ...this was a Friday, it could cause a run the next Monday… this is what we have been getting ready for, this is what we have legislation for."[189]

The Department of Finance, through its role on the DSG, liaised with staff of the Attorney General in drafting the necessary legislation:

"…On Friday 5th September 2008 I received a telephone call from William Beausang – a colleague who was heading up the secret work we had been doing on banking crisis preparation…"[190]

Paul Gallagher said in his evidence:

"originally, it is true to say Deputy, that the focus was on individual institutions… and in August and September, there was a preparation for the possibility that a guarantee might have to extend beyond the individual institution."[191]

In his evidence to the Inquiry, Brendan McDonagh, NTMA, recalled this period in September 2008 as follows: *"…the whole focus was on having legislation ready to nationalise a building society and a bank, if required. The NTMA provided technical input into that draft legislation."*[192]

---

185 Michael Walsh former Non Executive Chairman and Director INBS, transcript, INQ00070-060.

186 Paper re INBS Options, DOF01822.

187 Credit Institutions (Financial Support) Act 2008 (CISA).

188 William Beausang, former Assistant Secretary General, Department of Finance, transcript, INQ00127-006.

189 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-013.

190 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-042.

191 Paul Gallagher, former Attorney General, transcript, INQ00110-006.

192 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript INQ00090-008.

He also said that:

"A separate piece of legislation was also being prepared by the Department of Finance and the Attorney General's office which would enable the NTMA and the Central Bank to provide secured lending to the financial institutions."[193]

10 September

On 10 September 2008, the Banking Supervision Department produced a paper at the request of the Department of Finance entitled *'Outlook for Liquidity Irish Domestic Institutions'*[194] and sent it to Kevin Cardiff. The paper said that there were two groups of banks emerging: AIB, BOI and EBS were having some success in raising funds; IL&P, INBS and Anglo were finding funding conditions very challenging. It gave more detail on the latter three.

IL&P: Irish Life and Permanent was frozen out of medium and long term funding markets. Short term funding of up to 30 days was available to IL&P but this was unreliable. The paper noted that IL&P had turned to the ECB for liquidity and that it was not anticipated that the bank would be able to move away from this funding for the rest of the year. The paper concluded that a downgrade would cause IL&P significant problems.

INBS: The traditional INBS model of relying on retail deposits rather than debt was causing it issues, the report noted, because it had little market access. In addition, the upcoming maturity of some debts was likely to cause issues in the coming period. The report also highlighted recent downgrades by Moodys' and Fitch as having led to outflows. This, as well as their limited access to ECB funding, meant they needed to acquire funding through the securitisation of some loans. The report also noted that procuring advice from Goldman Sachs was welcome.

Anglo: At this point, the Financial Regulator painted a pessimistic picture of Anglo's prospects. It reported that Anglo had been frozen out of the term funding markets, that there was no prospect of a Medium Term Note (MTN), that corporate and retail deposits were down significantly over recent months, and that secured borrowing was one of the few remaining options. The Regulator noted that Anglo suffers from an international perception that it is not "too big to fail" and so was frozen out of international markets. At the same time, the report stated that Anglo was reluctant to seek out ECB funding in case of a downgrade.

11 September

On 11 September 2008 there was more negative news for Ireland. Fitch's agency[195] downgraded its rating for INBS by one level to BBB+ from A.[196] On the same day EBS reported a half year profit drop of 37%.[197]

193 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript INQ00090-008.

194 Committee of Public accounts, Report on the crisis in the domestic banking sector: A preliminary analysis and a framework for a banking inquiry July 2012, (Appendix 2 document no. 20 Letter dated 10 September 2008 from Financial Regulator to Department of Finance with enclosed report on liquidity conditions), PUB00072-217.

195 Fitch's is one of the three recognised major international statistical rating agencies, Moody's and Standard & Poor's being the other two. This downgrade mirrored the same sentiments for downgrade by the Moody's 5 days previously.

196 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-169.

197 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-169.

13 September

On 13 September 2008 following the meeting between Anglo and INBS, David Drumm, CEO of Anglo, wrote to the Financial Regulator with a proposal on how Anglo would acquire INBS. This would have required Government support for any deficit in the INBS net assets, a funding and liquidity backstop to cover any loss of funding. Funding and liquidity support *"comfort"* would also need to be provided to Anglo to cover any secondary contagion effects, which would not be made public.[198] His letter included the following: *"I want to stress to you again that any solution not involving Anglo Irish Bank will lead to problems…"*

15 September 2008 – Failure of Lehman Brothers

On 15 September 2008, Lehman Brothers[199] filed for bankruptcy.[200] With assets of $639 billion and debt of $619 billion, it was the biggest bankruptcy filing in history. Simultaneously contagion fears through exposure to credit default swaps[201] engulfed AIG[202] leading the US Government to give it a loan of $85 billion. Trust in the wholesale market collapsed as investors looked to see who would fail next.

16 September 2008

On 16 September the IFSRA board meeting noted that Anglo, IL&P and AIB were all anticipating breaching regulatory liquidity requirements at various points over the next month.[203]

Meanwhile, Anglo management was actively considering and pursuing various merger and acquisition possibilities, including a possible merger with IL&P and a possible takeover of INBS following a request from the Financial Regulator. The Board was advised that the Regulator was aware of the challenges facing the banking sector, but that a solution had not yet been agreed. The Board agreed that contact should be made with the Central Bank and the Taoiseach to ensure that there was Governmental support for a workable solution.[204]

17 September 2008

A background note provided to the Minister for Finance and dated 17 September 2008 stated:

"The vulnerability to adjustments in the property sector and further tightening in the availability and cost of credit internationally has put Irish banks under increased pressure. This is impacting individual institutions differently, but all are under pressure, especially the smaller ones."[205]

---

198 Letter from David Drumm to Patrick Neary, 13 September 2008, DOF03148.

199 Lehman Brothers was a global financial services firm. It was the fourth-largest investment bank in the US (behind Goldman Sachs, Morgan Stanley, and Merrill Lynch), doing business in investment banking, equity and fixed-income sales and trading (especially U.S. Treasury securities), research, investment management, private equity, and private banking.

200 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-169.

201 A credit default swap (CDS) is a financial swap agreement that the seller of the CDS will compensate the buyer (usually the creditor of the reference loan) in the event of a loan default (by the debtor) or other credit event.

202 American International Group (AIG) is a US multinational insurance corporation with more than 88 million customers in 130 countries and is one of the world's largest insurers. It was deemed too big to fail by the US Government.

203 IFSRA minutes of meeting 16 September 2008, INQ00023-006.

204 Anglo Irish Bank board minutes dated 17 September 2008, IBRC00595-002.

205 Committee of Public Accounts, Report on the crisis in the domestic banking sector: A preliminary analysis and a framework for a banking inquiry July 2012 (Appendix 2 document no. 16 Background note for Minister for Finance on Financial Market Developments to 17 September 2008), PUB00072-217.

18 September 2008

On 18 September Michael Fingleton had a meeting with the David Doyle, Secretary General of the Department of Finance. He explained:

"The purpose was to ask or suggest to the Government that they would increase the guarantee on deposits from €20,000 to €100,000. That was the purpose of that meeting."[206]

The proposal to increase the Deposit Guarantee Scheme was raised by the Central Bank on the same day at a meeting with Brian Lenihan and others.[207] A one page minute of the meeting also records a report from John Hurley that liquidity was under great strain and there was now a *"potentially serious crisis."* John Hurley said that liquidity was tight for all six banks; AIB and BOI were *"ok for now"*, EBS and IL&P had ECB access, but INBS and Anglo were facing very immediate problems. Anglo was reported as *"the bigger problem"* and if it didn't stabilise could create *"knock on difficulties"*.

The Central Bank proposal to increase the Deposit Guarantee Scheme to cover deposits of €100,000 was agreed to by Brian Lenihan and he asked that a statement be prepared on the Scheme immediately. [208]

Commissioning External Advisors

There was a growing question at this time over the sufficiency of the Financial Regulator's knowledge of the banks' liquidity and balance sheet positions. Kevin Cardiff said:

"we believed ... were led to believe that the regulator had a good picture of the banks under its remit, that reasonable loan loss stress testing had been done, that the banks were regarded as solvent, resilient, capable of withstanding significant shocks and we accepted that. And we stopped accepting it at the beginning of September when, when we had the Nationwide issue and it became clear that in fact, this general sense of how the banks were being run wasn't, wasn't being backed up by very specific data."[209]

He said: *"myself, Brendan McDonagh, John Corrigan decided that we needed this kind of advice*[210]*"*

John Corrigan said: *"… there was a dearth of knowledge, of detailed knowledge around the institutions…"*[211] Following their meetings earlier in the month the NTMA encouraged the Central Bank and the Financial Regulator to get consultants into the banks to do a *"deep dive"*.[212]

206 Michael Fingleton, former CEO, INBS, transcript, INQ00077-018.

207 Note of meeting, 18th September 2008. List of attendees: Brian Lenihan, Department of Finance (Kevin Cardiff and David Doyle), NTMA (Michael Somers, John Corrigan, Brendan McDonagh), CBFSAI (John Hurley, Tony Grimes, Brian Halpin) and the Financial Regulator (Jim Farrell, Patrick Neary), DOF03376-001.

208 Note of meeting, 18th September 2008. List of attendees: Brian Lenihan, Department of Finance (Kevin Cardiff and David Doyle), NTMA (Michael Somers, John Corrigan, Brendan McDonagh), CBFSAI (John Hurley, Tony Grimes, Brian Halpin) and the Financial Regulator (Jim Farrell, Patrick Neary), DOF03376-001.

209 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-032.

210 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-071.

211 John Corrigan, former Director of Funding and Debt Management, NTMA, transcript, INQ00106-012.

212 John Corrigan, former Director of Funding and Debt Management, NTMA, transcript, INQ00106-009.

As a result, the Department of Finance and NTMA encouraged the Financial Regulator to commission Goldman Sachs and PwC to get more detailed information on the balance sheets of INBS and Anglo respectively. At the same time, the NTMA commissioned Merrill Lynch and Morgan Stanley as its external advisors.[213]

When Goldman Sachs was being commissioned (6/7 September[214 215]) Brendan McDonagh recalled sending an email[216] to Kevin Cardiff listing 33 *"obvious"* questions that *"we should know the answers to."*[217]

It was put to Patrick Neary that the State had paid millions of euros to outside consultants in September 2008 to carry out a review in relation to bank loan books and to capital adequacy; information that the Financial Regulator, required the banks to report on a daily/weekly/quarterly basis. He was asked why these consultants were required. He said:

"…the Authority (IFSRA) decided to quality assure the information that we had, that it would be good to have another set of eyes to look at the information and to make sure that we came to the same consensus view…"[218]

He also responded in a witness statement to the concerns regarding the adequacy of the Financial Regulator's information:

"It is not clear, however, what those inadequacies were... At no stage can I recall any such concerns being escalated to me. In the years preceding the crisis, the Banking Supervision Department of the Financial Regulator had implemented, in full, the prudential data reporting requirements (Finrep) of the EU Basel 2 Directive and had supplemented these quarterly reports with additional quarterly reports on non-performing assets and loan loss provisioning levels."[219]

He said the findings of the external advisors confirmed information the Financial Regulator already had. [220]

The Financial Regulator, *"with a little bit of pushing"* according to Kevin Cardiff,[221] engaged PwC on 18 September specifically to review Anglo's short term liquidity, credit quality and management assumptions in respect of these. Dennis O'Connor of PwC recollected:

"We commenced our work on Anglo Irish Bank on the following day, 19 September. Over the following number of days, our engagement was extended to include Irish Life and Permanent and Irish Nationwide Building Society."[222]

213 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-036.

214 Note of Meeting with Goldman Sachs, dated 21 September, DOT: Core Book 35, KCA00001-261.

215 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-036. Morgan Stanley were initially approached as advisors, this did not proceed beyond a couple of days owing to possible conflicts of interest.

216 Email Brendan McDonagh to Kevin Cardiff, 21 September 2008, NTMA00447.

217 Brendan McDonagh, former Director of Finance, Technology and Risk, NTMA, transcript, INQ00090-026.

218 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-075.

219 Patrick Neary, former CEO and former Prudential Director, IFSRA, statement, PNE00002-003.

220 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-074 to 109.

221 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-071.

222 Denis O'Connor, Partner PwC, transcript, INQ00097-003.

19 September – Merging with Anglo

On Friday, 19 September 2008 the INBS board formally met to consider an approach from Anglo to merge. A merger of INBS and Anglo had been suggested after the meeting with the Regulator on the 7 September. They considered that it had no benefit for INBS, because all the *"upside"* would be on the Anglo side.[223]

Discussions had been held by IL&P and the Financial Regulator and Department of Finance officials during the days prior to 19 September. The IL&P board met on Friday 19 September and was briefed on these discussions.[224] The position adopted at that meeting was:

- to reject an approach which Anglo had made proposing a merger.
- to develop the option of a possible takeover of EBS.

20 September - Increase of Deposit Guarantee Scheme

On 20 September, Ireland's Deposit Guarantee Scheme[225] was increased to €100,000 from €20,000 to try to reassure depositors that their money was safe. A briefing note for the Taoiseach, stated:

"The Governor of the Central Bank and the Financial Regulator have stressed repeatedly that Irish financial institutions are well capitalised and liquid with good quality assets."[226]

Morgan Stanley review of IL&P

On the same day, the Morgan Stanley report on IL&P[227] was presented to the Department of Finance. This report was based primarily on management accounts and discussions with management.

Morgan Stanley advised that the IL&P loan book was generally low risk, but 2006 mortgage and commercial lending were likely to cause bad debt provisioning to increase significantly in the future. [228] The bank had stopped *"buy to let"* lending and commercial lending was at an absolute minimum since early 2008.

Regarding liquidity, *"both ratings agencies had IL&P on negative outlook"* and the bank was relying heavily on ECB funding as the interbank and debt markets were effectively closed.[229]

The Morgan Stanley report presented Government with six potential options to lend support should the bank encounter difficulties, ranging from provision of equity capital by the State through to a good bank/bad bank split.[230]

223 INBS board minutes dated 19 September 2008, IBRC00796-005.

224 Minutes of IL&P board meeting dated 19 September 2008, PTSB00884.

225 Press release dated 20 September 2008, PUB00291.

226 Briefing for the Taoiseach, 20 September 2008, DOF03159.

227 Committee of Public Accounts, Report on the crisis in the domestic banking sector: A preliminary analysis and a framework for a banking inquiry July 2012, (Appendix 2 document no. 11 Discussion Documents prepared by Morgan Stanley), PUB00072-217.

228 Morgan Stanley, discussion materials on IL&P, INQ00075-003.

229 Morgan Stanley, discussion materials on IL&P, INQ00075-005 to 014.

230 Morgan Stanley, discussion materials on IL&P, INQ00075-015.

The Financial Regulator Meets the Banks

A series of meetings between Patrick Neary and six Irish banks took place on Saturday 20 September to try to ascertain the true liquidity position of each bank. As the minutes of these meetings are covered under Section 33AK the identities of the institutions cannot be disclosed.

Bank A advised the meeting that it had a confidence and liquidity issue. It had experienced €700 million of withdrawals since Q3 2007 and was concerned that it would suffer further withdrawals from deposits accounts above the new €100,000 guarantee limit. A document outlining the options available to the bank was presented at the meeting.[231]

Bank B advised the Financial Regulator that it was experiencing significant liquidity issues. Money was flowing out of deposits and the bank requested liquidity support in the form of a Central Bank promissory note.[232]

Bank C said that it would be out of cash in a matter of weeks. Irish lines were being cut by large depositors and if the current pace continued, then it would be in difficulty even sooner. It advocated a statement that no creditor of an Irish regulated entity will lose/fail. It said it could not offer funding for Bank A as it would be bad for its own rating.[233]

Bank D advised the Financial Regulator that it had lost access to US$ funding and that it had US$20 billion repayable in 30 days. It also advocated against involvement with Bank A, as it was considered that there would be a serious contamination risk.[234]

Bank E told the Financial Regulator that it was *"in good shape"* and that it was in talks with Bank F regarding a takeover. The Financial Regulator was also informed that Bank E regarded merger of Banks A and B as *"not credible"*.[235]

Bank F advised the Financial Regulator that its asset quality was high and that its capital could absorb all impairments even under most stressed scenarios. Funding was regarded as the big challenge. It was also stated that it regarded an amalgamation with Bank E as having potential, with productive discussions well underway.[236]

21-22 September – Goldman Sachs review of INBS

On 21 September 2008, Kevin Cardiff and other Department of Finance officials met with Goldman Sachs prior to receiving its report on INBS which had been commissioned over the weekend of the 6/7.[237]

"The assessment was perhaps a bit more upbeat than we had feared at the time, and in retrospect and with all the benefit of hindsight was hopelessly optimistic. On Sunday 21 September 2008, I heard this assessment in a meeting with Basil Geoghegan from Goldman Sachs and various others.

231 Central Bank Minutes of Meeting - CB Narrative, INQ00172.

232 Anglo Irish Bank board minutes dated 17 September 2008, IBRC00595-002.

233 IFSRA meeting September 2008, CB Narrative, INQ00163.

234 IFSRA meeting September 2008, CB Narrative, INQ00163.

235 IFSRA meeting September 2008, CB Narrative, INQ00163.

236 IFSRA meeting September 2008, CB Narrative, INQ00163.

237 Note of Meeting with Goldman Sachs, dated 21st September, DOT: Core Book 35, KCA00001-261.

While it might be difficult to get 100% back on some of the loans they had issued, there was nothing to suggest any losses could not be absorbed by INBS' own capital. In other words, they seemed to be in some trouble, would need some help, but were probably solvent."[238]

These reports had been commissioned at the "encouragement" of the Department of Finance and the NTMA.

The Goldman Sachs draft report on INBS[239] was provided to the Department of Finance on 22 September.

Their findings were based on discussions with INBS management, a data gathering exercise and an initial review of the top 60 commercial exposures. Goldman Sachs advised regarding INBS' assets that *"it is not possible at this point to ascertain the extent, depth, quantum and timing of potential losses."*[240]

On liquidity, net outflows since 5 September were €868 million (approximately 20% of liquid assets) and *"INBS is unable to access unsecured debt markets for liquidity."*[241] In short liquidity was *"considerably strained."*

23 September

On Tuesday at an IFSRA board meeting, it was confirmed by Pat Neary that legislation to nationalise a bank or building society was ready.[242]

24 September

Pádraig Ó Ríordáin, former Managing Partner of Arthur Cox, provided evidence that:

"Arthur Cox was engaged by the Department of Finance on the morning of Wednesday, 24 September 2008, to advise in respect of the emerging banking crisis."[243]

Eugene McCague, Chairman of Arthur Cox added:

"We were looking clearly at the option of the legislation for the nationalisation of Anglo and Irish Nationwide. This was what my main, if not sole, focus over those days..."[244]

There was bad news on 24 September, when CSO quarterly figures revealed that Ireland was officially in recession.[245]

---

238 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-005.

239 Goldman Sachs presentation on INBS, DOF03206.

240 Goldman Sachs Discussion materials regarding strategic options, DOF03206-008.

241 Goldman Sachs Discussion materials regarding strategic options, DOF03206-007.

242 IFSRA meeting 23-24 September meeting, INQ00158.

243 Pádraig Ó Ríordáin, Partner, Arthur Cox, transcript, INQ00111-003.

244 Eugene McCague, Partner, Arthur Cox, transcript, INQ00111-006.

245 The common definition of a recession is two successive quarter of decline. CSO Quarterly National accounts, quarter 2 2008 stated: GDP decreased by 0.8% compared to same period 2007. This is the second successive quarter in which GDP showed a decrease. [source: CSO.ie ref 180/2008].

PwC attended a large[246] meeting with officials and advisors on 24 September in Government Buildings. Kevin Cardiff described it as *"tense."*[247] A minute of the meeting records that representatives of PwC reported on the Anglo loan book, based on the work they had done. At the meeting Pat Neary said that there was no evidence that Anglo was insolvent, *"it is simply unable to continue from a liquidity point of view"* and that INBS was in a similar situation.

Kevin Cardiff underlined the urgency of the situation and it was agreed to prepare legislation on intervention options, including liquidity support, guarantees, nationalisation and a *"bad bank approach"*. This appears to contradict the information that Patrick Neary gave to the IFSRA board the previous day when he said that legislation to nationalise was ready.

25 September

At a further crisis meeting on Thursday, 25 September, IL&P told the FR that an explicit guarantee was needed.[248] Patrick Neary stated that this would cost in the region of €500 billion and went on to say that, if the State stepped in, the taxpayer would expect to get something back i.e. the guarantee was likely to require some surrender of equity. IL&P responded that *"the situation had gone beyond protecting equity."*[249] IL&P also updated FR on its merger talks with EBS, which it estimated would probably require €7/8 billion to set up on stable footing.

CBFSAI Board meeting

On the same day, John Hurley provided an update to the CBFSAI board on all the banks' liquidity difficulties and advised that one bank's situation was most critical. The Government asked for policy options and the resources of the Central Bank and Financial Regulator were committed to work on this as an urgent priority over the coming weekend.[250]

The meeting was also told that the Central Bank was keeping in close contact with the ECB regarding the difficult situation in Ireland and Europe. John Hurley said he had spoken directly with Jean-Claude Trichet.

It was noted at the meeting that a €20 billion fund from the Central Bank and NTMA would not be sufficient in the event of further liquidity losses by the domestic banks. The key policy item for the weekend would be whether Government should issue a six-bank guarantee.[251] The Governor mentioned that an explicit guarantee covering €400 billion liabilities was not something he would have favoured previously; however in the evolving situation, he now believed it required serious consideration.[252]

246 Attendees Brian Cowen, Brian Lenihan, the Attorney General, Pat Neary & Jim Farrell (FR); John Hurley & Tony Grimes (CB); David Doyle & Kevin Cardiff (DoF); Dermot McCarthy (DoT), Michael Somers & John Corrigan (NTMA) Basil Geoghegan (Goldman Sachs); Henrietta Baldock & Prasath (Merrill Lynch); Denis O'Connor (PwC); Eugene MacCague (Arthur Cox), DOF03377.

247 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-064.

248 File Note of Meeting with Financial Regulator 09.30 September 2008, PTSB02347.

249 File Note of Meeting with Financial Regulator 09.30 25 September 2008, PTSB02347-001.

250 Minutes of CBFSAI board meeting held on 25 September 2008, INQ00023-008/009.

251 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, statement, AGR00001-068.

252 Minutes of CBFSAI board meeting held on 25 September 2008, INQ00023-009.

That weekend, the CBFSAI produced its own paper on *"resolution options"* that said a blanket guarantee was the simplest option, and that it would include senior and unsubordinated debt. On the downside, the paper said a guarantee neglected the public interest argument and the potential costs to the taxpayer were unclear. Nationalisation was mentioned in the paper, but with a note of caution regarding the risks of contagion.[253]

After the meeting CBFSAI board member, Alan Gray[254] *"decided that evening to write to the Department of Finance, the regulator and the Governor of the Central Bank."*[255] He sent a strategic advice paper, presented under Indecon-headed paper, his consultancy company.[256]

His short paper briefly assessed a range of options to improve liquidity in the banking sector and potential responses to individual banks with liquidity issues.[257] On options for the sector as a whole, he said that a state guarantee of all loans merited serious consideration. He also said that a temporary guarantee had some clear merits over an unlimited guarantee but there was a risk of a market event when such a guarantee would end.[258] On individual banks he favoured market solutions and said nationalisation was the worst option and said *"negative system wide impacts are clear"* and *"the scale of the exchequer exposure and level of funding required is likely to be much greater when contagion impacts are taken into account."*[259]

26 September

A presentation made to the board of EBS on Friday, 26 September 2008, stated: *"Government intervention anticipated and unavoidable; potential scale of intervention is likely to be considerable and could change the Irish banking landscape here fundamentally."*

The presentation noted the extreme stress affecting all Irish institutions and the consequent vulnerability of EBS as a smaller entity among financial institutions.[260]

Department of Finance asks the advice of the NTMA

Around lunchtime, in an email[261] to Brendan McDonagh, William Beausang said the Secretary General wanted an analysis from the NTMA on problems that might be encountered for the sovereign rating if the State provided a *"guarantee for all deposits/credits of the domestic banking system or would have to provide substantial funding … for institutions taken into protection regime."* The Secretary General also noted that a system-wide guarantee would be controversial from a *"State aid perspective."*

In his reply[262] Brendan McDonagh said *"this is very difficult to answer"* as the potential exposure to

253 Crisis Resolutions Options Paper, INQ00168.

254 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants. [Brian Cowen stated to the Inquiry that he was someone whose views he respected], transcript, INQ00089-007.

255 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-007.

256 The Inquiry has evidence of a copy of the letter addressed personally to Kevin Cardiff, DOF03290.

257 Letter from Alan Gray to Kevin Cardiff, DOF03290-004/005.

258 Letter from Alan Gray to Kevin Cardiff, DOF03290-004.

259 Letter from Alan Gray to Kevin Cardiff, DOF03290-005.

260 EBS Board presentation, 26 September 2008, EBS00151.

261 Email from William Beausang to Brendan McDonagh, 13.26, 26 September 2008, DOF03309.

262 Email from Brendan McDonagh to William Beausang, 13.26, 26 September 2008, DOF03309.

the State *"is not yet independently quantified"*. He said Ireland could *"expect to be put immediately on negative watch and probably soon after be downgraded"*. He estimated that combining the taking on of balance sheets of both Anglo and INBS of €110 billion and *"guaranteeing the others of over €420 billion"* with a deteriorating budget deficit would lead to *"an increase in the cost of funding of perhaps at least 1 percent funding costs. If the State is funding a €50 billion national debt and a €110 nationalised bank"* then this increase would cost an extra €1.6 billion per annum.

Merrill Lynch review

On the same day Merrill Lynch (who had been formally engaged by the NTMA on 23 September to advise the Government), presented a draft preliminary analysis[263] to a group that included the Minister for Finance along with a number of senior representatives from the Central Bank, Financial Regulator and the Department of Finance.[264] Merrill Lynch pointed out that it had been engaged for just 48 hours and had *"not spoken to the management of any of the Irish banks"* and that its analysis was based on *"limited verbal information from the Ministry for Finance and IFSRA."*[265] The slides from Merrill Lynch's presentation gave pros and cons for a number of options including a Guarantee, a Secured Lending Scheme/ELA, Good Bank, Bad Bank, Protective Custody, and Liquidation.

A minute from the meeting[266] records that on a blanket guarantee, Merrill Lynch felt that this *"could be a mistake and hit national rating and allow poorer banks to continue."* Dangers included *"credibility and prolonging of weak institutions."* They said liquidation was the worst solution. The Minister asked for opinions to be articulated clearly over weekend *"so as to be ready to present to Govt."*

27 September – Brian Lenihan and Jean-Claude Trichet

In an interview for the RTÉ documentary *"Freefall"* in September 2010, Brian Lenihan said:

"Mr. Trichet rang me, and hadn't been able to get through to me. I was a racecourse in County Kilkenny at a Fianna Fáil event on the Saturday [27 September]. So I caught up with Mr. Trichet's message the following day which was that 'you must save the banks at all costs' ".

Jean-Claude Trichet,[267] former President of the ECB was asked to comment on the RTÉ interview and said that there was:

"No message to Brian, no message to the Government of Ireland, but, if you read the papers, at the time, all central bankers of the world were telling all governments "Don't do again Lehman Brothers" So, put that in your mind. There was no call from me to Brian."[268]

---

263 Presentation to NTMA, Merrill Lynch, dated 26 September 2008, DOF02557.

264 Attendees at Merrill Lynch presentation on 26 September 2008: Minister for Finance, MLx3,Bob O'Hara, Con Horan, Kevin Cardiff, David Doyle, DOF03375.

265 Presentation to NTMA, Merrill Lynch, dated 26 September 2008, DOF02557.

266 Minutes of Meeting with Merrill Lynch, 26 September 2008, DOF02809.

267 Jean Claude Trichet, former President of the ECB, presented a paper and responded to questions by members of the Joint Committee of which he had prior notification, at a meeting of the Institute of International and European Affairs at the Royal Hospital Kilmainham on 30 of April 2015. He did not appear as a witness before the Joint Committee, nor could he be directed to appear because he is not an Irish citizen, nor is he resident in the State. He was subsequently requested by the Joint Committee to assist the inquiry on issues where material clarifications were required. He chose not to assist.

268 Jean-Claude Trichet, former President of the ECB, transcript, INQ00140-025.

John Hurley told the Joint Committee that he had been in contact with Jean-Claude Trichet over the period leading up to the end of September, through various meetings; formal meetings in Frankfurt, informal meetings and teleconferences.[269] He confirmed that the liquidity position of the Irish banks was known to the ECB:

"The liquidity positions in relation to the Irish banks would have been pretty obvious as a result of the developments that were taking place on the ECB funding and that was moving in a particular way in the course of 2008."[270]

He also said that *"…the liquidity position of one bank in particular was known."*[271]

In response to the question *"Were you personally aware of the deteriorating liquidity and solvency in Irish banks in Ireland in 2008, in particular September 2008?"* Jean-Claude Trichet replied: *"I was aware of the liquidity constraint. I have to say all over Europe… And the Irish banks were part of it. But again, at that time, it was a general problem."*[272]

When asked: *"Did the Governor of the Central Bank of Ireland brief you or your officials in the ECB on the liquidity-solvency situation and the options being considered?"* He replied:

"I would say … Ireland was one of all the advanced economies, one of course of the 15 I already mentioned in Europe, and we had the same, I would say, message for all, "We are in the worst crisis since World War II, make no mistake, it is exactly the situation, it is absolutely drastic, you have to take that into account. On our side we are doing all that we can on the liquidity basis, you are responsible, your government, for the solvency basis."[273]

28 September

AIB noted at its board meeting that Sunday, that:

"…the authorities expected that two financial institutions would fail (unless white knights emerged), and would guarantee the obligations of the other financial institutions on a temporary basis."[274]

At a separate meeting, PwC presented its initial findings on Anglo, IL&P and INBS to the Central Bank and the Department of Finance since its appointment on the 18 September. This report focused principally on short term liquidity, credit quality and capital assumptions made by management in respect of these issues.

In an email later that day to Brendan McDonagh of NTMA, John Loughlin of PwC gave summary scenarios for the three banks discussed that morning: Anglo, IL&P and INBS. It recommended having contingency plans for all three in the week commencing 29 September. The analysis in the Memorandum of 28 September 2008 on the banks' loan books was based only on information that had been provided to Merrill Lynch from PwC regarding Anglo, from Goldman Sachs regarding INBS and limited verbal information from the Department of Finance and IFSRA.[275]

269 John Hurley, former Governor, Central Bank, transcript, INQ00047-063.
270 John Hurley, former Governor, Central Bank, transcript, INQ00047-065.
271 John Hurley, former Governor, Central Bank, transcript, INQ00047-064.
272 Jean-Claude Trichet, former President of the ECB, transcript, INQ00140-024.
273 Jean-Claude Trichet, former President of the ECB, transcript, INQ00140-024.
274 AIB board meeting minutes, AIB02247-001.
275 Email John Loughlin PwC to Brendan McDonagh NTMA, 28 September 2008, DOF07880.

Merrill Lynch review of Anglo, INBS, IL&P[276]

Following its draft report presented on Friday 26 September, Merrill Lynch provided a more detailed report by way of Memorandum[277] on Sunday 28 September 2008. The analysis in the Memorandum of 28 September 2008 on the banks' loan books was based only on information that had been provided to Merrill Lynch from PwC regarding Anglo, from Goldman Sachs regarding INBS and limited verbal information from the Department of Finance and IFSRA. This report was presented in NTMA Treasury building on the Sunday morning.[278] In summary, the report noted:

- The asset quality of INBS' commercial loan book was regarded as being generally good.
- Based on its own management projections, INBS has liquidity sufficient to meet its needs for around one to two months depending on the level of withdrawals.
- Merrill Lynch also had concerns over the influence of the Chief Executive.

Only 3% of the Anglo loan book was regarded as impaired by its management at that time. Merrill Lynch felt that falling property prices are likely to impact their book, particularly where they have lent on speculative development. The main issue for Anglo was a pressing need for liquidity as a result of a sustained outflow of corporate deposits and overnight funding being unavailable to banks of their credit rating. Merrill Lynch noted that Anglo had formally requested a short term liquidity advance of €1.7 billion from the Central Bank on Friday 26 September for the end of the month.

The asset quality of IL&P was reported as good but they were heavily reliant on wholesale funding and approaching the limit of their eligible collateral with the ECB.

Merrill Lynch also outlined strategic options on the reviewed banks, all of which would have required financial resources from the Government.[279] Among the six options considered was state protective custody for Anglo and INBS which Merrill Lynch felt would solve immediate liquidity issues, but at a high cost. On the impact on equity/debt holders, the report noted that *"there are significant retail interests."*[280] Another option was a good bank/bad bank scheme whereby the bad loans of the banks would be transferred to a State bank to allow a controlled orderly wind down. The report noted that it was difficult to predict how long the work out of the assets would take but Bank of Ireland published projections showed a three to five year period is required to recover 80% – 90% of book value. On the options of a state guarantee to all depositors and senior creditors of the six primary regulated financial institutions, the report noted that this could be over €500 billion, and that the wider market would have been aware that Ireland could not afford it if the guarantee was called in. It was commented that it might also be poorly perceived by other European States if liquidity flows were to migrate.

276 Memorandum from Merrill Lynch, NTMA00399-002/003.
277 Memorandum from Merrill Lynch, NTMA00399.
278 Brendan McDonagh, former Director of Finance, Technology & Risk, NTMA, transcript, INQ00090-017.
279 Memorandum from Merrill Lynch, NTMA00399-003 to 007.
280 Memorandum from Merrill Lynch, NTMA00399-004.

One option was discounted:

"…allowing an Irish bank to fail and go into liquidation without any government intervention. Whilst this option would initially have no financial impact to the government… The ensuing 'firesale' of assets could precipitate dramatic asset deflation and hence force other Irish banks to take significant write downs on their own asset portfolios thus depleting their capital positions."[281]

The report concluded:

"The market environment is highly uncertain with international developments adding to the pressure on Irish financial institutions… In this context, it is important for the Government to be prepared to act quickly and decisively as required, to step in and prevent a systemic problem."[282]

Sunday Cabinet Meeting

A pre-budget Cabinet meeting was held on Sunday, 28 September 2008. A Department of Finance briefing note prepared for the meeting stated that *"a tax shortfall of the order of €6.5 billion was likely by 2008."*[283] After the budget discussion[284] Brian Lenihan gave an oral presentation on the international financial markets and their impacts on the Irish banks.[285] The Minister explained how the volatility of the markets was adversely affecting liquidity positions.

The Joint Committee sought to determine whether the Cabinet had come to any conclusions on the banking crisis at its meeting. Dermot McCarthy responded: *"I can say very emphatically that there was no decision in respect of any banking matter taken at that meeting."*[286]

Former Minister, Mary Harney's memory of the discussion at the end of the Cabinet meeting was:

"… that banks were running out of money, that they were solvent but that they were running out of money… But I was aware that a serious situation was emerging, it wasn't a surprise to me."[287]

Mary Harney also stated that at the Cabinet meeting of the 28 September 2008: *"I don't think the word "guarantee" or anything like that was mentioned."*[288]

Dermot McCarthy also said that: *"... there was no orientation or mandate in respect of an approach arising from that Government meeting."* However, when asked if Cabinet members might have been aware of unfolding events, Dermot McCarthy said: *"... I think it would be fair to say that they wouldn't have been surprised that something did arise."*[289]

---

281 Memorandum from Merrill Lynch, NTMA00399-003.
282 Memorandum from Merrill Lynch, NTMA00399-007.
283 Briefing for Cabinet Meeting, Sunday 28 September, DOF03154.
284 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-012.
285 Bullet Points for cabinet 28 September 2008, DOT00161.
286 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-012.
287 Mary Harney, former Tánaiste & Leader of the Progressive Democrats, transcript, INQ00136-036.
288 Mary Harney, former Tánaiste & Leader of the Progressive Democrats, transcript, INQ00136-040.
289 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-012.

29 September

Anglo Irish Bank held a board meeting on 29 September. The minutes reported that the Group had experienced another day of outflows from the wholesale Funding Desk. Senior management in Anglo had decided to propose to BOI and AIB a joint approach to Government to discuss their concerns.[290]

Dermot Gleeson confirmed that Seán Fitzpatrick had sought a meeting with him in his capacity as Chairman of AIB:

"I had a phone call from Sean Fitzpatrick asking for a meeting, which I declined, and he also asked me if I'd go with him to the Central Bank, I think, or go to the Government. I'm not sure. Anyway that meeting did not happen."[291]

Chairman of Anglo, Seán Fitzpatrick and its Chief Executive, David Drumm met with the Chairman of Bank of Ireland, Richard Burrows and Group Chief Executive, Brian Goggin. The meeting lasted *"maybe 30 minutes, 45 minutes."*[292]

Richard Burrows said:

" they asked us if we would consider taking over Anglo, if we would consider buying any part of Anglo, they were looking for any kind of assistance at all that we could offer in a situation which was clearly of the utmost severity in terms of that default which they were likely to have the following morning."[293]

Brian Goggin said:

"we had absolutely no interest in acquiring Anglo Irish Bank and we politely told them that we could not be of assistance."[294]

Seán Fitzpatrick and David Drumm called to Alan Gray that same day:

"I did not invite them to come, they came. I believed they understood that the bank would not open the next day because that was the information that was available to the Financial Regulator and I think was widely known in the market. And I think they were very keen to try and find any option or any channel to, you know, have their views aired. They came and they ... Mr. Drumm had a presentation with him. I told him I had a very busy day and, you know, was there ... I'd prefer he would just tell me what was the purpose of the meeting. And he went through a number of points in his presentation. He didn't leave it with me. I told him these were issues that they should talk directly to the Central Bank on, and to the Financial Regulator, and that was what happened."[295]

The Anglo minutes also record that *"Bank of Ireland felt it was worthwhile,"*[296] but the AIB Chairman had declined an invitation to meet. The minutes also record that the Chairman and CEO reported *"on a number of discussions"* during the day with John Hurley regarding the urgent need for a solution to the systemic liquidity issues facing the system. They said they were advised that a

---

290 Anglo Board meeting minute, 29 September 2008, IBRC00605-001.

291 Dermot Gleeson, former Chairman, AIB, INQ00123-049.

292 Richard Burrows, former Governor, BOI, transcript, INQ00104-016.

293 Richard Burrows, former Governor, BOI, transcript, INQ00104-016.

294 Brian Goggin, former Group Chief Executive, BOI, transcript, INQ00139-009.

295 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-012.

296 Anglo Irish Bank, Minutes of the Board of Directors, 29 September, IBRC00605.

solution would be forthcoming.[297]

Richard Burrows also met with John Hurley that day. He had a pre-arranged meeting. He said this was to: *"talk about other matters which had to do primarily with wholesale funding and collateral for funding."*[298]

He also said that he took the opportunity:

"of explaining to Mr Hurley, the visit that I'd had from Anglo and explaining my concern at the very difficult situation which could result from this default the following morning and I asked if there was any plan in place in the Central Bank to deal with the situation."[299]

He said he was:

"…somewhat surprised to find out that there was not and it was Mr Hurley's guidance to me that if I wanted to take matters further, that I should make an approach to Government."[300]

According to the Bank of Ireland Board minutes, the Central Bank and Financial Regulator asked Bank of Ireland to consider acquiring IL&P in a situation where Anglo and INBS had already failed.[301]

Richard Burrows' impression was that John Hurley was:

"…surprised at the information that I gave him that we'd had this call and this visit by the Chairman and Chief Executive of Anglo and the state of desperation which they had reached on that morning."[302]

John Hurley, in his evidence said that he had not been informed of the meeting between BOI and Anglo that day *"… I don't believe he [Burrows] told me about that meeting. I believe what he told me about were the problems of Anglo Irish."*[303] John Hurley also noted in his evidence that confidentiality considerations would have restricted the context of the discussion of these matters outside of the relevant participants.

Brian Goggin said:

"The issue confronting us on 29 September was the fact that I and the Governor of the Bank of Ireland had been put on notice that Anglo Irish Bank was going to default the following day."[304]

Richie Boucher said in his evidence to the Joint Committee that:

"Anglo had come to us [BOI] that afternoon to say "we're going to default" that's effectively what they said, and my belief is that our chief executive and our chairman felt that they had to tell the Government something was going."[305]

297 Anglo Irish Bank, Minutes of the Board of Directors, 29 September, IBRC00605.

298 Richard Burrows, former Governor, BOI, transcript, INQ00104-016.

299 Richard Burrows, former Governor, BOI, transcript, INQ00104-017.

300 Richard Burrows, former Governor, BOI, transcript, INQ00104-017.

301 BOI Court Minute extract, 3 October 2008, BOI03886.

302 Richard Burrows, former Governor, BOI, transcript, INQ00104-043.

303 John Hurley, former Governor, Central Bank, transcript, INQ00047-097.

304 Brian Goggin, former Group Chief Executive, BOI, transcript, INQ00139.

305 Richie Boucher, Group CEO, BOI, transcript paragraph 606. BOI Court minute extract dated 3 October refers to a visit by Fitzpatrick and Drumm to BOI to consider a takeover of Anglo. They also advised that they would be approaching AIB with the same request, BOI03886-002.

Brian Goggin informed BOI Group Liquidity Committee that a meeting had been arranged with the Taoiseach for later that evening at which a group of senior bankers would discuss the possibility of a Government guarantee being provided for all borrowing by Irish institutions.[306]

During the day also according to William Beausang:

"work was being carried out with the office of the Attorney General on the emergency legislation".[307]

Brian Lenihan had a pre-arranged meeting with former General Secretary ICTU and Central Bank board member, David Begg, to discuss the mounting problems facing the economy and the labour market. David Begg confirmed to the Joint Committee that they did not discuss the banking crisis.[308]

AIB Chairman Dermot Gleeson said:

"In the afternoon of Monday the 29 September I received a phone call from Richard Burrows of Bank of Ireland. At that stage there was extreme turmoil in the markets and there was a clear impression that Anglo was in serious trouble and that the plan of the authorities was to take Anglo and INBS into some sort of State care – Richard indicated that matters were so difficult we should seek to speak with the Taoiseach and Min for Finance."[309]

Richard Burrows said: *"a phone call was made out of our office in Bank of Ireland to the Taoiseach's Department and as a result of that, the meeting was set up."*[310]

Richard Burrows said that the purpose of the meeting was:

"…. to make sure that they (Government) were fully aware of the severity of the situation that could unfold the following morning and the impact that they could have on the banking situation of large."[311]

Dermot Gleeson said that the purpose was to:

"….discuss the dramatically deteriorating international solution, the apparently dire straits in which Anglo found itself and the possible repercussion of Anglo's imminent collapse for Bank of Ireland and Allied Irish Bank."[312]

The meeting was arranged for 21:30, *"that was the time we were told to come."*[313]

306 Bank of Ireland Group Liquidity Committee Minutes, 29 September, BOI00394-010.
307 William Beausang, former Assistant Secretary, Department of Finance, statement, WBE00051-014.
308 David Begg, former General Secretary ICTU and Central Bank board member, transcript, INQ00118-012.
309 Notes of events occurring on Monday & Tuesday (29 & 30 September), Dermot Gleeson, AIB02291.
310 Richard Burrows, former Governor, BOI, transcript, INQ00104-017.
311 Richard Burrows, former Governor, BOI, transcript, INQ00104-017.
312 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-009.
313 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-049.

Findings of the Joint Committee

1. The Minister for Finance, Brian Cowen, confirmed that he saw the 'Financial Stability Issues' paper prepared by the Department of Finance in January 2008.
2. In February 2008, in a follow-up to the January Financial Stability Issues Paper, a Department of Finance presentation warned that to 'provide an open-ended legally binding state guarantee would expose the Exchequer to the risk of significant cost and should not be regarded as part of the tool kit'. The paper also stated that a State guarantee to underwrite a bank's solvency position could only be justified when the entire financial system was at risk of collapse.
3. In August 2007, the NTMA decided to stop placing deposits with any Irish bank. The Joint Committee further found that the NTMA was legally obliged by a Minister for Finance direction of 19 December 2007, to place deposits with AIB, BOI, IL&P and EBS. Two days later it was directed to place deposits in Anglo. In August 2008, further letters of instruction were issued by the Minister for Finance in this regard. The Joint Committee found that NTMA had €790 million of deposits in Irish banks.
4. The Joint Committee found that a joint approach was made to the banks in March 2008 by the Central Bank and the Financial Regulator to seek 'liquidity support' from some banks for others. It remains unclear if this approach was ever communicated to Government. It is also unclear if the approach failed because one bank asked for some form of government guarantee if it were to participate.
5. No independent in-depth 'deep dive' investigation of the banks had been commissioned by the authorities before September 2008.
6. Despite the work of the Domestic Standing Group in the period from July 2007 to July 2008, crisis management preparations never advanced to a level capable of dealing with a major bank crisis.
7. Bank nationalisation legislation had been drafted prior to the night of the guarantee. Bank resolution legislation which would have allowed for the winding up of a financial institution and which could have allowed for another legislative option had been discussed by the relevant authorities in July 2008. However such legislation had not been requested from the Attorney General or the Office of the Attorney General.
8. Legislation for a blanket bank guarantee was available on 30 September 2008.

Recommendation of the Joint Committee

1. Legislation governing the powers of the Minister for Finance relating to directions to the NTMA should be reviewed.

Chapter 7: The Guarantee

Introduction

The decision taken on Monday night, 29 September 2008 and the early hours of Tuesday, 30 September 2008 to recommend to the Cabinet that a blanket Guarantee should be introduced was examined in detail by the Joint Committee. Over twenty witnesses gave evidence on the basis of their involvement in different aspects of the day's activities which culminated in that recommendation. Much of the evidence given was based on recollections. Some notes taken by people at the time of these events were made available to the Joint Committee.

The Joint Committee sought to establish what happened on the night of the Guarantee and why an incorporeal cabinet decided to guarantee all six banks.[1]

The Night Commences

The following participants were in attendance at all or part of the meetings:

- Brian Cowen, Taoiseach
- Brian Lenihan, Minister for Finance
- John Hurley, Governor, Central Bank
- David Doyle, Secretary General, Department of Finance
- Kevin Cardiff, Second Secretary General, Department of Finance
- Dermot McCarthy, Secretary to the Government and Secretary General, Department of the Taoiseach
- Eugene McCague, Arthur Cox, legal adviser to the Department of Finance
- Paul Gallagher, Attorney General
- Tony Grimes, Director General, Central Bank
- Patrick Neary, CEO, Financial Regulator
- Jim Farrell, Chairman, Financial Regulator
- William Beausang, Assistant Secretary, Department of Finance

The following people participated from 21:30 as requested:

- Dermot Gleeson, Chairman of Allied Irish Banks
- Eugene Sheehy, Chief Executive, Allied Irish Banks
- Richard Burrows, Governor, Bank of Ireland
- Brian Goggin, Chief Executive Officer, Bank of Ireland

1 AIB, BOI, Anglo, EBS, IL&P, INBS.

Standing by in Government Buildings were:

- Brendan McDonagh, Director of Finance, Technology and Risk, NTMA
- Oliver Whelan, Director of Funding and Debt Management, NTMA
- Pádraig Ó Ríordáin, Arthur Cox
- Cathy Herbert, Advisor to the Minister for Finance
- Joe Lennon, Advisor to An Taoiseach
- Peter Clinch, Advisor to An Taoiseach

No official minutes were taken of the meeting that took place in Brian Cowen's office in Government Buildings on the night of September 29/30. No official documents have been made available to the Joint Committee. A small number of personal unofficial contemporaneous notes were made available to the Joint Committee.

Brian Cowen, who chaired the meeting, commented on the impact of not having a note of the meeting: *"I have to take responsibility, I am sorry that there isn't an accurate, full note of that meeting. It would be the protection of all of us, if there were."*[2]

The meeting appears to have started sometime between 18:00 and 19:00. Dermot McCarthy recalled that: *"I think I was notified that there would be such a meeting earlier in the afternoon and I arrived at it, I think, some short time before 7 p.m."*[3] His expectation in joining the meeting was that: *"… this would be a matter of hearing a briefing and to prepare what might be put to Government."*[4]

John Hurley was asked about the meeting on the night of the 29 September 2008:

"My recollection is that the preliminary meeting that I described … the first plenary meeting, there was a very broad discussion on the options and the view was that we should tease out the different options."[5] He said: *"I think I went over to Government Buildings probably around 6.30 p.m."* He outlined that the first meeting: *"…started with a detailed discussion on the liquidity position, on the threats facing the system, how the individual banks were."*[6]

Patrick Neary outlined his recollection of events:

"We advised the meeting that on the basis of the information available to the authority, all banks were in compliance with their required capital ratios, were in a position to meet their obligations on a going concern basis, but liquidity was becoming a critical issue for them, especially Anglo."[7]

---

2 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-025.

3 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-013.

4 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-013.

5 John Hurley, former Governor, Central Bank, transcript, INQ00047-074.

6 John Hurley, former Governor, Central Bank, transcript, INQ00047-073.

7 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-006/007.

Brian Cowen said that:

"Mr Neary and Mr Farrell, from the regulator's office, outlined their serious concerns. I recollect that they were of the view that something significant had to be done immediately to stabilise the situation. In that respect, they spoke of the need for introduction of a Guarantee…"[8]

Was a Guarantee discussed prior to the Night?

The Joint Committee wanted to establish whether the idea of a bank guarantee had been discussed at any time before the guarantee meeting. Brendan McDonagh, had been directly involved in negotiations and conversations about the growing crisis during September. In his evidence he observed:

"The first and only reference to a blanket Guarantee throughout all the engagement in September 2008 was an email... at 1.26 p.m. on Friday 26th of September 2008… the NTMA view on, inter alia, the potential sovereign implications of a blanket bank Guarantee."[9]

"there was no substantive discussion involving myself – and as far as I am aware with my senior NTMA colleagues – about a bank guarantee in the months, weeks or days leading up to 30 September..."[10]

Kevin Cardiff e-mailed Government advisors, Merrill Lynch, when he realised that the guarantee option was now emerging as the preferred solution.

"I noted, being aware of their views and also having emailed Merrill Lynch as soon as it became clear that a broad guarantee approach would be a key focus of discussion, that Merrills and NTMA, our advisors, would be likely to advise against the broad guarantee option, on balance."[11]

Head of European Financial Institutions at Merrill Lynch, Henrietta Baldock replied to him immediately with reference to the Merrill Lynch Memorandum from the previous day, Sunday September 28. The Memorandum attached to her email reiterated that:

"It is clear that certain lowly rated monoline banking models around the world, where there is concentration on a single asset class (such as commercial property) are likely to be unviable as wholesale markets stay closed to them. This has inevitably had an impact on our conclusions and we believe it is important to act quickly to deal with these institutions to avoid a systemic issue."

The Merrill Lynch Memorandum also asserted that State protective custody would protect depositors, senior creditors and dated subordinated debt holders (via a State guarantee) and would mean:

"equity holders and undated junior subordinated debt holders would receive nothing, providing a capital cushion of €1.4 billion in the case of Irish Nationwide and €7.5 billion in the case of Anglo. It is important that all other creditors are reimbursed to avoid a contagion effect with the other Irish banks…"[12]

---

8 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-006.

9 Brendan McDonagh, former Director of Finance, Technology & Risk, NTMA, transcript, INQ00090-005.

10 Brendan McDonagh, former Director of Finance, Technology & Risk, NTMA, transcript, INQ00090-004.

11 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-013.

12 Email from Henrietta Baldock, Merrill Lynch to Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, DOF03233-002/003.

Brian Cowen confirmed that Brian Lenihan was involved in the discussions at this stage and *"agreed with the analysis and the up to date position given by the Governor. He indicated that he [Brian Lenihan] felt part of the solution would be the nationalisation of Anglo Irish Bank."*[13]

Brian Cowen described how, following a discussion:

"The options were narrowing down to a nationalisation plus a Guarantee, or simply a guarantee of the system itself. The other options referred to by Merrill Lynch which had been discussed, were discounted at that stage."[14]

The role of the ECB in the Guarantee

The Joint Committee wanted to understand whether the ECB and/or its President Jean-Claude Trichet played a role at the meeting. Brian Cowen said:

"Governor Hurley had been in touch with the President of the ECB, Jean-Claude Trichet, over the weekend and confirmed to the meeting that there was no euro-wide initiative in the offing and just as other countries had to take decisions on their banks, it was clear that we were on our own, we would have to deal with this at a national level."[15]

David Doyle was questioned on the ECB position. He replied:

"On the core question [whether the ECB would allow a bank failure] the view of the ECB as quoted to the meeting by the Governor on the night was that Mr Trichet had advised him that no bank failure could be allowed, or words to that effect."[16]

John Hurley was asked whether the ECB knew about the potential for the Irish Government to put a guarantee in place. He replied:

"It would have been one of the options but it would have been mentioned as an option that might have to be considered. But there was no specific pre-dialogue on specific options but there would… in the context of discussions, there would have been an understanding of the broad options that would have to be considered."[17]

The former President of the ECB, Jean-Claude Trichet stated in his opening address to the Joint Committee:

"… it is also important that the Guarantee was introduced by the Irish Government without any co-ordination with the ECB, or with any other European partners, and I was the witness of that, or any other international partners."[18]

He was asked:

"… if you could just clarify, in the period of … prior to September 2008, were the ECB engaged in any way with the Irish Government, the Irish Central Bank or Irish financial services in any manner related to the implementation of the design or the structure of a guarantee?"

13 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-006.

14 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-007.

15 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-006.

16 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-016.

17 John Hurley, former Governor, Central Bank, transcript, INQ00047-069.

18 Jean-Claude Trichet, former President of the ECB, at his appearance at the Royal Hospital, Kilmainham, 30 April 2015, INQ00140-007.

Jean-Claude Trichet replied:

"No contact between the Irish Government and either me or the ECB or to my knowledge, their governments, because I had myself the other governments calling on me and saying, "What's happening?" …We were not kept abreast of any development in Dublin by the Irish authorities, and as regards the Guarantee, we learned of the Guarantee through the media."[19]

Jean-Claude Trichet was asked if he was aware: *"…that Anglo Irish Bank was virtually certain to default the next day?"*[20]

He responded: *"Again, it was not the responsibility of the ECB to survey the banks… So no memory, No, I would say, responsibility in this domain."*[21]

Paul Gallagher was asked if he accepted the rationale as stated by Trichet regarding the role of the ECB. He said: *"The ECB is forbidden to bail out any banks and the European institutions are forbidden to do so..."*[22]

When questioned on whether it was a fact that the banks were the *"State's responsibility"*, he replied *"I think that was the significance, that you shouldn't let a bank fail, the responsibility is yours, that was something that the Government already knew."*[23]

Kevin Cardiff's evidence on lobbying

The Joint Committee asked Kevin Cardiff:

"can you outline the individuals and organisations who suggested that a broad legal guarantee approach before the night of the guarantee? Who sought the views of those individuals and organisations?"

He replied:

"Okay. End of April, Sean Fitzpatrick [to] John Hurley... a few days later, maybe a week later somebody and, unfortunately, and in my notes it just says DD suggested the idea of a broad guarantee ... I'm not sure whether legal or political, quite possibly at that stage political... A lot of these approaches were to John Hurley. May ... 23 May, I think, to me. I was at a seminar at which Charlie McCreevy was speaking and he said, "Kevin, look I think you need to make some sort of broad statement." So political... In July, there was a meeting of some sort with ... with Davy stockbrokers. I can't remember just now who, but I probably could find it in notes, if was necessary. And they said, ''Look lads, probably if things get worse, you might consider a guarantee so why don't you just do it now?"... But all of these were conversations; you wouldn't read too much into them. These were ... of their nature, they had to be a little bit exploratory so I'm not saying that, you know, anyone was nailing their colours to a mast at any of these points."[24]

19 Jean-Claude Trichet, former President of the ECB, at his appearance at the Royal Hospital, Kilmainham, 30 April 2015, INQ00140-022.

20 Jean-Claude Trichet, former President of the ECB, at his appearance at the Royal Hospital, Kilmainham, 30 April 2015, INQ00140-027.

21 Jean-Claude Trichet, former President of the ECB, at his appearance at the Royal Hospital, Kilmainham, 30 April 2015, INQ00140-028.

22 Paul Gallagher, former Attorney General, transcript, INQ00110-009.

23 Paul Gallagher, former Attorney General, transcript, INQ00110-010.

24 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-025/026.

When this was put to Charlie McCreevy, he said:

"I have no recollection of the meeting or the conversation. He said he attended an event at which I was presumably the guest speaker, I'm presuming it took place in Dublin. And I don't know whether ... after the event, whether sitting around and having a cup of tea, whether I asked him ... I told him or he asked me for an opinion. But, so I've no recollection of what I said then. But I would have a clear view as to what I would've been thinking around that particular time... there was all this emphasis on Ireland, so, as Kevin said at the ... the thing, and I'd say it's very accurate what he said, I said more or less to him "I think it's time", I probably said "Someone should make a broad statement about the situation"."[25]

John Hurley was asked if he remembered any specific lobbying for a guarantee and said:

"No ... lobbying, I think, is ... I know what lobbying is, having been a secretary of a number of Departments. I know specifically what it is and I would have acute antennae out in relation to it. I never felt I was lobbied in relation to a guarantee but I would ... any Governor or any secretary of a Department would have had numerous contacts during this particular period, and any time I was contacted, and there was something significant, I would have told the Minister."[26]

Was the Guarantee decision made before the meeting?

Kevin Cardiff said in his written statement that he *"emailed Merrill Lynch as soon as it became clear that a broad guarantee approach would be a key focus of the discussion…"*[27] From the evidence the Joint Committee has seen that this email was sent at 18.37.[28]

William Beausang represented the Department of Finance on the DSG. He provided documents to the Joint Committee which included an email that he had received at 21.11 on the night of the meeting. According to William Beausang the email had been forwarded to him by David Doyle and it came from the Central Bank. It was *"a draft Government press release"*[29] confirming a guarantee decision on the part of Government for the domestic banks involving a six month period:

"to guarantee the retail, wholesale deposit and inter-bank lending … of the six domestic credit institutions (i.e. Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society and Educational Building Society".[30]

In his written statement William Beausang said that *"It appears to have been authored earlier in the evening in the Central Bank in advance of the commencement of the meeting in Government Buildings."*[31]

25 Charlie McCreevy, former Minister for Finance, transcript, PUB00346-018.

26 John Hurley, former Governor, Central Bank, transcript, INQ00047-080.

27 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-013.

28 Memo from Merrill Lynch, 29 September 2008, DOF03233-001.

29 William Beausang, former Assistant Secretary, Department of Finance, statement, WBE00051-014.

30 Draft Government press release re Government Guarantee, WBE00019-001.

31 William Beausang, former Assistant Secretary, Department of Finance, statement, WBE00051-014.

The Joint Committee asked William Beausang about the draft press release:

"Ah well ... well, I don't know why it existed. I mean, I don't know why ... I mean, the Central Bank obviously had prepared it earlier in the day in advance of the discussions in Government Building. I suppose…"[32]

Because much work had been carried out on the nationalisation option, including draft legislation, he was asked if a similar draft was ready for this option. He replied *"No, there wasn't a press release for a nationalisation of any institution, no."*[33]

Brian Cowen was asked about the email:

"The Governor of the Central Bank was of that ... had come to that view, and made a contribution on that basis. And that may ... it may explain why people in the Central Bank were preparing a draft on that because that was their view."[34]

Alan Gray is asked for advice

A break in the meeting was called. Brian Cowen returned to his own office. He told the Joint Committee:

"During that break I decided to get an external view. Mr. Alan Gray, an economist and a Central Bank board member, was someone whose views I also respected. I phoned him and asked him what he thought of a guarantee option being used."[35]

Alan Gray outlined the nature of his conversation with Brian Cowen:

"…the option that the Taoiseach asked my view on, was the very same option that was raised at the Central Bank board meeting the previous Thursday, which was an option to give a guarantee to the six financial institutions. And he asked me what did I think of it and what would be the market reaction."[36]

Brian Cowen was asked about what Alan Gray had said to him during the phonecall:

"Mr Gray emphasised that providing a guarantee would, obviously, give an advantage to those institutions to whom the guarantee would apply vis-à-vis competitors, since they would have the backing of the Irish Government."

"Mr. Gray also stated that if we were considering the introduction of a Guarantee of any kind, that it should be strictly time-limited."[37]

Alan Gray told the Joint Committee:

"I did not give a precise timeframe but I said it should be as short as possible, and I had in mind the fact that it was probably about exactly a year previously when Northern Rock went bust that the UK Government - and, I think, very wisely - did not say, "We'll give a guarantee for five years." They said, "This is a temporary guarantee to deal with an exceptional period of financial turbulence."[38]

32 William Beausang, former Assistant Secretary, Department of Finance, transcript, INQ00127-025.

33 William Beausang, former Assistant Secretary, Department of Finance, transcript, INQ00127-026.

34 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-031.

35 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-007.

36 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-013/014.

37 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-007.

38 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-022.

In response to questions about whether he had advised Brian Cowen of the meeting with Anglo executives, Alan Gray said *"I did not and I did not refer that to anybody else….. I think if I referred to that it might be misinterpreted as some way suggesting I was trying to promote their interest."*[39]

In his written statement Kevin Cardiff explained that he had become aware sometime after the night of the guarantee that Seán Fitzpatrick had visited:

"at least one of these two banks [AIB and BOI] that day, and had asked that the larger bank would take over Anglo. I do not recall this rather salient piece of information being passed on in the meeting with the Taoiseach."[40]

Alan Gray was asked if, in that phone call, the Taoiseach had indicated to him that the Minister for Finance was favouring nationalisation. He replied: *"He did not."*[41]

During this break, Brian Cowen and Brian Lenihan had a private discussion explained by Brian Cowen as a chance for both men to find the best solution in the crisis situation. The Joint Committee is conscious of the fact that Brian Lenihan is now deceased. Efforts were made to elicit evidence in relation to his role that night.

Was Brian Lenihan overruled?

One potential point of conflict that was brought to the Joint Committee's attention was whether or not the Minister for Finance was *"overruled"* by the Taoiseach on the night. This was in relation to the possibility of nationalising Anglo and whether or not the Minister was in some way forced to change what was stated to be his original position and support a blanket guarantee. A side-meeting did take place in the course of the evening where the two Cabinet Ministers had a private discussion.

Central Bank Governor, Patrick Honohan, raised the idea that Brian Lenihan had been overruled by Brian Cowen on the night of the guarantee. In evidence to the Joint Committee, he referred to his chapter in the book *"Brian Lenihan, In Calm and in Crisis"* and explained that he believed, on the basis of what Brian Lenihan had told him, that as he stated in the book *"Brian argued strongly for the immediate nationalisation of both Anglo and INBS – but … he was overruled on the night."*[42]

When asked who was present who would have had the authority to overrule the Minister for Finance, Patrick Honohan replied *"The Taoiseach and the Attorney General were present. They are the only other political people who were present on the day."*[43]

Brian Cowen confirmed the two men had had a private meeting and said:

"We were talking the issues through and there was no question of our conversation being in any way adversarial or confrontational with each other. Both of us were deliberating and striving to find the best course of action for the country at this point in time."[44]

---

39 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-049.

40 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-011.

41 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-033.

42 Patrick Honohan, Governor, Central Bank, transcript, PUB00273-040.

43 Patrick Honohan, Governor, Central Bank, transcript, PUB00273-040/041.

44 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-008.

Cathy Herbert, who was in Government Buildings on the night of the Guarantee but not in the room, spoke with Brian Lenihan very soon after the meeting. She said that she had no recollection of him raising the issue in any discussion with her after the event. She said *"it seems strange to me that he would have said he was overruled."*[45] She also said:

"I think that if it had been a problem, if there had been a serious disagreement, in other words if he felt he had been overruled in… and if he was … had a complaint, I would have known. And I didn't…he would have discussed it."[46]

David Doyle also said*: "I was never aware that there was a suggestion that the Minister was overruled."*[47]

Kevin Cardiff said that Brian Lenihan discussed the private meeting with him afterwards and that he told him that after he and the Taoiseach had left the room to speak privately:

"…he agreed with the Taoiseach to follow the broad guarantee approach. He did not use the word "overruled" but rather indicated that he thought it important that he and the Taoiseach presented a common political position."[48]

Paul Gallagher said he had not been privy to the meeting and that Brian Lenihan had never told him that he had been overruled.[49]

Decision to recommend a blanket guarantee

David Doyle recalls that when Brian Cowen and Brian Lenihan returned from their meeting that a decision had been reached. He said:

"Eventually the Taoiseach came back in and said they had decided to recommend to the Cabinet a Guarantee and that Anglo was not being nationalised. I am pretty certain he said "for the moment"*."*[50]

Brian Cowen said:

"Eventually, I put it to the table that it seemed to me that a full Guarantee option provided the best prospects of addressing the urgent liquidity problem and of sending a clear message that Ireland was standing behind the financial system – which would be understood by the markets and for a limited time… It is my recollection that I then asked everyone could we run with a guarantee – only approach in principle. There was agreement on that and further details would now have to be worked out."[51]

45 Cathy Herbert, former Special Advisor to former Minister for Finance, Brian Lenihan, transcript, INQ00091-006.

46 Cathy Herbert, former Special Advisor to former Minister for Finance, Brian Lenihan, transcript, INQ00091-019.

47 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-072.

48 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-009.

49 Paul Gallagher, former Attorney General, transcript, INQ00110-016.

50 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-014.

51 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-008.

Did Brian Cowen have a pre-determined view of the outcome of the meeting?

In the evidence given by Kevin Cardiff about the meetings on the night of the Guarantee he said:

"I thought the meeting would go somewhat differently where he would say "Okay, Department of Finance or Central Bank or whatever, you start from scratch and build up"*. But actually he had a view, I think from the start."*[52]

Kevin Cardiff also said: *"In fact, the decision to give them a Guarantee was not fully made but I think it was certainly in the mind of the Taoiseach long before that evening started."*[53]

Brian Cowen was asked if he had made his mind up before the meeting. He replied: *"I hadn't my mind made up going into the meeting… It seemed to him [Kevin Cardiff] that I had my mind made up which I didn't…"*[54]

David Doyle was asked for his recollection:

"My recollection is the Taoiseach was a pretty direct character. He'd put it on the table and say "Now let's examine this" *I don't recall like if he had come in and said, "*let's examine this. We're not going to discuss anything else. Let's just do it.*" I'd accept that that wouldn't have been an appropriate position, but that's not what he did. He put it on the table and the debate went on for about 6 or 7 hours after that."*[55]

The banks arrive

At 20:57, the Central Bank emailed its *'best'* information on the banks to William Beausang. The figures from that day were most up to date for IL&P and Anglo, with the other bank figures from lunchtime that day. It was stark for all the banks.[56]

The two main banks, AIB and BOI had arranged to be at Government Buildings to meet the Taoiseach at 21:30 and they came into the meeting room after a break. Each bank had two representatives. The Joint Committee has no evidence to suggest that any other bank was invited to attend this meeting or that any other bank attempted to have a meeting with Government representatives that day.

The Joint Committee spent considerable effort to establish the key reason the banks had sought the meeting. Eugene Sheehy was asked by the Joint Committee why the banks had made the request to meet. He said *"Because 29 September was a tumultuous day in the history of international financial services and we were a part of it."*[57]

52 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-017.

53 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-018.

54 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-039.

55 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-039.

56 Email from Brian Halpin, Central Bank to William Beausang, former Assistant Secretary, Department of Finance, DOF03240-001.

57 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-029.

In his contemporaneous record of the night,[58] Eugene Sheehy explains that four separate meetings occurred between the banks and the officials and government representatives, with long gaps between each meeting. His notes indicate that he told the meeting that AIB was:

"in a reasonably strong position but it was experiencing stresses in the market but that we had adequate liquidity to meet our regulatory requirements until the end of October."[59]

Eugene Sheehy's note also said that BOI's Brian Goggin:

"presented a similar outlook, also stressing that the situation was deteriorating and we were a number of weeks away from both banks being funding all of its requirements in the overnight market which, while a viable option was highly undesirable and fraught with risk…"[60]

In his contemporaneous short note of this meeting with the banks, Kevin Cardiff noted that Richard Burrows offered a view that there was a *"rapidly deteriorating situation everywhere… situation threatens the stability of our organisations."*[61]

His note added that Eugene Sheehy had observed that *"people we've dealing with for decades pulling back – 1 month we will be funding bank overnight. But if can't even get that, disaster – bankruptcy."*[62]

In his evidence, when asked about Kevin Cardiff's note, Eugene Sheehy said:

"No, that's not what I said [at the time]. We were solvent. The system, in general and globally, was entering into a condition it had never been in before. We had to do something about it. That's what we said to Government."[63]

The Joint Committee sought to conclude whether the two banks AIB and BOI brought with them a prepared written proposal for a guarantee. We heard and read conflicting evidence on the matter.

Dermot Gleeson said that *"an initial draft had been furnished"* and *"I think by Bank of Ireland"* and *"was in a form which we [AIB] thought was too bare"*.[64] His view, was that AIB *"furnished a more extensive formula."*[65]

"my recollection is that there was a form of words written on a single sheet of paper in handwriting by either Eugene or me, I don't know, and it would have said, you know, something like "deposits", "bonds", and something else. But that was what was handed over."[66]

Eugene Sheehy could not confirm this from his recollection:

"I've racked my brain on this, Deputy, and I can't actually remember whether there was a piece of paper or not. If there was, it must have been a very small piece of paper or it must be in the Department's records. I can't remember it."[67]

---

58 File Note of Eugene Sheehy, AIB, 29 & 30 September 2008, AIB03324-001.

59 File Note of Eugene Sheehy, AIB, 29 & 30 September 2008, AIB03324-001.

60 File Note of Eugene Sheehy, AIB, 29 & 30 September 2008, AIB03324-001.

61 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, DOT: Core Book 35, KCA00001-274.

62 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, DOT: Core Book 35, KCA00001-274.

63 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-029.

64 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-010.

65 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-010.

66 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-011.

67 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-013.

BOI documents examined by the Joint Committee indicated that contemporaneous minutes from an internal bank meeting on 29th of September 2008 referred to *"a draft guarantee being prepared"*[68] Brian Goggin was asked about these minutes. He said, *"I have absolutely or had absolutely no recollection of a document being drafted, and for the record, there was no document..."*[69] The BOI Group Secretary confirmed this position to the Joint Committee.

The Joint Committee subsequently wrote to Brian Goggin, Richard Burrows, Dermot Gleeson and Eugene Sheehy to ask for further clarifications. The witnesses from Bank of Ireland confirmed their previous evidence, that there was no document.

Dermot Gleeson of AIB said:

"In my recollection, a slip of paper, upon which there were some words or formulae written (possibly in handwriting) was brought by AIB to the meeting."[70]

Eugene Sheehy of AIB said:

"AIB did not bring either a draft guarantee or a suggested form of words to Government Buildings on 29 September 2008."[71]

The Joint Committee never saw the document that was mentioned or any other such documents.

Kevin Cardiff said in his written statement *"They [the banks] explicitly sought a very broad guarantee and provided a suggested wording."*[72] He also said *"They asked that Anglo be nationalised."*[73] and *"Yes, they did provide a draft. Only one version so far as I can recall…"*[74] He went on to say that to the best of his recollection *"it was one document and it came from the banks. It certainly wasn't generated by us and then handed to them."*[75]

Brian Cowen remembered a document but *"…I don't recall that being a very big document. It was, you know, maybe four or five lines maybe, from memory now."*[76]

Dermot McCarthy's *"…recollection is that there was a formula, a definition, if you like…"*[77] He was also of the view that it *"had the support of both institutions."*[78] As regard the content, he recalled it as *"a definition of types of deposits and instruments which would be covered."*[79]

David Doyle could not recall it. He said *"I don't recall myself seeing a draft of the guarantee…"*[80] Pádraig Ó Ríordáin was *"unaware of any draft from the banks and I don't have a copy."*[81]

---

68 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-021.

69 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-020.

70 Dermot Gleeson, former Chairman, AIB, statement, DGL00005-003.

71 Eugene Sheehy, former Group CEO, AIB, statement, ESH00002-003.

72 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance. statement, KCA00002-011.

73 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance. statement, KCA00002-011.

74 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance. transcript, PUB00350-005.

75 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-005.

76 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-004.

77 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-042.

78 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-042.

79 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-042.

80 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-015.

81 Pádraig Ó Ríordáin, Partner, Arthur Cox, transcript, INQ00111-008.

Paul Gallagher drew attention to the distinction between the *"having sight of that document or having the document in your hand that the banks said they brought?"*[82] He replied *"I don't precisely remember that"*.[83]

The NTMA on the night of the guarantee

Brendan McDonagh had been invited to Government Buildings by Kevin Cardiff because he had become increasingly involved in advising the Department of Finance since April 2008. He arrived at around 21.30 and was asked to sit in a room adjacent to the main meeting room. He was accompanied by his colleague Oliver Whelan. Neither man was asked to join the meeting while the decision about the guarantee was being made.

"Whilst my colleague, Mr Whelan, and I were in Government buildings on the night of the 29 September, we were not, as I previously advised, made aware as to the reason why we were there… why we were required, or consulted, or otherwise asked to input prior to the Government taking the Guarantee decision."[84]

Brendan McDonagh said that he recalled hearing the news, while he was waiting, that the Troubled Asset Relief Program (TARP), the US programme to purchase assets and equities from financial institutions as a rescue plan, had been rejected by the US Senate.

Alan Gray remembers the decision on TARP:

"The decision of the US Congress to reject the TARP Bailout Plan meant that while there was a chance up to then that liquidity pressures would ease, I thought when I heard the decision on the television, things had fundamentally changed. My view is that the Guarantee was the least-worst option available."[85]

Kevin Cardiff also recalled when he heard about TARP:

"One such interruption, to give an example, came when Joe Lennon, one of the Taoiseach's advisers, came in to the meeting room to break the news that in the US Congress the TARP plan – the plan that was intended to save their banking system and economy, and by the way also reduce the contagion effects for Europe –had failed to pass the Congress. It had some real implications for the process in Government Buildings. The first was that the money markets were likely to be even more unsettled the next few days, adding to the pressure for really decisive action in Ireland that night."[86]

Kevin Cardiff said: *"Brendan was outside because the people in the room… the senior people in the room didn't choose to bring him in."*[87]

82 Paul Gallagher, former Attorney General, transcript, INQ00110-007.

83 Paul Gallagher, former Attorney General, transcript, INQ00110-007.

84 Brendan McDonagh, former Director of Finance, Technology & Risk, NTMA, transcript, INQ00090-004.

85 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, statement, AGR00001-026.

86 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-098.

87 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-021.

Brian Cowen was questioned by the Joint Committee on the reason why the NTMA were excluded from the meeting. He said *"I wouldn't have known who was outside the door until whoever came in the door. You know what I mean."*[88]

The Joint Committee raised the issue of whether there had been a decision to exclude the NTMA from the discussions.

Dermot McCarthy said: *"No, I don't believe that's the case… The CEO and others were present at briefings with the Taoiseach in the days before the Guarantee."* He also commented on the relationship, saying:

"There was a very good relationship between Dr. Somers and Taoisigh directly and the NTMA was regarded across the system … as a very expert body and its views were both sought and respected."[89]

Former Chief Executive Officer, Michael Somers and Director John Corrigan of the NTMA, were in the US on the night. Brian Cowen said: *"I found it unfortunate that the main men were away, out of the country, they were doing NTMA business."*[90]

When pressed on whether Brendan McDonagh would have been able to speak on behalf of the NTMA Michael Somers replied *"Yes, yes, I mean, I would have had full confidence in what … in his judgement and his expertise".*[91]

Eugene McCague, was asked whether the NTMA should have been in the room, he replied: *"I don't think there was a need for them to be in the room but I assume they were available, if required."*[92]

When questioned as to whether, in hindsight, the expert opinion of all of the different state authorities was in the room at the time, given that the NTMA was not present, Dermot McCarthy said:

"… It would have been preferable if the senior personnel from the NTMA were available and present but their views were known, and indeed, voiced in terms of the discussion by Kevin Cardiff in particular."[93]

When questioned on the issue of whether the discussions would have benefitted from the NTMA view, David Doyle said:

"Well, I think they would, there would potentially have been a more thorough discussion. I know at least one of the people that was there from the NTMA in the Outer Chamber would have been as sceptical or possibly more so sceptical, about one of the financial institutions."[94]

---

88 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-121.

89 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-022.

90 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-121.

91 Michael Somers, former Chief Executive, NTMA, transcript, INQ00093-012.

92 Eugene McCague, Partner, Arthur Cox, transcript, INQ00111-026.

93 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-015.

94 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-034.

Kevin Cardiff explained that he had given the NTMA view to the meeting:

" I certainly made sure that the … the fact that the NTMA/Merrill Lynch, the team, had a different view was presented to the Taoiseach, the Minister, the Attorney, who were all in the room."[95]

Brian Cowen confirmed that their view was presented at the meeting. He said: *"The NTMA position had been reflected in what Mr Cardiff had to say, it wasn't a question they were being ignored or that their position wasn't being articulated, it was."*[96]

The Joint Committee asked Brendan McDonagh to speculate on what he would have said to the Taoiseach if his views had been sought. He replied *"I don't think I would have said anything different other than what I'm saying to you now is that I would have pressed strongly for the nationalisation."*[97]

On the Question of Nationalisation of Anglo or INBS

The Joint Committee heard much evidence about the debate between nationalisation and a guarantee. Dermot McCarthy said *"The option of nationalisation of Anglo was considered, but it was concluded that such actions could have more negative than positive effects on market confidence."*[98]

Brendan McDonagh confirmed that position. He said:

"There was a strong view within the NTMA and certainly by myself and, I believe, by some of my other senior colleagues but, certainly Mr Corrigan, that Anglo and Irish Nationwide should be nationalised"[99]

He also said:

"Because, I suppose, we were always sceptical about the business model of Anglo Irish Bank. It was, effectively, a monoline institution with, effectively, just mainly property lending, and that it had rapid growth and we just couldn't understand the business model."[100]

The Joint Committee questioned Michael Somers on the NTMA position, particularly at the end of September 2008. Michael Somers said *"I'm not saying that I felt strongly about it [the nationalisation of Anglo] at that stage. It was kind of an evolving view."*[101]

The Joint Committee sought clarification from Michael Somers on the difference in emphasis between his view and that of Brendan McDonagh, given that Michael Somers was *"the boss."* He said:

"I know I was, but I would have taken his advice and if he [Brendan McDonagh] felt that that was the correct decision because, as I say, he went into it an awful lot more than I did, I would have accepted his decision and said "okay, yes, I'll go along with that, We'll nationalise it "[102]

95 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-021.

96 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089 -121.

97 Brendan McDonagh, former Director of Finance, Technology & Risk, NTMA, transcript, INQ00090-022.

98 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-005.

99 Brendan McDonagh, former Director of Finance, Technology & Risk, NTMA, transcript, INQ00090-009.

100 Brendan McDonagh, former Director of Finance, Technology & Risk, NTMA, transcript, INQ00090-009.

101 Michael Somers, former Chief Executive, NTMA, transcript, INQ00093-012.

102 Michael Somers, former Chief Executive, NTMA, transcript, INQ00093-013.

John Corrigan was questioned by the Joint Committee on the issue of nationalisation. He responded *"well, certainly, I shared the view with Brendan McDonagh, and I think the chief executive was of the same view that Anglo should have been nationalised."*[103]

Eugene McCague, Chairman of Arthur Cox, stated *"I do recall Mr Cardiff strongly argued the case for nationalisation"*.[104]

Brian Cowen was asked *"Well, is your testimony this evening (that) the three parties now, that are on record that are in favour of nationalising Anglo, are Mr Cardiff, Mr Lenihan and the NTMA?"* He replied *"That would be my position."*[105]

Alan Gray was not present at the meeting. However, as he had spoken by phone to Brian Cowen on the night, the Joint Committee asked him if he thought nationalisation would have been a better option. He said:

"… my view… would've been that it would be a mistake unless we had undertaken due diligence… I have seen in so many cases…the private sector comes to the state with a failed institution and wants them to nationalise it and, the cost is always with the taxpayers and..."[106]

Kevin Cardiff was asked by the Joint Committee why he recommended the nationalisation of Anglo and/or INBS. He replied *"I advocated a nationalisation ... with a guarantee for Anglo and a strong public statement, amounting to a political guarantee, for the other banks"*.[107]

When asked why he recommended this, he said *"I thought they were shot. Not in solvency terms but in terms of their future businesses. If you think about it, they had a property-based business at a time when property seemed to be slumping"*.[108]

In his evidence, Brian Goggin said:

"In the earlier part of the evening, when there was a discussion around the desirability or possibility of nationalising Anglo Irish Bank or Irish Nationwide, the construct – which would have been very similar to the one that was laid out to me at 11 o clock that morning in Dame Street by the Central Bank and Financial Regulator – a scenario where two banks would have failed and the rest of the banks would have to be provided with a guarantee. I mean, that was the genesis of the input I had going in to Government Buildings that night. So yes, I mean that was a kind of scenario, initially in the early stages of the discussion. These two banks would be dealt with and the rest of the banks would be given a guarantee. But it didn't play out that way.[109]

---

103 John Corrigan, former Director of Funding and Debt Management, NTMA, transcript, INQ00106-008.

104 Eugene McCague, Partner, Arthur Cox, transcript, INQ00111-006.

105 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-122.

106 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-055.

107 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-005.

108 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-053.

109 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-011.

David Doyle said:

"Nationalisation would not, of course, have been a bank failure as such, but it might have been regarded in the panicked market conditions as tantamount to a failure, and indicative of greater dangers".[110]

Brian Cowen explained why he had opted for the Guarantee:

"Nationalising a bank meant taking all of the assets and liabilities onto the State's books there and then, immediately. The nationalisation option was, in effect, an open-ended guarantee. The guarantee option looked like a safer option if it was time-limited."[111]

Could Anglo open for business on Tuesday morning?

The Joint Committee wanted to establish whether the meeting had taken place against the likelihood that Anglo would not be able to open its doors on Tuesday September 30. The knock-on effects of such a closure would have been serious. John Hurley was asked if Anglo would default without a guarantee being agreed at that meeting. He replied: *"It wouldn't have defaulted because we had made arrangements for emergency liquidity assistance…. We would not have allowed such a situation to happen…."*[112]

John Hurley explained that the arrangements made had been confirmed by a letter of comfort, from the Minister for Finance earlier that day, relating to legal arrangements to ensure emergency liquidity was available to the bank through the Central Bank. John Hurley said, when asked, that he had informed Anglo that day that emergency funding would be available.[113]

AIB and BOI were each requested to provide liquidity support to Anglo. After some internal consultation each agreed to provide €5 billion until the weekend provided that repayment was guaranteed by the Government.

William Beausang gave evidence that he left the meeting that night after the first part to *"prepare the letter of comfort the Central Bank required to provide ELA the next day."*[114]

John Hurley was asked to confirm that, regardless of the decision taken in Government Buildings that night, Anglo would have continued to function the next day. He said: *"Anglo Irish Bank was going to open the following morning".*[115]

However, he said that that wasn't the issue, but that:

"The issue was the contagion effect on (sic) Anglo Irish Bank on the entire system...we were in a situation where it was going to be impossible to keep emergency liquidity assistance to Anglo Irish Bank quiet. It was out there in the marketplace that they were in difficulty. The contagion effect from Anglo was very real. And these are risks and you make a judgment on the risk."[116]

---

110 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-005.
111 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-006.
112 John Hurley, former Governor, Central Bank, transcript, INQ00047-090.
113 John Hurley, former Governor, Central Bank, transcript, INQ00047-091.
114 William Beausang, former Assistant Secretary, Department of Finance, statement, WEB00051-014.
115 John Hurley, former Governor, Central Bank, transcript, INQ00047-091.
116 John Hurley, former Governor, Central Bank, transcript, INQ00047-091.

Other options considered for Anglo

The Joint Committee asked Dermot McCarthy if it might have been possible to guarantee *"the liquidity of Anglo for at least a day".* He said:

"…there would have been strong concern that if one moved to buy a day or two, that that was money that would be burnt, in the context of the immediate issue but also that the prospect then of taking effective, decisive action would be diminished. So it wasn't seen as a viable alternative."[117]

He said that this position was *"… very much on the explicit advice of the Governor and the Financial Regulator..."*[118]

Alan Gray was asked if liquidation of Anglo might have been an option. He replied *"I believe that there would've been a bank run in Ireland and I think the economic consequences would've been catastrophe."*[119]

John Hurley was also asked if the liquidation of Anglo was considered. He replied:

"It wasn't considered on the night, I don't agree liquidation was an option…Professor Honohan has his view, I don't have that view and I would not have advised any government to take that risk."[120]

Kevin Cardiff said: *"No official advisor advocated a liquidation of Anglo at that point. Even now I think that would have been too dangerous to contemplate."*[121]

Brian Cowen was also asked his views on allowing a bank to fail. He said:

"Allowing Anglo to fail was simply not an option on the night. It would have implications for the whole system. The costs involved in terms of causing a run on other banks as well would put the whole payments system at risk and cause irreparable damage to the economy as a result of a banking meltdown." It would, in Governor Hurley's words, *"set the country back 25 years…"*[122]

The Question of Solvency

The Joint Committee spent considerable time trying to establish whether the question of the banks solvency was debated on the night of the Guarantee. The issue is important because as John Hurley pointed out: *"If Anglo Irish Bank was insolvent on the night, there would have been no emergency liquidity assistance."*[123]

Mary Harney, former Tánaiste and Leader of the Progressive Democrats, was asked about the issue of solvency on the night and stated: *"the information on which the Guarantee was based clearly did not indicate a solvency issue."*[124]

---

117 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-014/015.

118 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-014.

119 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-054.

120 John Hurley, former Governor, Central Bank, transcript, INQ00047-080.

121 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-005.

122 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-006.

123 John Hurley, former Governor, Central Bank, transcript, INQ00047-114.

124 Mary Harney, former Tánaiste & Leader of the Progressive Democrats, transcript, INQ00136 -112.

When asked by the Joint Committee if the Government Guarantee was *"the most expensive bluff in Irish political history."* John Gormley, former Minister and Leader of the Green Party, responded *"Absolutely not … we were assured that this was a liquidity crisis and that's why we introduced the blanket Guarantee on that basis."*[125]

The Joint Committee asked Brendan McDonagh if INBS and Anglo Irish were solvent. He stated: *"I don't believe they were solvent."* He continued: *"If you can't pay your debts when they are due, you are effectively insolvent."* The Joint Committee put it to him that as he had described insolvency *"from an accountancy point of view,"* that was this not technically insolvent, he replied:

"No I had bigger concerns, Deputy, that nobody could give me any information…certainly from the regulator's side, of what their balance sheets …any detail about their balance sheets or asset quality. There just was no information."[126]

John Corrigan, in response to a question as to whether he had a view on the solvency of Anglo responded:

"And if you just take the snapshot of the night of the Guarantee, but for the Guarantee, presumably, Anglo wouldn't have been able to meet its obligations and therefore, arguably, could have been regarded as being insolvent."[127]

When John Hurley was asked about when he believed Anglo became insolvent, he replied: *"I don't know the answer to that Deputy, but I mean, it wasn't insolvent at the time, nor for a considerable period, afterwards, in my view."*[128]

When questioned by the Joint Committee on this issue, Dermot McCarthy said:

"I think there was an orientation to define the problem as a liquidity one, and it was, of course, in origin, a liquidity one, which meant that the concern about the solvency question, the capital adequacy, the potential exposure on loan books, and so on, wasn't engaged with as easily as it arguably should have been."[129]

He also said:

"I think that the reality was that the information which came to light slowly and painfully over some time should have been known to the system well before the Guarantee."[130]

Eugene McCague, Chairman of Arthur Cox said, in relation to Anglo and Irish Nationwide: *"I don't recall anyone arguing the case that they were insolvent on the night."*[131]

125 John Gormley, former Leader of the Green Party & Minister for Environment, transcript, INQ00136-110.

126 Brendan McDonagh, former Director of Finance, Technology & Risk, NTMA, transcript, INQ00090-019.

127 John Corrigan, former Director of Funding and Debt Management, NTMA, transcript, INQ00106-011.

128 John Hurley, former Governor, Central Bank, transcript, INQ00047-115.

129 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-046 to -047.

130 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-047.

131 Eugene McCague, Partner, Arthur Cox, transcript, INQ00111-006.

He also said:

"So there was a view that if the liquidity issue wasn't dealt with, then obviously it would lead to insolvency. But I don't recall anybody calling it directly and saying "I believe this bank is insolvent as of tonight.""[132]

Paul Gallagher was questioned as to whether there were people in the room who had serious concerns that some banks were actually insolvent. He replied: *"That is emphatically not the case… and I say in my statement that the Governor and the Financial Regulators made it clear the banks were solvent but illiquid."*[133]

John Hurley said:

"There is no way that a central bank can give emergency liquidity assistance to an insolvent bank; and we can only give emergency liquidity on the basis of a certificate from the Financial Regulator that the bank is solvent."[134]

Patrick Neary, said in his evidence to the Joint Committee:

"I didn't believe that any institution was insolvent on the date of the guarantee. Based on the information available to us, which ... I've talked about it before, came in from the returns. They came in from the institutions. And also we had had Pricewaterhouse in in a couple of the institutions and also there was another corporate finance house which was advising one of the institutions, had also looked over the portfolio. And based on all of those sources, there was no evidence that there was a solvency issue in any of the institutions on the night of the guarantee."[135]

However, the Governor of the Central Bank and the Financial Regulator's statement on the solvency of all six financial institutions was based on the loan book analysis of all six financial institutions carried out by PwC. This analysis was carried out under a tight time limit and was reliant on information from management. According to Brian Cowen, their analysis was *"hopelessly optimistic"*.[136] He also said: *"Yes, well I mean it is true that in a, in a very turbulent market situation it is difficult to know what's illiquid and what's insolvent."*

John Hurley was asked if insolvency of any bank was discussed on the night. He said:

"Not to my knowledge... there would have been, you know, a view that maybe additional capital is required, but that would be a normal discussion. It was not… there was no insolvency discussion that I can recall."[137]

David Doyle was asked if there was a concern at the meeting of a risk of insolvency and he replied: *"There was. There was an immediate consideration that illiquidity would rapidly become insolvency."*[138] He was further asked whether there was a concern that banks themselves, given the loan losses, could be insolvent in the future. He replied:

---

132 Eugene McCague, Partner, Arthur Cox, transcript, INQ00111-013.

133 Paul Gallagher, former Attorney General, transcript, INQ00110-007.

134 John Hurley, former Governor, Central Bank, transcript, INQ00047-114.

135 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-074.

136 Brian Cowen, former Taoiseach and Minister for Finance, statement, BCO00002-003.

137 John Hurley, former Governor, Central Bank, transcript, INQ00047-111.

138 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-054.

"Well, that debate around nationalisation reflected the concern that there could be a problem emerging. And if that problem emerged, that would damage the market… So the argument that they should be nationalised related to the concern about the quality of the loan book, but in the case of AIB, Bank of Ireland, EBS, Irish Life and Permanent, there was no such concern. There was a concern about Anglo and Nationwide."[139]

The scope of the Guarantee

Much has been written and said about how the terms and scope of the Guarantee were arrived at. Again the absence of any documentation or formal minutes means that the detail of evidence offered on the terms and scope relies largely on memory.

Brian Goggin was asked if BOI was asking for a guarantee for itself. He said:

"My concern ... my concern in going to Government Buildings was in relation to one specific issue, i.e., a major bank was going to default the following day. The issue of a guarantee was proposed as a possible solution in terms of trying to help the Government deal with the issue. The point that's being made here, as I interpret it, is that Bank of Ireland, in isolation, absent any other issues in the marketplace, did not require a guarantee."[140]

Kevin Cardiff was asked what he believed the banks sought at the meeting. He said:

"Yes, the banks did seek a broad guarantee, including for themselves. Some people say it was four banks, some people say it was six, but if you nationalise two, then you have to look after them ... it's the same thing."[141]

Brian Goggin said:

"My input was that the Anglo Irish Bank and Irish Nationwide needed to be dealt with, they were having a ferocious contagion effect on the system, and that, in that scenario, the rest of the banking system would need to be guaranteed, for a period of time, to give stability to the system." [142]

Dermot Gleeson said:

"What we thought we were talking about was a guarantee for AIB, Bank of Ireland and two other banks … In a context where Anglo and Nationwide were about to be taken down."[143]

139 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-054.

140 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-037.

141 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-005.

142 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-011.

143 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-010.

What the Guarantee should include

As the discussion moved into the detail of a guarantee, the issue of whether senior debt, subordinated debt and dated subordinated debt would be covered by the guarantee was discussed.

Dermot McCarthy was asked about the inclusion of dated subordinated debt. He said:

"... both the banks and the official side in effect were of the view that it should be included, partly because of the structure of the funding of the banks, and indeed, to a lesser extent the State. But also because of the desire to give a clear, unambiguous, definitive message through the guarantee."[144]

John Hurley said: *"… if you didn't really present well and the markets didn't understand your message, all of the work could go for naught."* [145]

Michael Somers, although not present on the night to give advice, told the Joint Committee:

"I would have guaranteed deposits. Whether I would have guaranteed the full 100% of deposits or not, I don't know. I certainly would have balked, I think, at going any further than that because I wouldn't have felt it was absolutely necessary to go any further than that."[146]

When questioned as to whether existing senior bondholders should have been guaranteed, he said:

"I would have needed a lot of persuasion. I mean, my attitude would have been; give as little as you can, until you are pushed to give more and you are absolutely convinced that you have to give more."[147]

He also said:

"Normally you wouldn't include subordinated debt in a guarantee ... dated subordinated debt ... but really the issue had to do with how we would be coherent with markets the following morning."[148]

He said that the question was *"… do we take the risk of not including subordinated debt when it is not such a big issue in terms of costs in the context of the overall guarantee?"*[149]

In his evidence to the Joint Committee, Patrick Honohan said that Brian Lenihan had told him that he had *"…argued strongly not to go down to cover the subordinated debt."* [150]

John Hurley was asked to clarify if Brian Lenihan was *"in the room for that portion of the decision?"* and he replied *"I believe so, yes."*[151]

144 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-037.

145 John Hurley, former Governor, Central Bank, transcript, INQ00047-075.

146 Michael Somers, former Chief Executive, NTMA, transcript, INQ00093-013.

147 Michael Somers, former Chief Executive, NTMA, transcript, INQ00093-014.

148 John Hurley, former Governor, Central Bank, transcript, INQ00047-074.

149 John Hurley, former Governor, Central Bank, transcript, INQ00047-074/075.

150 Patrick Honohan, Governor, Central Bank, transcript, PUB00273-040.

151 John Hurley, former Governor, Central Bank, transcript, INQ00047-081.

Eugene Sheehy gave his reason for the inclusion of bonds as follows:

"… I certainly argued, that the bonds should be included and the reason for that was if you looked at the mistakes that were made in the US around Lehman's and the inconsistency from day to day of the regulatory response…"[152]

He went on to point out that on the night *"… AIB had no bonds or subordinated debt instruments that would in any way have been enhanced by the guarantee."*[153]

Brian Goggin was asked to comment on criticisms relating to the inclusion of such debt in the Guarantee. He replied:

"…I had absolutely no idea whatsoever what the aggregate amount or the maturity profile of the liabilities of Bank of Ireland were on that occasion. I hadn't even looked at them; they didn't register on my horizon."[154]

Junior dated bondholders

Brian Goggin confirmed that BOI had suggested that junior dated bondholders should be included because they were:

"… concerned about the crossover between junior dated... and senior bondholders, senior creditors… it was important from our perspective to ensure that that stability was achieved and that the capacity of the banking system and the sovereign would not be impaired in terms of accessing the very individuals who are both providers of dated subordinated and senior bonds."[155]

The technical details of the Guarantee were discussed between the banks and the officials.

Kevin Cardiff said in his statement to the Joint Committee:

"After the decision had been made in principle, I was asked to produce drafts of the final announcement, based on the banks' wording – I believed that this wording was broader in a number of respects than had been understood by the official parties, and I told the Taoiseach in a side conversation, that if we accepted their wording, 'the banks would be laughing at us', or words to that effect – the Taoiseach immediately asked me to ensure the draft reflected the understanding of the official parties as to the decision taken, rather than the banks' draft."[156]

Eugene Sheehy's contemporaneous note records:

"The Government submitted a form of guarantee(copy attached) [it was not attached when the Joint Committee received this evidence] which in our view, while inspirational in terms in what we were all looking for, fell short on lack of specificity. We had drawn up an alternative form which included language which was more specific and also included a definite timeline... Clearly there was concern on the Government side that this was too specific and would move the obligations very pointedly from the banks to the Government's balance sheets."[157]

152 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-017.

153 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-017.

154 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-064.

155 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-022/023.

156 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-014.

157 File Note of Eugene Sheehy, AIB, 29 & 30 September 2008, AIB03324-003.

He was asked by the Joint Committee about AIB's *"alternative form, mentioned in this note."*[158] He replied:

"The honest answer is I can't remember the piece of paper. We were certainly in dialogue with the Government about technical issues of what should be in, what shouldn't be in, we could have written it out. I have no piece of paper as a record of the night other than my note (as above)."[159]

None of these copies or versions of a guarantee was seen by the Joint Committee.

Guarantee decided upon by incorporeal cabinet meeting

The Joint Committee asked why the decision to offer a blanket guarantee to all the banks was made by way of an incorporeal Cabinet meeting. Dermot McCarthy outlined how the decision arose, as follows:

"…I would say approaching 11 o'clock when that was, if you like, unambiguously clear and I think the Taoiseach made the judgement that it wasn't going to be feasible to convene a meeting."[160]

Dermot McCarthy explained how he organised the meeting:

"I asked a colleague from the Government Secretariat to make contact with the private secretaries of the members of the Government, which would be the normal pattern, to put them on notice that they would be called about an incorporeal later in the night, and the actual incorporeal was conducted, from memory, between about 1.20 a.m. and 1.50 a.m."[161]

As Taoiseach, Brian Cowen was responsible for calling the incorporeal cabinet meeting. When questioned by the Joint Committee on the issue, he said:

"Now I take the point and it's a matter of regret to me …, that it would have been better for me to call a meeting – even if I had to call a Cabinet Meeting at 6 o'clock the next morning, it would have been better. I accept that."[162]

The issue of the suitability of the incorporeal cabinet meeting was raised with John Gormley, who said: *"It was actually open to any member of the Cabinet to say to Mr Lenihan* "I don't want an incorporeal, I want a full meeting on this.*"*[163]

Dermot McCarthy was asked if *"… ringing people, one after the other, at all a substitute for the, kind of, debate that you get around this table, and shouldn't we be careful about incorporeal cabinet meetings?"*

He said:

"Absolutely … and they are, on matters of substance, as opposed to formalities, things like giving permission to the President to lead the State, might have to be done at short notice, that sort of thing is perfectly effectively done in an incorporeal … it's not desirable, and, in my experience, is only done when it's unavoidable."[164]

158 File Note of Eugene Sheehy, AIB, 29 & 30 September 2008, AIB03324-003.

159 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-029.

160 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-030.

161 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-030.

162 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-030.

163 John Gormley, former Leader of the Green Party and Minister for Environment, transcript, INQ00136-014.

164 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-046.

Timeframe for the proposed guarantee

The Joint Committee sought to establish how the decision had been made to extend the Guarantee over a two-year period. The Central Bank's draft press release had proposed a six-month guarantee.

Brian Cowen said: *"It was an issue, I think, that would have been discussed when the banks were there and it was an issue that was decided upon ultimately by just ourselves - the State actors."*[165]

Kevin Cardiff recollected that the banks had sought a longer time period:

"One of them was that the banks' wording - we had a two-year limit - the banks' wording, as far as I can recall it, would have said that any new borrowing in the course of that two years would be guaranteed for the full extent of its term."[166]

Eugene Sheehy outlined the position of AIB in the following terms:

"It just becomes technically very difficult to do anything with a one-year guarantee, so we recommended a two-year guarantee, and subsequently the European Commission came out and said that that was the only type of instrument that would have had a chance of working; less duration would not have worked."[167]

Brian Cowen said: *"…the view was that two years seemed to be, in the judgment of those that were there, the best guesstimate they could have of having a credible but time-limited guarantee…"*[168]

Funding cliff

When asked by the Joint Committee whether there was any conversation about a potential for a funding cliff at the end of the guarantee period, John Hurley said: *"There was a discussion about periods, about ... and the cliff issue ... I think it was probably a substantive point in the determination of the two years."*[169]

Capital injections

The Joint Committee asked Kevin Cardiff if the issue of capital injections had been discussed at the meeting. He was asked:

"On the night of the guarantee, just for clarification, did anyone from the State side ask any of the institutions present about the likelihood of capital injection by the taxpayer, can you recall?"[170]

Kevin Cardiff replied: *"I don't recall the specific question being asked, no."*[171]

---

165 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-024.

166 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-018.

167 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-018.

168 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-024.

169 John Hurley, former Governor, Central Bank, transcript, INQ00047-094.

170 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-030.

171 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-030.

Banks suggest change to the Government's official guarantee statement

The night's work was coming to an end and officials had been asked to prepare an official statement about the decision to guarantee all the banks. The first draft document included the fact that all the banks were solvent at that time. The bank representatives moved to change this.

Dermot Gleeson said:

"I think the Financial Regulator wanted to include a statement in some sort of press release, Deputy, that "All Irish financial institutions are solvent", or something like that, and we advised against it… We thought that we were going to take Anglo to the weekend. Anglo was going to be dismantled at the weekend ... and to put a statement out on Monday night saying "All Irish financial institutions are solvent" ... and then people investing in Anglo the next day and finding it dismantled at the weekend, that could cause trouble. That was the point we were making."[172]

Eugene Sheehy said: *"This was a liquidity guarantee, it didn't, the solvency issue wasn't relevant as far as I could see."*[173]

The final document removed any mention of solvency.

In his contemporaneous note Eugene Sheehy wrote *"There were also issues in the Government's draft which we were uneasy about relating to attestations by the FR [Financial Regulator] that the system was solvent and that all banks were solvent."*[174]

Brian Goggin was asked for his recollections, *"Oh yes, I think ... my recollection is that AIB, I think, made the running on it but we certainly supported the view"*.[175]

Dermot Gleeson said: *"Well I suppose we didn't think some of them were solvent"*[176]

When asked whether AIB had a view that Irish Nationwide was insolvent, Dermot Gleeson replied:

"Well ... I don't ... I thought ... I am not a chartered accountant, and solvency is one of the deep mysteries of chartered accountancy but we thought Nationwide was irretrievably broke."[177]

In his written statement Kevin Cardiff said:

"I pointed out, that while the Regulator was happy to say the institutions were solvent, it was clear that once guaranteed they could not in any circumstance be allowed to fail – and so any capital or cash shortfall would have to be addressed: there would be no choice in the matter".[178]

Patrick Neary was asked if he had suggested that such a statement be included in the draft:

"Definitely not and in fact, I never had sight of that draft statement, and the Central Bank Act 1971, I think, makes it quite clear that… because a bank is licensed under the Central Bank Act 1971 is not a warranty as to its soundness. And I think, I know that this is a speculative point, I

172 Dermot Gleeson, former Chairman, AIB, transcript, INQ00121-022.

173 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-053.

174 File Note of Eugene Sheehy, AIB, 29 & 30 September 2008, AIB03324-004.

175 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-032.

176 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-021.

177 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-020.

178 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-013.

mean, if it had been put to us at the meeting, the chairman and I obviously would have discussed it. But I would be pretty reluctant to agree to any statement like that – we don't give warranties as to soundness to anybody."[179]

Leaving the Building

Evidence from the two banks who attended Government Buildings that night conflicts as to what was known or understood by them about the nature of the Guarantee, as they left the meeting in the early hours of the morning.

Brian Goggin said:

"my recollection is that we were informed that the Government had decided they were providing a blanket guarantee for all banks. So when I eventually left Government Buildings that night at about 3.30 a.m., there was no ambiguity in my recollection and in my understanding of what was done that night."[180]

He subsequently confirmed that as far as he was concerned: *"I left Government Buildings believing there to be a six-bank guarantee."*[181]

Richard Burrows agreed with the recollection of Brian Goggin and, when questioned about the evidence by AIB that it was a four bank guarantee, stated: *"We were all informed at the same time in the same meeting."*[182]

However, Dermot Gleeson had a different view. He said: *"…we had left Government Buildings that night thinking that there were four banks going to survive with the guarantee"*[183]

Eugene Sheehy had a similar recollection to that of Dermot Gleeson:

"When we saw the guarantee document for the first time the following morning, we could not understand why Anglo and Irish Nationwide were included. All our discussions that night were based upon a premise that Anglo was to be taken down."[184]

Further clarification was sought by the Inquiry and witnesses confirmed their earlier testimony.

Dermot Gleeson stated: *"I am absolutely certain that we were not informed of the blanket guarantee before we left Government Buildings."*[185] He cited his *"almost contemporaneous notes"*[186] of a conversation he had with Paul Gallagher. He stated that the:

"Attorney General said to me on a personal basis on the way out of the meeting that I should not assume that the Government was committed to any particular course of action in respect of any institution."[187]

179 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-080.
180 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-013.
181 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-024.
182 Richard Burrows, former Governor, BOI, transcript, INQ00104-035.
183 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-038.
184 Eugene Sheehy, former Group Chief Executive, AIB, transcript, INQ00133-006.
185 Dermot Gleeson, former Chairman, AIB, clarification statement, DGL00005-003.
186 Dermot Gleeson, former Chairman, AIB, clarification statement, DGL00005-003.
187 Dermot Gleeson, former Chairman, AIB, clarification statement, DGL00005-003.

In his written response Dermot Gleeson stated: *"I have the clearest recollection of that statement from the Attorney General."*[188]

Brian Goggin reiterated his previous evidence to the Joint Committee and said:

"My evidence given to the Joint Committee is clear. When I left Government Buildings that night at 3.30am, there was no ambiguity in my understanding of what was done that night – the decision had been made. A blanket guarantee was being put in place for six institutions."[189]

After the meeting, a Government statement was issued stating that the Bank Guarantee would extend for two years and cover *"all deposits (retail, commercial. institutional and interbank), covered bonds, senior debt and dated subordinated debt (lower tier II)."*[190] In addition the Guarantee would be made for *"any new facilities issued from midnight 29 September 2008 and expire on midnight 28 September 2010."*[191]

The full statement read:

"The Government has decided to put in place with immediate effect a guarantee arrangement to safeguard all deposits (retail, commercial, institutional and interbank), covered bonds, senior debt and dated subordinated debt (lower tier II), with the following banks: Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society and the Educational Building Society and such specific subsidiaries as maybe approved by Government following consultation with the Central Bank and the Financial Regulator. It has done so following advice from the Governor of the Central Bank and the Financial Regulator about the impact of the recent international market turmoil on the Irish Banking system. The guarantee is being provided at a charge to the institutions concerned and will be subject to specific terms and conditions so that the taxpayers' interest can be protected. The guarantee will cover all existing aforementioned facilities with these institutions and any new such facilities issued from midnight on 29 September 2008, and will expire at midnight on 28 September 2010.

The decision has been taken by Government to remove any uncertainty on the part of counterparties and customers of the six credit institutions. The Government's objective in taking this decisive action is to maintain financial stability for the benefit of depositors and businesses and is in the best interests of the Irish economy.

The Financial Regulator has advised that all the financial institutions in Ireland will continue to be subject to normal ongoing regulatory requirements. This very important initiative by the Government is designed to safeguard the Irish financial system and to remedy a serious disturbance in the economy caused by the recent turmoil in the international financial markets."[192]

188 Dermot Gleeson, former Chairman, AIB, clarification statement, DGL00005-003.

189 Brian Goggin, former Group CEO, BOI, clarification statement, BGO00002-003.

190 Government Decision to Safeguard the Irish Banking System, DOT: Core Book 35, KCA00001-298.

191 Government Decision to Safeguard the Irish Banking System, DOT: Core Book 35, KCA00001-298.

192 Government Decision to Safeguard the Irish Banking System, DOT: Core Book 35, KCA00001-298.

What Legislation had been prepared in advance of the meeting?

The Joint Committee sought evidence on the process and timing of legislation to nationalise an institution and the actual date on which the Guarantee became a legal instrument.

When questioned on whether there was legislation ready on the night of the Guarantee to facilitate nationalising of a bank, John Hurley stated *"My understanding is legislation was ready."*[193]

Kevin Cardiff was asked whether:

"legislation that was ultimately used in January ... in around January, (2009) four months later, for all sense and purposes, the same legislation that was available on the eve of the guarantee?"

He replied that: *"Well, it didn't take four months to do it. When we did it, it took a few days. The four-month gap was a policy decision."*[194]

When asked: *"was it ready to go?"* he replied: *"The legislation could have been in the House while we finished ... middle of the ... middle of the morning, it could have been in the House by that evening."* [195]

Was the Legislation fit for a guarantee or nationalisation?

Pádraig Ó Ríordáin was asked if there was already in existence sufficient legislative provision for either nationalisation or a guarantee. He replied:

"Yes, I think there certainly was. So there was ... when we came in there was already a very advanced Bill that had been prepared by the Attorney General's office, which dealt with nationalisation and which also had sections in there enabling the Minister to provide financial assistance to individual banks."[196]

David Doyle was asked if there was legislation available and prepared which would have been capable of advancing the nationalisation of Anglo or another financial institution on the night of the Guarantee. He replied: *"It was at an advanced stage and it could have been turned around, with the input of the parliamentary draftsmen and the Attorney, within a very short period."*[197]

Brian Cowen confirmed his knowledge of this draft nationalisation legislation. He said: *"We had legislation ready to go, if we were going some, sort of, a guarantee route. That was ready, you know, so, in fairness, an awful lot of contingency work was done."*[198]

Eugene McCague drew attention to a section in the Bill which gave the Minister very wide powers to give financial support to a credit institution and financial support, including the word *"guarantee"* but *"that section would not have been adequate to deal with the type of blanket guarantee that was introduced on 30 September."*[199] He stated that the *"legislation that we were*

193 John Hurley, former Governor, Central Bank, transcript, INQ00047-075.

194 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-010.

195 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-009/010.

196 Pádraig Ó Ríordáin, Partner, Arthur Cox, transcript, INQ00111-017.

197 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-019.

198 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-045.

199 Eugene McCague, Partner, Arthur Cox, transcript, INQ00111-007.

looking at was legislation which had been … around since about May or June … It was based on the Northern Rock legislation…"[200]

When did the Guarantee become legally effective?/Could there have been any changes made before it was introduced?

The Joint Committee wanted to establish whether changes could have been made to the Guarantee before the legislation was enacted.

When David Doyle was asked his views, he replied: *"When the announcement was made, there was a moral statement made."* [201]

Paul Gallagher commented:

"I think the issue always was what would be the effect on the financial system. And for a Government to renege on what was clearly a statement intended to quieten the markets would have had very serious consequences and presumably, though it's not a matter for me to say, the very consequences that were sought to be avoided on the night of the guarantee." [202]

Kevin Cardiff was asked: *"Did the Minister have the power to guarantee the banks at that stage or did he have to wait for the scheme to be approved?"* He replied: *"Well, you needed first the legislation."*[203]

The Joint Committee asked Kevin Cardiff whether there was any discussion along the following lines: *"Well, maybe we should actually hold off on this, maybe we should not sign the dotted line in terms of the order and reconsider at least some of the institutions?"*[204] Kevin Cardiff replied *"I don't recall a discussion about pulling out at that stage. I think we'd gone beyond that point. In practical terms, we were beyond the no return point."*[205]

He also said:

"...remember, a lot of new money came in on foot of the guarantee but it didn't come in four weeks later. It started coming in immediately. So, that you would pull out of the guarantee with hundreds of millions, billions and millions of deposits, based explicitly on it, would've created a ... would've created ... I don't know. It would've been extraordinarily risky."[206]

Paul Gallagher explained the passage of the necessary legislation:

"Subsequent to the night of the guarantee, the Credit Institutions (Financial Support) Act 2008 which was initiated in the Houses of the Oireachtas on 30 September, was enacted by 2 October and this legislation empowered the Minister to provide the guarantee … On 15 October 2008 the guarantee scheme was published by the Government and it was formally approved by the Houses of the Oireachtas on 17 October."[207]

200 Eugene McCague, Partner, Arthur Cox, transcript, INQ00111-007.
201 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-055.
202 Paul Gallagher, former Attorney General, transcript, INQ00110-024.
203 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-079.
204 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-079.
205 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-079.
206 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-079.
207 Paul Gallagher, former Attorney General, transcript, INQ00110-003.

Paul Gallagher also clarified when the covered institutions became legally guaranteed:

"Well, the ... it seems to me that, as a matter of law, until they became actually members of the scheme - it was the scheme that provided the financial support. The Act provided that financial support could be provided individually or through a scheme. The Government opted for a scheme. That was approved. And to avail of the scheme you had to become a participating institution. And to be a participating institution you had to be designated."[208]

On further questioning about whether this meant the banks were covered from the 24th or 29th, he said: *"Or the 29th, but I think it was the 29th (October)."*[209]

The following is the sequence of events from the announcement of the guarantee until its coming into effect:

Timeline for Guarantee

2008:

- 30 September: Government announce Bank Guarantee.
- 1-2 October: Dáil and Seanad pass the Credit Institutions (Financial Support) Bill.
- 2 October: President signs the Credit Institutions (Financial Support) Act 2008.
- 17 October: Dáil and Seanad pass the Approval of Credit Institutions (Financial Support) Scheme 2008.
- 24 October: Minister signs S.I. No. 411/2008 - Credit Institutions (Financial Support) Scheme 2008.
- 24 October: Signature of the deeds of acceptance completed by the financial institutions.
- 29 October: Minister designates the financial institutions which are covered by the scheme.

Witnesses reflected on their decision to choose the option of a blanket bank guarantee on 30 September 2008.

Brian Cowen said:

"It has to be emphasised that no decision was risk free. There was no one good or right option that would guarantee a solution to the problem. It was about trying to pick the least worst option..."[210]

He also said:

"The Governor (Central Bank – John Hurley) made the point that we would have one go at addressing this and if it didn't work, we may not get a second chance to revisit it as confidence could be gone."[211]

208 Paul Gallagher, former Attorney General, transcript, INQ00110-023.
209 Paul Gallagher, former Attorney General, transcript, INQ00110-023.
210 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-007.
211 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-006.

Paul Gallagher gave his views in relation to the advice given by John Hurley. He said:

"… he was unstinting and fearless and clear. And he gave very clear and unambiguous advice to the Government and the Government was told the economy will go back 25 years, this is the best you can do."[212]

He said that the Government *"was advised that the crisis was of systemic dimensions."*[213]

Alan Gray, who gave advice to Brian Cowen, stated that he believed:

"...the bank guarantee, which was a horrific and unjust decision on the Irish people, was the best option because of the restricted options that were available by the time we got to the night of the 29th."[214]

David Doyle's view was that: *"…by the time the end of September arrived, the international meltdown was such that I didn't really see a practical alternative."* [215] He also said it was *"... essential to avoid a complete collapse of the banking system and the economy."*[216] and *"it was the least worst option on the night."*[217]

When questioned on what would have unfolded over the following day and weeks had the Guarantee not been put in place, John Hurley said:

"I think the banking system would have become unstable. I think there could have been runs on Irish banks. The implications of that would have been devastating for the country and I think you would have seen an unravelling of the economic and financial life of the country over a period of time, and the cost of that would have been horrific."[218]

Dermot McCarthy said:

"The advice was that the Government had one opportunity to make a decisive intervention, to stabilise liquidity and secure the Irish banking system. It would have no certainty of success but the alternative was certain disaster."[219]

Paul Gallagher was asked if the guarantee decision was taken to save the banks. He replied *"…I think it has become part of the narrative and I think it is fundamentally wrong ...it wasn't about saving the banks, it was about saving the financial system."*[220]

Brendan McDonagh said:

"When it came to the night of the guarantee and the Government made the guarantee decision - and I respect that's the Government's decision - it seemed to be out of the hat that, you know, the least probably viable option in my view. And I mean it's only my view in terms of the options put forward by Merrill Lynch, was suddenly the one that was pulled out of the hat."

212 Paul Gallagher, former Attorney General, transcript, INQ00110-015.

213 Paul Gallagher, former Attorney General, transcript, INQ00110-013.

214 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-045.

215 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-013.

216 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-008.

217 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-017.

218 John Hurley, former Governor, Central Bank, transcript, INQ00047-117.

219 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-005.

220 Paul Gallagher, former Attorney General, transcript, INQ00110-009.

Why did the State guarantee private debts?

Brian Cowen outlined his concern that the markets would not accept anything other than a blanket guarantee: *"Where a first initiative may be deemed inadequate by the market, putting forward a second course of action could then completely undermine our credibility."*[221]

When asked *"was it moral or just or defensible that such a decision was taken?"*[222] i.e. for private debt by private entities was to be *"….put on to the shoulders of the Irish people,"*[223] John Hurley replied in relation to the Government decision:

"…the choices were very, very limited. And if they didn't take a decision to actually manage the situation at that time, I said earlier that I thought our financial system would have come down with extraordinary implications for the country, not just for a week or a few days but for years."[224]

In trying to establish what Brian Lenihan thought, the Joint Committee sought the view of Cathy Herbert who was not in the room at the meeting, but was in Government Buildings. She spoke with Brian Lenihan following the decision. She said:

"I think it was about 2.30 a.m. - 3 a.m., I'm not exactly sure"[225]

"…He was worried, he was concerned. He was worried about ... that the guarantee mightn't stick, worried that it wouldn't be enough…."[226]

Patrick Neary assured the nation on RTÉ's Prime Time in October that Irish financial institutions were *"well capitalised"* in comparison to European banks. He expressed confidence that loan losses would be manageable. He said: *"Well, I think that, with hindsight, and based on what emerged since in relation to those portfolios, that that assessment was optimistic."*[227]

On 15 October 2008 Kevin Cardiff emailed officials in the Department of Finance, the NTMA, CBFSAI, the Regulator, the Office of the Attorney General and representatives of Arthur Cox. He laid out some items he thought needed to be discussed including what recapitalisations or consolidations might be required and whether any nationalisations might be required. In his own words these were *"brainstorming scenarios"*.[228]

In his evidence to us, he said:

"Well, what I was trying to do was refocus. We had focus on the guarantee. There was a great deal of technical work to be done in a very short time, but I didn't think that was going to be the last intervention measure by a long shot. It was clear that we had to be ready for other things, and so I was saying, "Okay, guys, clear your heads a little bit, the guarantee is now moving along, continue that work, but we have to start thinking about the other options and the other things"*."*[229]

---

221 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-006.
222 John Hurley, former Governor, Central Bank, transcript INQ00047-121.
223 John Hurley, former Governor, Central Bank, transcript INQ00047-121.
224 John Hurley, former Governor, Central Bank, transcript INQ00047-121.
225 Cathy Herbert, former Special Advisor to former Minister for Finance, Brian Lenihan, transcript, INQ00091-005.
226 Cathy Herbert, former Special Advisor to former Minister for Finance, Brian Lenihan, transcript, INQ00091-005.
227 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-101.
228 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-125.
229 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-042.

Alan Gray also considered that there was a need to start thinking about other options, on the 20 October 2008 he wrote to Kevin Cardiff regarding the need to *"focus on starting the effective risk management for the Guarantee and the exit strategy."* He also set out his specific thoughts on a single page on possible actions to increase the capitalisation of the Irish institutions, to reduce capital requirements by increasing liquidity, and to reduce lending in certain institutions.[230]

In his evidence, he said:

"So I said ... the key points I was making is that I knew that there were ... everyone was very involved in implementing the guarantee but I felt that we ... policy makers needed to focus on the effective risk management for the guarantee and the exit strategy."[231]

Trichet gets in touch

On 16 October 2008 Jean-Claude Trichet wrote an urgent letter to Brian Cowen in relation to the liabilities covered in the blanket Guarantee scheme.[232] The letter, which was copied to Brian Lenihan and John Hurley, said:

"the liabilities covered under the Minister for Finance's guarantee of certain liabilities of systemically important credit institutions designated by the Minister under the scheme include interbank deposits and senior unsecured debt. I am writing to request that the Irish Government arrange that interbank deposits with a maturity of up to three months be excluded from the liabilities covered under the draft scheme."

He also raised concerns with the manner in which the decision had been taken:

"In this respect, I would like to draw your attention to the ECB opinion on the draft scheme, which was adopted yesterday by the ECB Governing Council. In its opinion the ECB attached great importance to the declaration made by the euro area Heads of State on 12 October 2008, according to which Member States have to act in a coordinated manner to avoid that significant differences in national implementation could have a counter-productive effect, creating distortions in banking markets. The euro area Heads of State also acknowledged the need to work in cooperation with the ECB so as to ensure consistency with the management of liquidity by the Eurosystem and compatibility with the operational framework of the Eurosystem. Against this background, the ECB opinion notes that uncoordinated decisions to guarantee interbank deposits in some Member States should be avoided as they may involve a fragmentation of the euro area money market."

When questioned by the Joint Committee, Jean-Claude Trichet said:

"The Guarantee was "an initiative of the Government of Ireland, which was not at all a global consensus or a European consensus."[233]

"all governments were, of course, shocked by the fact that one particular country was taking an extraordinary decision, including some of your neighbours."[234]

---

230 Letter from Alan Gray to Kevin Cardiff, 20 October 2008, DOF02116-001/002.

231 Alan Gray, Economist, former Non Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants, transcript, INQ00096-023.

232 Letter from Jean-Claude Trichet to Brian Cowen, 16 October 2008, DOT00374.

233 Jean-Claude Trichet, former President of the ECB, at his appearance at the Royal Hospital, Kilmainham, 30 April 2015, INQ00140-031.

234 Jean-Claude Trichet, former President of the ECB, at his appearance at the Royal Hospital, Kilmainham, 30 April 2015, INQ00140-027.

"And, again, in a dramatic situation, I don't criticise the Government of Ireland myself, even if there was a point that we noted as not being optimal from our own legal standpoint."[235]

Within months the Government had to provide capital injections for some of the banks, the details of which are in Chapter 8.

Findings of the Joint Committee

1. The option of guaranteeing the banks did not arise for the first time on the night of the guarantee meeting on 29 September 2008. The option of introducing a guarantee was first formally noted in January 2008, again in February 2008 and again in June 2008.
2. A draft press release announcing a six-month bank guarantee had been prepared by the Central Bank prior to 21:10 on the night of the guarantee. The draft release only covered deposits and interbank lending.
3. The Department of the Taoiseach did not keep minutes of the meetings on the night of the guarantee and was unable to provide any drafts of the proposed guarantee as it evolved.
4. The word 'solvent' as it pertained to the status of the covered banks was removed from the final official Government statement, announcing the guarantee.
5. Bank executives from AIB and BOI when leaving Government buildings on the night of 29 September 2008 had differing views on whether the Government was going to proceed to guarantee 4 or 6 banks.
6. Conflicting evidence was provided as to whether representatives from BOI and AIB did provide their own written guarantee proposals to the meetings on the night of the guarantee.
7. In the absence of a bank guarantee, the Central Bank had put in place sufficient measures to ensure that all banks would have opened on the 30 September 2008, and no default of any bank would have taken place that day. However, the Joint Committee found that it was the strong view of the Governor that a guarantee was necessary.
8. The information available to decision-makers on the night of the guarantee about the underlying health of the Banks was inadequate.
9. Prior to the meeting it was made clear by ECB authorities that there was no Eurozone wide initiative coming and the Sovereign was to ensure that no bank was to fail.
10. The Government was advised by the Central Bank and Financial Regulator that all 6 banks were solvent on the night of the guarantee.

235 Jean-Claude Trichet, former President of the ECB, at his appearance at the Royal Hospital, Kilmainham, 30 April 2015, INQ00140-025.

Chapter 8: Post-Guarantee Developments

Introduction

Following the issuance of the Guarantee, the Financial Regulator issued a letter to all Covered Institutions, advising them that the existence of the Guarantee should not be used as a marketing or advertisement tool to attract funding which could potentially create liquidity distortions in the banking markets.[1]

In the short-term, the Guarantee had stabilised and improved the liquidity position of the Covered Institutions.[2] However, by January 2009 the Guarantee was "just about" working with regard to providing non-ECB liquidity to the banks.[3]

In testimony to the Inquiry, former Group Chief Executive of Ulster Bank, Cormac McCarthy, in response to questioning on the impact of the Guarantee on Ulster Bank, said that it was:

"Very significant. Within a period of weeks there were billions of wholesale customer deposits and a degree of retail deposits flowed out of the institution."[4]

This was reiterated in the RBS Group Annual Report and Accounts 2008, which stated:

"The governments of some of the countries in which the Group operates have taken steps to guarantee the liabilities of the banks and branches operating in their respective jurisdiction. Whilst in some instances the operations of the Group are covered by government guarantees alongside other local banks, in other countries this may not necessarily always be the case. This may place subsidiaries operating in those countries, such as Ulster Bank Ireland Ltd, which did not participate in such government guarantee schemes, at a competitive disadvantage to the other local banks and therefore may require the Group to provide additional funding and liquidity support to these operations."[5]

In October 2008, the British Government announced that they would recapitalise Ulster Bank's parent company, RBS.[6] By December of that year Great Britain owned 58% of the shares.[7] Therefore, according to Richie Boucher, Group Chief Executive in BOI, Ulster Bank *"…had been, effectively, nationalised by the British Government, so the depositors had an implicit guarantee."*[8]

1 Letter from the Financial Regulator to all Covered Institutions, Q4 2008, INQ00166-001, (Subject to S33AK, Central Bank Act 1942).
2 Ann Nolan, Second Secretary General, Department of Finance, statement, ANO00002-001.
3 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-114.
4 Cormac McCarthy, former CEO, UB, transcript, INQ00086-048.
5 RBS Group Annual Report and Accounts 2008, page 29: http://www.investors.rbs.com/~/media/Files/R/RBS-IR/annual-reports/rbs-group-accounts-2008.pdf
6 RBS Group Annual Report and Accounts 2008, page 104: http://www.investors.rbs.com/~/media/Files/R/RBS-IR/annual-reports/rbs-group-accounts-2008.pdf
7 RBS Group Annual Report and Accounts 2008, page 148: http://www.investors.rbs.com/~/media/Files/R/RBS-IR/annual-reports/rbs-group-accounts-2008.pdf
8 Richie Boucher, Group CEO, BOI, transcript, INQ00085-038.

The Joint Committee considered whether or not the Guarantee could have been rolled back in part or rescinded for one or more of the Covered Institutions as the scale of the potential liabilities in the Covered Institutions were discovered during Project Atlas.[9] This is also discussed in Chapter 7.

Notwithstanding the moral obligation, there was an opportunity between the announcement of the Guarantee and the formal designation by the Minister for Finance of the Covered Institutions under the Credit Institutions (Financial Support) Scheme 2008 (CIFS)[10] on 24 October 2008, to change the terms and scope of the Guarantee. For example, one of the banks could have potentially been excluded. When questioned about this option, Kevin Cardiff said:

"…remember, a lot of new money came in on foot of the guarantee but it didn't come in four weeks later. It started coming in immediately. So, that you would pull out of the guarantee with hundreds of millions, billions and millions of deposits, based explicitly on it, would've created a ... would've created ... I don't know. It would've been extraordinarily risky. But, no, … I don't recall a discussion about pulling out at that stage. I think we'd gone beyond that point. In practical terms, we were beyond the no return point."[11]

On the question of what might have had happened had a bank such as Anglo been kept outside of the Guarantee in the first instance, Paul Gallagher, former Attorney General, said:

"…you could have let Anglo go on its own, you didn't have to do anything, but the judgment was made that leaving a bank that, I think Governor Honohan in his report says was 'of systemic importance', systemic not that we needed this bank but systemic importance in terms of the consequences. And one of the things that was apparent from the information given to the Government by the other banks was the other banks were distinguishing between Anglo and INBS and themselves and understandably so. But the report that they gave us of the reactions from the money markets was Ireland was untouchable. And if you have one bank go, given what was known as the overexposure to property, the ready consequence I assume … was they'd say, 'These other banks have huge exposure to property. There may be distinctions but we're not convinced and the whole lot goes.' … and that was the calculation made with regard to Lehman Brothers and it went so badly wrong and I think there was a huge fear that if that gamble is taken, that things would just be out of control. And those are the judgments that have to be made and were made."[12]

There was a power in the CIFS to revoke the Guarantee under certain conditions. Section 8 of the CIFS provided:

"The Minister may review and vary the terms and conditions of this Scheme from time to time, at no later than six-month intervals, to ensure that it is achieving the purposes of the Act of 2008. At such a review, the Minister shall consider, inter alia, the continued requirement for the provision of financial support under this Scheme with regard to the objectives of this Scheme and section 2(1) of the Act of 2008. The results of any such review shall be provided to the European Commission."[13]

When questioned about this, Paul Gallagher said:

9 Project Atlas was a PwC report on the health of the Irish banking system, commissioned by the Financial Regulator in 2008.

10 http://www.irishstatutebook.ie/eli/2008/si/411/made/en/print

11 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-079.

12 Paul Gallagher, former Attorney General, transcript, INQ00110-028.

13 http://www.irishstatutebook.ie/eli/2008/act/18/section/8/enacted/en/html#sec8

"There's a power to revoke it in the guarantee scheme if, for example, the conditions of the guarantee weren't being complied with, otherwise it was intended to last for two years, subject to a review. And it was conditional on the basis which … or, sorry, it was conditional on the circumstances which required the giving of the guarantee continued, and if they didn't continue, then the Minister was entitled to bring it to an end and would be required to do so by the EU."[14]

However, rather than being shortened, the Guarantee was actually extended beyond the original end-date of 2010 through the Eligible Liquidity Guarantee Scheme.[15]

Impact of the Guarantee on Restructuring

Separate, but related to the need to recapitalise and restructure the Covered Institutions, was the question of whether or not the Guarantee delayed vital bank restructuring. Governor of the Central Bank, Patrick Honohan stated the following in oral testimony:

"We were in suspended animation for two years. One of the things the guarantee did, and we were talking about the subordinated debt, but guaranteeing the senior debt had a double effect. It is not just a question of not paying those guys, but any restructuring of the banking system, like liquidating or closing, would have triggered immediate payment under the guarantee from the Government. That meant that doing something with Anglo Irish Bank or with INBS, all these things, could be considered at leisure, because there was nothing one could viably do until the end of September 2010 and by that stage the damage was done."[16]

This was supported by Marco Buti, Director General for Economic & Financial Affairs, European Commission, in his evidence to the Joint Committee, where he said: *"…the banks had to be restructured and, from that viewpoint, the blanket guarantee clearly did not help."*[17]

Michael Noonan, the Minister for Finance, said that the Guarantee should have been *"… accompanied by a restructuring and a recapitalisation of the banks…"* thereby possibly guarding against Ireland's need to enter into a Bailout Programme two years later.[18]

Capital Position of the Covered Institutions

In October 2008, Patrick Neary, former Chief Executive, IFSRA, appeared on RTE's *'Prime Time'* Programme. He said that Irish financial institutions were well capitalised in comparison to European banks. He was confident they would be able to deal with loan losses incurred during the ordinary course of business into the foreseeable future.[19]

---

14 Paul Gallagher, former Attorney General, transcript, INQ00110-041.

15 Paul Gallagher, former Attorney General, transcript, INQ00110-041; The Credit Institutions (Eligible Liabilities Guarantee Scheme) 2009 in made pursuant section 6 (4) of the Credit Institutions (Financial Support) Act 2008 and came into effect on the 9 September 2009.

16 Patrick Honohan, Governor, Central Bank, transcript, PUB00273-009.

17 Marco Buti, Director General for Economic & Financial Affairs, European Commission, transcript, INQ00100-019.

18 Michael Noonan, Minister for Finance, transcript, INQ00102-020.

19 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-080.

That assessment had been supported only a few days previously by Merrill Lynch. In their advice to the Minister for Finance, relating to the liquidity and strategic options available to the Government on 28 September 2008 Merrill Lynch stated: *"It is important to stress that at present, liquidity concerns aside; all of the Irish banks are profitable and well capitalised…"*[20]

The then Taoiseach, Brian Cowen had also advised the Dáil on 30 September 2008 that: *"while Ireland along with all developed economies has experienced a sharp decline in its property market, there is very significant capacity within the institutions to absorb any losses…"*[21]

The then Minister for Finance, Brian Lenihan, met with the Governor of the Central Bank and the Financial Regulator to discuss the PwC reports generated for Project Atlas, which confirmed that the capital position of each of the institutions reviewed was in excess of regulatory requirements as at 30 September 2008.[22]

However, notwithstanding these positive assertions, over time, the Project Atlas reviews started to uncover evidence of a markedly different and less positive situation. In addition, the Minister for Finance was aware that international capital market expectations relating to capital levels in the banking sector had altered and that an injection of capital, by the State, would be required.[23]

PwC 'Project Atlas' Reports

Having completed their Project Atlas 1 review in September 2008, PwC[24] were engaged once again on 9 October 2008 to review the financial and capital positions of the six[25] financial institutions covered by the Guarantee (the Covered Institutions). This examination was known as *'Project Atlas 2'*.[26] PwC concentrated on reviewing a sample of loan books and losses, focusing initially on the top 20 borrowers in each Covered Institution, but this was subsequently extended to the top 50 borrowers, when evidence was found that a large number of borrowers had loans with two or more lenders.[27]

Part of the Project Atlas 2 review consisted of examining scenarios showing the impacts which various asset write-downs would have on Tier 1 Capital.[28] However, these scenarios were based on unrealistically low impairment levels with the fall in asset values accelerating.[29]

20 Merrill Lynch Wealth Management memo, NTMA00399-002.

21 Statement by An Taoiseach, Brian Cowen, 30 September 2008, DOT00164-005.

22 Government announcement on maintaining capital levels in the Covered Institutions, 30 November 2008, PUB00288-001.

23 Government announcement on maintaining capital levels in the Covered Institutions, 30 November 2008, PUB00288-001.

24 As PwC had completed a lot of the necessary background work, the firm was engaged to carry out further reviews, as required.

25 Allied Irish Banks plc, Anglo Irish Bank Corporation plc, Bank of Ireland Group, Educational Building Society, Irish Life & Permanent plc, Irish Nationwide Building Society.

26 Denis O'Connor, Partner, PwC, statement, DOC00001-006.

27 Denis O'Connor, Partner, PwC, statement, DOC00001-006.

28 See Glossary of Terms.

29 See impairment levels in terms of basis points contained within Project Atlas II Volume 1 Overview Working Draft, 17 November 2008, DOF02573-090, (e.g. Commercial/Corporate impairment of 150bps in scenario 1 and 125 bps in scenario 2 – equates to 4.5%/3.75% impairment over 3 years when asset values had already fallen in excess of this since the beginning of 2008).

The scope of Project Atlas 2 was further broadened in November 2008 to include a review, known as Project Atlas 3, of land and development loans and related loan security. On this occasion, PwC were tasked with assessing the top 75 land and development loans within the Covered Institutions as at 30 September 2008. As part of the process, Jones Lang LaSalle (JLL) were engaged to carry out a review of valuations on the underlying assets supporting the top 20 land and development exposures in each Covered Institution.[30]

The results of Project Atlas 3 showed significant differences on land and development loans between the Covered Institutions' own valuations of €27.405 billion and the JLL valuations of €19.568 billion – a difference of €7.837 billion across the five of the Covered Institutions reviewed.[31]

JLL's and Banks' valuations of land and development loans, Q4 2008

€ in millions	OirL	OirL	OL	OL	OL
[redacted] JLL Valuations					
Land and Development	6,129.1	1,710.6	2,826.8	5,178.1	125.4
Investment	773.1	663.8	1,662.2	516.7	-
Total	**6,902.2**	**2,374.4**	**4,489.0**	**5,694.8**	**125.4**
Bank Valuations					
Land and Development	7,929.7	2,853.5	3,861.2	7,967.0	218.1
Investment	928.0	963.6	2,059.8	624.4	-
Total	**8,857.7**	**3,817.1**	**5,921.0**	**8,591.4**	**218.1**

Source: Project Atlas, Draft Property Values Review[32]

The material differences between JLL's and the five Covered Institutions' valuations in respect of their land and property loan portfolios highlighted falling asset values and served as a forecast of impending material losses on the Covered Institutions' property-related loans. In this regard, John Corrigan, former CEO of the NTMA said:

"…clearly the property values continued to fall and the whole funding regime continued to come under more strain, so while they [i.e. the six Covered Institutions – the five in the above table plus IL&P] probably were solvent at that point in time [i.e. when Project Atlas was undertaken], clearly the situation deteriorated rapidly."[33]

30 Jones Lang LaSalle valuations were completed over the period November/December 2008.

31 Irish Life & Permanent plc was not included in the Jones Lang LaSalle valuations of land and development loans, as they did not lend to this part of the property sector; Project Atlas, Draft Property Values Review, 4 February 2009, DOF05792-013.

32 Project Atlas, Draft Property Values Review, 4 February 2009, DOF05792-013.

33 John Corrigan, former CEO, NTMA, transcript, INQ00106-028.

As set out in the table below, overall, PwC reviewed loans totalling €253 billion, of which €159.2 billion related to property backed lending. €62.6 billion of that latter amount related to land and development loans, with €30.3 billion connected to land-bank developments. This represented almost one fifth of total property-backed lending of €159.2 billion, over half of which were either unzoned or, if zoned, had no planning permission.

Total Loans reviewed by PwC

	Oir L Sep-08 €bn	Oir L Sep-08 €bn	Oir L Sep-08 €bn	Oir L Sep-08 €bn	Oir L Sep-08 €bn	Oir L Sep-08 €bn	Combined Sep-08 €bn
Land & Development	23.7	13.1	19.7	5.6		0.5	62.6
Property Investment	26.7	24.9	40.9	1.8	1.5	0.8	96.6
Property backed lending	50.4	38	60.6	7.4	1.5	1.3	159.2
Other loans (non-personal)	45.6	33.4	8.9	2.2	3.2	0.5	93.8
Total Loans (ex. Personal)	96	71.4	69.5	9.6	4.7	1.8	253.0

Source: Merrill Lynch and PwC summary[34]

Debtor concentrations revealed by the 'Project Atlas' Reports

Michael Somers, former Chief Executive, NTMA, said the following in his evidence:

"When the Pricewaterhouse report came in, I must say I was flabbergasted when I saw the size of the loans … which were advanced by the Irish banking system to individuals. I mean, they ran to billions. And I think I wrote to the Minister for Finance, he'd asked me to write a letter to him about what I thought of the overall economic and financial scene, and I wrote to him and one of the things I mentioned was that some individual had loans from the banking system equivalent to 3% of our GNP, which I thought was absolutely staggering."[35]

It also transpired that large sums had been lent to a small number of developers, many with exposures to numerous banks. In this regard, Denis O'Connor, Partner with PwC said:

"…top ten borrowers had loans of €17.7bn with the six guaranteed banks and that was before any additional borrowings they had in Ulster Bank or Bank of Scotland Ireland."[36]

John Corrigan, former CEO, NTMA, suggested in his evidence that this was *"…information the regulator didn't seem to have up until that."*[37]

34 Merrill Lynch and PwC summary, DOF03984-002.
35 Michael Somers, former CEO, NTMA, transcript, INQ00093-021.
36 Denis O'Connor, Partner, PwC, transcript, INQ00097-003.
37 John Corrigan, former CEO, NTMA, transcript, INQ00106-028.

David Doyle, former Secretary General in Department of Finance, noted that PwC *"…in the course … of a couple of days were able to feed us [Department of Finance] information about the liquidity exposures, information that we [Department of Finance] didn't have otherwise."*[38]

However, in his evidence, Patrick Neary, former Chief Executive, IFSRA, said that PwC were engaged because they had the resources to promptly carry out the work required and that PwC's findings simply confirmed information the Financial Regulator already had.[39]

Asked to respond to the figures obtained from the Project Atlas reviews, representatives of the banks gave varying testimony. Brian Goggin, former Group Chief Executive of BOI stated:

"I don't believe that Bank of Ireland was disproportionately exposed or active in the property and construction sector. I think the issue that affected the Bank of Ireland was the absolute amount in money terms of that exposure. Bank of Ireland had quite a broadly diversified loan book in its totality."[40]

Brian Goggin noted that 65% of the BOI's lending in property and construction was in investment property *"generating a contracted rental flow."* He did not accept that the bank had an over-concentration of risk in the property and construction sector.[41]

By contrast, responding to similar a similar question regarding Project Atlas, Richie Boucher accepted that BOI had an over-concentration of risk in the property and construction sector, though he suggested that the bank believed at the time that this risk was manageable and lacked *"sufficient recognition"* of the connection between property markets in Ireland, the United Kingdom and the rest of the world.[42]

Richard Burrows, former Governor of the BOI Group, when asked by the Joint Committee to comment on how Project Atlas had highlighted problems in the BOI's property portfolio, said:

"I think they did a forensic job at the time. It was a matter of opinion, of course, as to what value you could attribute to any particular security, because the market was effectively closed. I think they made a reasonable attempt at it."[43]

Michael Fingleton, former Chief Executive, INBS noted that PwC had carried out a detailed analysis of INBS's loan book which was positive.[44]

The Joint Committee was prevented by the potential of causing prejudice to the criminal proceedings from hearing evidence from several other proposed witnesses on this and other issues.

38 David Doyle, former Secretary General, Department of Finance, transcript, INQ00113-036.

39 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-074.

40 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-005.

41 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-006.

42 Richie Boucher, Group CEO, BOI, transcript, INQ00085-015.

43 Richard Burrows, former Governor, BOI, transcript, INQ00104-045.

44 Michael Fingleton, former CEO, INBS, statement, MFI00001-013.

Adequacy of the 'Project Atlas' Reports

Though Project Atlas revealed a need to restructure and recapitalise the Covered Institutions, in assessing the adequacy of the Project Atlas Reports, the then Taoiseach, Brian Cowen, said the following:

"PwC was engaged to review the loan books and the capital position of the six Irish banks covered by the guarantee. The PwC report stated under a number of stress test situations that all of the Irish financial institutions which they reviewed would have sufficient capital to meet the regulatory requirements up to 2011. This analysis was hopelessly optimistic and certainly did not envisage the crisis to develop the way that it subsequently did."[45]

When referred to Brian Cowen's above assessment, Denis O' Connor, a Partner with PwC, said that the scenario analyses were conducted *"before NAMA [and] before Tier 1 Capital Ratios increased from 4% to 10%."* He also drew attention to two other factors impacting on the estimates, namely:

- paper equity whereby PwC had assumed that the loans were backed by equity but it *"wasn't really equity"*.
- reliance by lenders on personal guarantees given by borrowers which *"proved not to have any value."*[46]

Aidan Walsh, Partner, PwC added that the scenarios had been examined in October 2008, which was around the time of Budget 2009. That Budget, he said, *"was framed against assumptions that GDP would decline by 1% in 2009 and unemployment might rise to 7%."* However the actual values turned out to be a GDP decline of *"something [like] 7%"* and an unemployment rate rise of 15%. Thus, *"the economic outlook in official documentation at the time was far more benign than the recession that evolved in Ireland over the subsequent two years."*[47]

However, insofar as the PwC analyses are concerned, two important points arise:

1. *Time:* With the crisis deepening, time was of the essence. Taking the time necessary to adequately interrogate each loan appears not to have been an option for PwC, as the financial institutions could have collapsed during the period, leaving the economy without a proper banking system. In this regard, Ann Nolan of the Department of Finance said:

   "…we couldn't give ourselves the luxury of taking six months to look at every single loan because the banks might have collapsed in that time, which would have left every small business in Ireland without a proper banking system."[48]

2. *Management information:* PwC's work on Project Atlas was based on the management accounts of the relevant banks. Such accounts are limited in their nature as they are:
   - draft accounts.
   - prepared internally, usually by the finance division or equivalent.

45 Brian Cowen, former Taoiseach and Minister for Finance, statement, BCO00002-005.
46 Denis O'Connor, Partner, PwC, transcript, INQ00097-008.
47 Aidan Walsh, Partner, PwC, transcript, INQ00097-008.
48 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-016/017.

- not audited accounts and not subject to external audit scrutiny and assessment.
- typically unapproved by the board of the relevant bank.
- can differ from bank to bank.

However, reliance on management information by PwC in carrying out its work seemed unavoidable.

According to the evidence of Denis O'Connor, Partner with PwC, the reports prepared by PwC did not undergo any independent verification procedures.[49] The initial work was focussed on liquidity and a high level review of major lending positions and loan provisions booked by the banks.[50]

According to Patrick Neary: *"…the professional approach taken by Pricewaterhouse … while it did rely on the banks ... questioned and interrogated the information."*[51]

However the situation was one where a worsening and accelerating crisis could scarcely be described, let alone quantified with certainty. A status report was urgently needed, even if it was considered inadequate.

Ann Nolan, Second Secretary, Department of Finance, described the PwC reports as the *"…initial due diligence."*[52] She asked whether PwC could have *"known better"* and indicated that she was not sure, even though the exposures eventually turned out to have been significantly understated.[53] This view was reiterated by John Hurley, former Governor of the Central Bank, who said in his evidence that:

"…falling market and values were going to be determined very much in the context of the falling market, so it wouldn't have been known at a particular moment in time how far property prices were going to go…"[54]

John Corrigan said that the PwC work:

"…certainly was a worthwhile exercise in that it exposed the extent to which … various developers were multi-banked, and it exposed the concentration of the system in various developers…"[55]

Under PwC's scenario 2 the total impairment charges were estimated at approximately €32 billion.[56] However, ultimately the State was required to invest €64.2 billion in the Irish financial institutions.[57]

49 Denis O'Connor, Partner, PwC, transcript, INQ00097-034.
50 Also referred to as an Impairment provision, this is an amount set aside from profits to cover the expected loss on a loan that is impaired.
51 Patrick Neary, former CEO and former Prudential Director, IFSRA, transcript, INQ00132-110.
52 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-016.
53 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-021.
54 John Hurley, former Governor, Central Bank, transcript, INQ00047-118.
55 John Corrigan, former CEO, NTMA, transcript, INQ00106-028.
56 Jones Lang LaSalle summary, DOF04897-004.
57 Department of Finance report for Banking Inquiry, 13 April 2015, DOF07852-003.

Budget Brought Forward to October 2008

By June, the Exchequer had estimated a tax shortfall of €3 billion for the year, while a further shortfall of €1.3 billion was evident by the end of August. As the Project Atlas loan book reviews were being conducted, the economy entered in to recession in September. The 2009 Budget, due to be announced in December 2008, was brought forward by 2 months to October 2008.[58]

As a result, planned pay increases for the public sector were cancelled and additional taxation measures were required to reduce the gap. Among the corrective measures announced, was the introduction of the Income Levy.

The budget was framed on the basis that tax revenues would increase by 1% in 2009, even though revenue was expected to fall by 13.7% in 2008. This growth was assumed despite GDP contracting in 2008 and the expectation that it would do so again in 2009. Increases in current expenditure were agreed, while capital expenditure was cut back.[59]

Recapitalisation programme announced

The Department of Finance became the driving force for discussing recapitalisation requirements with the financial institutions.[60]

Ann Nolan told the Inquiry:

"The PwC analysis showed clearly that there was a serious problem with land and development loans, both because of the total volume of such loans across the system and because of the small number of developers who had huge debts across the system."[61]

When John Corrigan, former CEO of NTMA was questioned about AIB and BOI, he said:

"…there was extreme pushback from the two banks at the outset of these discussions…certainly they resisted the notion of recapitalisation."[62]

In her evidence, Ann Nolan said that BOI was: *"…most realistic…AIB told us…they didn't need any capital…they were, you know, well able to cope."*[63]

In their Court[64] minutes of 13 October 2008, BOI indicated that they would require a capital injection, but it was decided that it was not an opportune time to approach the Government, given the recent Guarantee decision and the Budget due to be announced the following day.[65] BOI's Court continued to discuss how they could approach the Government for taxpayer investment as a source of equity, given the tightening of liquidity and the high cost of capital they were experiencing over the period.[66]

---

58 Oral PQ, 25 September 2008, DOF07613-003/004.

59 Budget 2009: An Assessment for CBFSAI, Q4 2008, CB-Narrative INQ00167-001.

60 Ann Nolan, Second Secretary General, Department of Finance, statement, ANO00002-002; John Corrigan, former CEO, NTMA, also advised the Joint Committee that in the case of the first round of recapitalisations "the Central Bank really wasn't involved", transcript, INQ00106-014.

61 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-002.

62 John Corrigan, former CEO, NTMA, transcript, INQ00106-033.

63 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-034. This is also supported by Eugene Sheehy, former Group Chief Executive, AIB, where he confirms saying AIB would rather die than take equity in October 2008, transcript, INQ00133-012.

64 Bank of Ireland's board is known as the "Court."

65 BOI Court minute 13 October 2008, BOI03889-002.

66 BOI Court minute 17 October 2008, BOI04042-004.

In October 2008 BOI had internal discussions about the bank's possible need for a capital injection by the State as one of a number of options reviewed by the bank at that time.

It was also noted that Brian Goggin would explore the idea of a *"capital injection by the taxpayers,"* but that this would not be done until after the Budget which took place around that time, mid-October. The bank's public position at that time was that the bank did not require taxpayer funding.[67]

Richard Burrows said:

"In any public statement, if you're in a situation looking for capital, the last thing you want to do is to start talking about that publicly because that just engenders a great deal of uncertainty and loss of confidence in an institution. It's like a central banker or Minister for Finance not talking about a devaluation before he does it; he can't because you almost make the situation worse-"He confirmed to the Joint Committee that the topic of the bank's recapitalisation had been raised at a meeting with the Minister for Finance before the end of the year – "late autumn of 2008."[68]

When asked about the board minutes, Brian Goggin said:

"the discussions around capital, as evidenced in these papers, had all to do with new capital rules arising out of the decision by the UK Government to increase the core tier 1 ratio of the UK banking system, up to 7.5%. That immediately put pressure back on the Irish banks. The capital discussions here have nothing whatsoever to do with solvency; it's all to do with new regulatory impositions."[69]

Kevin Cardiff was asked if BOI had raised the matter of requiring capital on the night of the Guarantee, given that the bank was raising it internally just two weeks after the guarantee meeting. He said, clarifying an earlier answer, that:

"the minutes you've sent to me talk a bit more about precautionary capital. Capital is … in a sense, they're consistent with what I was saying last time, that at this point, there was a need for capital mostly based on changing market expectation, that they're already saying, even on 18 October, "Look, let's look at that." *And also, …… we and the official system started to focus on capital also almost immediately, probably around the 15th (October 2008) or so, I think, I sent an e-mail to people saying we have to now do an exercise about capital, and about whether nationalisations may be required, and so forth."*[70]

"having said that, I think even now they may have been a little bit coy, at the very least, because it was some months later we were still discussing with them how much capital they needed. I don't think they were entirely upfront, let's say, about their own desires……. if they had been more upfront about that, we might have moved along a little bit quicker."[71]

67 BOI Court Minute Extract 17 October 2008, BOI04042-004.

68 Richard Burrows, former Governor, BOI, transcript, INQ00104-060.

69 Brian Goggin, former Group CEO, BOI, transcript, INQ00139-063.

70 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-030.

71 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-030/031.

When asked to comment on the position of AIB in October 2008, Eugene Sheehy, former Group Chief Executive of AIB, said:

"There's also lots of documents you will have seen that we were adequately capitalised at the time. If a board had decided to raise funds in a share placement with customers, you would have to immediately announce that. At the time we were looking at capital, and we had a whole range of mitigants that we thought we could apply. We were a long, long way from ever having to, at that stage, ask shareholders to pay up."[72]

It is clear from the board minutes of 11 December 2008, that AIB still believed that they were *"…adequately capitalised…"*[73] and did not require any capital from the State. Dermot Gleeson told the Inquiry that he did not know when AIB became insolvent. However he referred to the fall in house prices and said: *"The real trouble was 2009, and I don't know when in 2009-10 AIB became insolvent."*[74]

Anglo also believed that they would raise sufficient capital. According to Gary McGann, former Non-executive Director, Anglo *"…there was a belief that a recapitalised Anglo could have a future but it would need (a) stronger funding sources and (b) probably a broader funding footprint."*[75]

Questioned by the Joint Committee on when Gary McCann would have realised that Anglo's future as an independent financial institution without any intervention or State support was no longer tenable, he said: *"I don't think there was a point in time...at all points in time the board saw this as a funding liquidity challenge."*[76] At a meeting on 12 December 2008, the board of Anglo discussed a potential mechanism for raising capital through a rights issue or a preference share issue and suggested that existing investors were prepared to participate in an equity offering.[77]

Recalling her first meeting with representatives from AIB and Anglo, Ann Nolan spoke of being *"…stunned at the amount of capital the private sector was going to put into them."*[78] However, the anticipated capital injections from private sources did not materialise for either of the two banks, as investors had lost confidence in the Irish banks.[79]

Throughout the month of December 2008, meetings continued between the Department of Finance, the NTMA, the Central Bank, Merrill Lynch and Arthur Cox Solicitors to discuss the recapitalisation programmes for AIB, BOI and Anglo. In his evidence, John Corrigan spoke of one particular meeting on 13 December 2008, where the NTMA, amongst others, pressed strongly for Anglo to be nationalised.[80]

72 Eugene Sheehy, former Group CEO, AIB, transcript, INQ00133-012.
73 AIB Board minute 11 December 2008, AIB02517-002.
74 Dermot Gleeson, former Chairman, AIB, transcript, INQ00123-010.
75 Gary McGann, former Independent Non-executive Director, Anglo, transcript, INQ00082-024.
76 Gary McGann, former Independent Non-executive Director, Anglo, transcript, INQ00082-024.
77 Anglo Board Minute, 12 December 2008, IBRC00626-001.
78 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-034.
79 David Doyle, former Secretary General, Department of Finance, statement, DDO00001-011.
80 John Corrigan, former CEO, NTMA, transcript INQ00106-003; Minutes of sub-group meetings, 13 December 2008, DOF04995-001.

According to Pádraig Ó Ríordáin, former Managing Partner of Arthur Cox:

"…once the State guaranteed each of the banks, then the State was, obviously, vulnerable to any default by any of the banks."[81]

Accordingly, the Government made an announcement on the 14 December 2008 that the State would support the Covered Institutions through a recapitalisation programme of up to €10 billion, so as to meet with their regulatory capital requirements.[82]

Ultimately, the Government announced on 21 December 2008 that the State would inject €1.5 billion into Anglo and €2 billion each into AIB and BOI by way of preference shares. It was anticipated that a further €1 billion for AIB and BOI would be required[83] but, according to Kevin Cardiff, the Government wanted the relevant banks to sell assets, increase profits and reduce costs to support their own levels of capital.[84] Kevin Cardiff said that providing the needed capital upfront would reduce the incentive for these banks to raise additional capital on their own and that *"…people didn't want to give them that luxury."*[85]

Nationalising Anglo, 15 January 2009

Once the decision to recapitalise AIB, BOI and Anglo was made, Arthur Cox were tasked with carrying out a due diligence exercise.[86]

According to Ann Nolan, there were *"…deep concerns about recapitalising Anglo without nationalising it, simply because of the issues that had led to the chairman's resigning."* As a result, Arthur Cox prioritised their due diligence on that bank.[87]

Over the period from the end of 2008 into early 2009, two parallel work-streams continued on Anglo – one examining recapitalisation and the other nationalisation. According to Ann Nolan, the Department of Finance needed to be ready for either option once the due diligence exercise was completed. Arthur Cox, the Office of the Attorney General and the Department of Finance continued their work on the *Anglo Irish Bank Corporation Bill 2009* – the legislation to nationalise Anglo. Meanwhile, the Department continued work on the recapitalisation aspect, formally notifying the European Commission on 8 January 2009.[88]

Arthur Cox reverted to the Department a week later on 15 January 2009, reporting on issues of legal concern within the bank.[89] In addition to these issues, Anglo's business model was considered *"fatefully flawed"*[90] and according to Ann Nolan, *"…there was no capacity to regenerate profits,*

81 Pádraig Ó Ríordáin, Partner, Arthur Cox, transcript, INQ00111-014.

82 Government announcement on €10bn recapitalisation of Covered Institutions, 14 December 2008, DOF00752-001.

83 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-019.

84 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-035.

85 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-035.

86 Pádraig Ó Ríordáin, Partner, Arthur Cox, statement, POR00001-006; Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-003. Due to legal privilege, little detail is held on the scope of this exercise.

87 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-013.

88 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-013.

89 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-038.

90 John Corrigan, former CEO, NTMA, transcript, INQ00106-010. This is reiterated by Pádraig Ó Ríordáin, Partner, Arthur Cox, transcript, INQ00111-018/019.

which the other banks had."[91] As a result, a number of options in respect of Anglo had to be considered, as follows:

- to continue with the original recapitalisation of €1.5 billion, either by preference shares or ordinary shares
- to nationalise
- to disengage[92]

Due to a number of factors, including the provision of the State Guarantee, Europe's expectation that no bank should fail[93] and the likely contagion effect across the financial system, the option of the State to try to disengage from Anglo was not considered *"realistic"*, according to Ann Nolan.[94] Having formally consulted with the Central Bank, Financial Regulator, NTMA and officials in the Department of Finance, the Minister for Finance, Brian Lenihan, sought a decision from the Government to take full control of Anglo by way of nationalisation and to replace the management board.[95]

On 15 January 2009, the Minister for Finance, on behalf of the Government, announced that Anglo would be nationalised with immediate effect. This did not increase the exposure of the State, as the State was already liable since the issue of the Guarantee in the previous September.[96] However, it would appear to the Joint Committee that nationalising Anglo was carried out without the full knowledge of how much additional capital Anglo would ultimately require.

Recapitalisation of the Covered Institutions, continued.

In his evidence to the Joint Committee, former Taoiseach, Brian Cowen stated that:

"…the success of the guarantee on the night was to restore liquidity that was badly needed at that critical time. It was a success for a short time and … sentiment against Irish banks continued."[97]

The Guarantee did not address the on-going liquidity problems being faced by the Covered Institutions. They were still facing an extremely unstable outlook, with major withdrawals of deposits and established credit lines leading to substantial recourse to the Central Bank for short-term liquidity support.[98]

Consultations continued between AIB, BOI and the Department of Finance on the recapitalisations through to the end of 2008 and into early 2009. The focus was on the capital amounts required and the associated terms and conditions.[99]

91 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-038.

92 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-003.

93 John Hurley, former Governor, Central Bank, transcript, INQ00047-077 to 079.

94 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-003.

95 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-003. Memo for Government decision on Nationalisation, 15 January 2009, DOF02259-001.

96 Pádraig Ó Ríordáin, Partner, Arthur Cox, transcript, INQ00111-020.

97 Brian Cowen, former Taoiseach and Minister, transcript, INQ00089-114.

98 Memo to Government on a proposal for a NAMA, March 2009, DOF03553-001.

99 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-003.

In February 2009, the Government agreed a Core Tier 1 capital injection of €3.5 billion for both AIB and BOI through a proposed purchase of preference shares by the National Pension Reserve Fund (NPRF).[100] BOI advised members of their Court on 18 March 2009 that they needed additional capital and the only available source was the Government.[101] According to Michael Somers, former CEO of the NTMA, the NTMA became involved because it had the cash from the National Pension Reserve Fund (NPRF) and the Government wanted the agency to invest it in the banks.[102]

Certain conditions were attached to the recapitalisations, such as:

- a fixed dividend of 8% was payable annually on the preference shares.[103]
- the Government could appoint 25% of the banks' directors.[104]
- both AIB and BOI were required to increase their lending to SMEs[105] by 10% and to provide additional lending of 30% to first time buyers in 2009.[106]
- senior executives were required to take a reduction of at least 25% in total remuneration and would receive no bonuses or salary increases for 2008 and 2009.[107]

However in March 2009, while carrying out a legal and financial due diligence exercise on both institutions[108] the NPRF wrote to the Minister for Finance advising him that *"…it is likely that the proposed €3.5bn preference share investment in AIB will fall short of what is required."*[109]

It appeared to the NTMA that AIB felt its position was no worse than that of BOI and that AIB would only recommend to their shareholders an amount of additional capital that was equal to the amount to be provided to BOI.[110] It was agreed, ultimately, that AIB would sell their US and Polish subsidiaries to cover the shortfall and a capital injection of €3.5 billion was reaffirmed.[111] The sale of the Polish subsidiary did not occur until early 2010, after the Central Bank had completed the PCAR (Prudential Capital Assessment Review) and *"…insisted that the assets be sold…"*[112]

Meanwhile, Anglo continued to struggle post-nationalisation. The market had lost confidence in the bank and the new management board could not curtail its deteriorating capital position.[113] As Ann Nolan commented: *"… Anglo surprised on the downside every time you looked at it for the entire period … and that's just looking at the losses."*[114]

---

100 Memo for Government – Recapitalisation of the Banking System, 11 February 2009, DOF07683-001.
101 Memo to BOI Court, 18 March 2009, BOI04068-003.
102 Michael Somers, former CEO, NTMA, transcript, INQ00093-022.
103 Memo for Government, 11 February 2009, DOF07683-002.
104 Memo for Government, 11 February 2009, DOF07683-002.
105 See Glossary of Terms.
106 Memo for Government, 11 February 2009, DOF07683-006.
107 Memo for Government, 11 February 2009, DOF07683-005/006.
108 This was due diligence exercise undertaken by PwC and Arthur Cox.
109 Letter to Minister for Finance from NPRF 20 March 2009 re proposed purchase of preference shares in AIB and BOI, NTMA00001-002. See also Memo to Government, 22 April 2009, DOF03558-003.
110 John Corrigan, former CEO, NTMA, transcript, INQ00106-033.
111 Memo to Government, 22 April 2009, DOF03558-003 to -005.
112 Ann Nolan, Second Secretary General, Department of Finance, statement, ANO00002-007.
113 Memo to Government, 22 April 2009, DOF03558-002/003.
114 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-021.

In its December 2008 monthly accounts, Anglo's Core Tier 1 Capital Ratio stood at 5.7%. By February 2009, this had fallen to 4.9%. In effect, Anglo had only €790 million of capital to absorb any further losses on their loan book before they would be in breach of their 4% regulatory capital requirement.[115] The business model was broken and did not facilitate a source of income to make up the additional capital that the bank urgently required.[116]

According to Kevin Cardiff, Anglo *"…was never going to get all of the capital it might want upfront."*[117] Consequently, capital injections were phased: in June 2009 the Minister for Finance invested €3 billion and a further €1 billion was invested in August 2009.[118]

While the NTMA was reluctant to use the NPRF to recapitalise AIB and BOI, this went ahead on the Minister for Finance's instruction.[119] John Corrigan said that it was considered that *"…there was a strong probability that the State would get its money back…"* from BOI and AIB, but it was believed to be unlikely that the money would be recouped from Anglo. For this reason, the recapitalisation of Anglo was made using cash drawn from the Exchequer rather than the NPRF.[120]

Why did the authorities not see the scale of the recapitalisation problem upfront?

Problems arose for the State authorities such as the Department of Finance and the NTMA when seeking to estimate the projected scale and timing of bank recapitalisations. On the basis of evidence presented to the Inquiry, these problems arose from the following factors:

1. *Declining asset values:* Officials did not foresee the extent of the future drop in asset values. The drop in values reached up to 50% for housing[121] and around 90% for non-developed land.[122]
2. *Reliance on management information:* PwC were engaged to review the loan books and capital positions of the Covered institutions. However, as previously discussed, though PwC's work expanded over time, it was based predominantly on the management accounts of the Covered Institutions and did not involve any independent verification. The Joint Committee is of the view, such work should have been commissioned.[123]
3. *Non-performing loans:* The extent of non-performing large commercial loans, especially land and property related, was not known prior to their transfer to NAMA in 2010. It transpired ultimately that only 23% of the property-related loans transferred to NAMA were in actual fact performing, which was close to only half of the NAMA Participating Institutions' own estimates. Furthermore, there were significant variances between those institutions.[124] That exerted a major influence on the scale and timing of the recapitalisations of individual institutions.

115 Memo for Government on Recapitalisation of Anglo and AIB, DOF03558-002.
116 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-021.
117 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-025.
118 Note to Minister for Finance, Capital Injection into Anglo Irish Bank, July 2009, DOF05979-001.
119 Michael Somers, former CEO, NTMA, transcript, INQ00093-009.
120 John Corrigan, former CEO, NTMA, transcript, INQ00106-015.
121 Gerard Gannon, Executive Director, Gannon Homes, statement, GGA00001-002.
122 Patrick Davitt, CEO, IPAV, transcript, INQ00066-016.
123 Denis O'Connor, Partner, PwC, transcript, INQ00097-034.
124 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-046.

The unknown scale of the above together with other poor lending practices, interest roll-up and reliance on paper equity made projections on bank recapitalisations difficult to estimate in a volatile market. This eventually necessitated the engagement of Blackrock Solutions to assess and model bank portfolios in 2010 and 2011, through the PCAR and PLAR exercises.[125]

Mini Budget April 2009

In tandem with the capital injections into AIB and BOI, the economic situation continued to deteriorate. The Government felt it necessary to introduce further fiscal adjustments, in the form of a *"mini-budget"*, in April 2009. A review of Exchequer revenue and expenditure revealed that the expected General Government Deficit as a percentage of GDP had only reduced to 10.75%.[126] In October 2008, the Government planned to reduce this to a 6.5% deficit.[127]

When the *"mini-budget"* was introduced, the Exchequer borrowing requirement was forecast to be €20.3 billion.[128] In reality, the borrowing requirement exceeded the forecast considerably, rising to €24.6 billion by the end of 2009.[129] Overall, expenditure cuts of €1.5 billion and tax increases of €1.8 billion were introduced.[130]

This 2009 *"mini-budget"* also included significant institutional changes, most notably the creation of NAMA[131] and the reform of the Central Bank.[132]

Three-year Business Plans from Covered Institutions

In October 2009, a Memorandum for Government indicated that the Government was considering a number of options for restructuring the banks. These included a possible merger of EBS and INBS and a possible sale of the combined entity to IL&P; the possibility of either Ulster Bank or Bank of Scotland Ireland taking over the combined EBS/INBS entity and the acquisition by a foreign institution of EBS/INBS. [133]

Each of the Covered Institutions was required to prepare and submit a 3-year business and recovery plan to the Central Bank setting out how management intended to return the relevant Covered Institution to a stable, properly capitalised and profitable position. The plans would also have to be approved by the European Commission and monitored on a quarterly basis.[134]

Ultimately, the merger of EBS and INBS did not proceed. The Government decided to merge EBS with AIB as it failed to get sufficiently attractive bids to sell EBS.[135] Anglo and INBS were deemed

125 Prudential Capital Adequacy Review (PCAR) was a review of the Covered Institutions' capital positions; Prudential Liquidity Assessment Review (PLAR) was used to identify the amounts of assets required to be disposed of by the banks to aid their return to stable funding levels.

126 ESRI Quarterly Economic Commentary Spring 2009, DOF07521-029.

127 Budget Statement 2009, announced 14 October 2008. Source: http://oireachtasdebates.oireachtas.ie/debates%20authoring/debateswebpack.nsf/takes/dail2008101400006?opendocument

128 Macroeconomic and Fiscal Framework 2009-2013, PUB00388-010.

129 Exchequer Statement December 2009, PUB00382-001.

130 Financial Statement of the Minister for Finance, Brian Lenihan, 7 April 2009, PUB00386-006.

131 Financial Statement of the Minister for Finance, Brian Lenihan, 7 April 2009, PUB00386-012.

132 Financial Statement of the Minister for Finance, Brian Lenihan, 7 April 2009, PUB00386-011.

133 Memorandum for Government, October 2009, DOF03573-001.

134 EC Ex post evaluation of Economic adjustment Program, PUB00356-047.

135 EC Ex post evaluation of Economic adjustment program, PUB00356-048.

to be non-viable and, therefore, a specific plan was put in place for these two institutions.[136] They ultimately became Irish Bank Resolution Corporation (IBRC). [137]

The preparation, approval and re-approval of these plans took from 2009 to 2013, with BOI's plan approved quickly under State aid rules and AIB's plan taking longer, due the merger of AIB and EBS. However, PTSB's plan was not approved until April 2015, as their restructuring proved slower than the other banks. Each of the banks produced several iterations of their plan over the period, as the economic environment continued to deteriorate and their capital requirements grew due to their increasing loan provisions.[138]

Changes in the Covered Institutions and Central Bank Throughout 2009

Between the announcement of the Government's Guarantee in September 2008 and completion of the first bank recapitalisation programme by the end of 2009, a number of significant changes unfolded as the financial institutions and official bodies adjusted to the new banking environment.

One of the first changes insisted upon by the Government as a condition of the Bank Guarantee was the appointment of Government nominated Non-Executive Directors to the boards of the Covered Institutions. Often referred to as Public Interest Directors, the reasons for their appointment were explained to the Inquiry by the former Taoiseach, Brian Cowen:

"Well public interest directors were ... the idea there was that whilst we didn't have ownership of these banks, we believed this was in the interest ... to try and help restore some public confidence in the governance of these organisations to have people who are in there.... they would be au fait with Government policy or public policy and would be bringing that perspective to the table while others from the private sector expertise might be bringing a commercial experience to it. It was a balance if you like, to try and ... to demonstrate (a) that it was important that there be public interest directors and (b) that they would be capable of ensuring that at board level people understood what the public policy priorities of Government would be in respect of how they were conducting their business."[139]

Alan Dukes, when asked about his role as a Public Interest Director for Anglo, stated:

"…you had a duty to the company and … you had a duty to the shareholder and … you had a duty of care to the employees of the company and you still had to bear the public interest in mind. But where all these things met was never clear."[140]

He went on to say:

"I rationalised it to myself on the basis that I was there to look after the public interest, the shareholder in the bank was the Minister for Finance. The Minister for Finance has a duty to the public interest and in a sense kind of embodies the public interest, so the objectives of the Minister for Finance satisfied the requirements that I look after the public interest."[141]

136 EC Ex post evaluation of Economic adjustment Program, PUB00356-047.

137 See below for an examination of the merger of Anglo and INBS and the formation of IBRC.

138 EC Ex post evaluation of Economic adjustment Program, PUB00356-057.

139 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-101/102.

140 Alan Dukes, former Public Interest Director, Anglo Irish Bank, transcript, INQ00141-052.

141 Alan Dukes, former Public Interest Director, Anglo Irish Bank, transcript, INQ00141-052.

The Minister for Finance nominated 12 Public Interest Directors, two directors to the board of each of the Covered Institutions.[142] These appointments, made in January 2009, were the first of many leadership changes across the six Covered Institutions. During 2009, AIB's Chief Executive, Chair and Group Finance Director retired,[143] while BOI's Governor chose not to stand for re-election and the BOI Group CEO stepped down.[144] IL&P accepted resignations from their CEO and CFO.[145] INBS also lost its Chairman and Chief Executive,[146] while EBS saw its Chief Financial Officer depart alongside the Managing Director of its Haven Mortgages subsidiary.[147] Numerous other non-executives and other members of senior management teams departed posts across the Irish banks during the year.

On the regulatory side, publication of the Central Bank's 2008 Financial Stability Report, was delayed due to market uncertainty. Initially scheduled for publication in November 2008, it was eventually decided in February 2009 that the report would never be published.[148]

There were also changes of key personnel within the Central Bank. Although it was announced in January 2009 that John Hurley would be reappointed for a second seven year term as Central Bank Governor, he had indicated to the Minister for Finance that he would not serve for more than one year and subsequently retired in September 2009, when he was succeeded by Patrick Honohan.[149]

At the Financial Regulator, its Chief Executive, Patrick Neary, retired in January 2009[150] and his role was taken over on an interim basis by the Financial Regulator's Consumer Director, Mary O'Dea.[151] This interim appointment was eventually extended until January 2010, when Matthew Elderfield arrived from his post as Chief Executive of the Bermuda Monetary Authority,[152] following an extensive international search.

By the time of Matthew Elderfield's appointment, the Central Bank and Financial Regulator had already begun to implement an extensive programme of reforms, driven by both national and international responses to the financial crisis. The report considers these reforms in more detail at Appendices 10 and 11.

142 Alan Dukes, former Public Interest Director, Anglo Irish Bank, transcript, INQ00141-012/013.

143 As noted in AIB Annual Report for the year ended 31 December 2009, Dermot Gleeson retired as Chairman on 1 July 2009, John O'Donnell retired as Group Finance Director on 31 August 2009 and Eugene Sheehy retired as Group Chief Executive on 30 November 2009.

144 As noted in Bank of Ireland Annual Report for the year ended 31 March 2009, Brian Goggin stepped down as Group Chief Executive from 25 February 2009, while Richard Burrows chose not to stand for re-election as Governor.

145 As noted in Irish Life and Permanent Report for the year ended 31 December 2008, Denis Casey resigned as CEO and Peter Fitzpatrick resigned as CFO.

146 As noted in INBS Financial Statements for the year ended 31 December 2008, Michael Walsh resigned as Chairman on 17 February 2009, while Michael Fingleton would retire as Chief Executive on 30 April 2009.

147 As noted in EBS Financial Statements for 2009, Alan Merriman ceased to be a Director on 10 March 2009, while Tony Moroney retired from the main board on 29 May 2009 and departed his post at Haven Mortgages on 9 September 2009.

148 Central Bank Board Meeting Minutes, Q1 2009, INQ00157-001 (Subject to S33AK, Central Bank Act, 1942).

149 John Hurley, former Governor, Central Bank, statement, JHU00006-001.

150 The Annual Report of Financial Regulator 2008 confirms Neary's retirement on January 2009.

151 Mary O'Dea, former Consumer Director and Chief Executive, statement, MOD00001-001.

152 Details of Matthew Elderfield's appointment is confirmed in a Regulatory and Operational Risk Report of AIB in October 2009, AIB02942-028.

Eligible Liability Guarantee Scheme (ELG Scheme)

The ELG Scheme[153] was introduced in December 2009 and ran in tandem with the Credit Institutions (Financial Support) Act 2008 (CIFS Act 2008) until September 2010. The CIFS Act 2008 guaranteed the liabilities of the Covered Institutions until end September 2010.[154] The ELG Scheme provided for an unconditional and irrevocable State Guarantee for certain eligible liabilities (including deposits) of up to five years in maturity incurred by the financial institutions from the date they joined the Scheme until the closure of the Scheme, subject to certain terms and conditions. The NTMA was appointed by the Minister for Finance as the ELG Scheme Operator.

On 26 February 2013 the Minister for Finance announced the closure of the ELG Scheme to all new liabilities from 28 March 2013. After this date, no new liabilities would be guaranteed under the Scheme. This did not affect any liabilities already guaranteed as of 28 March 2013. [155]

Prudential Capital Adequacy Review (PCAR) 2010

In early 2010, the Central Bank carried out a review of the Covered Institutions' capital positions. This Prudential Capital Adequacy Review (PCAR)[156] exercise identified a need for approximately a further €10.9 billion[157] of capital to be provided for AIB, Bank of Ireland and EBS combined.[158]

In giving evidence to the Inquiry, former Group Chief Executive of the EBS, Fergus Murphy said:

"EBS actually grew its retail deposits by circa €2 billion through the crisis, a notable feat when compared with the exodus of retail deposits from other institutions during this period. This particular action helped to stabilise the society and along with the actions on exiting commercial property and land and development finance and other actions, lessened the ultimate amount of capital that the organisation eventually required."[159]

BOI met their requirement for €2.66 billion additional capital by raising new capital in the market and by converting €1.7 billion of their existing €3.5 billion preference shares into ordinary shares. AIB sold its Polish operations and its investment in M&T Bank in the US, which contributed €3.4 billion of its capital requirement. The Government provided the balance of €4 billion.[160]

In September 2010, due to the increasing scale of discounts being applied to loans on being transferred to NAMA, the Central Bank determined that AIB would require a further €3 billion of capital over and above the €7.4 billion capital injection which had occurred in March 2010.[161] This figure was rolled-up into the revised capital requirements arising from the PCAR/PLAR 2011 exercise.[162]

---

153 Eligible Liabilities Guarantee Scheme. Source: http://www.ntma.ie/business-areas/funding-and-debt-management/eligible-liabilities-guarantee-scheme/

154 The Government extended this Guarantee on a number of occasions.

155 Eligible Liabilities Guarantee Scheme. Source: http://www.ntma.ie/business-areas/funding-and-debt-management/eligible-liabilities-guarantee-scheme/

156 Central Bank and Financial Regulator PCAR 2010, 30 March 2010, PUB00377.

157 AIB €7.4billion; BOI €2.66billion; EBS €0.875billion.

158 EBS was still a stand-alone entity at this point. IL&P was not included in this first PCAR exercise.

159 Fergus Murphy, former Group Chief Executive, EBS, transcript, INQ00120-004.

160 Department of Finance report for Banking Inquiry, 13 April 2015, DOF07852-004.

161 Memo for Government, Changes in NAMA, 29 September 2010, DOF03594-002.

162 PCAR 2011 Review, PUB00167-039.

Anglo and INBS were not formally part of the initial PCAR exercise in 2010, due to the fact that a final decision had not been taken on the restructuring of either institution. However the Central Bank did give an indication in its PCAR announcement in March 2010 that, as an interim measure, Anglo would require €8.3 billion of additional capital and that INBS would need €2.6 billion.[163] These requirements were satisfied by the issuance of a Promissory Note at the end of March 2010.[164] The quantum of this Promissory Note was increased on several occasions during 2010 as the extent of the final haircuts applied by NAMA to loans transferred from both Anglo and INBS became clearer.[165] Ultimately, the value of the Promissory Notes issued by the Government in support of Anglo and INBS reached €30.6 billion by the end of 2010.[166]

Merger of Anglo and INBS into IBRC

The Government's initial intention regarding the restructure of Anglo was to remould it into a new business bank. However, in 2009, Anglo made a loss of €12.7 billion. In 2010 it made a loss of almost €17.7 billion. The 2010 figures were partly driven by haircuts applied to NAMA loans, which amounted to €11.5 billion.[167] This, together with the severity of the Irish sovereign debt crisis and the additional capital required by Anglo, meant that the funding of any future business was likely to be challenging.[168] Hence, this plan was quickly abandoned in favour of splitting Anglo into an asset recovery vehicle and a funding bank.[169] A Restructuring Plan based on this approach was submitted to the European Commission on 22 October 2010.[170]

The Government had initially provided INBS with €2.7 billion to cover losses arising on its commercial property loan portfolio.[171] In September 2010, the NTMA recommended that a further €2.7 billion be provided to cover expected losses on the residual (post-NAMA transfer) loan book.[172] In evidence to the Inquiry, Michael Fingleton, Michael Walsh and John Stanley Purcell all indicated that they believed that the discounts applied by NAMA for their loans were excessive and that this led to INBS requiring more additional capital than they felt was required.[173] INBS had ceased to function as a lending institution and the Government was formulating proposals as to the future of the business. The Restructuring Plan for INBS had been submitted to the European Commission in June 2010 and it proposed *"the continued management of the society as a going concern in anticipation of a sale to a trade buyer."*[174]

---

163 Prudential Capital Assessment Review, PUB00377-005.

164 Memo for Government, Changes in NAMA, 29 September 2010, DOF03594-004.

165 Memo for Government, Changes in NAMA, 29 September 2010, DOF03594-002.

166 Department of Finance report for Banking Inquiry, 13 April 2015, DOF07852-004.

167 Anglo Annual Report & Accounts 2010, page 34

168 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-133.

169 Government Statement, 30 September 2010: "On the 8th September last I announced the Governments decisions on the restructuring and resolution of Anglo Irish Bank…..This envisages the splitting of the bank into two licensed and regulated credit institutions: an Asset Recover Bank….and a Funding Bank.." contained within Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, DOT: Core Book 35, KCA00001-328.

170 Joint EC Restructuring and Work Out Plan for Anglo & INBS, 31 January 2011, DOF00808-004.

171 The Economic Adjustment Programme for Ireland, February 2011, DOF05089-016.

172 The Economic Adjustment Programme for Ireland, February 2011, DOF05089-016.

173 Michael Fingleton, former CEO, INBS, transcript, INQ00077-019; Michael Walsh, former Chairman, INBS, transcript, INQ00079-044; John Stanley Purcell, former Director & Secretary, INBS, transcript, INQ00078-018.

174 EC Decision on State Aids, 29 June 2011, DOF00817-004.

The entry into the Bailout Programme and the subsequent negotiations with the Troika on the restructuring and future of the Irish banking system had a significant impact on the future of Anglo and INBS. See Chapter 10 – The Troika Programme.

A revised Joint Restructuring Plan was submitted to the EU in January 2011.[175] This plan provided for the sale of the deposit franchises of both Anglo and INBS, the management of the residential mortgage portfolio (ex-INBS) for eventual sale and the orderly wind-down of the combined commercial loan book over a 10 year period.[176] The combined entity would not require any further capital injections from the State. The Joint Restructuring Plan was approved by the European Commission in June 2011.[177] Anglo and INBS were merged into one entity in July 2011, to form IBRC and IBRC's executive management team focused on delivery of the agreed strategy.[178]

The Promissory Notes and Subsequent IBRC Dissolution

In his evidence, Pádraig Ó Ríordáin explained the use of Promissory Notes during the relevant period:

"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)."[179]

By the end of 2010, the State had provided capital of €34.7 billion in support of Anglo and INBS (IBRC), of which €30.6 billion was made up of Promissory Notes.[180] In his evidence to the Joint Committee, Pádraig Ó Ríordáin said:

"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."[181]

These Promissory Notes required a payment to be made to the Central Bank of €3.1 billion in March each year.[182] At the time, IBRC was reliant on Emergency Liquidity Assistance (ELA) from the Central Bank of circa €41 billion and, in the absence of an alternative funding solution from the ECB, it was imperative that IBRC retained its banking licence and access to ELA.[183] According to Michael Noonan:

"…maintaining Central Bank funding to support the wind-down of IBRC was the most prudent approach to protect the taxpayer. Various alternative sources of long term funding were explored

175 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, DOT: Core Book 35, KCA00001-328.

176 Joint EC Restructuring and Work Out Plan for Anglo & INBS, January 2011, DOF00808-005.

177 EC Decision on State Aids, 29 June 2011, DOF00817-039.

178 Mike Aynsley, former Group CEO, Anglo-IBRC, transcript, INQ00141-008.

179 Pádraig Ó Ríordáin, Partner, Arthur Cox, statement, POR00001-010.

180 Department of Finance submission to the Banking Inquiry, 13 April 2015, DOF07852-004.

181 Pádraig Ó Ríordáin, Partner, Arthur Cox, statement, POR00001-010.

182 Michael Noonan, Minister for Finance, transcript, INQ00102-006.

183 Michael Noonan, Minister for Finance, transcript, INQ00102-005.

but did not prove possible. It was only when a long-term viable solution for the promissory notes was found and the system more generally had stabilised, that we decided to liquidate the bank."[184]

In early February 2013, pursuant to section 3(3) of the Anglo Irish Bank Corporation Act 2009, Kieran Wallace and Eamonn Richardson of KPMG were appointed by the Minister for Finance as Special Liquidators to IBRC.[185] By doing so, this *"…triggered events of default under a range of agreements between IBRC, the CBI and third parties."*[186] According to Michael Noonan, this involved:

"…the winding down of its business operations, discharging the liability of IBRC to the Central Bank in a way that ensured no capital loss for the Central Bank, while the remaining loans of IBRC would be sold on the market or, if necessary, transferred to NAMA and, finally, converting the IBRC promissory note to a portfolio of fully marketable long-term Irish Government bonds. Through these actions the promissory notes and IBRC were to be eliminated from the Irish financial landscape with consequent reputational benefits."[187]

The Joint Special Liquidators now controlled the operations of the IBRC pursuant to the IBRC Act 2013.[188]

Financial Measures Programme (FMP), 2011

Ireland's entry into the Troika Bailout Programme in November 2010 (see Chapter 10 The Troika Programme) had two core elements: one relating to fiscal policy and structural reform and the other relating to bank restructuring and reorganisation.[189] Regarding the latter, a plan called the Financial Measures Programme (FMP) was developed. This provided for a fundamental downsizing and reorganisation of the banking sector and the recapitalisation of the Covered Institutions to the highest international standards.[190]

The FMP was announced on 31 March 2011 and its main elements were:[191]

- Sale of the Anglo deposit book to AIB and of the INBS deposit book to IL&P.
- Merger and wind down of Anglo and INBS.
- Merger of AIB and EBS.
- Recapitalisation of the two pillar banks, AIB/EBS and BOI.
- Recapitalisation of IL&P.
- Deleveraging of the banks.

In the view of Kevin Cardiff, former Secretary General at the Department of Finance, this programme marked *"a key turning point in the rescue of the Irish banking system."*[192]

184 Michael Noonan, Minister for Finance, transcript, INQ00102-005/006.
185 Special Resolution & Direction relating to IBRC, 6 February 2013, DOF05532-004.
186 IBRC Liquidation – Background Information, 6 November 2013, DOF05670-001.
187 Michael Noonan, Minister for Finance, transcript, INQ00102-006.
188 Source: http://www.irishstatutebook.ie/eli/2013/act/2/enacted/en/html.
189 Department of Finance, Briefing Pack Bank Implementation Group August 2011, DOF07670-005.
190 Department of Finance, Briefing Pack Bank Implementation Group August 2011, DOF07670-005.
191 Department of Finance, Briefing Pack Bank Implementation Group August 2011, DOF07670.
192 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-235.

Prudential Capital Adequacy Review (PCAR), 2011

As part of the FMP, the Central Bank undertook a further PCAR exercise in March 2011.[193] This exercise identified a need for the banks to raise a further €24 billion of capital. The exercise also included a Prudential Liquidity Assessment Review (PLAR) which was used to identify the amounts of assets required to be disposed of by the banks to aid their return to stable funding levels.[194]

The aggregate target for disposals agreed with the Central Bank was some €72 billion over the 3 year period 2011 to 2013.[195]

PCAR identified the need for additional capital of €24 billion, over and above the €46.3 billion that had already been invested by the State up to the end of 2010.

As part of this capital raising exercise, AIB,[196] BOI and PTSB[197] were required to undertake Liability Management Exercises (LME) which, in practice, meant buying back their subordinated debt from investors at a discount to the original face value. This *"burden sharing"* exercise in 2011 generated €5.198 billion of the additional capital required and reduced the State's funding requirement by that amount.[198] See Chapter 11 – Burden Sharing. Nonetheless, the State was still required to inject a further €16.6 billion [199] into Irish banks, including €3 billion of contingent capital,[200] as set out below:

193 EC Ex-post evaluation of Economic Adjustment Program, PUB00356-048.

194 Central Bank PCAR 2011 Review, PUB00167-033.

195 Central Bank PCAR 2011 Review, PUB00167-034.

196 Now including EBS.

197 PTSB was part of the PCAR/PLAR 2011 exercise, unlike the previous year.

198 Department of Finance report for Banking Inquiry, 13 April 2015, DOF07852-011.

199 Difference between initial requirement for €24billion and final amount of €16.6billion is accounted for by private sector investment in BOI.

200 Referred to as CoCo in the table below.

Capital requirement resulting from PCAR 2011 and how it has been met (€bn)

	AIB	EBS	*AIB & EBS*	BOI	PTSB	Total
Gross capital required pre buffer	10.5	1.2	*11.7*	3.7	3.3	18.7
Buffer (equity)	1.4	0.1	*1.5*	0.5	0.3	2.3
Equity capital requirement	**11.9**	**1.3**	***13.2***	**4.2**	**3.6**	**21.0**
Buffer CoCo	1.4	0.2	*1.6*	1.0	0.4	3.0
Total capital requirement	**13.3**	**1.5**	***14.8***	**5.2**	**4.0**	**24.0**
Capital raised:						
Private equity raising**			*0.0*	2.3	0.0	2.3
Liability management exercises			*2.1*	1.7	1.0	4.8
Other			*0.0*	0.0	0.3	0.3
Government capital injection			*11.1*	0.2	2.3	13.6
Equity capital			***13.2***	**4.2**	**3.6**	**21.0**
CoCo			*1.6*	1.0	0.4	3.0
Total capital			***14.8***	**5.2**	**4.0**	**24.0**
**** Includes debt for equity swaps**						

Source: PCAR 2011 Review[201]

As part of the PCAR 2011 exercise, PTSB were required to sell off its Irish Life business, which it eventually did in February 2013. The sale raised €1.3 billion, resulting in a reduction the State's ultimate contribution.[202]

Overall, on completion of the 2011 capital raising exercise, the State had provided the Irish banks with a total of €64.2 billion in the 3 years since a decision was first made to provide capital in December 2008. A summary of the total investment by the State in the Irish banks is set out in the table below.

201 PCAR 2011 Review, PUB00167-005.

202 Department of Finance report for Banking Inquiry, 13 April 2015, DOF07852-004.

Details of the State's investment						
Domestic Bank Recapitalisation	**AIB/EBS €' bn**	**BOI €' bn**	**IL&P €' bn**	**IBRC €' bn**	**Total €' bn**	**% of GDP****
Pre-PCAR 2011:						
Government Preference Shares (2009) - NPRF	3.5	3.5*			7	4%
Ordinary Share Capital (2009) - Exchequer				4.0	4	3%
Promissory Notes {2010)	0.3			30.6	30.9	20%
Special Investment Shares {2010) - Exchequer	0.6			0.1	0.7	0%
Ordinary Share Capital (2010)- NPRF	3.7				3.7	2%
Total pre-PCAR 2011	**8.1**	**3.5**	**0**	**34.7**	**46.3**	**30%**
PCAR 2011:					**0**	
Capital from Exchequer	3.9		2.7		6.6	4%
NPRF Capital	8.8	1.2			10	6%
Total PCAR 2011	**12.7**	**1.2**	**2.7**	**0**	**16.6**	**11%**
Purchase of Irish Life			1.3		1.3	
Total Recapitalisation from the State	**20.8**	**4.7**	**4**	**34.7**	**64.2**	**41%**
Source of Funds:						
Promissory Notes	0.3			30.6	30.9	**20%**
Exchequer	4.5		4.0	4.1	12.6	**8%**
NPRF	16.0	4.7			20.7	**13%**
Total	**20.8**	**4.7**	**4.0**	**34.7**	**64.2**	

Source: Department of Finance report for Banking Inquiry, 13 April 2015[203]

The deleveraging plan was successfully completed by the target date. The banks sold €45 billion worth of assets over the period of the plan through amortisation and the disposal of bank assets.[204]

203 Department of Finance report for Banking Inquiry, 13 April 2015, DOF07852-004.

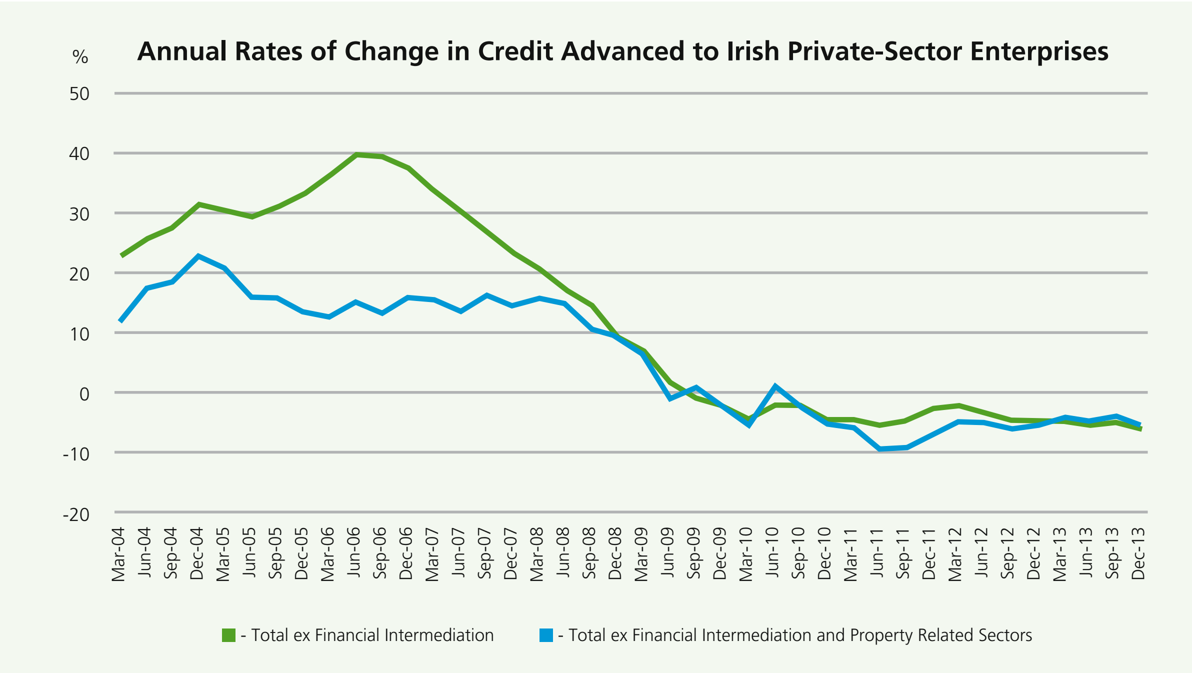
204 EC, Ex-post Evaluation of the Economic Adjustment Programme Ireland, 2010-13, PUB00356-055.

Cessation of new lending

One consequence of the crisis and the ensuing bank restructuring efforts was the almost total cessation of new lending for businesses of all sizes over the period 2009 to 2013.[205]

Despite specific provisions in the restructuring plans of both BOI and AIB for boosting credit availability to the business sector, both supply and demand for credit remained depressed, partly due to the recession and also due to the structural constraints under which the banks were operating.[206] These constraints included the need to restore the banks' capital ratios, a focus on asset recovery and disposal, liquidity constraints and a reduced appetite to take risk.[207]

The following graph depicts the percentage change in new lending to Irish private sector businesses over the period from 2001 to 2013.



Source: Central Bank of Ireland: Trends in Business Credit and Deposits[208]

What Remains in the Covered Institutions?

NAMA acquired loans from the Participating Institutions valued at €74.4 billion.[209] Taking account of discounts applied, the Participating Institutions ultimately reduced their balance sheets by around €70 billion (which was equivalent to 45% of GDP)[210] in line with the deleveraging targets set out as part of the Troika monitoring programme. The objective, as described by Brian Cowen, was to get

205 Central Bank of Ireland: Trends in Business Credit and Deposits Q4 2013: https://www.centralbank.ie/polstats/stats/cmab/Documents/2013q4_ie_trends_in_business_credit_and_deposits.pdf

206 Ajai Chopra, former Deputy Director, IMF, statement, ACH00001-015/016.

207 David Duffy, former CEO, AIB, transcript, INQ00134-007.

208 Central Bank of Ireland: Trends in Business Credit and Deposits Q4 2013: https://www.centralbank.ie/polstats/stats/cmab/Documents/2013q4_ie_trends_in_business_credit_and_deposits.pdf

209 C&AG Report, Progress Report 2010-2012, NAMA00010-019.

210 EC, Ex post Evaluation of the Economic Adjustment Programme Ireland, 2010-2013, PUB00356-015.

"…a situation going as quickly as possible where banks could show repaired balance sheets and get on with lending..."[211]

When the large property-related loans were transferred from the Participating Institutions to NAMA in 2010, residential property prices were still plunging. House prices reached their peak in September 2007 and their lowest point in March 2013.[212] The difference amounts to a fall of 51%.[213]

The decline in asset values, combined with high loan-to-value ratios in lending during the later stages of the boom years, resulted in many of the remaining loans in the financial institutions also being highly leveraged.

Dirk Schoenmaker, Professor of Banking and Finance at the Rotterdam School of Management, Erasmus University Rotterdam, commented as follows in an academic paper:

"…While in 2005, only half of first time buyers had LTV rates above 90 per cent, with very few above 100 per cent, these numbers went up in 2005 and 2006. By then, two-thirds of mortgages to first time buyers had LTV rates over 90 per cent and one third over 100 per cent …"[214]

The table below illustrates the volume of property loans which still remained on the Covered Institutions' balance sheets at the end of December 2013.

Outstanding loans and impairments of Irish banks, end-2013 (in € bn)

	Outstanding loans				Impaired loans	
	BOI	AIB	PTSB	Total	Impairment rate	Impairment loans
Mortgages	51.6	40.7	29.0	121.3	17.7%	21.5
CRE	16.8	19.7		36.5	56.9%	20.8
SME	13.6	13.7		27.3	25.1%	6.9
Corporate	7.8	4.3		12.1	25.1%	3.0
Consumer	2.8	4.3	0.3	7.4	6.1%	0.4
Total	92.6	82.7	29.3	204.6	25.7%	52.6

Note: Only fine of the six Irish banks (see Table 2) participated in the NAMA process. Anglo and INBS merged into IBRC. EBS was acquired by AIB.
Source: Annual reports 2013 of banks for outstanding loans; Central Bank of Ireland for impairment rate for SME and Corporate available.

Source: Schoenmaker[215]

211 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-118.

212 Residential Property Price Index, Central Statistics Office.

213 Based on CSO data – CSO does not provide absolute numbers but instead produces a price index to measure the change.

214 Dirk Schoenmaker, Stabilising and Healing the Irish Banking System: Policy Lessons, PUB00371.

215 Dirk Schoenmaker, Stabilising and Healing the Irish Banking System: Policy Lessons, PUB00371-015. The witnesses who appeared on behalf of the banks were not questioned in relation to the extent of the debt remaining after loans were transferred to NAMA.

At the end of 2013, two-thirds of all property-related loans remained on the balance sheets of the Covered Institutions and €42.3 billion worth of these were impaired loans (i.e. 17.7% of mortgages and 56.9% of CRE). That debt still existed even though, as already noted, €74 billion of property-related loans (referred to as CRE in the table above) had already been transferred from banks and into NAMA.

Whilst the Irish banks have taken large provisions for non-performing loans (53% as at June 2014), the level of actual loan write offs at 5.2% could be considered quite low.[216]

In his paper, Dirk Schoenmaker captures the lack of execution of the strategy. He states:

"Taking sufficient provisions for NPLs [non-performing loans] is a first step to heal banks. A necessary second step is to write off bad loans, to clean up bank balance sheets. On the first step, Ireland has been pro-active. On the second, progress is very slow…"[217]

Economist, Peter Bacon commented in his evidence:

"If there were a [further] Bacon report, what would it be focusing on at the moment? It would be saying, "Why in heaven's name, seven or eight years after the collapse, are we still dealing with a mortgage arrears problem?"[218]

Returning to the markets

During 2010 – 2012, Covered Institutions could only go to the markets with government-guaranteed CIF or ELG bonds. It was not until November 2012 that the Pillar Banks were in a position to return to the markets on a standalone basis.

BOI moved first with an unguaranteed 3 year, €1 billion, Asset Covered Security (ACS) bond[219] (also known as a Covered Bond) on 13 November 2012. AIB followed suit with an ACS issuance of €500 million the following month. In December 2012, BOI managed to raise €250 million in the first subordinated bond issue deal with a 10% coupon[220] and a maturity of 10 years in a targeted deal for their equity investors.[221]

Over the next year, the two Pillar Banks were set to issue more ACS Bonds and subordinated bonds but it took until 29 May 2013 before BOI went to the market with a senior unsecured and fully unguaranteed bond. BOI launched an unsecured bond for €500 million, which was oversubscribed.[222]

AIB were able to carry out a similar transaction in November 2013, which was also oversubscribed.[223]

216 Dirk Schoenmaker, Stabilising and Healing the Irish Banking System: Policy Lessons, PUB00371-025.
217 Dirk Schoenmaker, Stabilising and Healing the Irish Banking System: Policy Lessons, PUB00371-027.
218 Peter Bacon, Economist, transcript, PUB00334-020.
219 See Glossary of Terms.
220 See Glossary of Terms.
221 Recent bond issuance by the Irish "Pillar Banks", 20 November 2013, PUB00413-001.
222 Recent bond issuance by the Irish "Pillar Banks", 20 November 2013, PUB00413-001.
223 Recent bond issuance by the Irish "Pillar Banks", 20 November 2013, PUB00413-001.

Recent bond issuance by the Irish 'Pillar Banks'				
Announcement date	**Issuer**	**Description**	**ISIN**	**Amount issued**
13/11/2012	BKIR	3 Year ACS	XS0856562524	€1,000m
28/11/2012	AIB	3 Year ACS	XS0861589819	€500m
12/12/2012	BKIR	10 Year T2 debt	XS0867469305	€250m
22/01/2013	AIB	3.5 Year ACS	XS0880288211	€500m
15/03/2013	BKIR	5 Year ACS	XS0907907140	€500m
29/05/2013	BKIR	3 Year senior unsecured	XS0940658361	€500m
03/09/2013	AIB	5 Year ACS	XS0969616779	€500m
25/09/2013	BKIR	7 Year ACS	XS0975903112	€500m
31/10/2013	BKIR	12 Year ACS (private placement)	XS0991249623	€10m
06/11/2013	BKIR	3.5 Year ACS	XS0993264331	€1,000m
19/11/2013	AIB	3 Year senior unsecured	XS0997144505	€500m
('BKIR' referred to in the table above is Bank of Ireland)				

Source: Recent bond issuance by the Irish "Pillar Banks"[224]

This AIB transaction took the total bond issuance by the two Pillar Banks in 12 months to just over €5.7 billion with public transactions going out as far as 10 years.

AIB and BOI were now back in the international debt markets without the need for a support line from the State for the first time since the introduction of the Guarantee.

The possibility of retroactive recapitalisation

In June 2012, the European Heads of State decided to *"…break the vicious circle between banks and sovereigns, and that when a Single Supervisory Mechanism is in place involving the ECB, the European Stability Mechanism (ESM) could recapitalise banks directly."*[225]

The possibility of retroactive recapitalisation will also be available to Irish financial institutions, through a specific provision in the ESM.[226] According to Michael Noonan: *"…ESM may directly recapitalise banks or retroactively recapitalise banks. But it needs unanimity of the governors and it has to be done on a case-by-case basis…"*[227] (See Appendix 10 for further detail on SSM and ESM)

224 Recent bond issuance by the Irish "Pillar Banks", 20 November 2013, PUB00413-001.
225 PQ on Bank Recapitalisation, 3 October 2013, DOF00651-001.
226 PQ on Bank Recapitalisation, 3 October 2013, DOF00651-001.
227 Michael Noonan, Minister for Finance, transcript, INQ00102-060.

Findings of the Joint Committee

1. One consequence of the crisis and the ensuing bank restructuring efforts was the almost total cessation of new lending for businesses over the period 2009 to 2013.
2. The reasons that PwC's Project Atlas Report (September/October 2008) did not reveal the true extent of the capital requirements of the banks were:
   - the wider assumptions for the economy, taken from official forecasts and on which the work was based, did not materialise.
   - there was insufficient time for loan reviews given the fragility of the banking system.
   - the analysis was based on the management accounts of the relevant banks and not an independent verification of the loan books.
3. In October 2008 BOI had internal discussions about the bank's possible need for a capital injection by the State as one of a number of options reviewed by the bank at that time.

Chapter 9: Establishment, Operation and Effectiveness of NAMA

Introduction

In early 2009, the financial and construction sectors were at a standstill, with banks and developers alike dealing with the consequences of a liquidity crunch and an inflated property market. The Minister for Finance and his advisors[1] had growing concerns over the capacity of the covered financial institutions to meet their future obligations, especially given their inability to raise adequate capital.[2] Steps were taken to stabilise the financial system, alleviate doubts over capital adequacy and boost the capacity of the financial institutions both to deal with prospective loan impairments and to lend.

The Rationale for NAMA

The economist, Peter Bacon, was engaged by the NTMA, on the instructions of the then Minister for Finance, Brian Lenihan, to evaluate the options for resolving property loan impairments and the associated capital adequacy of the covered financial institutions. His detailed report[3] was completed in March 2009 and outlined three options:

1. *Maintain the status quo:* This first option was predicated on continuation of the bank recapitalisation programme already in place, with no additional measures being countenanced. This option was not considered beneficial by government, as to 'do nothing' would not address the liquidity shortage or promote new lending. Furthermore, it would increase the risk of sovereign default and threaten the stability of the financial system; [4]
2. *Insurance scheme:* The second option was for the State to establish an insurance scheme for certain types of assets held by the covered institutions, such as their land and development portfolios. This would involve the provision of insurance to the institutions against losses incurred on the loans secured against these assets, above a certain "first loss" position. They would continue to manage the loans which would remain on their books. The benefit of this option was the minimal upfront cost. However, its success would depend on a belief in the markets that the Government would be able to cover any losses. Moreover, this option would not address the liquidity crisis, nor would it incentivise the covered institutions to work through their impaired loans and get the best possible return for the taxpayer, once they had incurred their "first loss";[5] and
3. *Asset management agency:* The final option was to establish an asset management agency. It would purchase a portfolio of loans from each covered institution with payment being made by way of Government Bonds. It would then work out the loans over time, hoping to ensure

---

1 Memo for Government, March 2009, DOF03553-001/002. Note: The Bacon Report was considered by the Department of Finance, Central Bank, Financial Regulator, NTMA and Merrill Lynch, DOF03553-004.

2 Bacon Evaluation of Options for Resolving Property Loan Impairments and Associated Capital Adequacy of Irish Credit Institutions 2009, PUB00067-004.

3 Bacon Evaluation of Options for Resolving Property Loan Impairments and Associated Capital Adequacy of Irish Credit Institutions 2009, PUB00067.

4 Memo for Government, March 2009, DOF03553-002.

5 Memo for Government, March 2009, DOF03553-002/003.

the maximum possible return for the State. Because this option would crystallise the losses on the covered institutions' balance sheets, it would reduce the uncertainty over their bad debts and hopefully allow them to increase lending. It would also address the liquidity problem as it would allow the institutions to borrow from the ECB. The downsides were the upfront cost and, similar to the insurance scheme option, its success depended on the Government's ability to retain market confidence.[6]

From the outset, the 'status quo' option was not considered feasible by Government. The consensus among the Department of Finance, the Central Bank, the Financial Regulator, the NTMA and Merrill Lynch was strongly in favour of the establishment of an asset management agency, even though the insurance scheme would have deferred the realisation of impairments and have involved less upfront costs.[7]

However, none of the options were underpinned by robust knowledge on the status of the property-related loans held by the Covered Institutions which, on transfer to NAMA, came to be characterised by a paucity of loan information, high levels of debtor concentrations and poor loan collateral. In his evidence, Peter Bacon commented that:

"… [NAMA] subjected each and every loan to rigorous scrutiny. I would not have been party, at an individual level, to knowing what the security behind those loans was or what they were worth. There would have been all kinds of cross-guarantees at an individual level, which, working from macro data, one would not have had access to or knowledge of."[8]

When Peter Bacon and the NTMA presented the NAMA proposal to the Minister and Department of Finance officials, it *"came as something of a shock"* given its ambition and *"the size of the proposed contingent liability to be adopted by the State"*, according to the evidence of Kevin Cardiff, former Secretary General of the Department of Finance.[9] Peter Bacon recalled presenting the report, saying:

"I remember the response when I presented the figures in my report. There was a standing committee, chaired by the Minister, comprising the suspects one would expect - Finance, Central Bank and NTMA. I was invited to attend one of those and the Minister asked how my work was going and had I any numbers. I gave the meeting a work in progress account. I suppose that surprise was my memory of that meeting. Surprise from people at the numbers that were coming out."[10]

The standing committee, as referred to above, were also apprehensive over the cost to the State by way of contingent liability.[11] Peter Bacon, however, was concerned at how quickly the commercial property books in the covered institutions were declining and believed that these loans needed to be removed from the institutions before lending in the economy could resume.[12]

---

6 Memo for Government, March 2009, DOF03553-003.

7 Consensus - in favour of asset management over risk insurance solution – was reached by Department of Finance, Central Bank, Financial Regulator, NTMA and Merrill Lynch, Memo for Government, March 2009, DOF03553-004.

8 Peter Bacon, Economist, transcript, PUB00334-014.

9 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-024.

10 Peter Bacon, Economist, transcript, PUB00334-031.

11 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-024.

12 Memorandum for Government, March 2009, DOF03553-003.

Support for the NAMA option was based on a number of factors:

- *Impaired loans addressed:* The option would deal with the impaired property loans by removing them from the books of the covered institutions, forcing them to crystallise their losses.
- *Liquidity improved:* It would improve liquidity by giving the institutions collateral in the form of Government bonds that could be used to access ECB funding.
- *Relationship banking tackled:* It would take relationship banking out of the equation, giving greater impartiality for working out problem loans.
- *Mandate more focused:* NAMA could concentrate on maximising recovery without having to focus on the uncertainty of increasingly high impairments.
- *Banks enabled to rebuild:* Without the distraction of bad loans the financial institutions could rebuild sentiment and reposition themselves in their core business areas, such as lending for residential home loans and supporting SMEs.[13]

From Announcement to Implementation

NAMA's establishment was announced in the "mini-budget" of spring 2009.[14] From that date, it took over a year for the enabling legislation to be enacted and the loans to be transferred from the relevant institutions. The Office of the Attorney General commenced work on the legislation in April 2009[15] and the first tranche of loans was transferred in March 2010.[16]

The NAMA legislation needed to address many potential risks, while at the same time ensuring that its legal structures would enable NAMA to acquire all relevant property-related loans, obtain the underlying collateral, operate efficiently and protect taxpayer interests.[17]

It was also essential that NAMA would comply with the European Commission's State Aid rules.[18] This was quite a complex process, requiring the NAMA Steering Group to have ongoing consultations with the European Commission throughout the drafting process.

The draft legislation was completed in July 2009, at which time the Government decided that there should be a public consultation process. The consultation period ended in September 2009, and the legislation was enacted in November 2009.[19]

The scheme provided for under the NAMA Act secured the required State Aid approval from the European Commission on 26 February 2010.[20]

13 Memorandum for Government, March 2009, DOF03553-004. (See Glossary of Terms for definition of SME).
14 Financial Statement of former Minister for Finance, Brian Lenihan, 7 April 2009, PUB00386-012.
15 Paul Gallagher, former Attorney General, statement, PGA00001-012.
16 C&AG Special Report, Acquisition of Bank Assets, October 2010, NAMA00011-027.
17 Paul Gallagher, former Attorney General, statement, PGA00001-012/013.
18 Memorandum for Government, March 2009, DOF03553-022.
19 Paul Gallagher, former Attorney General, statement, PGA00001-012/013.
20 C&AG Special Report, Acquisition of Bank Assets, October 2010, NAMA00011-009. See also European Commission press release: State aid: Commission approves Irish impaired asset relief scheme, 26th February 2010 - http://europa.eu/rapid/press-release_IP-10-198_en.htm.

Principal Features of the NAMA Act

The legislation supported a number of key processes for loans to be transferred to NAMA, including:

- *Participatory discretion:* The legislation provided that the Minister for Finance could only reject or accept an application by a credit institution to become part of NAMA, not determine which credit institutions would take part, but could only designate a credit institution as a 'Participating Institution' if he was satisfied that it was systemically important to the financial system of the State.[21]
- *Eligible assets:* The types of assets that could be acquired by NAMA would be prescribed by the Minister and could include all loans for the purchase, exploitation or development of development land.[22]
- *Valuation discretion:* The acquisition value of a bank asset would be its long-term economic value as determined by NAMA.[23]
- *Developer liability:* NAMA would take over the position of a Participating Institution in relation to a loan or its security, and acquire all of the rights that the Participating Institution had formerly enjoyed as a result. This would have the practical effect that developers would continue to be liable for 100% of the money they had owed to Participating Institutions before their loans were acquired by NAMA.[24]
- *Maximise return:* NAMA would be obliged to obtain the best achievable financial return for the State.[25]

Effects on Developers

The Joint Committee received evidence from nine of the largest developers and property investors who participated in the NAMA scheme, four of whom gave evidence in public hearing and five by written statement.

From the announcement of NAMA in April 2009 to its eventual establishment in December 2009 and the subsequent transfer of the first tranche of loans in March 2010, uncertainty in the economy was prolonged.[26] There was a complete lack of liquidity in the market and financial institutions were no longer able to operate effectively. Work-in-progress on developments stopped, agreed sales fell through and the bottom fell out of the property market.

For Sean Mulryan, the prolonged uncertainty meant *"that the business [Ballymore Group] didn't operate for probably 12 months; it was just absolutely stopped."*[27] The difficulties were accentuated by the fact that the majority of his business interests had been in London and the market there had little understanding of either the banking crisis in Ireland or the role that NAMA was designed to

21 Section 67 of NAMA Act 2009, DOF06753-055.
22 Section 69 of NAMA Act 2009, DOF06753-057/058.
23 Part 5 - Valuation Methodology, NAMA Act 2009, DOF06753-060 to 065.
24 Section 99 of NAMA Act 2009, DOF06753-078.
25 Section 10 of NAMA Act 2009, DOF06753-025.
26 Sean Mulryan, Developer, Ballymore Group, statement, SMU00001-021 and transcript, INQ00119-024/025.
27 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-025.

play – they had to get their *"heads around"* the requirement of *"handing over such an enormous amount to a new entity."*[28]

Michael O'Flynn said that developers were caught in limbo between their existing financial institutions and NAMA.[29]

Joe O'Reilly commented that he *"…continued to asset manage and drive the business from that point of view."*[30]

In his statement to the Joint Committee, Gerard Gannon said:

"Like many other parties, I was apprehensive when NAMA was established and I feared the unknown. In some respects it offered relief as the banks had ceased to function and we were finding it difficult to carry on our normal day to day activities."[31]

Participating Institutions

Over the period from announcement to implementation, Participating Institutions were tasked by NAMA with completing questionnaires and organising exposures to allow for the eventual transfer of relationships. These questionnaires and related follow-up steps uncovered a number of problems such as a significant amount of interest rolled up by the Participating Institutions, widespread use of paper collateral and major reliance on solicitor's undertakings, amongst other issues.

Kevin Cardiff said in evidence:

"…there was a real problem that the assets that NAMA was purchasing in the banking market were not turning out to have the characteristics that NAMA had been led to expect – on various measures, the loans were not as good as they should have been."[32]

The property market generally also continued to deteriorate over the period.

Such issues came to be reflected in the discounts applied by NAMA to acquired loans. NAMA ultimately acquired €74.4 billion of assets for a final consideration of €31.7 billion, an average discount of 57%[33] of the total amount owed by the borrowers.[34]

To participate in the NAMA scheme, the credit institutions had to apply to the Minister for Finance within 60 days of the establishment of NAMA.[35] The Minister - in consultation with the Governor of the Central Bank and the Financial Regulator – could then decide to permit a institution to participate if the Minister was satisfied that the credit institution was systemically important to the financial system in the State and that the other requirements of the NAMA Act had been fulfilled.[36] NAMA was then set the task of acquiring loans from the Participating Institutions i.e. AIB, BOI, Anglo, INBS and EBS.

28 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-024.
29 Michael O'Flynn, Developer, O'Flynn Group, transcript, INQ00121-025.
30 Joe O'Reilly, Developer, Castlethorn Group, transcript, INQ00126-027.
31 Gerard Gannon, Developer, Gannon Homes, statement, GGA00001-009.
32 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-133.
33 According to C&AG final discount was 57% – Brendan McDonagh, CEO, NAMA refers to the final discount as 58%.
34 C&AG Progress Report 2010-2012, NAMA00010-009.
35 NAMA Act 2009, section 62, DOF06753-052.
36 NAMA Act 2009, section 67, DOF06753-055.

NAMA's Acquisition of Loans

NAMA's approach was to acquire the following types of loans from each of the Participating Institutions:

- loans for the purpose of purchasing, exploiting or developing development land.
- all other loans to that borrower, excluding credit cards.
- all loans to associated borrowers[37] of the borrower.
- financial contracts[38] between the borrower and the Participating Institution.[39]

It should be noted that this approach was not well received by all affected borrowers of the Participating Institutions. For example, in his evidence to the Joint Committee, Sean Mulryan of the Ballymore Group stated that:

"…[t]he reputational damage that Ballymore endured … was compounded by the fact that NAMA took over everything related to Ballymore – all loans, not just the poorer performing loans but the good loans and unencumbered assets as well."[40]

Kevin Cardiff explained that an advantage of the acquisition of the complete loan portfolio from a borrower, comprising both good and bad loans, was that NAMA would be able to get more value from individual borrowers:

"they would be able to concentrate three or four of their exposures into one place and manage them as a group, rather than having them managed separately …" [41]

The initial threshold for loans transferring from AIB, Anglo and Bank of Ireland was €5 million. However, following consultation with the NAMA Board, the Central Bank, Financial Regulator and the European Commission, the Government decided, in September 2010, that the loan threshold should be raised to €20 million in respect of AIB and Bank of Ireland.

In his evidence to the Joint Committee, Brian Cowen, former Taoiseach, stated that raising the threshold in this way allowed NAMA to operate to the highest level of efficiency and effectiveness in the management of the transferred loans and enabled all transfers to be completed by the end of 2010.[42]

NAMA also elected not to acquire certain other loans if the scale of exposure to land and development was only a nominal proportion of the borrower's overall debt.[43]

37 Associated borrowers as defined in section 70 of the NAMA Act 2009, DOF06753-058.

38 Non loan contracts such as an interest rate derivative that hedges interest rate exposure or options.

39 C&AG Special Report, Acquisition of Bank Assets, October 2010, NAMA00011-032.

40 Sean Mulryan, Developer, Ballymore Group, statement, SMU00001-021.

41 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript PUB00351-013. Note, this is also supported the C&AG Special Report, Acquisition of Bank Assets, October 2010, NAMA00011-031.

42 Brian Cowen, former Taoiseach and Minister for Finance, statement, BCO00002-018; European Commission report, 'The Economic Adjustment Programme for Ireland', February 2011, DOF05089-017 and C&AG's 'Special Report, Acquisition of Bank Assets', October 2010, NAMA00011-034.

43 Brian Cowen, former Taoiseach and Minister for Finance, statement, BCO00002-019; NAMA Annual Report and Financial Statement 2011, NAMA 00027-020.

In total, NAMA acquired 90% of all identified eligible loans from the Participating Institutions. The effect of this left the Institutions with a residual commercial real estate loan book, at the end of 2013, of €36.5 billion with an impairment rate of 56.9%.[44]

In terms of obtaining the requisite information on the acquired loans in order to facilitate due diligence, Alan Ahearne, former Special Advisor to Minister Lenihan, stated that:

"…the NAMA process … was going to gather very accurate information – time-consuming, but they were going to drill down and, on a loan-by-loan basis, get the sort of information that, ultimately, you needed."[45]

In his evidence to the Joint Committee, Brendan McDonagh, Chief Executive Officer of NAMA, commented: *"[The banks'] issue was trying to compile the data together for the due diligence, which was very difficult for them."*[46]

This view was supported in evidence provided by witnesses from two of the Participating Institutions. Kieran Bennett, former Chief Risk Officer with AIB, stated that:

"AIB's credit management information and stress test systems were poor and required considerable investment."[47]

Ronan Murphy, former Group Chief Risk Officer, Bank of Ireland, gave evidence in relation to management information systems within the bank generally, and said:

"…there was not enough Management Information System (MIS) functionality, controls, stress testing or scenario evaluation."[48]

Evidence provided to the Joint Committee on behalf of NAMA was that deficiencies in management information systems and in the banks' systems generally had the effect of slowing down the due diligence process.[49]

Overall, NAMA acquired over 15,000 loans,[50] the majority of which involved property exposures. Of the property-related loans transferred, 71% were associated with completed properties, 5% with incomplete developments and 24% with undeveloped land.[51] In all, over 75% of the acquired loans were non-performing.[52]

44 Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-009. C&AG 'Special Report, Progress Report 2010 – 2012', April 2014, NAMA00010-019.

45 Alan Ahearne, former Special Advisor to the former Minister for Finance, Brian Lenihan, transcript, INQ00094-027.

46 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-065 and Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-009.

47 Kieran Bennett, former Risk Officer, AIB, statement, KBE00001-004. Dermot Gleeson, former Chairman, AIB, also spoke of the MIS not being able to produce the information required by NAMA on interest roll-up, transcript, INQ00123-065/066.

48 Ronan Murphy, former Chief Governance Risk Officer, BOI, statement, RMY00001-012.

49 NAMA's written response to 10 specific questions by the Joint Committee, 11 March 2015, NAMA00097-007.

50 C&AG 'Special Report, Progress Report 2010 – 2012', April 2014, NAMA00010-009.

51 C&AG 'Special Report, Progress Report 2010 – 2012', April 2014, NAMA00010-024.

52 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-046. NAMA00104-001

Over 50% of the property collateral supporting the transferred loans was located in Ireland, with 34.5% of the total being in Dublin. Almost 34% of the property collateral was located in the United Kingdom, with 18.5% of that in London, as illustrated below:

Property Collateral for Loans - by region and asset type[a]

	Dublin	Rest of Ireland	Ireland Total	London	Rest of Britain	Britain Total	Northern Ireland	Rest of World	Total	%
Office	2,442	224	2,666	1,222	878	2,100	215	272	5,253	16.5%
Retail	1,514	1,395	2,909	279	878	1,157	216	145	4,427	13.9%
Other Investment[b]	1,300	1,110	2,410	399	826	1,225	343	504	4,482	14.1%
Residential[c]	2,313	1,383	3,696	375	914	1,289	133	156	5,274	16.6%
Hotels	455	479	934	1,344	465	1,809	12	282	3,037	9.6%
Total Completed Properties	8,024	4,591	12,615	3,619	3,961	7,580	919	1,359	22,473	70.7%
Land	2,417	1,757	4,174	1,356	490	1,846	279	158	6,457	20.3%
Development	521	608	1,129	888	446	1,334	61	327	2,851	9.0%
Total Land and Development	2,938	2,365	5,303	2,244	936	3,180	340	485	9,308	29.3%
Total	10,962	6,956	17,918	5,863	4,897	10,760	1,259	1,844	31,781	
%	34.5%	21.9%	56.4%	18.5%	15.4%	33.9%	3.9%	5.8%		

Source: National Asset Management Agency.
Notes:
a While some loans had not been subject to the full due diligence process by the end of December 2011, the property collateral for the loans had been valued.
b other investment property includes industrial property and properties with mixed uses.
c Includes property to the value of €452 million classified as residential investments.

Source: C&AG Special Report, Figure 2.9[53]

53 C&AG Special Report, Management of Loans, February 2012, NAMA00012-034.

NAMA valued the acquired loans in two ways. The first method was on a current market value basis and the second was on the basis of a long term economic value.[54] All loans acquired were valued as at 30 November 2009, regardless of when they were transferred to NAMA.[55] In most cases, the value of the loan was directly related to the value of the underlying collateral.[56] This methodology was approved by the European Commission.[57]

NAMA also took account of the enforceability of the related collateral and the extent to which a Participating Institution had secured its legal right to realise the collateral. In circumstances where this was not done to NAMA's satisfaction, the price paid for the loan was reduced accordingly. The reduction in the consideration price paid by NAMA for these loans as a result of unenforceable securities was €477 million initially. A further €334 million was clawed back from the institutions, following further loan-by-loan analysis, for the same reason. The par value of the loans was higher. Brendan McDonagh said: *"The value of collateral where we paid nil consideration was €3.5 billion in nominal terms"* as a result of unenforceable securities.*"*[58]

All loans attaching to an individual borrower were acquired in the same tranche, regardless of which Participating Institution had advanced the loan.[59] In total 780 *"borrower connections"*[60] were identified. Given the volume of loans transferred, this was completed in nine tranches.[61] NAMA began to acquire loans from 31 March 2010[62] starting with the largest ten borrowers across the Participating Institutions. By October 2011 the final tranche of loans had been transferred.[63]

According to the evidence of Seamus McCarthy, Comptroller and Auditor General, *"the loan acquisition process was carried out expeditiously by NAMA."*

"Audits and examinations carried out by my Office [C&AG] concluded that the property valuations, legal due diligence and loan valuation processes employed by NAMA were adequate and complied with regulations made by the Minister for Finance in March 2010."[64]

NAMA's payment methodology

NAMA's method of payment for the transferred loans was as follows:

1. Issuing Government guaranteed senior debt of €30.2 billion (95%), which the Participating Institutions could then use as collateral to borrow from the ECB.
2. Issuing unguaranteed subordinated debt of €1.6 billion (5%), which was redeemable based on NAMA's financial performance.[65]

---

54 C&AG 'Special Report, Progress Report 2010 – 2012', April 2014, NAMA00010-020.
55 C&AG 'Special Report, Progress Report 2010 – 2012', April 2014, NAMA00010-020.
56 C&AG 'Special Report, Progress Report 2010 – 2012', April 2014, NAMA00010-021.
57 C&AG 'Special Report, Progress Report 2010 – 2012', April 2014, NAMA Special Submission No. 2, NAMA00010-019.
58 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-059.
59 C&AG Special Report, Acquisition of Bank Assets, October 2010, NAMA00011-031.
60 NAMA Section 227 Review by Department of Finance, July 2014, NAMA00103-013.
61 C&AG Special Report, Progress Report 2010 – 2012, April 2014, NAMA00010-020.
62 C&AG Special Report, Acquisition of Bank Assets, October 2010, NAMA00011-027.
63 NAMA section 227 Review, July 2014, NAMA00103-020.
64 Seamus McCarthy, Comptroller & Auditor General, statement SMC00004-009.
65 C&AG Special Report, Acquisition of Bank Assets, October 2010, NAMA00011-024.

By December 2011, NAMA had acquired €74.4 billion of loans at a cost of €31.8 billion (43% of par value) from the five Participating Institutions. The breakdown of the transferred loans was as follows:

Loans acquired by NAMA

Participating bank[a]	Total borrower debt	NAMA payment for loans	Discount	
	€ billion	€ billion	€ billion	%
AIB	20.5	9.0	11.5	56
Anglo	34.4	13.4	21.0	61
Bank of Ireland	9.9	5.6	4.3	44
Educational Building Society	0.9	0.4	0.5	57
Irish Nationwide Building Society	8.7	3.4	5.3	61
Total	**74.4**	**31.8**	**42.6**	**57**

Source: National Asset Management Agency
Note:
a In 2011, Allied Irish Banks merged with the EBS. Anglo merged with the INBS and was renamed the Irish Bank Resolution Corporation. The loan acquisitions were recorded under the names of each participating bank prior to the mergers.

Source: Comptroller and Auditor General Special Report, Figure 2.1[66]

With only €31.8 billion being paid for loans of €74.4 billion, the discount of €42.6 billion had to be crystallised by the Participating Institutions. This resulted in the requirement for further recapitalisations throughout 2010 and into 2011 in order that the Participating Institutions could meet their minimum regulatory capital requirements.

Loan Management and Asset Disposals

NAMA acquired over 15,000 loans from 780 borrower connections. Of these loans, NAMA directly managed 189 borrower connections, with par debt totalling €61 billion and equating to around 85% of the loan values.[67] The remaining 586 borrowers were managed directly by the Participating Institutions, who acted as primary servicers.[68]

66 C&AG Special Report, Progress Report 2010 – 2012, April 2014, NAMA00010-021.

67 Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-010.

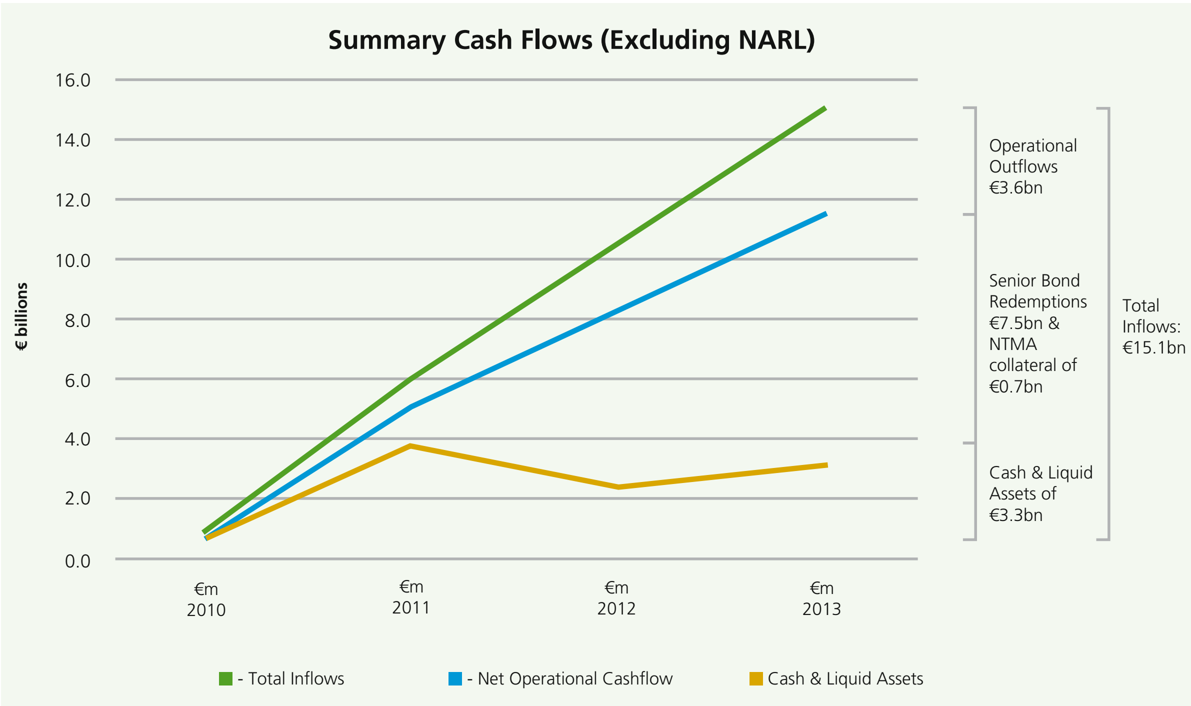
68 The primary servicer role includes maintaining and updating borrowers' loan records, processing receipts from borrowers and transferring cash received to NAMA, and reporting all transactions to the master servicer. NAMA00010-041.

NAMA required each of the 780 borrower connections to submit a business plan setting out how they planned to repay their debts. These business plans were reviewed by independent business reviewers appointed by NAMA. On the basis of these business plans and the other means of due diligence employed, NAMA had a full assessment of each borrower's position by July 2012.[69]

Once NAMA had completed this borrower assessment (mid-2012), it adopted one of the following loan management strategies in respect of each borrower: full restructuring, partial restructuring, support, consensual disposal or enforcement.

By the end of 2014, however, NAMA had appointed receivers to some or all of the assets of 50% of its debtors.[70]

From its establishment through to the end of 2013, NAMA generated total cash inflows of €15.1 billion from asset disposals of €10.9 billion[71] and non-disposal income of €3.6 billion[72] (mainly rental receipts).



Source: Department of Finance, Figure 12[73]

The Joint Committee heard evidence in relation to the practice of private equity firms, involving mostly foreign investors, buying up large amounts of property assets, including large portfolio sales by NAMA.

69 C&AG Special Report, Progress Report 2010 – 2012, April 2014, NAMA00010-042.

70 Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-010.

71 NAMA Annual Report and Financial Statement 2013, NAMA00028-014.

72 NAMA Annual Report and Financial Statement 2013, NAMA00028-035.

73 NAMA Section 227 Review by Department of Finance, July 2014, NAMA00103-029.

Frank Daly, Chairman, NAMA, stated in his evidence that, while he *"would love to see more Irish investors buying Irish assets"*, the fact is that overseas investors are needed and *"are actually good for the country."* He added that NAMA *"have not been fire-selling, and, in fact, we are at the situation now where it is impossible really to forecast when a market will peak or what is the optimum day that you sell your assets."*[74]

Peter Bacon said: *"it [NAMA] has acted more as a debt collection agency than as a property value maximising entity"*[75] and

"I think there was a decision on foot of the troika recommendation to accelerate NAMA receipts. That certainly would have infringed on any effort to achieve long-term maximisation."[76]

The Department of Finance set out the position in an Information Memorandum prepared for the Joint Committee as follows:

"NAMA has committed to ensuring that a pipeline of large portfolios of mainly Irish property assets will be available for sale to the market. In particular, it has committed that packaged transactions of properties with a minimum value of €250m will be offered for sale in each quarter. The aim is to provide certainty about regular asset flows which will provide clarity to potential investors, including international investors and REITs, and thus help to sustain the positive momentum in the market. As with loan sales, large portfolio sales have become an important element in NAMA's disposal activity."[77]

As required by the NAMA Act,[78] the Comptroller and Auditor General has examined NAMA on a number of occasions since its establishment. In his written statement to the Joint Committee, Seamus McCarthy, said:

"…overall, the examination found evidence that almost all property disposals reviewed had been sold through an open competitive process, or with testing of disposal prices against market valuation. This provides reasonable assurance that the prices obtained were in line with market prices at the time a property was sold."[79]

The Effectiveness of NAMA

In his evidence to the Joint Committee, Frank Daly said that NAMA was two years ahead of the target which it agreed with the Troika for the repayment of senior debt[80] by 2020.[81] This statement was supported by Michael Noonan, Minister for Finance, in his evidence to the Joint Committee.[82]

74 Frank Daly, Chairman, NAMA, transcript, PUB0331-043.

75 Peter Bacon, Economist, transcript, PUB00334-15.

76 Peter Bacon, Economist, transcript, PUB00334-21.

77 Department of Finance Submission to the Banking Inquiry, 13 April 2015, DOF07852-029.

78 Section 58 of the NAMA Act, 2009 provides for NAMA's Accountability to the Committee of Public Accounts. DOF06753-050.

79 Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-011.

80 Senior debt is debt that takes priority over other unsecured debt owed by the issuer such as subordinated debt. See Glossary of Terms for more detail.

81 Frank Daly, Chairman, NAMA, transcript, PUB00331-016/018/019.

82 Michael Noonan, Minister for Finance, statement, MNO00003-021.

NAMA plans to repay 80% of senior debt by the end of 2016 and 100% of subordinated debt by 2017/2018.[83]

In an assessment of Ireland's Bailout Programme, the European Commission stated that:

"By using a centralised asset protection scheme, banks effectively reduced the burden of legacy assets and strengthened their deleveraging and recapitalisation process. NAMA was well placed to manage and liquidate the acquired assets, which were clearly defined, limited in size and relatively easy to sell."[84]

According to Alan Ahearne, who was Special Advisor to Brian Lenihan:

"NAMA, serves as an international example of [the] successful management of bad assets…"[85]

He also gave evidence that:

"…one person's crystallisation is another person's facing up to reality. And what … NAMA forced … the banks, the bankers and everybody else to do was face up to the reality of what had happened."[86]

In his evidence, David Duffy, Chief Executive Officer of AIB, told the Joint Committee that:

"…the NAMA exercise for us gave us a better understanding on crystallisation of losses, of what the capital deficit was and what necessary actions needed to be taken. So from the narrow view of our execution relationship with NAMA, I would have to say that on balance it was beneficial."[87]

Richie Boucher, Group Chief Executive of BOI, also expressed the view that NAMA was a good solution to the problems facing the banks:

"It provided liquidity. It brought everything into the middle. It enabled people with expertise to look at the ... to forget about an individual bank's situation, how it would work out generally."[88]

In the evidence that he provided to the Joint Committee, Brendan McDonagh outlined a number of ways in which NAMA stimulated market activity:

- Injecting approximately €1 billion in capital to support the development of viable Irish projects which will continue to enhance the value of the underlying assets.
- Making €3 billion available in development funding, some of which will help fund the initiatives in the Dublin residential property market and the docklands Strategic Development Zone (SDZ).[89]
- By end-2015, it is expected that NAMA will have made available 2,000 residential units for social housing and have supported businesses employing about 15,000 people.[90]

83 Frank Daly, Chairman, NAMA, transcript, PUB00331-019 and Michael Noonan, Minister for Finance, statement, MNO00003-021.

84 Ex post Evaluation of the Economic Adjustment Programme Ireland, 2010-2013, PUB00356-055.

85 Alan Ahearne, former Special Advisor to former Minister for Finance, Brian Lenihan, transcript, INQ00094-003. Alan Ahearne commented that Spain and Slovenia copied the NAMA model almost verbatim, transcript, INQ00094-029.

86 Alan Ahearne, former Special Advisor to former Minister for Finance, Brian Lenihan, transcript, INQ00094-010.

87 David Duffy, Chief Executive, AIB, transcript INQ00134-009.

88 Richie Boucher, Group CEO, BOI, transcript INQ00085-023/024.

89 See Glossary of Terms.

90 Brendan McDonagh, CEO, NAMA, transcript PUB00331-006.

A less positive view was given by Michael O'Flynn of the O'Flynn Group in his statement submitted to the Joint Committee:

"I was told at a very early meeting by the senior [NAMA] executives, "We want disposals. We don't want plans. We don't want development. We don't need any more development."[91]

The question of how NAMA performed at an operational level was raised in the testimony of a number of developers who gave evidence to the Joint Committee and whose loans were acquired by NAMA.[92] Some developers offered no view on the effectiveness of NAMA based on their dealings with the agency, as they still had relationships to maintain.[93]

Other developers gave evidence that they have worked well within the NAMA process. For instance, in his evidence to the Joint Committee, Seán Mulryan said that:

"Ballymore has worked with NAMA, co-operated fully and has worked our way through what needed to be done."[94]

Joe O'Reilly of Castlethorn Construction and Chartered Land Group expressed a similar view:

"for the past six years, we've enjoyed a professional relationship with NAMA and we worked hard to assist the agency to meet its objectives."[95]

In his witness statement, Gerard Gannon commented that *"…without the establishment of NAMA, we would not be in a position to develop and build much needed family homes for first time buyers…"*[96]

NAMA said that their work required "intensive commitment by us in terms of time and resources involving experienced staff brought together from a wide range of disciplines…",[97] Ann Nolan, Second Secretary, Department of Finance said "…NAMA has proved efficient in dealing with these loans."[98] In their evidence to the Joint Committee, the developers Michael O'Flynn[99] and John Ronan[100] suggested that NAMA did not have the requisite skills and expertise to effectively manage the scale of acquired loans and assets.

Tom Parlon, Director General, Construction Industry Federation (CIF), provided the following assessment in evidence:

"The CIF believe that NAMA are doing a good job in handling a very difficult role ... They are also one of the few sources of development capital in recent years for the industry, as they are funding the finalisation and the development of some of their assets to realise their full value. Again, this is important and has played a part in the recovery of the construction sector. While we may have

---

91 Michael O'Flynn, Developer, O'Flynn Group, statement MOF00006-006/007 and -013 to 022; John Ronan, Developer, Treasury Holdings & Ronan Group Real Estate, statement, JRO00002-017 to 028.

92 Derek Quinlan, Sean Mulryan, Michael O'Flynn, Joe O'Reilly, John Ronan, Gerard Gannon, Gerard Barrett, Peter Cosgrave, Bernard McNamara.

93 Gerard Barrett, Group Chairman and Managing Director, Edward Holdings, statement GBA00001-022; Derek Quinlan, Financier, Quinlan Private, transcript, INQ00092-023.

94 Sean Mulryan, Developer, Ballymore Group, transcript, INQ00119-005.

95 Joe O'Reilly, Developer, Chartered Land and Castlethorn, transcript, INQ00126-005.

96 Gerard Gannon, Developer, Gannon Homes, statement, GGA00001-010.

97 Brendan McDonagh, CEO, NAMA, transcript, PUB00331-006

98 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-003.

99 Michael O'Flynn, Developer, O'Flynn Group, statement, MOF00006-016.

100 John Ronan, Developer, Treasury Holdings & Ronan Group Real Estate, statement, JRO00002-027.

expressed strong concerns in the past, I would like to think that the CIF and NAMA have since developed a more co-operative approach. As we have seen the progress being made by NAMA, the industry has come to realise that they are part of the solution."[101]

John Corrigan, former CEO, NTMA and NAMA Board member, said in evidence:

"I believe that the decision to set up NAMA was the correct one and, based on the NTMA's engagements with institutional investors and the credit rating agencies I am strongly of the view that its success played a huge role in Ireland later regaining access to the debt capital markets."[102]

In his evidence to the Joint Committee, Michael Noonan stated his belief that NAMA has played an important and effective role in reactivating the commercial property market in Ireland.[103]

Seamus McCarthy criticised certain features of NAMA's reporting of performance.[104] He stated that NAMA's objective of redeeming debt *"is not an adequate or relevant performance measure"* in terms of obtaining *"the best achievable financial return"* as specified in the NAMA Act. In that regard, the NAMA Board should have set an *"expected or target rate of return."* In its absence, the C&AG has been *"unable to conclude on the extent to which NAMA's performance to date had contributed to obtaining the best achievable financial return."* It was also *"difficult to assess the impact of accelerated or delayed cash receipts on NAMA's profitability."*[105]

Seamus McCarthy also informed the Joint Committee of his recommendation to the NAMA Board that it should set specific target financial return measures, which would be standard for a recovery unit of a financial institution or investment vehicle, that is to say an overall expected or target rate of return against which to measure overall performance, and a target rate of return on disposals and on property held by debtors and insolvency practitioners.[106]

The NAMA Board did not accept this recommendation, taking the view that *"such target rates of return would not be an appropriate metric for its business, on the basis that they would act as an unnecessary constraint on its flexibility, particularly given the stated objective of the Minister for Finance that NAMA should complete its work of deleveraging the portfolio as soon as possible."*[107] Seamus McCarthy concluded that in his opinion, *"setting target rates of return is not incompatible with flexible decision making."*[108]

Separately, the Comptroller and Auditor General expressed criticism of NAMA over its failure to achieve anticipated rental income. In the report, 'National Asset Management Agency – Management of Loans', it was commented:

"… For six borrowers, 2011 rental income was around 26% less than that projected at acquisition and, for this sample, only €8 million out of €10.5 million subsequently projected in business plans had been realised.

101 Tom Parlon, Director General, CIF, transcript, INQ00064-008.
102 John Corrigan, former CEO, NTMA, transcript, INQ00106-004.
103 Michael Noonan, Minister for Finance, statement, MNO00003-021.
104 Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-013.
105 Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-013.
106 Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-013.
107 Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-013.
108 Seamus McCarthy, Comptroller & Auditor General, statement, SMC00004-013.

The difference between rental income anticipated at loan valuation and net rental income received during 2011 on the cases sampled was mainly due to property management costs that were not provided for in the loan valuations which were conducted in line with industry norms for immediate sales."[109]

The one-year time-lag between Peter Bacon's proposal for a NAMA-type solution and the transfer of the first loans caused considerable uncertainty and difficulty for some developers, as they were caught in a 'no man's land' between their financial institutions and a NAMA not yet formally established.

For some developers, the establishment of NAMA bought time. Sean Mulryan told us:

"So while we knew we were in a good position to withstand the crisis, what Ballymore needed was time and a mechanism to get through the period between the collapse and the recovery. NAMA provided the means for Ballymore to do that."[110]

Having regard to the scale, complexities and risks involved, it was essential that the enabling legislation and the ultimate structure would be especially robust.

NAMA acquired 90% of all identified eligible loans from the five Participating Institutions above a threshold of €20 million, both performing and non-performing, and including unencumbered assets. The number of loans involved was in excess of 15,000, over 75% of which were non-performing. Over 50% of the transferred loans related to properties in Ireland and over 30% in England.

While the Participating Institutions worked to transfer the loans across to NAMA, there were difficulties in providing the information sought for due diligence purposes. The reason for this was suggested to have emanated from weaknesses in management information systems, stress tests, credit management information and scenario evaluation.[111]

NAMA directly managed 189 borrower connections, with par debt totalling €61 billion, equating to around 85% of the loans transferred to it (by value). The remaining 586 borrowers were managed by the Participating Institutions themselves who acted as primary servicers.

While some developers criticised NAMA's skillsets, this was disputed by other witnesses. Similarly, there were both positive and negative views on the developers' relationships with NAMA.

The review by the Joint Committee of NAMA's effectiveness is limited by the fact that we are only in a position to examine events up to December 2013. Furthermore, it will not be possible to fully assess NAMA's performance and effectiveness until an evaluation based on medium-term property price movements can be carried out.

---

109 C&AG Special Report, NAMA – Management of Loans, February 2012, NAMA00012-011.

110 Sean Mulryan, Founder, Chairman & Group Chief Executive of the Ballymore Group, transcript, INQ00119-005.

111 Submission to the Banking Inquiry: Nama Questions 11.03.15.pdf, NAMA00097-006/007

Findings of the Joint Committee

1. The acquisition of all loans, good and bad, gave NAMA full control to make decisions on the basis of a borrower's overall exposure to multiple lenders. However, the acquisition of good loans, as well as the bad, was not well received by all borrowers.
2. The review of NAMA's effectiveness was limited by the fact that only events up to December 2013 could be examined by the Joint Committee. Furthermore, it will not be possible to fully assess NAMA's performance and effectiveness until an evaluation based on medium-term property price movements is carried out.

Recommendation of the Joint Committee

1. The operation and effectiveness of NAMA should continue to be reviewed, in particular when medium term property price movements can be taken into account. When NAMA completes its work, it should be the subject of a further comprehensive and final review.

Chapter 10: Ireland and the Troika Programme

Introduction

On 27 November 2010, the Irish Government formally applied to enter a programme with the European Commission, the ECB and the IMF (also known as the Troika). This followed several weeks of informal discussions and one week of formal talks between the Government and the Troika. Entering into the Troika Programme (or *"bailout"* as it was more colloquially described by some witnesses) came as something of a surprise to the general public.

The Joint Committee wanted to understand why the Irish Government entered into the Troika Programme, the clear sequence of events leading to the Government decision as well as the implementation of the programme until Ireland's exit.

The Joint Committee also sought to understand:

- whether or not the risk of needing external assistance had been anticipated.
- whether other contingencies had been planned and/or attempted.
- the relationship if any between the Guarantee and the need to enter a programme.
- the extent to which outside or external events increased the likelihood of a programme being needed.

The question of burden-sharing, which arose in the course of the Troika Programme negotiations, is addressed in Chapter 11.

It should be noted that the ECB did not cooperate with the Banking Inquiry. While the ECB is legally accountable to the European Parliament, the Joint Committee are not aware of anything preventing the ECB from participating in a parliamentary inquiry. The Joint Committee's efforts to engage with the ECB are set out in Volume 2 of this report.

Informal engagement with the Troika Partners

The notion or possibility that Ireland might need external assistance at some point in managing the economic crisis was first considered by the relevant parties in September 2008. A request for "very preliminary and informal work on how a country enters an IMF programme" was requested by the then Assistant Secretary, Department of Finance, Kevin Cardiff. He said:

"Well, at that point, we might have looked for some ... we might have had to look for some external support. Certainly, it wasn't the plan ... it was nobody's intention but the first time I asked for some very, very preliminary and informal work on, you know, how one actually gets an IMF programme, was in September 2008, and at that point, I was thinking, you know, there was no work done on it. I just asked a colleague to make a discreet inquiry as to how you get into these things, if you do need them, just as a precaution because things were very bad from then."[1]

1 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-004.

In 2009 and again in 2010, it was communicated to the Government that IMF assistance was available, if needed. Former Deputy Director, IMF, Ajai Chopra, stated in evidence that the IMF had been in formal contact with the Irish authorities on at least two different occasions, in 2009 and 2010. However, he said this should not be interpreted as giving the impression that the IMF *"were out here badgering the authorities to get into a programme…"*[2]

If the IMF was not *"badgering"* the Government, neither were the Irish authorities engaging with the suggestion. As Kevin Cardiff said:

"Then in 2009, I believe there were hints in Washington, possibly also in Dublin, that, you know, IMF would be available if we wanted them. At that point, the Minister gave a pretty firm instruction to me and to others that we were not engaging with that suggestion but in part because ... remember, a bank crisis means you have to fill gaps in liquidity and gaps in bank liquidity are enormous. Capital is a lesser problem; liquidity is an enormous gap. And you really need the firepower of a central bank to do that. Now, in 2009 and into 2010, we had no problem getting funds for the Government, which is what the IMF provides."[3]

However, the consideration of entering a programme was not just an economic one; being *"bailed out"* had broader implications for the country, as former Chief Executive, NTMA, Michael Somers captured in his testimony before the Joint Committee:

"I never thought that it would happen. I mean, one of the nightmares for us for many years – because I was responsible for our end for many years – was the IMF. I mean, that was the thing. Actually … because we would be writing memos to Government telling them to cut back on their expenditure. That was the bogeyman that we held up, "Listen, if you don't behave yourselves and get your finances under control, the next thing is we'll have the IMF in here running the show for us." So, for me, I felt it was the ultimate humiliation actually for us, as a country, to have the IMF come in to run the show for us."[4]

Ajai Chopra told the Joint Committee of the *"stigma"* associated with entering an IMF programme:

"…the right time for a country to enter into a programme is when it's vulnerable but not in a full-blown crisis. Now, within that, there's a continuum. At one end of the continuum, you have a situation where a country can ask for help at the very first sign of some trouble, or it could wait, and the other end of the continuum would be that it cannot pay next week's wages, pensions and debt service. So within that, there's a number of other possibilities. Now, it's most unusual for a country to come right at the beginning, at the first sign of trouble, because there is an enormous amount of stigma. ... It's well known that there's stigma about entering into an IMF programme. And also there's always the hope that you can ride out the troubles. But it's equally disadvantageous to come at the very end, and Ireland did not do that."[5]

---

2 Ajai Chopra, former Deputy Director, IMF, transcript, INQ00101-029.

3 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-004.

4 Michael Somers, former CEO, NTMA, transcript, INQ00093-042.

5 Ajai Chopra, former Deputy Director, IMF, transcript, INQ00101-015.

Possibly the most active suggestion on the part of the IMF was that the Irish authorities might consider a programme of assistance came in the second quarter of 2010. Former Governor of the Central Bank, Patrick Honohan, spoke about this in his evidence to the Joint Committee:

"So I got a call from Ashoka Mody, who we know was subsequently in here and he ... out of the blue he said "You know we're coming, we're coming later in the month for the Article 4." Yes I know. "And we're just wondering would you think Ireland would be interested in one of these precautionary programmes?" And I knew that ... there are a number of ... two particular precautionary programmes, I'm not sure which one he was talking about. One of them was for countries that were really considered very well run, very well managed but just vulnerable to pressure from the market. Mexico I think qualified for one of these and may have taken one of these ones."[6]

The Central Bank was not advocating that Ireland pursue a precautionary line from the IMF at this stage. Patrick Honohan said:

"And I thought this might be quite good, we'd get a ... we'd get a seal of approval, potential access to money and it might be good. But I didn't think it as a wonderful thing which would have really been, you know, let's go for that, because if I had, we would have been advocating it as well."[7]

Nevertheless, Patrick Honohan said that he thought the idea worth considering:

"In six months' time, we had a real line [bailout programme]. So it ... okay, the step I took was to tell Mody, "I think you should raise it with the Government because I think it's a good idea." He raised it, I presume ... well, I know, because they came back to me and it was shot down. But I think it was ... it's more that it reflects, first of all, a sense that the IMF team thought we were being well-run, because they didn't give these things to countries that were not being well-run, and that there was that sense of concern. We weren't there blithely going along saying, "Everything's fine here." We were aware of the concern."[8]

Developments in Greece around this time may present some context. In April 2010, Greece was in discussions to enter a Troika Programme. Former Taoiseach Brian Cowen, told us that international perceptions of Ireland *"were not helped"* by the Greek situation whereby: *"Greek Government bond yields [had] soared to over 15% … its Government could not borrow any further [and] it applied for external assistance in April 2010…"*[9]

The Greek request for assistance prompted the suggestion by Patrick Honohan of the Central Bank that Ireland *"could"* be next to request assistance. As he told the Joint Committee, referring to an interaction he had with the then Minister for Finance, Brian Lenihan:

"[Brian Lenihan:] I have to ask you your advice on whether we should go ahead and support and put Irish money into this Greek programme that's being envisaged." So I think it was 10 April and I said, "I think you should," and he said, "Yes, I have the same view because you know we are going to make money on it because we are borrowing at this and we are going to get this amount of

6 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-017.

7 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-017.

8 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-035.

9 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-011.

money", and I said, "That's not the reason," I said, "The reason is we could be next." "Oh no," he said, "No, no, I've been talking to the people in Brussels and they say Portugal is next."[10]

It is important to underline the seriousness of the situation facing the Irish Government through 2010. As Brian Cowen said:

"But the point I'm making to you is that, regardless of what the IMF were saying, you know, we were coming to a position in relation to our own situation to say that we would prepare a four-year plan anyway, regardless if there was never a European dimension to it."[11]

Sovereign deficits were climbing in Europe as the crisis continued and the possibility of a Eurozone country exiting the Euro, either in tandem with or because of a default on Sovereign debts, was being discussed openly.

Kevin Cardiff spoke about the work of a small group focusing on Ireland's potential exit from the Euro:

"There was certainly work done on what would happen if we found ourselves unceremoniously shown the door or if that became the only option" before continuing: "there was a number of contingency papers drafted but the work was kept to an absolute very small group of people,"[12] and "the policy was clear… it was ... the Minister's view that the Government's view was clear. We are not working towards exiting the euro; we were working towards staying in it. That was always clear; there was never a debate."[13]

The Bank Funding Cliff, September 2010

As already set out in Chapter 7, the Government decided in September 2008 to guarantee all liabilities, both existing and new, for each of the Covered Institutions (the State Guarantee). Under the Credit Institutions Financial Support Act 2008 (CIFS Act 2008) all deposits, senior debt, covered bonds and dated subordinated bonds of the Participating Institutions were covered under this blanket guarantee scheme up to 29 September 2010. The only major exclusion was perpetual bonds.[14]

Within the two year period of the State Guarantee, the Irish Covered Institutions were able to refinance liquidity requirements as they were supported by the State's Guarantee and had access to monetary authorities. Initially the CIFS scheme guaranteed €375.25 billion, the additional €77.41 billion was already covered by the Deposit Guarantee Scheme.[15] The European Commission in its ex post evaluation of Ireland's bailout programme included the following assessment of the linkage that had become established between bank debt and national debt:

"In practice in September 2008, the authorities issued a two-year guarantee on existing banks' liabilities (Credit Institutions Financial Support Scheme - CIFS) amounting to €375bn (200% of GDP),

10 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-016.

11 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-083.

12 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-043/044.

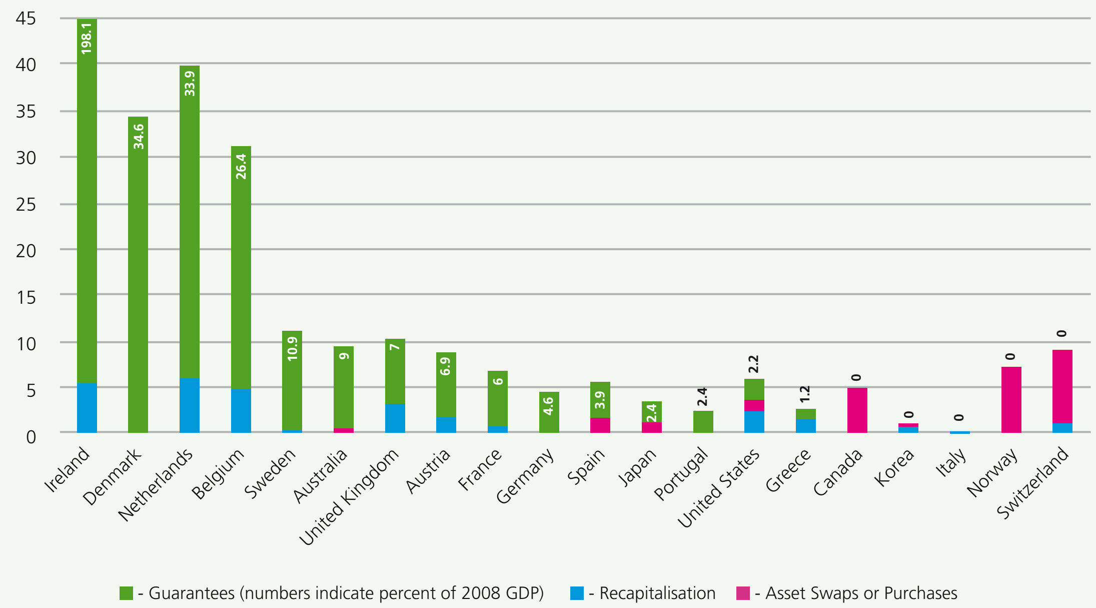
13 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-007.

14 The Irish Banking Crisis regulatory and Financial Stability Policy, 2003-2008, PUB00075-131.

15 Department of Finance submission to the Banking Inquiry, 13 April 2015, DOF07852-005.

in order to overcome banks' funding problems and address potential capital shortfalls. As a result, the solvency of the Irish sovereign and that of the banking system became directly intertwined. This eventually turned the banking crisis into a sovereign debt crisis…"[16]

Composition of financial support measures
Amounts Used, in % of 2008 GDP



Notes: Announced amounts in the cases of Denmark and Ireland. For Switzerland, amounts actually transferred in the case of asset swaps or purchases. In Italy, recapitalisation amounts to 0.1% and guarantees used to 0% of 2008 GDP
Source: OECD Secretariat and Banca d'Italia estimates based on IMF (2010a)

Source: Extract from OECD journal financial market trends volume 2010 Figure 7.1

As illustrated above, Ireland had by far the highest level of guaranteed financial support provided in % of GDP in 2008.[17]

This increasing volume of bonds, maturing in September 2010, created a potential "*funding cliff*" in the eyes of the authorities.

Author and journalist, Simon Carswell said that, because of the nature of the State Guarantee, *"there was always going to be a funding cliff at a particular point".*[18]

Patrick Honohan told us: *"if it had have been a one-year guarantee, the cliff would have just come earlier".*[19]

16 Ex post Evaluation of the Economic Adjustment Programme: Ireland, 2010 – 2013, Economic and Financial Affairs, European Commission, July 2015, PUB00356-025.

17 Extract from OECD journal financial market trends volume 2010, PUB00390-001.

18 Simon Carswell, Author & Journalist, transcript, PUB00179-033.

19 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-059.

In early 2010, the Central Bank, through the Prudential Capital Adequacy Review (PCAR) process, identified an additional need for approximately €10.9 billion in capital requirements for the Covered Institutions. As NAMA continued its work in transferring loans from the Covered Institutions and the extent of the discounts became clear, capital requirements for some of the banks increased (see Chapter 8).

Between October 2008 and May 2010, the Covered Institutions issued 174 guaranteed bonds, the total value of which amounted to €61.2 billion or, on average, €400 million per issue, as per the following table.

Characteristics of guaranteed bond issuance in individual countries for the period October 2008 to May 2010

Country	Total issuance (billion euro)	Number of issuers	Number of bonds issued	Average size of each bond (billion euro)	Average maturity at issuance (months)	Percentage of available guarantees
Australia	109,5	20	311	0,4	40	(3)
Austria	20,0	6	21	1,0	38	27
Belgium	4,0	1	4	1,0	23	21 (2)
Denmark	32.2	40	177	0,2	28	(3)
France	127,6	2	77	1,7	33	48
Germany	184,1	11	47	3,9	27	46
Greece	8,5	3	6	1,4	33	30
Ireland	61,2	10	174	0,4	30	100 (2)
Luxemburg	0,7	1	2	0,3	21	16
Netherlands	47,1	6	38	1,2	46	24
New Zealand	6,0	7	22	0,3	40	(3)
Portugal	4,4	5	5	0,9	36	22
South Korea	0,9	1	2	0,5	33	1
Spain	40,3	34	95	0,4	37	40
Sweden	18,3	5	71	0,3	40	14
United Kingdom	147,3	14	165	0,9	30	54
United States	248,2	42	191	1,3	33	14

(1) Source for committed amounts: European Commission.
(2) Authorised program size not available.
Source: Estimates by OECD Secretariat and Banca d'Italia based on Bloomberg and BIS.

Source: Extract from OECD journal financial market trends volume 2010, Table 3 [20]

20 Extract from OECD journal financial market trends volume 2010, PUB00390-002.

Special Advisor to the then Minister for Finance Brian Lenihan, Alan Ahearne, explained that the effect of these developments was that, by spring 2010, Irish banks were receiving inflows of *"half a billion a week"* and *"so that [funding] at least had stabilised"*.[21] Despite that, he said that:

"It was clear they wouldn't raise enough private funding to get over the cliff, and therefore the Eurosystem, the ECB and the Irish Central Bank would have to help out temporarily, but if they had, in the months that then followed, they would continue to issue bonds and raise funds, and they would've been able to repay that".[22]

As this situation was developing, the bank funding cliff was materialising for the Covered Institutions. The authorities were well aware of this, as Patrick Honohan said:

"So, first of all, the funding cliff did not become evident in May 2010, the funding cliff was evident ... certainly from the time that I started in September 2009. I constantly asked, as I said earlier ... they kept on saying "Well, there's going to be these maturities of debt in this week and that week." I asked "When is the worst month?" and they said "The worst month. The next month is always the worst month, but after that it's September 2010". And that's because, after the guarantee, as I understand it, the banks issued bonds and deposits to mature at or before ... shortly before the guarantee. So it was well known this was going to be a cliff; so we're going to have to do something to build sufficient confidence in the banking system that the depositors, when they get to the end of September, will say, "Oh yeah we'll just roll that over for another year. That's, of course, what we failed to do."[23]

When Dermot McCarthy, former Secretary General in the Department of the Taoiseach, was asked if, in his opinion, the duration of the State Guarantee created the conditions for the funding cliff that precipitated the bailout, he stated:

"It may have done, Chairman, in this sense: that clearly a time-limited guarantee was always going to create an exit issue. Now, that was anticipated quite early on and my recollection is that, in early 2009, the Minister sought the approval of the Government to seek agreement for a variant on the guarantee scheme to allow the issue of longer-term bonds and there was then a new scheme, the eligible liabilities guarantee scheme, which was approved by the Commission much later in 2009. Then there was the question of extending the period from September 2010 and, from recollection, I think it was June, or mid-year, that approval was received. So, there were attempts to avert that cliff situation emerging but, I think, in practice, it did contribute to the timing, the build-up of those liquidity pressures in the latter part of 2010".[24]

Whilst the Irish authorities were aware of and preparing for the funding cliff, it is less clear to what extent the ECB was being kept informed. Patrick Honohan told the Joint Committee about his efforts, in summer 2010, to alert the ECB to the forthcoming bank funding cliff:

"I wrote at the end of July and I fully expected then in August ... early meeting to be pulled aside and you know, "What do you mean saying this?", this is, you know ... dead silence, which I took as good

21 Alan Ahearne, former Special Advisor to the former Minister for Finance, Brian Lenihan, transcript, INQ00094-015.

22 Alan Ahearne, former Special Advisor to the former Minister for Finance, Brian Lenihan, transcript, INQ00094-015.

23 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-037/059

24 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-026.

news, they must have figured this out themselves, this is no surprise in my letter. So I wrote another letter in ... in August. I shouldn't really be going into a lot of detail about communications within the Eurosystem, to some extent I'm writing on behalf of Ireland of course which is what allows me to talk about them at all. So I ... obviously I provided full information at the end of August again. Then of course I did get the response, the concern and the anxiety was starting to build there."[25]

Patrick Honohan noted a *"change in attitude"* on the part of the ECB at this point:

"But it was really the change in attitude in August of 2010 and September, and, in September, we were absolutely in the centre of attention. And I remember one senior colleague saying, "I'm afraid that Greece is Europe's Bear Stearns but Ireland will be Europe's Lehman's." That was in September 2010."[26]

Former President of ECB, Jean-Claude Trichet gave a retrospective view on the period:

"…By late 2010, the imminent expiry of the original two-year guarantee - which in the meantime had been partially superseded by the so-called eligible liabilities guarantee, ELG, had left the Irish authorities in an extremely difficult situation. The so-called CIFS cliff, the wave of debt maturing in September 2010 issued under the guarantee confirmed Ireland's loss of access to sovereign markets. Combined with other factors, such as the ever-worsening fiscal situation, the Irish Government was confronted with no alternative but to ask for official support…"[27]

Meanwhile, Kevin Cardiff told us that, in summer 2010, the Government *"started the process with the European Commission of getting renewals in place for the end of the guarantee"*.[28] This was approved *"around 21-22 September 2010."*[29]

Arising from the introduction of the Eligible Liabilities Guarantee Scheme, the Irish Covered Institutions were able to access funding to repay the bonds maturing after the expiry of the original State Guarantee at the end of September 2010.

The "Cliff" and the Sovereign Interlink

As of September 2010, the ECB was a significant creditor to Covered Institutions through Emergency Liquidity Assistance (ELA) and the Irish Sovereign's credit ratings were being adversely impacted by increasing losses in the Covered Institutions, including concerns over asset quality, over-exposure to property and property-related transactions and falling asset values.

Investors saw a link between the perceived health of the Covered Institutions and the cost of Government debt. John Corrigan, CEO of NTMA commented that, around September 2010, *"… The extent of the additional capital requirements and, in particular, the huge loss announced by Anglo during this period were major factors in Ireland subsequently having to withdraw from the bond markets…"*[30]

25 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-018.

26 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-029.

27 Jean-Claude Trichet, former President, ECB, transcript, PUB00349-006.

28 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-065.

29 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-005.

30 John Corrigan, former CEO, NTMA, transcript, INQ00106-005.

The ECB was becoming more concerned about the reliance of the Irish Covered Institutions on ELA, which was collaterised with securities issued or guaranteed by the Irish Government, and at a time when the Government was seeing its own borrowing costs rising to a point where it may not have been possible to borrow any more, with Irish bond yields *"touching 7%"*.[31] Although ELA was for banks, because the State stood behind the banks, ELA could effectively be considered as a liability of the State.

Towards the end of September 2010, the Government withdrew from the Sovereign bond market, announcing *"that it would not borrow any further funds for a period, and in the meanwhile would draw down on the large cash pile it then held, precisely for this type of eventuality…"*[32]

The anticipation of further banking costs post-September 2010, combined with a question mark over whether the Sovereign could continue to service such large debts while also managing the ever-widening negative fiscal position, meant that interest rates for Irish Government debt had effectively risen to a level that was unsustainable.

Kevin Cardiff said:

"There is no particular 'magic number' level at which interest rates become unsustainably high for a sovereign borrower: it depends on all sorts of factors. But some commentators had decided that a 7% yield might be seen as a 'cut-off' point, after which a country should be seen as being in trouble. Irish yields were heading for that point…"[33]

In the view of Simon Carswell: *"ELA was the trigger for the bailout"* because *"the European Central Bank's view was that it had taken on a credit risk with Ireland and it was exposed to Ireland because the State had stood behind the banks"*.[34] Patrick Honohan made a similar point when he said that the *"rapid increase in ELA"* in September 2010 made observers believe a programme of support would be necessary.[35]

Whether the *"funding cliff"* was a pivotal issue was questioned by Kevin Cardiff when he said that *"frankly, the funding cliff was a small number of tens of billions"* and that *"in bank liquidity terms, on a balance sheet of €400 billion or €500 billion, it's a residual piece"*.[36]

Pressure Points

Pressure on the Government from the ECB was now growing, as illustrated by evidence given to us. Kevin Cardiff said:

"During September 2010, Brian Lenihan took a call from Jean-Claude Trichet, president of the ECB. Trichet was demanding to know what Ireland was doing about the continuing pressure on the fiscal and banking position…Trichet demanded that the European Commission be allowed to come to Ireland to examine the situation. ..."[37]

---

31 This was referred to in a tweet by David McWilliams, as reported in Kevin Cardiff statement, KCA00002-134.

32 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-133.

33 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-134.

34 Simon Carswell, Author & Journalist, transcript, PUB00179-033.

35 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-004.

36 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-066.

37 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement KCA00002-127.

From this point on, a series of meetings were held in Dublin and Brussels from the end of September, through October and November, to consider how the Irish Government might resolve its continuing fiscal and banking difficulties. This prompts us to ask whether some form of programme was already imminent at this point – and whether there was an ECB bias in favour of Ireland entering a Troika Programme?

Kevin Cardiff, in his written statement, described a meeting on 22 September 2010 in Brussels, where a team led by Minister Brian Lenihan held a confidential discussion with EU officials:

"…at this stage no one present was actively advocating a bailout – in fact most of those present wanted to avoid it. Certainly, after spending some time with him alone, Lenihan told me that Commissioner Rehn thought it was still on balance more likely than not that a bailout could be avoided – though it had to be considered a possibility – even, according to Lenihan, suggesting that the Portuguese were a more likely candidate for bail-out at that stage than was Ireland. But Marco Buti, who reported directly to Rehn, told me separately that it was his personal view that a bailout would probably on balance be required. He was not advocating it, at this stage, merely giving an opinion on the likely turn of events However, while neither the European nor the Irish political systems were yet prepared for a bailout, it could certainly be seen as starting to feature in discussions as at least a "Plan B", from then on. For Ireland, however, it was considered too soon to contemplate."[38]

When this was put to Marco Buti, he said:

"I think at the time, the ... after having had the Greek programme, with the mounting tensions and the increase ... rapid increase in the spreads on the Irish Government bonds, I think it was not only ... it was not essentially myself; I think that it was quite, you know, a widespread view that should the crisis not abate by itself - it didn't look like it at the time - that Ireland could be a potential candidate for an assistance programme…"[39]

In October 2010, the ECB wrote to the Government expressing its concern regarding the *"extraordinarily large provision of liquidity by the Eurosystem to the Irish banks."*[40]

The ECB suggested that ELA provisions might only be able to continue with *"progress in economic policy adjustment, enhancing financial sector capital and bank restructuring"*.[41]

The Government was in the process of formulating a four year National Recovery Plan 2011-2014[42] to manage the fiscal situation and budget shortfall. This work had commenced in the summer of 2010.[43]

By end-2009, General Government Gross Debt had reached 66% of GDP, reflecting the large deficits recorded in the intervening period, amongst other factors.[44] It was estimated that the ratio would be 95% of GDP at end 2010.[45] The main reason for this very large increase in 2010 was the capital support of €30.9 billion provided to a number of Covered Institutions within the banking

38 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-130.

39 Marco Buti, Director General for economic and Financial Affairs, European Commission, transcript, INQ00100-021.

40 Letter from Jean-Claude Trichet, former President, ECB, to Brian Lenihan, former Minister for Finance, dated 15 October 2010, DOF03413.

41 Letter from Jean-Claude Trichet, former President, ECB, to Brian Lenihan, former Minister for Finance, dated 15 October 2010, DOF03413.

42 National Recovery Plan 2011-2014, DOF07578.

43 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript PUB00351-044.

44 National Recovery Plan 2011-2014, DOF07578.

45 National Recovery Plan 2011-2014, DOF07578.

sector in 2010, which was classified within the General Government Debt.[46] (See also Chapter 8). The fiscal situation and budget shortfall demanded urgent adjustment and this was formulated into a National Recovery Plan 2011-2014.[47]

In evidence from Alan Ahearne, the Joint Committee was told that Brian Lenihan had suggested to EU officials that, together with this plan, Ireland might enter a precautionary programme with quarterly surveillance until mid-to-late 2011, when Sovereign cash reserves would have run-out. It was hoped that if access to the market was not available then, the Government would enter a full programme. Alan Ahearne said the Minister was looking for time. His evidence is interesting in this respect, when considering possible alternatives to the full Troika Programme that was agreed in November 2011:

"Ireland was under pressure in sovereign ... in the markets. The national recovery plan would have been part of it, so what he wanted to do was get the national recovery plan out, publish it. He wanted the ECB to say that ... because the banks were separately under stress on their funding, he wanted the ECB to say publicly that they stood behind the Irish banks and provide liquidity. By the way, the ECB were never asked to give capital to the Irish banks. It's not that they were asked to pay for a single cent, they were being asked to give funding but they were repaid all the funding. But he wanted them to say that they would stand behind him. And then he was willing to enter some sort of precautionary programme and what he had in mind is they could ... I mean, he said they could do quarterly surveillance if they wanted but the Irish State had enough ... the sovereign had enough money to keep going to the middle of 2011. So he said "Look, let's use that money. If the markets haven't improved, we can run down that money. We've just given ourselves time, given everybody time [the Irish State] given the Europeans time." Because they were in turmoil over what was going on - this was, remember, the start of the EU area crisis - maybe get some money to keep the State going until the end of 2011 and at that stage if Ireland still did not have access to the markets, they had pulled out at this stage, then we'd go for a full-blown programme, but he wanted some time."[48]

The "Deauville Declaration"

In his evidence, John Corrigan referred to a statement made at an EU summit in Deauville, Northern France in October 2010:

"The tone of eurozone sovereign bond markets was severely damaged in October 2010 when, at an EU summit in Deauville, Chancellor Merkel and President Sarkozy said that holders of eurozone sovereign debt should be forced to take losses or haircuts as part of any debt restructuring."[49]

This statement on 18 October 2010, referred to in evidence by John Corrigan, became known as the *"Deauville Declaration"* caused *"further market jitters and the damage was done and bond yields jumped further"* in the words of Brian Cowen.[50]

46 Department of Finance-Banking Inquiry Team – Information Memorandum DOF07852-004.

47 National Recovery Plan 2011-2014, DOF07578.

48 Alan Ahearne, former Special advisor to the former Minister for Finance, Brian Lenihan, transcript, INQ00094-018.

49 John Corrigan, former CEO, NTMA, transcript, INQ00106-005.

50 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-011.

On 25 October 2010, Brian Lenihan led a team of officials to Brussels to meet with the European Commission and ECB. As Kevin Cardiff described it to the Joint Committee, *"The first part of the meeting was with the European Commission only – maintaining for a brief moment the fiction that the ECB was present to deal mostly with banking matters."*[51]

The Irish party at the meeting presented their projections for 2011. While there was broad agreement on many of the points presented, there were a number of difficulties:

"…But even allowing for that difference there was some real space between us on what the 2011 adjustment should be. Lenihan, in the course of the discussion had already drifted towards his limit of €5bn and Rehn had come down to €6bn, but there the room for manoeuvre seemed to stop…"[52]

Kevin Cardiff also said in evidence:

"… The differences in macro-economic assumptions led to a technical difference between us in reaching the target of a 3% deficit by 2014. (The IMF already believed this was an unrealistic target, but the Commission was not ready for that discussion at that stage)."[53]

Jürgen Stark and Klaus Masuch of the ECB joined the discussion for the *"banking"* part of the meeting and, in his evidence, Kevin Cardiff summarised what they said at that meeting as follows:

"…The ECB was owed €116bn by Irish banks and the situation was getting worse – this was not sustainable. 'Emergency', Stark noted, was supposed to mean short-term and there was unease in the ECB about the ongoing nature of this lending, which had to be re-approved every two weeks. There was therefore an urgent need to consider a restructuring plan for the banking system, which should be part of an "overarching programme" also involving fiscal adjustments…" [54]

The G20 Summit in Seoul

A meeting of the G20 Nations took place in Seoul, South Korea on 11-12 November 2010.[55] At this meeting, the Irish economic situation was discussed and, following these discussions, it would appear that the possibility of a precautionary programme receded. Dermot McCarthy testified:

"… On 12 November the Taoiseach received a phonecall from the President of the European Commission expressing the concern of the G20 at the risk to international financial stability posed by the fragility of the Irish situation".[56]

51 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-136

52 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-138.

53 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-138.

54 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-139.

55 See Glossary of Terms.

56 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, statement, DMC00001-004.

Brian Cowen advised:

"…On 12 November the ECB, the governing council, decided that it could not sustain its large exposure to Irish banks. On the same day, ECB-EU sources commenced off-the-record media briefings leading to reports that Ireland would need a bailout and the discussions were under way. On 13 November there were internal discussions with myself, Minister Lenihan and key officials. We were clear that if discussions were to take place it would be, if you like, talks about talks…."[57] [58]

Further testimony was given to the Joint Committee by Alan Ahearne in this regard:

"Reuters or one of the news agencies had a story that said Ireland applying for the ... is going to apply for a programme. So I called back and said "What's this all about?" and I was told at that stage that a call had come in, I think, the night before, sorry, or at some stage around then, from Olli Rehn to Brian Lenihan and he had said - in the conversation as it was related to me - "Hi Brian. It's midnight in Seoul. Things have changed." And what he meant was... "Things have changed.", is that on the Monday or Tuesday, there was this potential to explore a precautionary programme but by the time we got to later that week there was no time to do that."[59]

The Irish authorities were not pleased that these discussions had been made public, albeit through anonymous briefings to the press. As Kevin Cardiff explained to the Joint Committee:

"It was, though, clearly inappropriate that at the outset, at the point when we were trying to make decisions, that back door briefings of the media should be used to undermine our position in the markets so as to add to our pressures. Democratic systems should not rely on undermining reputations and distributing misinformation via anonymous briefings."[60]

It is unclear whether or not these discussions and anonymous briefings had a material effect on the need for official external assistance. However, it would appear that from this point onwards, Ireland was more likely to enter into a Troika Programme, pending negotiations and a decision by the Government.

An Intervention by the Central Bank Governor

In the midst of these considerations and discussions, public speculation on the part of the media as to Ireland's possible entry into a bailout programme was growing. Public pronouncements on the part of two Cabinet Ministers on the weekend of 13-14 November 2010 to the effect that the Government was not about to seek financial aid from the Troika, was followed by an intervention from the Central Bank Governor Patrick Honohan on 18 November 2010.[61] The Governor's comments were at odds with the official line from Government at the time regarding the purpose of discussions.

Kevin Cardiff told the Joint Committee:

---

57 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-012.

58 Marco Buti gave evidence that he was not aware of the briefings described by Brian Cowen. Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, INQ00100-022.

59 Alan Ahearne, former Special Advisor to the former Minister for Finance, Brian Lenihan, transcript, INQ00094-019.

60 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-007.

61 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-165.

"While the discussions were due to get under way, there was some surprise news. Patrick Honohan, the Central Bank Governor, telephoned RTÉ from Frankfurt. He announced to the Irish public that he expected these discussions to lead to a very substantial EU/IMF bailout package, without notice to the Minister for Finance or the Government…"[62]

When the Joint Committee asked Patrick Honohan about this intervention, he said:

"…and I think if you look at the wording of the statement ... of the interview that I gave on "Morning Ireland" you'll see I went very, very close to saying that the ECB would provide all the finances that would be necessary…."[63]

He continued:

"Now, was I trying to contradict the Taoiseach? Was I trying to contradict other Ministers who'd said that? No, I wasn't trying to do that. Maybe I wasn't sufficiently attuned to the political happenings that were going on in Dublin because I'd been in Brussels and Frankfurt and, you know, doing all these discussions. When the Taoiseach said ... of the time said, "We're not in negotiations," I took that to be the standard thing ... understood, by informed people, to say, "Oh you're not in negotiations, you're in pre-negotiations".[64]

In his evidence to Joint Committee, Brian Cowen commented on Patrick Honohan's interview in the following terms:

"… and I just want to emphasise this, he did make the point in the interview that this is a matter for the Government and he went on to give an opinion…"[65]

In her evidence, Cathy Herbert, Special Adviser to Minister Brian Lenihan said:

"…He was irritated by it. Brian Lenihan was only ever irritated briefly. I mean, not long afterwards he said to me, you know, "The Governor had his own pressures. He's a member of the ECB. He's independent in the exercise of his duty." He [Brian Lenihan] had appointed him as Governor and he got over it…."[66]

The public was now alive to the likelihood that Ireland would need an external assistance programme of some form. The Joint Committee queried whether the Cabinet had been kept informed of the advanced stage of discussions and whether misinformation in the public domain caused confusion.

Brian Cowen told the Joint Committee:

"There were discussions going on, we had not agreed to go into a programme, we had not applied for a programme, but we were in discussions about the possibility. But until we knew where that was going we weren't even acknowledging that, not because you're trying to mislead anyone, but you don't want the European people you're talking to think that this is all ... that you can say what you like to us and we're going to go in anyway."[67]

62 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-172.

63 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-065.

64 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-065.

65 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-093.

66 Cathy Herbert, former Special Advisor to former Minister for Finance, Brian Lenihan, transcript, INQ00091-008.

67 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-087.

Brian Cowen further elaborated that the failure of the Government to share a united message was due to a *"miscommunication, there was a miscommunication that happened, and as head of the Government I should take responsibility for that."*[68]

A letter from Jean-Claude Trichet

On Saturday, 20 November 2010, the Minister for Finance received a letter from Jean-Claude Trichet dated 19 November 2010. The letter stated:

"…It is the position of the Governing Council that it is only if we receive in writing a commitment from the Irish Government vis-a-vis the Eurosystem on the four following points that we can authorise further provisions of ELA to Irish financial institutions:

1. *The Irish government shall send a request for financial support to the Eurogroup;*
2. *The request shall include the commitment to undertake decisive actions in the areas of fiscal consolidation, structural reforms and financial sector restructuring, in agreement with the European Commission, the International Monetary Fund and the ECB;*
3. *The plan for the restructuring of the Irish financial sector shall include the provision of the necessary capital to those Irish banks needing it and will be funded by the financial resources provided at the European and international level to the Irish Government as well as by financial means currently available to the Irish Government, including existing cash reserves of the Irish Government;*
4. *The repayment of the funds provided in the form of ELA shall be fully guaranteed by the Irish Government, which would ensure the payment of immediate compensation to the Central Bank of Ireland in the event of missed payments on the side of the recipient institutions…."* [69]

In his evidence to the Joint Committee, Patrick Honohan described this letter as *"gratuitous"*:

"Meanwhile ECB officials made public and private overtures to the Irish Authorities to encourage application for a programme. Given the views of Irish officials, already preparing the ground for a programme, these overtures were behind the curve and as such can be considered at best as having been largely gratuitous. This includes the letter of the ECB President to the Minister for Finance on November 19."[70]

Jean-Claude Trichet's letter caused the Irish Government position to crystallise. The situation was clear: if the terms of the letter were not adhered to, Irish Covered Institutions would not receive any further emergency liquidity assistance from the ECB.[71]

Kevin Cardiff explained the significance of this letter in his evidence:

---

68 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-088.

69 Letter from Jean-Claude Trichet, former President of the ECB, to Brian Cowen, former Taoiseach and Minister for Finance, dated 19 November 2010, DOT00376.

70 Patrick Honohan, Governor, Central Bank, statement, PHO00009-005.

71 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-172.

"The ECB advice in regard to entry to the EU-IMF programme was specific, it was directly tied to conditions they had outlined in correspondence, and there were consequences for non-compliance. The ECB had its reasons and I don't say that they were wrong from their perspective, certainly, but their view was clearly an important pressure point."[72]

Jean-Claude Trichet was asked about this letter at an event organised by the Institute of International and European Affairs held on 30 April 2015 at Kilmainham Hospital, Dublin.[73] It was put to Jean-Claude Trichet that it was a clear and unambiguous threat that, if Ireland did not apply for a bailout programme, the ECB would turn off the lifelines for the Irish Covered Institutions.[74] His response was as follows:

"…And I have to say that the letters, the exchange of letters, made clear that as lender of last resort, looking at a situation which was deteriorating by the day, we could not continue to be the lender of last resort to institutions which were clearly considered insolvent by all their environment, their financial environment."[75]

He further stated:

"The letter is there. It was returned in order to avoid any ambiguity. There is not any ambiguity thanks to the letter. You see exactly what the letter is saying but I didn't ask anybody to speak publicly on such matters".[76]

He added:

"the main argument[s] that explains the decision of the Government of Ireland at the time"[77] *and said that "combined with other factors, such as the ever-worsening fiscal situation, the Irish Government was confronted with no alternative but to ask for official support".*[78]

Discussions to Negotiations to Programme

As the decision to formally apply for a Troika Programme came into view, Irish Government officials were concerned that Ireland's corporation tax rate might become a feature in any negotiations. As Kevin Cardiff stated to the Joint Committee:

"There would be important obstacles to agreement. It seemed likely that demands to change our corporation tax rates would be made by some countries. Others might seek collateral for their loans, which could create enormous practical, political and legal obstacles."[79]

It was made clear by the Government that no concession would be made on the corporation tax rate due to its importance to economic recovery. As Brian Cowen told the Joint Committee: *"…Efforts had been made from time to time to put our corporation tax rate on the agenda, which we refused to countenance…"* [80]

72 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-006.
73 The circumstances in which he answered questions are set out in Appendix 1 of this report.
74 Jean-Claude Trichet, former President, ECB, transcript, INQ00140-033.
75 Jean-Claude Trichet, former President, ECB, transcript, INQ00140-038.
76 Jean-Claude Trichet, former President, ECB, transcript, INQ00140-040.
77 Jean-Claude Trichet, former President, ECB, transcript, INQ00140-007.
78 Jean-Claude Trichet, former President, ECB, transcript, INQ00140-026.
79 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-160.
80 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-012.

Asked by the Joint Committee whether or not it was put to the Irish authorities that Ireland should increase its corporation tax rate, Dermot McCarthy told us:

"No, Deputy, I don't believe so but I think the concern, the anxiety was that part of … this process, of course, required the agreement of the member states and that it was in the engagement with member states that the risk of such a condition … was feared might arise. And that was based on, if you like, the broad environment rather than specific messaging."[81]

It is not clear if Ireland's corporation tax rate was ever formally tabled by any of the Troika partners during the negotiations but the perception of a threat was real and, in securing a programme of assistance, the protection of the corporation tax rate was considered a *"considerable win"*. [82]

This view was endorsed by Ajai Chopra of the IMF in his evidence to the Joint Committee:

"…The corporate tax was a central feature of Ireland's business model at the time, to the extent that a country has a business model, and even though there may be a good case to address this over the medium term, we did not think that this needed to be a part of the programme at that time..."[83]

The Cabinet met on 21 November 2010 to formally consider (and subsequently agree to) entering negotiations on a programme of assistance with the Troika. [84] After a Eurogroup meeting on 21 November 2010, the Irish Government officially requested financial support from the European Union, the IMF and the Euro Area member states.

Formal negotiations took place from 21 November 2010 to 26 November 2010.[85]

Work on a four-year recovery programme was close to finalisation prior to the commencement of negotiations. The programme, 'National Recovery Plan, 2011 - 2014,'[86] specifying the steps to reach a further €15 billion adjustment in the State finances, was reviewed and approved by the Government on 24 November 2010, while negotiations were ongoing.

As Brian Cowen said in his evidence:

"…When the Troika did get it [National Recovery Plan] after Cabinet approval, they agreed to adopt it as a central plank of the programme. It was, as we believed it to be, rigorous and realistic and designed to meet the economic challenges we faced. The EU-IMF programme was finalised and adopted by Government on 27 November 2010 and one additional year was allowed to reach the general 3% deficit threshold if required…"[87]

The view of the Troika on the National Recovery Plan is also worth stating:

In his evidence, Marco Buti, Director General for Economic and Financial Affairs with the European Commission said: *"...I think we supported very strongly the national recovery plan that the Irish Government had put in place and were elaborating at the time...."*[88]

---

81 Dermot McCarthy, former Secretary General, Department of the Taoiseach and Secretary General to the Government, transcript, INQ00108-037.

82 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-007.

83 Ajai Chopra, former Deputy Director, IMF, transcript, INQ00101-026.

84 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-012.

85 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-089.

86 National Recovery Plan 2011-2014, DOF07578.

87 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-013.

88 Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, INQ00100-021.

Ajai Chopra stressed the importance of Ireland having taken ownership of economy recovery by formulating its own plan: *"…the important thing is much of the programme was designed by the Irish authorities..."*[89]

Kevin Cardiff summed up the content of the Troika negotiations to the Joint Committee:

"On other areas of the negotiation with the external partners, we strove hard to get the best deal possible for Ireland and, indeed, we achieved some considerable wins. First, no threat to our corporation tax system, on which many jobs depended and depend; no collateral requirement for the loans; adoption, wholesale, of the Irish four-year plan – national recovery plan; agreement to Irish figures for fiscal adjustment, so no addition front-loading of the fiscal adjustment beyond the numbers that had already been announced by the Irish Government. At some point, we got an extra year to make the overall fiscal adjustments required. We got a tacit – unfortunately not explicit, but a tacit – ECB commitment to continued banking system support and we got a "no fire sales" approach to bank deleveraging, which probably saved us some billions later." [90]

Ultimately, the Cabinet met on 27 November 2010 and agreed to enter an 'EU-IMF financial assistance programme'[91]

Summary of National Recovery Plan and the Programme Terms

The Troika Programme comprises two distinct parts:

1. One part, *Programme for the Recovery of the Banking System*, dealt with bank restructuring and reorganisation involving support to the value of some €35 billion. This programme amounted to an intensification of the measures already adopted by the Government. It provided for a fundamental downsizing and reorganisation of the banking sector in order that it would become proportionate to the size of the economy. The objective, as stated in the Troika Programme, was that the financial institutions would be capitalised to the highest international standards and, in time, would be in a position to return to normal market sources of funding.
2. The second part of the Troika Programme dealt with fiscal policy and structural reform totalling some €50 billion support over the period 2011 – 2014, with the potential for this to be extended for an additional year subject to milestone compliance. Ecofin acknowledged the EU Commission's analysis that a further year might be required to achieve the 3% deficit target. [92]

The Troika Programme endorsed the Government's budgetary adjustment plan of €15 billion over the subsequent four years (2011-2014) and the commitment for a €6 billion front-loading of fiscal adjustments and other measures in 2011. [93] The details of the Troika Programme closely reflected the key objectives set out in the National Recovery Plan.

89 Ajai Chopra, former Deputy Director, IMF, transcript INQ00101-030.

90 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-007/008.

91 Letter from Minister for Finance to Olli Rehn, former Comissioner on Economic and Monetary Affairs, European Comission; Dominique Strauss-Khan, former Managing Director, IMF and Jean-Claude Trichet, former President of the ECB, DOF03431.

92 The timeframe was extended by one year to 2015- Government statement, 28 November 2010, DOF03444-002.

93 Government Statement Announcement of joint EU - IMF Programme for Ireland, DOF03444.

Use of Funds under the Troika Programme[94]

Use of funds	Eur bln	%	
Banking system	10	12%	Immediate recapitalisation
Financing of State	50	59%	
Contingency	25	29%	Banking system supports
Total	85	100%	

The following provides a summary of the National Recovery Plan as prepared by the Government in 2010:[95]

- An overall fiscal adjustment of €15 billion in order to meet the 3% deficit target by 2014.
- The adjustment to involve €10 billion in expenditure savings and €5 billion in additional tax revenues.
- 40% or €6 billion of the overall adjustment to be made in 2011.
- Deficit to be reduced to 9.1% of GDP in 2011 and to below 3% by 2014.
- Debt to GDP ratio to peak at 102% in 2013 and to fall to 100% by 2014.
- No change to the 12.5% corporation tax rate.

According to Brian Cowen:

"These spending cuts and tax increases involved a total adjustment of over €15bn in the four budgets we introduced, including the 2011 budget. It represented two thirds of the total required adjustment to bring the budget deficit below 3% as required by EU Stability and Growth Pact rules…"

He added that:

"…the EU-IMF programme … provided the means and the Credit Institutions Act 2010 provided the legislative basis to implement the necessary restructuring and downsizing of a domestic banking system to a more sustainable model for the future…"[96]

94 In accordance with the Government announcement of Troika Programme for Ireland, 28 November 2010, DOF03449-004

95 National Recovery Plan 2011-2014, DOF07578-005.

96 Brian Cowen, former Taoiseach and Minister for Finance, transcript, INQ00089-013/014.

Sources of programme funding

Lenders	Eur bln	%	Interest rate p.a.	
EU & Bilateral lenders	22.5	26%	6.05%	EFSF (European Financial Stability Fund)
EU & Bilateral lenders	22.5	26%	5.70%	ESFM (European Financial Stability Mechanism)
NPRF	17.5	21%		National Pensions Reserve Fund
IMF	22.5	26%	5.70%	EFF (Extended Fund Facility)
Total	85	100%		
Source: Irish Gov press release Nov 28, 2010 Source: Interest rates NTMA note Dec 1, 2010				

Source: Government Statement Announcement of joint EU - IMF Programme for Ireland[97]

The "Bilateral lenders" (namely the United Kingdom, Sweden and Denmark) each contributed separately to the Troika Programme as they are not part of the Eurozone.[98]

Ireland contributed €17.5 billion from the National Pensions Reserve Fund as part of the Troika Programme. Such a measure was alluded to in the correspondence from the ECB of 19 November 2010:

"The plan for the restructuring of the Irish financial sector shall include the provision of the necessary capital to those Irish banks needing it and will be funded by the financial resources provided at the European and international level to the Irish Government as well as by financial means currently available to the Irish Government, including existing cash reserves of the Irish Government."[99]

Brian Lenihan stated in the Dáil on 1 December 2010:

"Furthermore, the State is in the happy position of being able to contribute €17.5bn towards the €85bn from its own resources, including the National Pension Reserve Fund. Why would we borrow expensively to invest in our banks when we have money in a cash deposit earning a low rate of interest."[100]

In evidence, Marco Buti stated that he regarded the contribution as an appropriate and prudent move from the perspective of the financial markets. He said it was not a precondition but that it impressed the markets and also saved the country money.

Budgetary position and outlook on entering Troika Programme

Ireland was in a precarious fiscal state on joining the Troika Programme. The Current Budget balance in 2010 was significantly negative and the outlook for 2011 was scarcely better, as shown in the table below.[101]

97 Government Statement Announcement of joint EU - IMF Programme for Ireland, DOF03444.

98 Government Statement Announcement of joint EU - IMF Programme for Ireland, DOF03444-003.

99 Letter from Jean-Claude Trichet, former President of the ECB, to Brian Cowen 19 November 2010, DOT00376-003.

100 Statement by Minister for Finance, Brian Lenihan T.D. on the EU/IMF Programme for Ireland and the National Recovery Plan 2011 to 2014, DOF03449-004.

101 National Recovery plan 2011-2014, DOF07578-110.

Budgetary Data					
Table A.4.1 Budgetary Projections 2010-2014					
CURRENT BUDGET	**2010**	**2011**	**2012**	**2013**	**2014**
Expenditure	**€ bn**	**€ bn**	**€ bn**	**€ bn**	**€ bn**
Gross Voted Current Expenditure	54.8	52.8	50.9	49.4	48.0
Non-Voted {Central Fund) Expenditure	6.4	6.8	8.8	10.0	11.0
Gross Current Expenditure	**61.2**	**59.7**	**59.7**	**59.4**	**59.1**
less Expenditure Receipts and Balances	13.8	12.7	13.0	13.4	13.9
Net Current Expendliture	**47.4**	**47.0**	**46.7**	**46.0**	**45.2**
Receipts					
Tax Revenue	31.5	33.4	36.3	39.2	42.2
Non-Tax Revenue	2.7	2.0	1.1	0.9	0.9
Net Current Revenue	**34.2**	**35.4**	**37.5**	**40.1**	**43.1**
CURRENT BUDGET BALANCE	**-13.2**	**-11.6**	**-9.2**	**-5.9**	**-2.1**

Source: Budget 2011 Table A.4.1

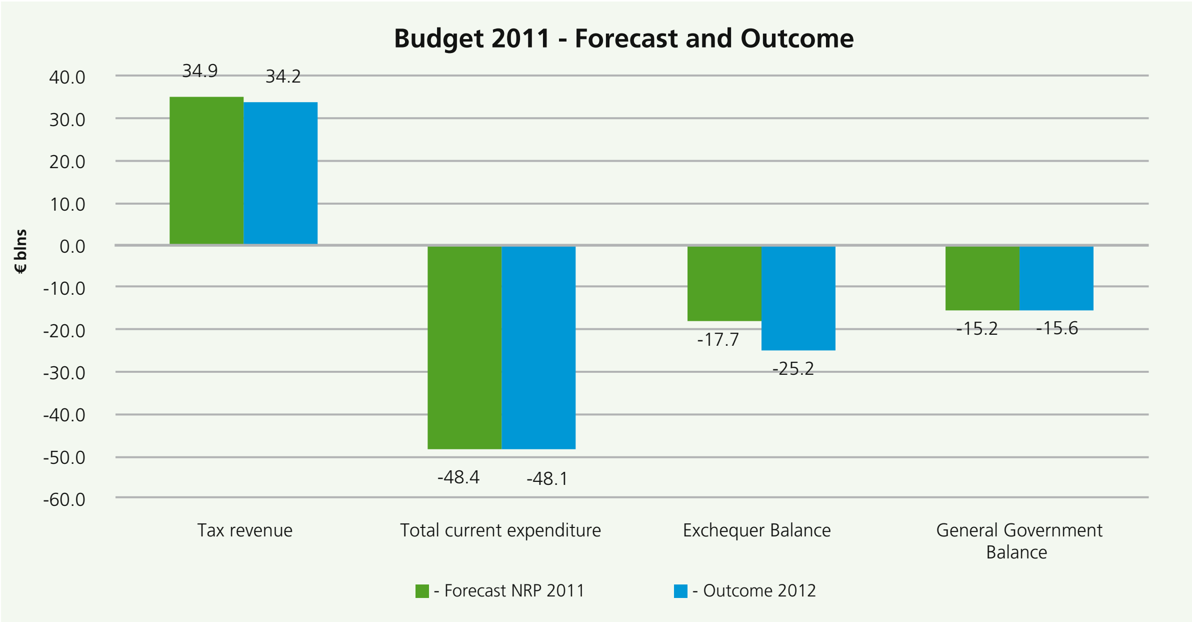
The overall underlying General Government Balance was estimated at the time to be 11.7% of GDP.

Budget 2011[102]

Against the backdrop of a bad fiscal situation and serious liquidity problems in the banks, the first Budget under the National Recovery Plan provided for adjustments of €6 billion, mainly in the form of higher taxation and restrictions on current and capital expenses. The introduction of the Universal Social Charge (USC) and the reduction of tax bands were some of the tax revenue increase measures taken.

Estimates given in late 2010 turned out to be very close to the actual outcome in 2011.

102 Source for Budget 2011 from http://www.budget.gov.ie/budgets/2011/2011.aspx



Graph prepared on behalf of the Joint Committee using information sourced from www.budget.gov.ie/budgets[103]

The substantially larger than anticipated Exchequer Deficit resulted from an amount of over €7.5 billion for bank recapitalisations (See Chapter 8 Post Guarantee developments). Tax revenue rose by more than €2.6 billion, but remained slightly behind the forecast. This was mainly due to the lack of growth: GDP sank by 1.3%, as against a forecast of +1.3%, and the unemployment rate rose to 14.3% versus an estimate of 13.2%. Income tax, corporation tax and VAT stayed slightly behind predictions.

Government debt rose to €169 billion or 109% of GDP at year end-2011 but at least a further widening of the underlying fiscal structural deficit was halted.

A New Government

The new Government, elected in March 2011, sought to amend certain terms of the Troika Programme by agreement with the Troika Partners. This amendment led to reduced interest rates and the extension of loan maturity terms by an additional 7 years,[104] reducing the cost of servicing the debt over a longer period.

In September 2011, the Government negotiated several changes to the Troika Programme of assistance as follows:[105]

- The Memorandum of Understanding was amended to allow for the jobs initiative, restoration of the minimum wage and the provision that no further loans would be transferred to NAMA.

103 This graph was prepared solely to assist the reader. It does not constitute evidence and was not presented as evidence to any witness providing testimony to the Inquiry.

104 From 12.5 to 19.5 years for EFSM loans and from 15 to 22 years for EFSF loans. This extension should also increase the period under which Ireland will be under Post-Programme Surveillance (PPS). This should normally run until 75% of the assistance has been paid back. Source: EC Ex post Evaluation of the Economic Adjustment Programme Ireland, 2010-2013, PUB00356-042

105 Government's Negotiation of Programme of Assistance and Interest Rate Savings, DOF03494, DOF03493-001.

- The interest rate was renegotiated, giving rise to significant savings. The annual saving based on the full drawdown of the €45 billion available from the EU and bilateral loans were estimated at the time to be between €900 million and €1.2 billion.[106]

Ajai Chopra gave evidence to the Joint Committee regarding these changes:

"I wouldn't say there were fundamental changes. There were a number of small changes, and actually not a very large number. There was the issue of the minimum wage, which was taken ... which the new Government did not continue with, with the proposed policy of the previous Government. There was a little bit more ... there was more emphasis ... there was some switch in some fiscal measures geared a little bit more towards job creation. So I wouldn't say there were any fundamental changes".[107]

Upon these changes being agreed, the new Government also made changes to the National Recovery Plan. Ajai Chopra gave the following view:

"The national recovery plan was put forward by the previous Government, and you know, as we have said, the subsequent Government modified a few elements of it but the fundamental structure remained."[108]

On the issue of the interest rates applied by each of the Troika partners to the Troika Programme loans, the following document from the Department of Finance explains the initial agreement:

"The average interest rate on the €67.5 billion available to be drawn from these three external sources under the EU-IMF programme is 5.82 per cent on the basis of market rates at the time of the agreement. The actual cost will depend on the prevailing market rates at the time of each drawdown. The average life of the borrowings, which will involve a combination of longer and shorter dated maturities, under each of these sources is 7.5 years and the interest rates applying to borrowings from each are set out below based on market rates at the time of the agreement."[109]

From the beginning of the Troika Programme, there was concern as to the higher rate being applied on the EFSF and EFSM facilities vis-à-vis the terms of the other facilities. John Corrigan, in providing evidence to the Joint Committee, said:

"the EFSF and the EFSM […] were pricing those [their loans] off the facilities that they had given to Greece. Initially the discussions were they were looking at giving us very short-term facilities when we engaged with them in November, and we persuaded them in those discussions that if we were to go for a programme, that they ... for any programme to be meaningful, they would have to look at maturities of the order of seven years or beyond. They did, they did go for the extended maturity but the initial interest rates were well over 5% and they were ... they were reduced, I think, during the course of ... in mid-July 2011."[110]

106 These figures were only valid when all of the €45billion had been drawn down and for as long as the amounts remained outstanding.

107 Ajai Chopra, former Deputy Director, IMF transcript, INQ00101-013.

108 Ajai Chopra, former Deputy Director, IMF, transcript, INQ00101-030.

109 EFSM Interest rates, DOF03793-001.

110 John Corrigan, former CEO, NTMA, transcript, INQ00106-022.

When asked about the terms of the Troika Programme, Patrick Honohan, said that:

"there were subsequent, considerable improvements in the terms of financing, not least through the reduction of EU interest rates from the initial level of about 5.7%, 5.8% per annum and the lengthening of the loan maturities and subsequently through the carefully designed financial arrangements around the liquidation of IBRC, especially the so-called promissory note exchange."[111]

He further elaborated: *"these improvements, combined of course with close adherence to the budgetary targets in the following three years, allowed the Government to take the decision to exit the programme on schedule at the end of 2013."*[112]

One explanation for the interest rate negotiation and reduction was provided by Kevin Cardiff:

"It wasn't much negotiable at that point. The Minister had done some talking to other Ministers in the Eurogroup and so forth, so far as I know. It was fairly clear there was not much shift on that. So the focus was on other things. But even in the memo for Government saying "Let's join this programme"*, there was a line saying "and by the way, the interest rate could be lower and we are going to continue working on that". And there was, you know, people were making approaches as early as February, I think February, certainly March ... of the ... of the following month. We almost succeeded and it would have been a pity because, in fact, we got an even bigger reduction than we had been looking for or than we had been hoping for, let's say, in July. So in a sense, the little bit of delay helped. We also had in mind, I mean, we talk about other people being cynical, we were a bit cynical ourselves. We also had in mind that if things got worse in other parts of Europe, the case for an interest rate reduction for those other parts of Europe would be much stronger than for Ireland even and that we would be able to piggy-back on that, which is more or less what happened."*[113]

Budget 2012[114]

Budget 2012 marked the second year under the National Recovery Plan. It was also the first Budget announced by Michael Noonan as the new Minister for Finance.

The 2012 Budget was prepared within the parameters of the National Recovery Plan and adherence was closely observed by the Troika partners under the EU-IMF Financial Assistance Programme. Although there was limited room for manoeuvre, some flexibility was given, as an additional year had been granted in November/December 2010 to return to within the target deficit of 3% of GDP under the Stability and Growth Pact.

€3.8 billion of additional fiscal adjustments was announced in Budget 2012. €750 million capital expenditure savings and €1.45 billion current expenditure consolidation were implemented. Additional new tax measures accounted for €1.6 billion approximately.

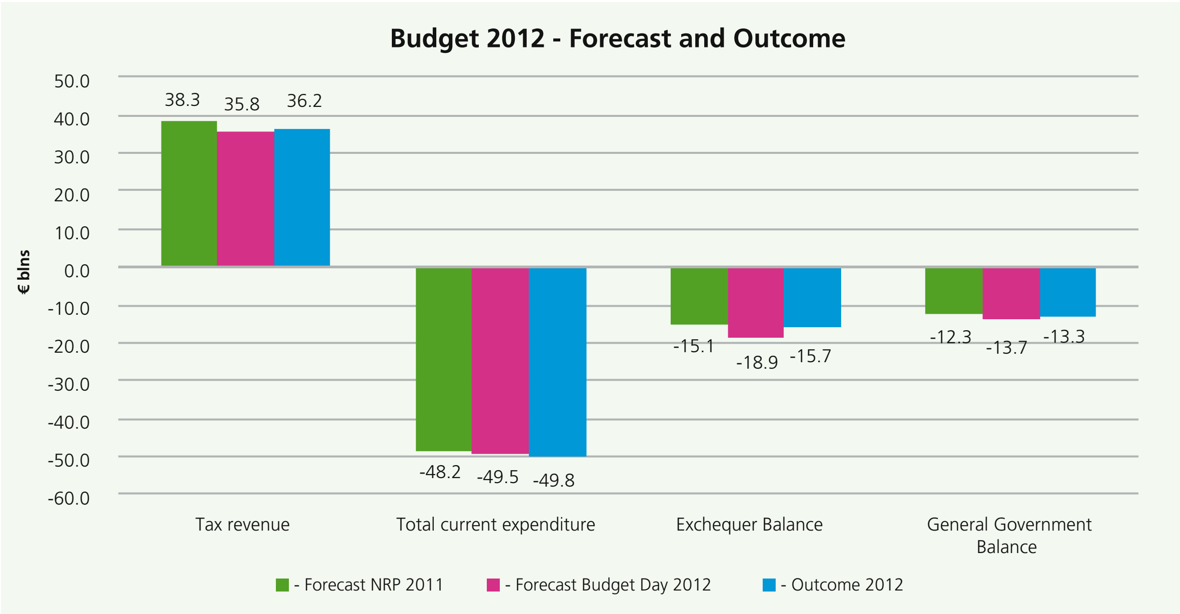
111 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-004.

112 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-005.

113 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-044.

114 Source for Budget 2012 from http://www.budget.gov.ie/budgets.2012/2012.aspx

Of note were the introduction of the Household Charge, which led to the planned introduction of the Property Tax in 2014, an increase in the CGT rate from 25% to 30%, the increase of the VAT rate from 21% to 23%, changes to Pay-Related Social Insurance (PRSI) employer contribution and increases of carbon and motor tax.



Graph prepared on behalf of the Joint Committee using information sourced from www.budget.gov.ie/budgets[115]

The chart above shows original and adjusted estimates. Tax revenues remained behind the original estimates when the National Recovery Plan was announced but rose by more than €2 billion, compared to 2011 and slightly exceeded the Budget Day projections. After the fall in the previous year, GDP had started to recover and grew by 5.5%. This recovery had not fed through to the unemployment rate, which rose higher than expected, to 14.7% in 2012. Rates of 14.1% and 12% had been forecasted one and two years earlier.

Despite all the adjustments, it had still been expected that the Exchequer Balance would remain substantially negative and that is what transpired. Overall, Government debt rose to €192 billion or 117% of GDP at year end-2012.[116]

Budget 2013[117]

The third Budget under the National Recovery Plan included further fiscal adjustments amounting to €3.5 billion, as required under the EU-IMF Financial Assistance Programme. Adjustments of a further €3.1 billion and €2.0 billion were expected for the following two years in order to bring the

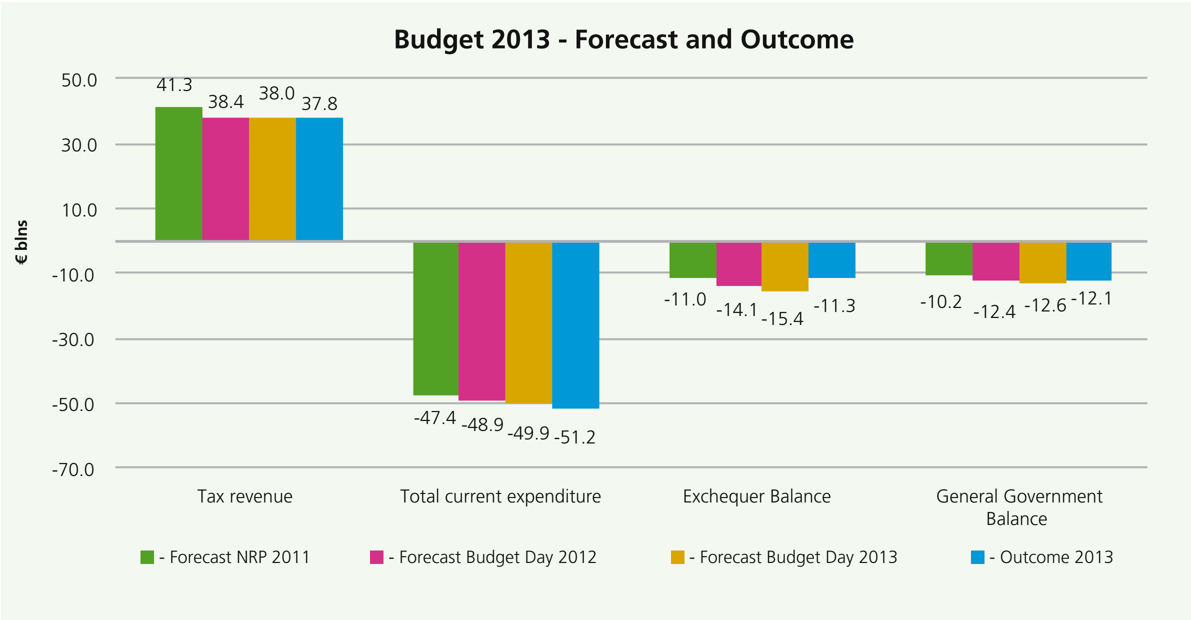
115 This graph was prepared solely to assist the reader. It does not constitute evidence and was not presented as evidence to any witness providing testimony to the Inquiry.

116 New Government Finance Statistics issued by CSO, www.cso.ie.

117 Source for Budget 2013 from http://www.budget.gov.ie/budgets/2013/2013.aspx.

Government Balance into line with the target set in the Stability and Growth Pact.[118]

The Local Property Tax was introduced in the 2013 Budget as one of the main taxation measures. Substantial increases in excise duties and motor tax were also announced. PRSI and Pension Fund changes were also contributing significantly to revenues.



Graph prepared on behalf of the Joint Committee using information sourced from www.budget.gov.ie/budgets[119]

The chart above shows original and adjusted estimates. Tax revenues increased by a further €1.6 billion to €37.8 billion but again remained behind the original forecasts. Expenditure grew considerably stronger than expected for the first time since the Budgets of 2009.

Despite the widening gap between revenues and expenses, the Exchequer Deficit was reduced to some €11 billion. This was mainly due to lower debt servicing costs after the restructuring in February 2013 of the Promissory Note Debt and following additional capital receipts of €2.3 billion from the sale of Irish Life plc and Contingent Capital Notes in Bank of Ireland.[120]

The Irish economy had built upon the signs of recovery seen in 2012. GDP growth reached 6.7% and the unemployment rate fell from 14.7% to 13.5%. House prices in Dublin City rose strongly in the second half of the year and started recovering in the rest of the country.

Despite the major fiscal adjustments and signs of economic recovery, the Exchequer Balance remained substantially negative. Government debt rose to €215.6 billion or 123% of GDP at year end 2013. Further adjustments were still needed.

118 General Government Balance and Fiscal Consolidation Forecasts 2013 – 2015, Medium-Term Fiscal Statement November 2012 Pg5, http://www.budget.gov.ie/budgets/2013/2013.aspx.

119 This graph was prepared solely to assist the reader. It does not constitute evidence and was not presented as evidence to any witness providing testimony to the Inquiry.

120 http://oldwww.finance.gov.ie/viewdoc.asp?DocID=7505, Bank of Ireland - Disposal of Contingent Capital Notes by the Minister for Finance.

Monitoring the Programme

It was agreed in a *'Memorandum of Understanding between the European Commission and Ireland'*, signed by the Minister for Finance, the Governor of the Central Bank of Ireland and the European Commission,[121] that implementation of the measures under the Troika Programme would be monitored using continuous performance criteria, indicative targets and structural benchmarks and by means of quarterly programme reviews in compliance with requirements under the Excessive Deficit Procedure (EDP).

Following each quarterly review, funds were released as per the Programme, subject to the agreement of all parties. The IMF produced and published a quarterly report after each review, 12 reviews in total. The final report was dated December 2013.[122]

Marco Buti, European Commission stated in evidence that, when implementing the Troika Programme, the Commission had *"many contacts with the social partners"*.[123] Ajai Chopra, IMF, also stated that the Troika had met with *"a wide range of social partners."*[124]

Both witnesses testified that shielding the most vulnerable from the cutbacks was a central objective. Ajai Chopra said:

"…Protecting the socially vulnerable at a time of difficult economic adjustment was a central policy goal. Even before the program started, deep fiscal consolidation had been implemented in 2008, 2009 and 2010 with comparatively modest social distress."[125]

Marco Buti said:

"…If one looks at the ... at indicators of, let's say, inequality of distribution of income, of material deprivation, etc., you can see that the operation of the tax and benefits systems helped substantially to lessen the impact. This does ... I am not minimising at all the fact that it was harsh for everybody, but in terms of overall, let's say, fairness considerations, I think the programme was implemented adequately…"[126]

Exit from the Programme

Conditions improved slowly as the Programme continued. In July 2012, Ireland re-entered the International Bond Markets and Moody's raised the Sovereign rating back to investment grade, to Baa3, in January 2014.[127] As John Corrigan said in his evidence:

"...The investor relations programme yielded relatively early results when, in 2012, we raised €5.2bn on the market in long-term debt, regained regular access to the short-term markets and succeeded in reducing the outstandings on the January 2014 bond to €7.6bn..."[128]

121 Memorandum of Understanding between European Commission and Ireland, DOF03460-011.

122 Twelfth review under the extended arrangement and proposal for post-program monitoring dated December 2013, DOF00740. http://www.imf.org/external/pubs/ft/scr/2013/cr13366.pdf

123 Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, INQ00100-029.

124 Ajai Chopra, former Deputy Director, IMF, transcript, INQ00101-025.

125 Ajai Chopra, former Deputy Director, IMF, statement, ACH00001-012.

126 Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, INQ00100-030.

127 The Irish financial assistance programme – Department of Finance, DOF07710-022.

128 John Corrigan, former CEO, NTMA, transcript, INQ00106-006/7.

Following a successful 12th quarterly review at the end of 2013, Ireland exited the Troika Programme.[129] The Government agreed to exit the Programme on 14 November 2013 without the need for a pre- arranged precautionary facility or backstop.[130]

The IMF, in a press release dated 19 December 2013, commented that Ireland had *"pulled back from an exceptionally deep banking crisis, significantly improved its fiscal position, and regained its access to the international financial markets…"*[131]

As mentioned previously in this Chapter, the ECB did not cooperate with the Banking Inquiry, undermining the Joint Committee's ability to investigate matters fully (noting that the Joint Committee did put questions to Jean-Claude Trichet at the Institute of International and European Affairs event held on 30 April 2015 at the Royal Hospital Kilmainham Hospital). The Joint Committee believes that there is a serious democratic deficit when it comes to the ECB's accountability to the Inquiry in terms of significant decisions taken by the Irish Government that it was directly involved in over the period under investigation.

Findings of the Joint Committee

1. The Irish authorities were in discussions from September 2010 with the individual Troika partners prior to a government decision to enter into formal negotiations on a Troika programme.
2. The letter from the ECB to Minister Brian Lenihan on 19 November 2010 threatened that it would not continue to provide ELA support for Irish banks if Ireland did not enter into a bailout programme.
3. The Deauville Declaration pushed up Irish bond yields, reducing the possibility of Ireland's re-entry to sovereign bond markets at the time.
4. The National Recovery Plan was the basis for agreement between the Irish Government and the Troika.
5. By October of 2010 Ireland's entry into a bailout programme was inevitable, but the timing of the entry into the programme was determined by factors outside of the Government's control.
6. The possibility that Ireland might need external assistance from the IMF at some point in managing the economic crisis, was first considered in September 2008 by Second Secretary of the Department of Finance, Kevin Cardiff.

129 The terms and conditions of the programme loan agreements and financial frameworks are still applicable in 2015 and continue to be monitored on an ongoing basis. Both the IMF and the EU conduct post-programme monitoring following completion of a programme. This provides for regular missions and reports on a bi-annual basis which will continue until 75% of the financial assistance has been paid back. Refer to Memorandum for Government 12th Review mission of the EU-IMF programme of financial support for Ireland, DOF00459-003.

130 Memorandum for Government 12 Review mission of the EU-IMF programme of financial support for Ireland, DOF00459-003.

131 IMF Survey December 19, 2013, DOF00739-001.

Chapter 11: Burden Sharing

Introduction

Kevin Cardiff, former Secretary General, Department of Finance, described "burden-sharing" to the Joint Committee as:

"…bondholders [would have] received less than the face value, of their loans to the Irish banks, thus ensuring an improvement in the balance sheet position of the banks (if they don't have to repay so much, their liabilities are reduced) and in turn reducing the cost to the Irish taxpayer of saving the banks. So the idea is that some of the losses of the banks are forced back onto the investors in bank bonds."[1]

A central question that the Joint Committee considered was whether or not the financial burden of recapitalising and restructuring the banking system following the Guarantee decision could and should have been shared with holders of senior bonds in the Covered Institutions.

Such a move was not necessarily straightforward and, ultimately, losses were not imposed on senior bond-holders (though voluntary burden sharing with subordinated bondholders did take place through the Liability Management Exercise (LME), as outlined later in this chapter).

The Joint Committee wanted to know why the burden was not shared with the senior bondholders.

As with our investigation of matters pertaining to Ireland's entry to the Troika Programme in Chapter 10, the work of the Joint Committee work was limited due to the fact that the ECB did not appear before the Committee, despite being invited to attend. Furthermore, other foreign stakeholders were not invited to appear (for example representatives of the G7 countries[2]).

Views of the Department of Finance, Central Bank and NTMA

Kevin Cardiff made the following observation in his witness statement to the Joint Committee:

"There had been a small experiment in senior bond burden-sharing earlier in the crisis period. Irish Nationwide offered at one stage to buy back senior bonds from the market at the reduced price at which they were then trading. The amounts were small and no bondholder was going to be forced to take the deal, but the reaction from Moodys credit rating agency was very swift. They came very close to downgrading the whole Irish banking system, on the basis that any wavering in the Government's support to the banking system and its creditors, even on such a voluntary basis, would be tantamount to a declaration that all bondholders could expect to make losses. That the initiative was the building society's not the Government's made no difference. This position was somewhat surprising, but indicated the extent to which any burden-sharing with senior bondholders might be expected to 'shock' the market."[3]

1 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-192.

2 The G7 countries are Canada, France, Germany, United Kingdom, Italy, Japan and United States.

3 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-193. See also Moody statement, 6 August 2009. Source: https://www.moodys.com/research/Moodys-reviews-Irish-Nationwide-ratings--PR_184442

Patrick Honohan, Governor of the Central Bank, in his written statement to the Joint Committee, explored some of the possible options open to Government immediately prior to the expiration of the Guarantee in 2010: *"...faced with the steep cliff of bank liability maturities in September, I gave some consideration to possible alternative courses of action which might be recommended to Government."*[4]

In a footnote to his statement, Patrick Honohan, Governor of the Central Bank suggested that:

"…one possibility was for the Government to abrogate the bank guarantee (in respect of Anglo and INBS) in August or September 2010 and to bail-in the bond holders and potentially large depositors. While, if successful, such a measure would have reduced the amount paid out to bank creditors by the State, it would also have represented a very large and conspicuous default of the State on a class of creditors which it had created by virtue of the guarantee and confirmed by the CIFS legislation of October 2008."[5]

Notwithstanding the possibility of imposing losses on senior bondholders, it was stated that the view of the ECB was also central to the success of any decision, if one had been taken. Patrick Honohan observed:

"It seemed doubtful whether it could even be successfully accomplished: for example, pressure from the ECB might well have resulted in any such decision having to be reversed in a way that resulted in the State resuming its obligations in regard to these liabilities while still suffering the loss of market credibility implied by a default."[6]

An earlier NTMA position on the matter, presented in evidence by Brendan McDonagh, Director of Finance, NTMA, is worth noting. In his evidence to the Joint Committee he said:

"Up until … May 2009 when I was with the NTMA, there was a very strong view that... senior bondholders definitely needed to be repaid their money and there was no talk of a bail-in at that stage."[7]

---

4 Patrick Honohan, Governor, Central Bank, statement, PHO00009-003/004.

5 Patrick Honohan, Governor, Central Bank, statement, PHO00009-003.

6 Patrick Honohan, Governor, Central Bank, statement, PHO00009-004.

7 Brendan McDonagh, former Chief Executive Officer, NAMA & Director of Finance, Technology & Risk NTMA, transcript, INQ00090-024.

Bonds Emerge from Cover of Guarantee

The total bonds in issue as at 1 April 2011 were €64.3 billion, split as per the table below:

Source: CBI report updated 1 April 2011 (Initial report 2 March 2011)

€m	Senlor Bonds Guaranteed	Senior Bonds Unguaranteed Secured	Senior Bonds Unguaranteed Unsecured	Subordinated Bonds
AIB	6,063	2,765	5,872	2,601
BOI	6,178	12,284	5,164	2,751
EBS	1,025	1,991	472	65
IL&P	4,704	2,999	1,156	1,203
Anglo	2,963	0	3,147	145
INBS	0	0	601	175
Total	**20,934**	**20.039**	**16,413**	**6,940**
Above table extracted from the CBI official site - Press Release: Updated Information Release 1 April 2011				

Source: Department of Finance submission to the Banking Inquiry[8]

The expiration of the State Guarantee at end of September 2010 may have presented a new opportunity to share the burden of the various recapitalisations of the Covered Institutions with holders of bonds coming out of the Guarantee. One such possibility was said to have been discussed between Alan Ahearne, Special Advisor to Brian Lenihan, the former Minister for Finance and IMF officials in early October 2010, when the Minister was attending an IMF meeting in Washington DC. This discussion took place not long before a large payment was required to redeem the Anglo bonds.[9] Evidence was given by Alan Ahearne concerning this meeting as follows:

"I went to Washington DC with him [the Minister], because you mention the IMF, in early October and I met with a couple of IMF officials, I think one of whom you're meeting tomorrow. [The Joint Committee were to meet Ajai Chopra next day.] And … they said "Is the Minister aware that there's about €4 billion of Anglo bonds that are now unguaranteed, senior non-guaranteed?" I said he is aware of that and he was aware of that. They said "It's a lot of money", and I said "He's aware of that." So it was clear from the short discussion I had with them at that stage that they had spotted this and they had these concerns."[10]

8 Department of Finance submission to the Banking Inquiry, 13 April 2015, DOF07852-010.

9 Alan Ahearne, former Special Advisor to the former Minister for Finance, Brian Lenihan, transcript, INQ00094-006.

10 Alan Ahearne, former Special Advisor to the former Minister for Finance, Brian Lenihan, transcript, INQ00094-006.

Troika Partners View on Burden Sharing

Ajai Chopra, former Deputy Director of the IMF, commented that he *"would not distinguish"* between the ECB and the European Commission in terms of seniority, as they were both *"working in concert."*[11] Marco Buti, Director General for Economic and Financial Affairs, European Commission, also commented that *"Clearly, there was a bit of give and take in all this…but the IMF was an equal partner as the other institutions."*[12]

The IMF maintained a positive disposition towards burden-sharing as discussions on a possible bailout programme got underway. The *"IMF approach"* included burning holders of unguaranteed, unsecured senior bonds. As described by Aja Chopra in his evidence to the Joint Committee, IMF staff were:

"…of the view that imposing losses on just junior bondholders was not sufficient and that the issue of imposing losses on senior, unguaranteed, unsecured bondholders should also be explored and I listed criteria for this, which is: look at the overall magnitude of banks' losses, to look at the issue of returning the banks to a more stable funding structure and also to look at the issue of potential knock-on effects on others. And as I said in the statement, this needs to be done within a robust legal and institutional framework that strikes a reasonable balance between creditor safeguards and flexibility."[13]

In his evidence to the Joint Committee, Kevin Cardiff noted his understanding of the Troika parties' initial position on burning bondholders:

"As the bailout discussions got underway formally after 21 November 2010, we thought the IMF might be open to the idea of having some of the senior bank bondholders take losses on their investments in the banks. We were pretty sure the ECB would be dead set against and the Commission too was likely to be against the idea, but maybe not so strongly."[14]

Evidence presented to the Joint Committee would suggest that the IMF and European institutions may indeed have been working with different considerations in mind. For instance, Ajai Chopra noted that: *"…the key issue became the issue of contagion… they [the European institutions] were very concerned that moving on imposing losses on senior bondholders in Ireland would adversely affect euro area banks and their funding markets."*[15]

Was Contagion an Issue?

Asked if the dominant consideration of the European Commission and the ECB was the spill-over effect to the wider Eurozone of imposing losses on holders of bonds in Irish-owned banks, Marco Buti, Director General for Economic and Financial Affairs with the European Commission confirmed:

"...you are correct in this. So the spillovers … were … in particular to the rest of the euro area. However … the EFSF and the EFSM going out and borrowing to on-lend to Ireland in a situation on

11 Ajai Chopra, former Deputy Director, International Monetary Fund, transcript, INQ00101-033.

12 Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, INQ00100-035.

13 Ajai Chopra, former Deputy Director, International Monetary Fund, transcript, INQ00101-009.

14 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-192.

15 Ajai Chopra, former Deputy Director, International Monetary Fund, transcript, INQ00101-009.

even potentially larger market unrest and even higher interest rates would have been … damaging for Ireland also. So the effects ... the negative loop from Ireland to the rest of the euro area and back to Ireland … were certainly present in the assessment." [16]

Ajai Chopra said:

"The view of the IMF staff was, this does need to be taken into account but that this was something that was anticipated by markets and if it was done within the context of a programme where the sovereign has already lost access to markets, it is something that the markets should have been able to absorb and even if they were not able to absorb it, there were mechanisms to help address that contagion…"[17]

He also said:

"Recent academic research confirms the view that spillover risks were exaggerated. An empirical analysis of funding cost spillovers in the euro zone (NBER Working Paper 21462, August 2015) finds that contagion between most euro zone banks is limited because they have fairly weak links, and that contagion risks are significant only when the biggest euro zone banks are involved."[18]

Negotiation with Troika on Burden Sharing

The IMF was in favour of reaching a positive decision on having some of the senior bondholders take imposed losses on their investments.

Ajai Chopra said that, in November 2010, *"IMF staff made Lee Buchheit, a specialist international lawyer on these matters, available to the Irish authorities in Dublin to advise on how burden sharing might be done to avoid legal challenges."*[19] This evidence was supported by Pádraig Ó Ríordáin of Arthur Cox, Legal Advisor to the Department of Finance.[20]

According to Kevin Cardiff:

"At the time, we were led to believe that Dominique Strauss-Kahn, head of the IMF, was not only in favour of this approach but believed he could persuade other major players in world finance, including the major European Governments, the Americans and the ECB to go along. Strauss-Kahn was to, and did, convene a conference call to pursue this arrangement. There had even been early indications of a positive hearing from US Treasury Secretary Geithner."[21]

We heard that the viewpoint of then US Treasury Secretary, Timothy Geithner was allegedly crucial in Ireland's attempts to impose losses on senior bondholders. As Cathy Herbert, Special Advisor to the former Minister for Finance, told us:

"It is difficult to avoid the conclusion that putting Ireland into a bailout programme was killing a number of birds with one stone. It solved the ECB's problem with the extent of our banks' dependence on the Eurosystem for emergency lending and it eased the concerns of the then US

16 Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, INQ00100-015.

17 Ajai Chopra, former Deputy Director, IMF, transcript, INQ00101-008.

18 Ajai Chopra, former Deputy Director, IMF, statement, ACH00001-011.

19 Ajai Chopra, former Deputy Director, IMF, statement, ACH00001-010.

20 Pádraig Ó Ríordáin, Partner, Arthur Cox, transcript, INQ00111-012.

21 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement KCA00002-031.

Treasury Secretary, Tim Geithner who made clear to his European colleagues at the G-7 meeting in Seoul earlier in November the need to prevent a banking collapse in Ireland in order to protect the global financial system."[22]

In his evidence, Michael Noonan, Minister for Finance, said: *"Tim Geithner was Secretary to the Treasury in the United States, and I met Tim Geithner on several occasions, and he's often recited as being somebody who was against burden-sharing, and he was, he makes no bones about it."*[23]

We also heard of the alleged intervention by external political actors in the final stages of the negotiations on a Troika Programme. According to Alan Ahearne: *"I understood it was a G7 conference call, but it may not have been, but it obviously involved sort of people at that level, and that it had been decided that the burning of bondholders had been vetoed."*[24]

Patrick Honohan told us that he had asked Brian Lenihan if he had considered doing something about it. He said that the Minister replied: *"I can't go against the whole of the G7."* He [the Minister] thought it was *"politically, internationally politically inconceivable…"*[25]

The Troika agreed to refinance Ireland in November 2010, with the first major drawdown from the Troika Programme made in January 2011. Imposing losses on senior bondholders without imposing losses on depositors, while at the same time entering a Troika Programme, was apparently not an option at this point. Patrick Honohan said: *"…No, the decision has been taken. There is not going to be a programme if you burn the bondholders."*[26]

Commenting on the view that bondholders were ranked equally with depositors and the issues that may arise in burden-sharing, Patrick Honohan said:

"This is all under Irish law … an argument not fully recognised by a lot of the outside observers who said, "Why are you paying for the banks? ... They didn't realise that the obligation to the creditors of the banks had become equal in importance to the … status of debt holders."[27]

The former Attorney General, Paul Gallagher, when asked in relation to the legal difficulties of burning bondholders said *"…it would be foolish and misleading to suggest that that wouldn't give rise to legal difficulties; it would. We considered those very carefully and, indeed, post the bailout, I had various meetings to look at that."*[28]

Paul Gallagher then went on to talk about those meetings. He told the Joint Committee:

"I had meetings also with IMF representatives and specialist lawyers to consider that and we confirmed repeatedly that that could be done in legal terms, notwithstanding the legal difficulties, and it depended solely of the approval of the Troika to doing that, and that as you know was prohibited and was a condition of the bailout."[29]

---

22 Cathy Herbert, former Special Advisor to the former Minister for Finance, Brian Lenihan, statement, CHE00001-010.

23 Michael Noonan, Minister for Finance, transcript, INQ00102-015.

24 Alan Ahearne, former Special Advisor to the former Minister for Finance, Brian Lenihan, transcript, INQ00094-007.

25 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-086.

26 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-070.

27 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-011.

28 Paul Gallagher, former Attorney General, transcript, INQ00110-009.

29 Paul Gallagher, former Attorney General, transcript, INQ00110-009.

Marco Buti offered the following assessment:

"At the end of the day, the Troika are three partners and we came to the common judgment that this was not the right thing to do. The ECB was very forceful on that. I think with hindsight ... I think it was the right thing to do - not to go for the bail-in of senior bondholders."[30]

Evidence received from the NTMA is also worth noting. John Corrigan, Chief Executive Officer NTMA, wrote to Brian Lenihan on 28 November 2010, stating that he had:

"… learnt during the course of the discussions that the external authorities and the European Central Bank (at board or equivalent level) had taken the view that burden sharing with unguaranteed bank senior bond holders was "not on the table." It is unfortunate that, notwithstanding the fast moving pace of recent events, I was not made aware of this outcome."[31]

Did the Programme Memorandum of Understanding leave the door open for Burden Sharing at a future date?

The Government agreed to enter the Programme with the Troika on 28 November 2010 (as explored in Chapter 10). Burden sharing with bondholders was not a part of this agreement. However, the Memorandum of Understanding (MoU) between Ireland and the Troika partners made no mention of senior bondholders.[32] The Joint Committee wanted to know: was there an understanding or a belief that burden-sharing could take place at a future date?

Patrick Honohan, referring to the holders of bonds in the banks which were not going concerns, said:

"…we never committed to not burning the bondholders. We committed to not including the burning of bondholders in the programme … So, it was still there for attitudes to shift…"[33]

A second attempt at Burden Sharing

A new Government was elected on 9 March 2011 and began exploring the possibility of burden-sharing. This was done in tandem with the Financial Measures Programme (explored in Chapter 8), which created the Pillar Banks and provided for the merger and wind down of Anglo and INBS.[34]

Ajai Chopra said:

"When the new government took office in March 2011, about three months after the launch of the program…Their position was that the pillar banks need to be able to operate in the market as strong banks with a positive future and ongoing relations with all counterparties. In making such a distinction, the hope was that burden sharing with the senior creditors of the failed banks would be allowed."[35]

30 Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, INQ00100-014.

31 Letter from John Corrigan, NTMA to Minister Lenihan re Burden Sharing, 28 November 2010, NTMA00024-001.

32 Memorandum of Understanding between Ireland and the Troika, 16 December 2010, DOF03460.

33 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-086.

34 Sale of Anglo & INBS Deposit Books, note for Minister 28 January 2011, DOF00807-006.

35 Ajai Chopra, former Deputy Director, IMF, statement, ACH00001-010.

From the Joint Committee oral hearings, it would appear there was still a belief on the part of the Government that burden-sharing would be possible once the Troika Programme had begun and the restructuring of the banking system, as outlined in the Financial Measures Programme (FMP), had taken place. As Patrick Honohan explained:

"I wrote to the Minister, the new Minister, Michael Noonan, offering my advice on this matter, and I said, 'Look, the ECB are firmly against, for going-concern banks, but it is possible that they would accept a bail-in for the ... for Anglo and INBS.'"[36]

The restructuring of Anglo and INBS element of the FMP was submitted by the outgoing Government in January 2011.[37]

Michael Noonan, who was elected to office in March 2011 said:

"Building upon the advice of the Department of Finance, the NTMA and the Central Bank, I announced the Government's pillar banking strategy. The strategy set out the Government's plans in relation to what I would describe as the going-concern banks, that is, Bank of Ireland, AIB, EBS and Irish Life and Permanent. It was the Government's response to the announcement by the Central Bank of Ireland of the results of their PCAR or stress tests. The objective was to have smaller, domestically focused and well-capitalised banks operating in Ireland. A joint restructuring plan for the other banks, Anglo Irish Bank and Irish Nationwide, had been submitted to the European Commission by the previous Government in January 2011 and these institutions had no role in the strategy at that time."[38]

In his written statement to the Joint Committee, Ajai Chopra gave his interpretation of the Pillar Bank strategy:

"The purpose was to leave open the possibility for burden sharing with senior bondholders later in the program, especially for failed banks where there was a stronger case for greater burden sharing with creditors. In particular, Anglo Irish was a failed bank with losses that were many multiples of its capital and it did not need to worry about future counterparty relations. Sizeable liability management exercises for banks' junior debt were underway when the program started and further such exercises were envisaged, helping to reduce fresh injections of capital by the government."[39]

Within the NTMA in early 2011, the possibility was also explored, as John Corrigan said:

"...the NTMA commissioned a study to look at a bail-in burden-sharing scheme involving senior as well as subordinated debt holders in the covered institutions…"[40]

The scheme identified substantial potential savings, depending on the level of discount or haircut applied and the institutions involved. The NTMA recommended that burden-sharing with senior bondholders be initiated following PCAR/PLAR results in March 2011.[41]

36 Patrick Honohan, Governor, Central Bank, transcript, PUB00352-086.
37 Michael Noonan, Minister for Finance, transcript, INQ00102-003.
38 Michael Noonan, Minister for Finance, transcript, INQ00102-004.
39 Ajai Chopra, former Deputy Director, IMF, statement, ACH00001-010.
40 John Corrigan, former CEO, NTMA, transcript, INQ00106-006.
41 NTMA, Bail-in Strategy with Holders of Senior and Subordinated Debt, NTMA00427-006.

Irish senior unsecured bank bonds were trading at levels consistent with clear anticipation of a cut in the principal, reflecting that some burden-sharing was anticipated.[42]

Liability management exercises with subordinated bondholders were pursued through 2011, which helped mitigate the cost to the State of the Central Bank's 2011 PCAR (discussed further in Chapter 8), the results of which were announced on 31 March 2011 and which identified an additional capital requirement of €24 billion.

A second attempt at burden-sharing with senior bondholders was not successful, even though there was an expectation that it could be.

We wanted to know what prevented this from happening. Given the significance of this episode, it is worth quoting evidence heard by the Joint Committee in this regard.

Kevin Cardiff said:

"Finally, however, we got the message (I heard it by telephone from an ECB official, but Ministers may have heard directly also, I understand, and the same message was passed also by email) that in fact the ECB Governing Council had decided to make it clear to us that in the event that we pursued even the merest modicum of burden-sharing – even purely voluntary – we could not expect any supporting statement from them, thus undermining all the power of the banking announcements."[43]

He added:

"…we had been negotiating for months with them for ... to get some sort of really positive statement that would say the ECB is behind us … And the instruction from the ECB was that, if you want that prize, you do not burn anybody, any way senior, senior bonds, at all. And it was quite explicit."[44]

Kevin Cardiff told us that the *"decision"* of the ECB was *"very close to being an instruction."*[45]

As part of the announcement of the FMP, announced on 31 March 2011, the Irish Government wanted a positive statement from the ECB to demonstrate that the ECB was behind Ireland and its restructuring of its banking system.[46] According to Kevin Cardiff, the ECB made explicitly clear that if Ireland wanted such a positive statement from the ECB, it could not burn any senior bondholders in any way.[47] The positive statement requested by the Irish Government was issued by the ECB on 31 March 2011.[48]

---

42 Ajai Chopra, former Deputy Director, IMF, statement, ACH00001-011.

43 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-244.

44 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-045.

45 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00350-008.

46 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-082.

47 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-082.

48 "The Governing Council of the European Central Bank (ECB) welcomes the Irish authorities' rigorous assessment of the capital needs of Irish banks and supports the government's commitment to ensure that these capital needs are met in a timely manner…" Extract from ECB press release 31 March 2011, AIB01838-003/4.

Minister for Finance, Michael Noonan said:

"The issue of burden sharing with IBRC [Anglo and INBS] was considered. There was €3.7 billion of unsecured unguaranteed senior debt in Anglo and INBS in early 2011. As IBRC was different from the other banks, the Government pushed for burden sharing for these bondholders, conditional on the support of the ECB. In advance of my statement on banking matters on 31 March 2011, I had sought ECB support and the initial speech that I made to the Dáil ... the draft of the initial speech that I made to the Dáil included a statement on burden sharing for this €3.7 billion. However, despite our best efforts, it was made clear to both the Taoiseach and myself and my officials that the ECB would not support such a statement or moves to burden share with IBRC. Weighing up the potential savings of €3.7 billion that would accrue to IBRC against the immediate and devastating impact of withdrawal of ECB support on Ireland, the Government took the decision not to proceed with the burden sharing with senior bondholders."[49]

Attending at the Institute of International and European Affairs meeting at the Royal Hospital Kilmainham, the former ECB President, Jean-Claude Trichet, was asked by the Joint Committee whether the ECB had threatened the withdrawal of support, in particular using the metaphor of a *"bomb"* going off in Dublin, if burden-sharing was pursued. In response, Jean-Claude Trichet said:

"What I certainly said, because we had discussed that in the governing council of the ECB, was that it was unwise to do that. And that was our strong feeling at the time where Ireland was helped by us more than any other country in ... as I already said, in Europe, and perhaps in the world. So let's put yourself in the situation. We have a country which is progressively regaining competitiveness in very, very difficult times. We expressed only the sentiment of the Governing Council to the Government or Ireland. The Government of Ireland is responsible and the Government of Ireland takes decisions."[50]

There were two phone calls between the ECB and Minister Michael Noonan, on 31 March 2011, as indicated previously by Michael Noonan. In his evidence to the Joint Committee, the Minister conveyed to us the substance of these phone calls:

"So what it came down to was how we would arrange things and what the amount would be and then I told him that as part of the programme, we were burning bondholders and he didn't agree. He didn't agree and he asked me was I aware that this would be treated by the markets as a default, which was reasonably strong pressure because I know that after the time you've put in here, you understand the details of all this thing. ELA, emergency liquidity assistance, was underpinning Anglo to the tune of €41 billion at that time. ELA can't be given to a bank that defaults."[51]

Michael Noonan said that Jean-Claude Trichet:

"…raised the question of the financial services industry in Ireland and particularly in Dublin and he suggested that even though he couldn't say categorically, it might not be possible for people in the financial services in Ireland, particularly in Dublin, to finance themselves on the market if they were situated in a country that was in default."[52]

---

49 Michael Noonan, Minister for Finance, transcript, INQ00102-006.

50 Jean-Claude Trichet, former President of the ECB, at his appearance at the Royal Hospital, Kilmainham, 30 April 2015, transcript, INQ00140-032.

51 Michael Noonan, Minister for Finance, transcript, INQ00102-013.

52 Michael Noonan, Minister for Finance, transcript, INQ00102-013.

Michael Noonan consulted with officials and, on a subsequent telephone call with Jean-Claude Trichet, reaffirmed the Government's position. In response, he said that Jean-Claude Trichet:

"…sounded irate but maybe he wasn't irate but that's the way he sounded and he said if you do that, a bomb will go off and it won't be here, it'll be in Dublin."[53]

The Joint Committee asked Michael Noonan about the level of engagement that he had with Jean-Claude Trichet on the specific issue of burning unguaranteed bondholders. The Committee asked: *"you talked about the two phone calls that you've had with Mr. Trichet during… that day... What other engagements did you have with Mr. Trichet in relation to the burning of bondholders, before or after?"* to which Michael Noonan replied, *"I didn't revisit it after that."* [54]

When in Kilmainham, Jean-Claude Trichet gave his general view of the ECB's relationship with the Irish Government:

"You know exactly what were our relationship. We have published our letters. Full stop. You have to know ... you know with the adjective, the comma, the full stop, exactly what was our relationship with Ireland. You have the letters ... the four letters that have been published. The rest of it I can only ... I assume totally the fact that the Governing Council of the ECB considered it was not appropriate for Ireland in the situation in which Ireland was, which was one of the worst you could imagine, to go along this burning and that you would have had probably a lot of very adverse consequences. It was finally what was decided by the Government, if I'm not misled. The decision was not taken by the ECB."[55]

As in November 2010, the March 2011 attempt by the new Government to impose losses on senior bondholders, this time likely focussing on the now defunct institutions, such as Anglo and INBS, was not successful. Once again, the intervention of the ECB appears to have been critical. The voluntary liability management exercises with subordinated bonds continued, and this is addressed further detail below.

The Joint Committee referred Michael Noonan to comments that he made on RTÉ from Washington DC on 15 June 2011 that seemed to indicate that the Government would again pursue the burning of bondholders in Anglo Irish Bank and INBS, with the consent of the ECB. In response, he said:

"Because I was … now had moved my negotiation on to changing the promissory note and, as part of the promissory note, the bondholder issue was still in there. I hadn't conceded … I never agreed with Trichet. I never agreed with Trichet. I never told Trichet we wouldn't go ahead. What we did was I made a statement in the Dáil and that was that we weren't including it in what was announced to the Dáil that day, and then the promissory note discussions were very intricate and took a long time to get a result."[56]

---

53 Michael Noonan, Minister for Finance, transcript, INQ00102-013.

54 Michael Noonan, Minister for Finance, transcript, INQ00102-027/028.

55 Jean-Claude Trichet, former President of the ECB, at his appearance at the Royal Hospital, Kilmainham, 30 April 2015, transcript, INQ00140-032/033.

56 Michael Noonan, Minister for Finance, transcript, INQ00102-028.

Michael Noonan further clarified:

"The conversations I had with the Commission and with the ECB and with the IMF after that was that we could not continue paying €3.1 billion every March to service a promissory note arrangement … and that we needed it restructured, and that as part of the restructuring the issue of senior bondholders would have to be revisited."[57]

EU interests vis-à-vis Irish taxpayer interests, a perspective

Ajai Chopra said:

"The EC and ECB often put euro area-wide concerns above what is appropriate for the individual member. The obvious example is the issue of burden sharing with senior unsecured bondholders, where European institutions focused on wider euro area concerns even if this resulted in a higher burden for Irish taxpayers and higher Irish public debt…"[58] and *"…it is understandable that there is a strong sense in Ireland that burden sharing between Irish taxpayers and bank creditors has been unfair."*[59]

Irish taxpayers were inappropriately burdened with banking debts arising specifically from a failure to impose losses on senior bondholders in any of the Covered Institutions.

Did Burden Sharing take place in Ireland?

Separate to the evidence outlined above, the Joint Committee were interested in the following questions:

- What level of burden-sharing took place in Ireland?
- If burden-sharing with senior bondholders had taken place, when might have been the optimal time to carry this out and what saving might it have achieved?

These two questions are considered below.

Shareholders

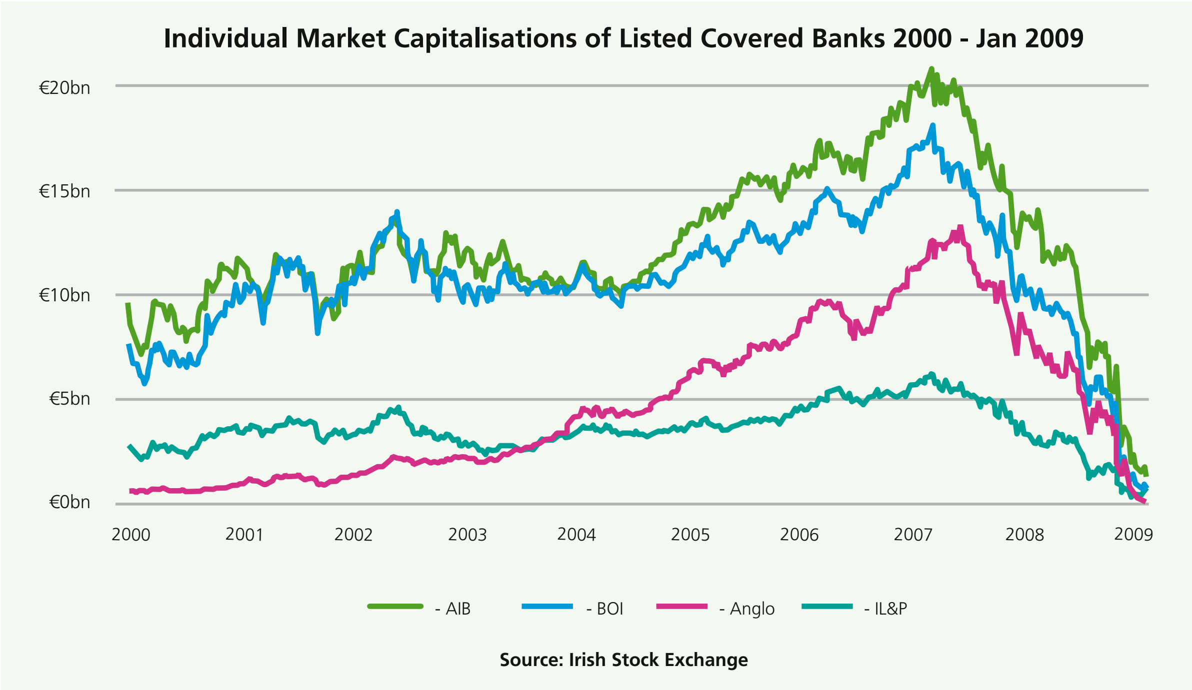
As illustrated in the graph below, the value of shareholder investments reduced by 100% in the case of Anglo and circa 99% in the case of AIB, Bank of Ireland and IL&P over the course of 2008. The combined market capitalisation of the four banks reached a peak during 2007 of circa €53.7 billion[60] before tumbling to a low of €141.6 million, as the effects of the financial crisis took hold.

57 Michael Noonan, Minister for Finance, transcript, INQ00102-028.

58 Ajai Chopra, former Deputy Director, IMF, transcript, INQ00101-005.

59 Ajai Chopra, former Deputy Director, IMF, statement, ACH00001-010.

60 Department of Finance submission to the Banking Inquiry, 15 April 2015, DOF07852-013.



Source: Nyberg[61]

Liability Management Exercise (LME)

Throughout the period 2009 to 2011, Irish banks carried out a number of Liability Management Exercises (LME). This was essentially the equivalent of burden-sharing with junior bondholders on a voluntary basis. Under LME, the banks bought back or replaced a number of the existing subordinated bonds totalling €24.6 billion of debt for a price of €9.5 billion. In that way, the banks reduced their liability by €15.457 billion (€10.259 billion pre-March 2011 and €5.198 billion post-March 2011), reducing the level of recapitalisation required from the taxpayer.[62]

Foreign investors

A proportion of Irish bank bonds were owned by foreign investors throughout the period under review, albeit that trend underwent a downward trajectory from early 2008 onwards. With bond prices dropping significantly over this period, these subordinated bondholders would likely have been burned as part of the LME, if they volunteered to do so.

61 Nyberg Report, Misjudging Risk - Causes of the Systemic Banking Crisis in Ireland, Figure 2.3, PUB00156-019.

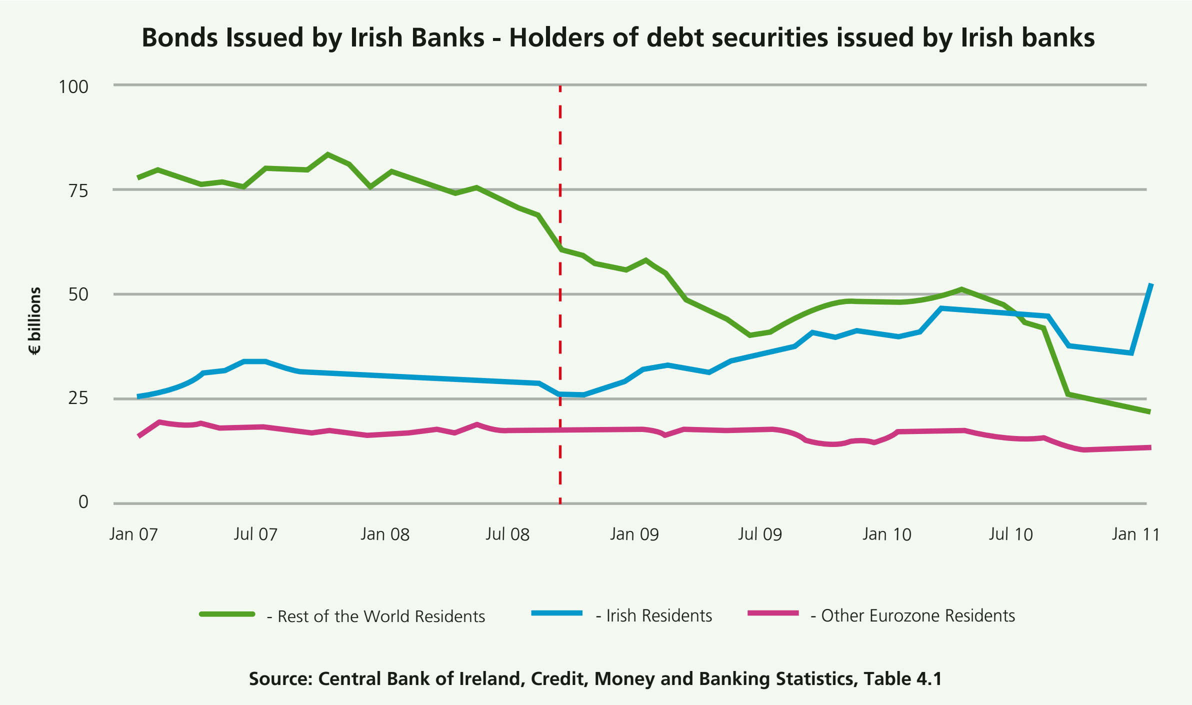
62 Department of Finance submission to the Banking Inquiry, 13 April 2015, DOF07852-012.

Liquidation of IBRC

Legislation passed on 7 February 2013 triggered events of default under a range of agreements between IBRC, the Central Bank of Ireland and third parties.[63]

What might have been saved and when

As illustrated in the following graph, foreign holders of Irish bank bonds had greatly reduced their holdings between 2008 and 2010 to the extent that less than 50% of these bonds were held outside of Ireland by the end of 2010.



Source: Seamus Coffey[64]

If the aim of burning bondholders was to reduce the liabilities of the banks (and thus the taxpayer) while also reducing potential losses to Irish investors, the graph would suggest that the most effective time to burn bondholders may have been during the period immediately before the Government Guarantee was put in place.

However, it would appear that there was an intention, or expectation at least, on the part of the IMF that burden-sharing could be imposed on bondholders once the State Guarantee had ended (as noted earlier).

In our oral hearings, the Joint Committee explored what might have been saved in burning bondholders and when may have been the most advantageous time to do this.

63 Dept. of Finance, IBRC in Special Liquidation. Background Information and Current Status Update. 6 Nov 2013, DOF05679-001.

64 Seamus Coffey, Lecturer in Economics, University College Cork: Source: http://economic-incentives.blogspot.ie/search/label/Central%20Bank%20Statistics Raw Data taken from: http://www.centralbank.ie/polstats/stats/cmab/Pages/Money%20and%20Banking.aspx , Table 4.3.

As stated above, 2008 would have been the most advantageous time to burn bondholders in terms of what might have been saved. However, the following evidence is from individuals who only discussed the scenario from late 2010 onwards.

As of November 2010, outstanding unsecured, unguaranteed senior bonds were said to amount to approximately €16 billion. Ajai Chopra, using a *'rule of thumb'*, said that €8 billion may have been saved had a haircut been applied to these bonds.[65] Kevin Cardiff said that the IMF put the senior estimated unsecured debt figure to be between €18 billion and €19 billon.[66]

Ann Nolan, Second Secretary General in the Department of Finance was of the view that, had burden-sharing happened in late 2010 in relation to Anglo or INBS, that €3.6 billion would have been on the table.[67] Alan Ahearne gave a similar estimate, when he said the amount of money available from Anglo bonds for burden sharing in November 2010 was *"€3.5 billion or €4 billion."* On the question of potential savings, Alan Ahearne said that Brian Lenihan *"had in his mind 50% discount so you might say €1.5 billion to €2 billion [would have been saved from applying haircuts to Anglo bonds]."*[68]

Documentation seen by the Joint Committee and prepared by the Department of Finance estimated that, as of 1 April 2011, the Covered Institutions had issued bonds valued at €64.3 billion, which were split between guaranteed and unguaranteed secured and unsecured senior bonds (€57.4 billion) and subordinated bonds (€6.9 billion).[69]

At the end of March 2011, the NTMA produced a *'Bail-In Strategy with Holders of Senior and Subordinated Debt'*.[70] This strategy document estimated that of the €12.7 billion senior unsecured debt and the €6.5 billion subordinated debt in AIB, Bank of Ireland, EBS and IL&P, a haircut amount of approximately €12.5 billion could be achieved.[71]

AIB and Bank of Ireland outlined their concerns on burden-sharing.[72] They were of the view that burden-sharing with senior debt should only apply to non-viable institutions. The primary implications in the view of AIB and Bank of Ireland were:

- continued closing out from the funding markets.
- triggering of credit default swaps.
- withdrawal of market counterparties.
- events of default also being triggered.

The NTMA were of the view that these adverse effects could be ameliorated if burden-sharing with senior debt was conducted system-wide with the benefit of existing legislation.[73]

---

65 Ajai Chopra, former Deputy Director, IMF, transcript, INQ00101-017.
66 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, transcript, PUB00351-011.
67 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-019.
68 Alan Ahearne, former Special Advisor to the former Minister for Finance, Brian Lenihan, transcript, INQ00094-007.
69 Department of Finance submission to the Banking Inquiry, 13 April 2015, DOF07852-010.
70 NTMA, Bail-in Strategy with Holders of Senior and Subordinated Debt, NTMA00427.
71 NTMA, Bail-in Strategy with Holders of Senior and Subordinated Debt, NTMA00427-004.
72 NTMA, Bail-in Strategy with Holders of Senior and Subordinated Debt, NTMA00427-005.
73 NTMA, Bail-in Strategy with Holders of Senior and Subordinated Debt, NTMA00427-005.

However, it is not clear from evidence before the Joint Committee whether unsecured senior debt in the going concern banks as at 31 March 2011 was being actively considered for burden-sharing by the Government.

	Debt Eligible for Restructuring		Haircut Levels		Haircut Amounts		
Bank	**Senior Unsecured € m**	**Junior € m**	**% Senior**	**% Junior**	**Amount Senior € m**	**Amount Junior € m**	**Total Amount € m**
AIB	5,864	2,600	60%	90%	3,518	2,340	**5,858**
BOI	5,198	2,581	45%	80%	2,339	2,065	**4,404**
EBS	520	150	60%	90%	312	135	**447**
IL&P	1,156	1,203	60%	90%	694	1,083	**1,777**
Total	**12,738**	**6,534**			**6,863**	**5,623**	**12,486**
Source: AIB/BOI/EBS/IL&P, Lazard Frères and Central bank of Ireland							

Source: NTMA[74]

In relation to Anglo and INBS, there were *"€3.6 billion of senior unsecured unguaranteed bonds and €0.1 billion of subordinated liabilities"* that could be subject to haircuts.[74] Of this, the NTMA was of the view that potential savings to the State of €2.4 billion could be achieved.[75]

	Debt Eligible for Restructuring		Haircut Levels		Haircut Amounts		
Bank	**Senior Unsecured € m**	**Junior € m**	**% Senior**	**% Junior**	**Amount Senior € m**	**Amount Junior € m**	**Total Amount € m**
Merged Anglo/INBS	3,629	141	63%	90%	2,286	127	**2,413**
Source: Anglo/INBS and Lazard Frères							

Source: NTMA[75]

Taken together, the NTMA estimated that €9.1 billion might have been saved if haircuts – which ranged from 45% in Bank of Ireland up to 63% in Anglo/INBS - had been applied to senior, unsecured, unguaranteed bondholders across the six Participating Institutions at the end of March 2011.[76] This would have comprised of €6.863 billion from the four main banks and €2.286 billion from Anglo/INBS.

74 NTMA, Bail-in Strategy with Holders of Senior and Subordinated Debt, NTMA00427-004.

75 NTMA, Bail-in Strategy with Holders of Senior and Subordinated Debt, NTMA00427-005.

76 John Corrigan, former CEO, NTMA, transcript, INQ00106-016.

The recommendation made by the NTMA was:

"Given the … fact that the markets are expecting and have priced in burden sharing with subordinate and senior debt, it is the recommendation of the NTMA that, subject to a view being taken by Government on the potential implications of an adverse reaction from the external authorities and the implementation of an appropriate legal framework, immediate steps should be taken following the announcement of the PCAR/PLAR results to enable burden sharing with both senior and subordinated debt."[77]

However, we are ultimately of the view and must stress that it is not possible to estimate the exact savings that could have been achieved from burden-sharing by the Government, if the decision to do so was taken, as savings would have been dependent on the haircut applied, the type of bond being *"burned"*, the timing of the move and the particular institutions included.[78]

Findings of the Joint Committee

1. IMF mission staff favoured imposing losses on senior bond holders in October/November 2010 as part of Ireland's negotiations for a Troika Programme. That position was also held by the Irish Government.
2. The Attorney General explored the possibility of burden sharing with senior bondholders with legal assistance from the IMF in November 2010.
3. There would have been no Troika Programme agreed in November 2010 if the Government proceeded with the imposition of losses on senior bondholders.
4. In March 2011, the NTMA prepared a report for the Department of Finance which suggested that a scheme of burden sharing with junior and senior bondholders be introduced.
5. The withdrawal of ELA was used as an explicit threat to prevent the Government from imposing losses on senior bondholders in March 2011.
6. The ECB position in November 2010 and March 2011 on imposing losses on senior bondholders, contributed to the inappropriate placing of significant banking debts on the Irish citizen.

Recommendation of the Joint Committee

1. The Irish Government should seek to have the relevant European statutes examined and if necessary amended to allow the ECB to participate in parliamentary inquiries.

---

77 NTMA, Bail-in Strategy with Holders of Senior and Subordinated Debt, NTMA00427-006.

78 Department of Finance submission to the Banking Inquiry, 13 April 2015, DOF07852-010.

Appendix 1: Inquiry Framework Overview

Establishment and Terms of Reference

In November 2014 the Joint Committee of Inquiry into the Banking Crisis ("the Joint Committee") was mandated by Dáil Éireann and Seanad Éireann to conduct an Inquiry under section 7 of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act, 2013 ("the 2013 Act").

Our Orders of Reference were amended to establish us as a Part 2 Committee under section 7 of the 2013 Act by Dáil Éireann and Seanad Éireann on 25th and 26th November 2014 respectively. The Terms of Reference required us to inquire into the reasons Ireland experienced a systemic banking crisis, including the political, economic, social, cultural, financial and behavioural factors and policies which impacted on or contributed to the Crisis. We were charged with investigating relevant matters relating to three inter-related streams of inquiry:

- banking systems and practices.
- regulatory and supervisory systems and practices.
- crisis management systems, and policy responses and the preventative reforms implemented in the wake of the Crisis.

Our Terms of Reference set out 23 matters which could be covered and 23 categories of persons to whom these matters related. The time period for the Inquiry was 1 January 1992 to 31 December 2013.

Inquiry Framework and Methodology

We directed the provision of documentation in accordance with the 2013 Act[1] and also sought the provision of further documentation on a voluntary basis. We also invited all witnesses to provide relevant documents with their witness statements, which some witnesses did.

Directions for documents were issued to AIB, BOI, EBS, IBRC, PTSB, UB, Deloitte, EY, KPMG, PwC, the Central Bank, the Department of Finance, the Department of the Taoiseach and the NTMA. Documents were also sought from NAMA on a voluntary basis. In total, approximately 500,000 pages of documents were provided (further details are in Volume 2).

We heard oral evidence from 34 witnesses on a voluntary basis as part of the Context Phase. We took oral evidence on oath from 97 witnesses as part of the Nexus Phase. We requested or directed written statements from all public hearing witnesses and also directed written statements from an additional 42 non-appearing witnesses. We then issued requests for clarification from 31 witnesses on a voluntary basis following the conclusion of our public hearings. Some witnesses gave evidence in more than one capacity. Where witness evidence is cited in the body of the Report, the title and tenure cited is that which is relevant to the evidence given.

1 Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act, 2013 ("the 2013 Act"), Section 67.

We have relied in this Report on oral, written and documentary evidence to analyse the banking crisis. We have done this by focusing on the main actors, in our view, who were involved in relevant positions during this period. In certain limited cases, we considered that engaging with certain relevant persons or directing certain documents created too great a risk in terms of prejudice to criminal proceedings, and we worked within these parameters in issuing directions.

However, for various reasons, a number of key actors were not available to provide evidence to us. Any reference to those persons in the course of the Report, are therefore based on the evidence of other parties. We are aware that there is no substitute for direct evidence from a person themselves for what they did or did not do or say, and we have had due regard to the weight to be attached to this evidence where it arises. The reasons for the absence of most of the relevant parties are dealt with in Volume 2 of the Report. However, we would like to note that a significant person in the course of the time period for the Inquiry was the late former Minister for Finance, Brian Lenihan. We have had to rely, where possible, on the accounts of those who spoke to Brian Lenihan.

Additionally, Jean-Claude Trichet, former President of the ECB, declined an invitation to appear before us but agreed to respond to our questions during an academic lecture at the Institute of International and European Affairs at the Royal Hospital Kilmainham. This was in a personal capacity and was not on behalf of the ECB. The transcript of the event was admitted into evidence and has been relied upon in the Report.

Following due consideration as required by the 2013 Act, the draft Report was sent to certain persons so that they would have an opportunity to make submissions to us. Submissions received were duly considered in our review of the draft Report as a result of which weincorporated a number of changes into the final Report to be sent to both Houses of the Oireachtas.

Report Structure and Terminology

There are two companion Volumes to this Report. Volume 2 sets out the detailed framework, processes and protocols which governed the structure, management and running of the Banking Inquiry and makes recommendations for future inquiries. Volume 3 sets out the oral evidence, witness statements and documentary evidence considered by us in preparing our Report.

Many complex terms arise in the Report and for ease of reference a list is set out in the Glossary of Technical Terms and Acronyms. For ease of reading, abbreviations have been used in some cases for common institutional names. A list of these abbreviations can be found in the List of Abbreviations.

Appendix 2: Members of the Joint Committee

Deputies

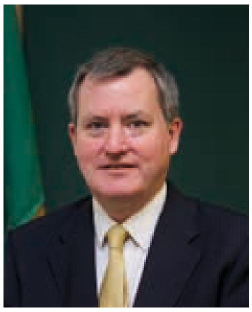
Ciarán Lynch (Lab) (Chairman)

Pearse Doherty (S.F.)

Joe Higgins (SP-AAA)

Michael McGrath (F.F.)

Eoghan Murphy (F.G.)



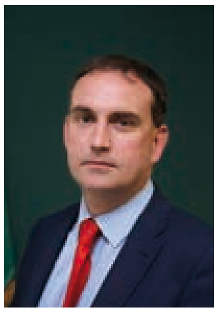
Kieran O'Donnell (F.G.)

John Paul Phelan (F.G.)

Senators

Sean Barrett (Ind.)

Michael D'Arcy (F.G.)



Marc MacSharry (F.F.)

Susan O'Keeffe (Lab.)

Appendix 3: Orders of Reference of the Joint Committee

Order of Dáil Éireann of 14 May 2014, as amended on 25 November 2014 and further amended on 6 October 2015

1. That a Select Committee be appointed, to be joined with a similar Select Committee of Seanad Éireann to form the Joint Committee of Inquiry into the Banking Crisis, for the purposes of conducting an inquiry within the meaning of section 7 of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013, in accordance with, and subject to, the Terms of Reference Resolution for the inquiry.
2. The Terms of Reference of the Joint Committee shall be as set out in the Terms of Reference Resolution of the Dáil of 25th November 2014 for the Inquiry.
3. The Select Committee shall consist of seven (7) members of whom –
   (a) notwithstanding Standing Order 90, the Chairman of the Select Committee shall be Deputy Ciarán Lynch; and
   (b) the other members of the Select Committee shall be Deputies Pearse Doherty, Joe Higgins, Michael McGrath, Eoghan Murphy, Kieran O'Donnell and John Paul Phelan,

   and the provisions of Standing Orders 92(2) and (3) shall not apply.
4. The Chairman of the Select Committee shall be the Chairman of the Joint Committee.
5. The quorum of the Joint Committee shall be five (5), of whom at least one shall be a member of Seanad Éireann, and that quorum shall be present for the duration of all meetings of the Committee.
6. The Joint Committee shall have the powers set out in Standing Order 83(1), (2), (2A), (3), (4), (5), (7), (8) and (9).
7. The Joint Committee shall have the power to nominate persons to assist it in its deliberations; and such persons shall attend meetings as the Joint Committee may determine.
8. The Joint Committee shall report, pursuant to Standing Order 107G, to both Houses of the Oireachtas no later than 28 January 2016, and Standing Order 86 shall not apply.

Order of Seanad Éireann of 14 May 2014 as amended on 26 November 2014 and further amended on 6 October 2015

1. That a Select Committee be appointed, to be joined with a similar Select Committee of Dáil Éireann to form the Joint Committee of Inquiry into the Banking Crisis, for the purposes of conducting an inquiry within the meaning of section 7 of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013, in accordance with, and subject to, the Terms of Reference Resolution for the inquiry.
2. The Terms of Reference of the Joint Committee shall be as set out in the Terms of Reference Resolution of the Seanad of 26th November 2014 for the Inquiry.

3. The Select Committee shall consist of the following four (4) members:

   Senators Seán D. Barrett, Michael D'Arcy, Marc MacSharry and Susan O'Keeffe,

   and the provisions of Standing Orders 80(1) and (2) shall not apply.
4. The Chairman of the Joint Committee shall be a member of Dáil Éireann.
5. The quorum of the Joint Committee shall be five (5), of whom at least one shall be a member of Seanad Éireann, and that quorum shall be present for the duration of all meetings of the Committee.
6. The Joint Committee shall have the powers set out in Standing Order 71(1), (2), (2A), (3), (4), (5), (7), (8) and (9).
7. The Joint Committee shall have the power to nominate persons to assist it in its deliberations; and such persons shall attend meetings as the Joint Committee may determine.
8. The Joint Committee shall report, pursuant to Standing Order 103L, to both Houses of the Oireachtas no later than 28 January 2016, and Standing Order 75 shall not apply.

Appendix 4: Terms of Reference of the Banking Inquiry[1]

1. The Joint Committee of Inquiry into the Banking Crisis appointed by Order of Dáil Éireann of 14th May, 2014, and Order of Seanad Éireann of 14th May, 2014 shall conduct an inquiry under section 7 of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013 (hereinafter referred to as "the 2013 Act") in accordance with this Terms of Reference Resolution.
2. The subject matter of the inquiry shall be to inquire into the reasons Ireland experienced a systemic banking crisis, including the political, economic, social, cultural, financial and behavioural factors and policies which impacted on or contributed to the crisis, by investigating relevant matters relating to banking systems and practices, regulatory and supervisory systems and practices, crisis management systems, and policy responses and the preventative reforms implemented in the wake of the crisis.
3. In conducting the inquiry, the Joint Committee–
   a) may investigate and scrutinise the actions of banking institutions, and authorities responsible for the supervision of such institutions and for laws on such supervision, as set out in the Schedule to this Resolution; and
   b) shall have regard to the domestic and international background context for the banking crisis and the inquiry and may inquire into, including, but not limited to, the following:
      i. the findings and recommendations of previous reports into the crisis, whether they have been implemented, and if so, their effectiveness and long-term impact;
      ii. relationships between State authorities, political parties, elected representatives, supervisory authorities, banking institutions and the property sector;
      iii. reactions to early warnings of the impending crisis, and divergent or contrarian views on the prevailing consensus; and
      iv. the role of the media.
4. The matters which may be covered by the inquiry shall be as specified in Part A of the Schedule to this Resolution.
5. The categories of persons to which the matters which may be covered by the inquiry relate shall be as specified in Part B of the Schedule to this Resolution.
6. The time period for the inquiry shall be 1st January, 1992 to 31st December, 2013.
7. The European Union and other relevant jurisdictions shall be the location for the purposes of the inquiry.
8. The Joint Committee shall have the power to send for persons, papers and records under [Dáil Standing Order 83(2A)/Seanad Standing Order 71(2A)] and/or pursuant to part 6 of the 2013 Act and in particular, sections 67, 68, 70, 72 and 73 of the said Act.

---

1 as agreed by Dáil Éireann on 25 November 2014 and Seanad Éireann on 26 November 2014.

9. The Joint Committee may inquire into matters, persons and time periods in addition to those specified in this Resolution, solely and exclusively where such are deemed by the Committee to be directly relevant to the subject matter of the inquiry as set out in paragraphs (2) and (3).
10. The Joint Committee shall have the powers referred to in section 7(1)(c) and (d)(i) and (ii) of the 2013 Act and any findings of fact made in this Part 2 inquiry may be used in other Part 2 inquiries.
11. The Joint Committee may make a finding that any matter in relation to systems, practices, procedures or policy or arrangements for the implementation of policy ought to have been carried out in a different manner in accordance with section 17(3) of the 2013 Act.
12. The Joint Committee may, in accordance with section 17(3)(b) of the 2013 Act, make recommendations arising from any findings of fact, and such recommendations may include recommendations for legislative change and for new legislation.

SCHEDULE

Part A: Matters which may be covered by the inquiry

Conduct, events, activities, circumstances, systems, practices, procedures relating to the following:

Context

1. Findings and recommendations of previous reports on Ireland's banking crisis.
2. International, EU and domestic policy context, including key findings of reports of international monitoring agencies and also including the role and impact of membership of the Euro.
3. Relationships between State authorities, political parties, elected representatives, supervisory authorities, banking institutions and the property sector.
4. Early warnings, divergent and contrarian views.
5. The role the Euro, including the role Ireland's membership of the Euro, may have played in the banking crisis and the related matter of the strength of sterling relative to the Euro.
6. The role of the media.

Banking systems and practices

7. Corporate Governance and Business Model.
8. Lending Policy and Credit Control.
9. Risk Management (including Internal Audit, Audit Committees).
10. Funding and Liquidity Management.
11. External Audit Reports and Communications.
12. Board and executive remuneration.

Regulatory and Supervisory systems and practices

13. Structure and conduct of Regulatory and Supervisory Systems.
14. Monitoring and supervision of the Financial Industry, including enforcement.
15. Role of the Central Bank including Financial Stability.
16. Role of the Department of Finance.
17. Role and influence of International Organisations.
18. Role of the Houses of the Oireachtas.

Crisis management systems and policy responses

19. Crisis Management Arrangements in the lead-in to, and following, the Guarantee decision.
20. The Bank Guarantee decision of 30th September, 2008 including the lead up to and the decisions taken regarding its implementation afterwards.
21. Direct policy responses to the crisis, including the National Asset Management Agency, bank nationalisation, recapitalisation, the use of Emergency Liquidity Assistance, the Special Liquidation of IBRC, the issue of promissory notes and the EU-IMF programme of assistance.
22. Legislative and regulatory – national and EU – measures taken since the crisis, particularly in relation to bank resolution and creditor preference.
23. Impact of the banking crisis on bank creditors, including any efforts to achieve burden sharing with creditors and the role and influence of the European Central Bank on the question of burden sharing with creditors.

Part B: Categories of persons to whom the matters at Part A relate

1. Persons employed by or contracted to–
    a) credit institutions specified by Order of the Minister for Finance pursuant to section 6 of the Credit Institutions (Financial Support) Act 2008, including but not limited to: Chairpersons, Chief Executives, board members, other relevant executives and advisors;
    b) other credit institutions licensed by the Central Bank to operate within the State, including but not limited to: Chairpersons, Chief Executives, board members, other relevant executives and advisors.
2. Persons who were the recipients of commercial loans, including for commercial property, from the credit institutions within the scope of this Schedule.
3. External auditors for credit institutions within the scope of this Schedule.
4. Central Bank: Governors, Directors, Directors General, Prudential Directors, board members, other relevant officials and advisors.
5. Irish Financial Services Regulatory Authority/Financial Regulator: Chairpersons, CEOs, members of the Authority, other relevant officials and advisors.
6. Domestic Standing Group members.
7. Cabinet: Members of Cabinet, Attorneys General, and advisors to Government.

8. Department of the Taoiseach: Secretaries General, relevant Assistant Secretaries, other relevant officials and special advisors.
9. Department of Finance: Secretaries General, Second Secretaries, relevant Assistant Secretaries, other relevant officials and special advisors.
10. Members of the Houses of the Oireachtas, members of the European Parliament and members of Local Authorities.
11. Political Parties: General Secretaries, Officers at National level and other relevant officials.
12. European Central Bank: President and relevant officials.
13. ECOFIN and constituent bodies, including but not limited to, the Economic and Financial Committee.
14. Relevant persons employed by or contracted to the European Commission.
15. Relevant persons within special purpose mechanisms to deal with the crisis at European Union level, including but not limited to the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM).
16. Relevant persons employed by or contracted to the International Monetary Fund.
17. National Asset Management Agency: Chairperson, Chief Executive and other relevant officials.
18. National Treasury Management Agency: Chief Executive and other relevant officials.
19. National Pension Reserve Fund: Chief Executive and other relevant officials.
20. Persons who expressed divergent or contrarian views, including but not limited to persons employed by or contracted to the credit institutions within the scope of this Schedule, the Central Bank, the Irish Financial Services Regulatory Authority/Financial Regulator and the Department of Finance.
21. Media: Senior Editors, Board Members and Financial Controllers in media organisations.
22. Junior and Senior Bond-holders of credit institutions within the scope of this Schedule.
23. Any other relevant persons solely and exclusively where such persons are deemed by the Joint Committee to be directly relevant to the subject matter of the inquiry.

Appendix 5: Public Hearings Witness Lists

Context Phase: December 2014-April 2015

Date	Name	Theme
17 December 2014 **18 December 2014** **15 January 2015**	**Peter Nyberg** **Rob Wright** **Patrick Honohan**	Theme 1: Previous reports on the Banking Crisis
21 January 2015	**Philip Lane** **Klaus Regling**	Theme 2: International, EU and Domestic Policy Contexts Theme 1: Previous reports on the Banking Crisis
28 January 2015	**Edward Kane**	Theme 3: Banking, regulatory and supervisory policy
05 February 2015	**William Black**	Theme 3: Banking, regulatory and supervisory policy
05 February 2015 **11 February 2015** **18 February 2015**	**Mario Nava** **John FitzGerald** **Marco Buti** **Donal Donovan**	Theme 2: International, EU and Domestic Policy Contexts
25 February 2015	**Gregory Connor** **Eamonn Walsh**	Theme 3: Banking, regulatory and supervisory policy
26 February 2015	**Terrence McDonough**	Theme 2: International, EU and Domestic Policy Contexts
26 February 2015 **04 March 2015**	**David McWilliams** **Alan Ahearne**	Theme 4: Early warnings, divergent and contrarian views
04 March 2015 **10 March 2015**	**Peter Bacon** **Simon Carswell**	Theme 6: Relationships between sectors
11 March 2015	**David Farrell** **Niamh Hardiman**	Theme 2: International, EU and Domestic Policy Contexts
11 March 2015 **12 March 2015**	**Patrick Honohan** **Elaine Byrne** **Frank McDonald**	Theme 1: Previous reports on the Banking Crisis Theme 6: Relationships between sectors
25 March 2015 **26 March 2015**	**Harry Browne** **Julien Mercille** **Tom Murphy** **Tim Vaughan** **Maeve Donovan** **Michael Doorly** **Geraldine Kennedy** **Ed Mulhall** **Paul Mulligan** **Gerry O'Regan**	Theme 5: The role of the media during the property boom
02 April 2015	**Marie Hunt** **John Moran**	Theme 6: Relationships between sectors

Nexus Phase: April to September 2015

Date	Session	Institution	Name
22 April 2015	Morning & Afternoon	NAMA	**Frank Daly & Brendan McDonagh**
23 April 2015	Morning Afternoon	Allied Irish Bank	**Dermot Gleeson** **Donal Forde**
29 April 2015	Morning Afternoon	Allied Irish Bank	**Michael Buckley & Eugene Sheehy** **David Duffy**
30 April 2015	Morning	Bank of Ireland	**Brian Goggin**
06 May 2015	Morning Afternoon	Bank of Ireland Ulster Bank	**Richie Boucher** **Cormac McCarthy**
07 May 2015	Morning Afternoon	Ulster Bank Economists - AIB, UB, BOI	**Michael Torpey & Robert Gallagher** **John Beggs, Pat McArdle & Dan McLaughlin**
13 May 2015	Morning Afternoon	CIF/IPAV[1] Deloitte	**Liam Kelleher, Tom Parlon & Patrick Davitt** **Pat Cullen & Gerry Fitzpatrick**[2]
14 May 2015	Morning Afternoon	Bank of Ireland KPMG	**Laurence Crowley & Richard Burrows** **Terence O'Rourke & Paul Dobey**
20 May 2015	Morning Afternoon	PWC Ernst & Young	**Ronan Murphy & John McDonnell** **Paul Smith & Dargan FitzGerald**[3]
21 May 2015	Morning & Afternoon	Central Bank of Ireland/Regulator	**John Hurley**
27 May 2015	Morning Afternoon - A Afternoon - B	Central Bank of Ireland/Regulator	**Tony Grimes** **Mary Burke** **Con Horan**
28 May 2015	Morning & Afternoon	Central Bank of Ireland/Regulator	**Patrick Neary**
10 June 2015	Morning - A Morning - B Afternoon	Central Bank of Ireland/Regulator	**Mary O'Dea** **Cyril Roux** **Tom O'Connell**
11 June 2015	Morning Afternoon	Central Bank of Ireland/Regulator	**Liam O'Reilly** **Brian Patterson**
17 June 2015	Morning Afternoon	Department of Finance	**Tom Considine** **David Doyle**
18 June 2015	Morning Afternoon - A Afternoon - B	Department of Finance	**Kevin Cardiff** **John Moran** **Derek Moran**
24 June 2015	Morning - A Morning - B Afternoon	Department of Finance	**John McCarthy** **Kevin Cardiff** **William Beausang**
25 June 2015	Morning & Afternoon	Central Bank of Ireland/Regulator	**Patrick Honohan**

1 Construction Industry Federation/Institute of Professional Auctioneers and Valuers.
2 Witness appeared on a voluntary basis.
3 Witness appeared on a voluntary basis.

Date	Session	Institution	Name
01 July 2015	Morning - A Morning - B Afternoon	Department of Finance	**Ann Nolan** **Donal McNally** **Charlie McCreevy**
02 July 2015	Morning & Afternoon	Department of Finance	**Brian Cowen**
08 July 2015	Morning & Afternoon	Department of Taoiseach	**Brian Cowen**
09 July 2015	Morning - A Morning - B Afternoon - A Afternoon - B	Advisor Developer NTMA NTMA	**Cathy Herbert** **Derek Quinlan** **Brendan McDonagh** **Michael Somers**
15 July 2015	Morning - A Morning - B Afternoon	NTMA Irish Banking Federation Department of Taoiseach	**John Corrigan** **Pat Farrell** **Dermot McCarthy**
16 July 2015	Morning - A Morning - B Afternoon	Attorney General Advisor Department of Taoiseach	**Paul Gallagher*** **Eugene McCague & Pádraig Ó'Ríordáin** **Bertie Ahern**
22 July 2015	Morning Afternoon - A Afternoon - B Afternoon - C	EBS Developer Developer Central Bank of Ireland/Regulator	**Fergus Murphy** **Michael O'Flynn** **Sean Mulryan** **David Begg & John Dunne**
23 July 2015	Morning - A Morning - B Afternoon	Fine Gael: Leader & Finance Spokesperson 2002-2007 Labour: Leader & Finance Spokesperson 2002-2007 Developer	**Enda Kenny & Richard Bruton** **Pat Rabbitte & Joan Burton** **Joe O'Reilly**
29 July 2015	Morning - A Morning - B Afternoon - A Afternoon - B	EBS EBS Leaders: PD & Green Party EBS	**Alan Merriman** **Ethna Tinney** **Mary Harney & John Gormley** **Fidelma Clarke**
30 July 2015	Morning Afternoon	Anglo Irish Bank IBRC	**Fintan Drury** **Alan Dukes & Mike Aynsley**[4]
02 Sept 2015	Morning Afternoon - A Afternoon - B	Irish Nationwide Building Society	**Michael Fingleton** **John Stanley Purcell** **Michael Walsh**
03 Sept 2015	Morning - A Morning - B Morning - C Afternoon - A Afternoon - B	Anglo Irish Bank Anglo Irish Bank Anglo Irish Bank Irish Life & Permanent Irish Life & Permanent	**Gary McGann** **Peter Fitzgerald** **Matt Moran** **David Gantly** **David Went**
09 Sept 2015	Morning - A Morning - B Afternoon - A Afternoon - B	PWC Advisor Anglo Irish Bank Central Bank of Ireland/Regulator	**Denis O'Connor & Aidan Walsh** **Alan Ahearne** **Tom Browne** **Alan Gray**

4 Witness appeared on a voluntary basis.

Date	Session	Institution	Name
10 Sept 2015	Morning - A	International Monetary Fund	**Ajai Chopra**[5]
	Morning - B	European Commission	**Marco Buti**[6]
	Afternoon	Department of Finance	**Michael Noonan**

5 Witness appeared on a voluntary basis.

6 Witness appeared on a voluntary basis.

Appendix 6: Witness Profiles

Nexus Phase Public Hearing Witnesses		
Name	**Relevant Role(s)**	**Relevant Period (approx.)**
Ahearne, Alan	Special Advisor to former Minister for Finance, the late Brian Lenihan TD	2009 - 2011
Ahern, Bertie	Taoiseach	1997 - 2008
Aynsley, Mike	Group Chief Executive, Irish Bank Resolution Corporation	2009 - 2013
Beausang, William	Assistant Secretary, Department of Finance - Banking, Finance and International Division	2005 - 2011
Begg, David	General Secretary, ICTU	2001 – 2015
	Non-Executive Director Central Bank and CBFSAI	1995 - 2010
Beggs, John	Chief Economist, AIB Global Treasury	1992 - 2011
	Chief Economist, Allied Irish Banks Plc	2011 - 2012
Boucher, Richie	Group Chief Executive, Bank of Ireland	2009 - present
Browne, Tom	Managing Director of Lending Ireland, Anglo Irish Bank	2005 - 2007
Bruton, Richard	Fine Gael, Opposition Finance Spokesperson	2002 - 2007
Buckley, Michael	Group Chief Executive, Allied Irish Banks plc	2000 - 2005
Burke, Mary	Head of Banking Supervision	May 2006 to October 2008
	Head of Banking Supervision (International Banks)	October 2008 to June 2010
	Head of Prudential Policy	June 2010 to present
Burrows, Richard	Governor, Bank of Ireland Group	2005 - 2009
Burton, Joan	Labour Party, Finance Spokesperson	2002 - 2007
Buti, Marco	Director General for Economic and Financial Affairs, European Commission	2008 - present
Cardiff, Kevin	Secretary General, Department of Finance	2010 - 2012
	Second Secretary Department of Finance	2006 - 2010
Chopra, Ajai	Deputy Director, International Monetary Fund, responsible for the design and monitoring of Ireland's financial rescue program	2010-2013
Clarke, Fidelma	Chief Risk Officer, EBS	2009 - 2012
Considine, Tom	Secretary General, Department of Finance	2002 - 2006
Corrigan, John	CEO, National Treasury Management Agency	2009 - 2015
	Director of Funding and Debt Management	1991 - 2009
Cowen, Brian	Minister for Finance	2004 – 2008
	Taoiseach	2008 - 2011
Crowley, Laurence	Governor, Bank of Ireland Group	2000 - 2005
Cullen, Pat	Partner, Deloitte & Touche Ireland	1986 – present
	Managing Partner, Deloitte & Touche Ireland	2007-2011
Daly, Frank	Chairman, National Asset Management Agency	2009 - present
Davitt, Patrick	Chief Executive Officer, Institute of Professional Auctioneers & Valuers	2013 - present

Nexus Phase Public Hearing Witnesses		
Name	**Relevant Role(s)**	**Relevant Period (approx.)**
Dobey, Paul	Partner, KPMG Ireland	1998 - present
Doyle, David	Secretary General, Department of Finance	2006 - 2010
Duffy, David	Chief Executive Officer, Allied Irish Banks plc	2011 - 2015
Dukes, Alan	Director, Irish Bank Resolution Corporation	from 2008
	Chairman, Irish Bank Resolution Corporation	2010 - 2013
Dunne, John	Director General of IBEC	1993 - 2000
	Non-Executive Director of CBFSAI	2003 - 2010
Drury, Fintan	Non-Executive Director, Anglo Irish Bank	2002 – 2008
Farrell, Pat	Chief Executive Officer, Irish Banking Federation	2004 - 2013
Fingleton, Michael	Chief Executive, Irish Nationwide Building Society	1971 – 2009
Fitzgerald, Dargan	Audit Partner, Ernst & Young Ireland	2000 - present
Fitzgerald, Peter	Director of Corporate & Retail Treasury, Anglo Irish Bank	2006 – 2008
Fitzpatrick, Gerry	Audit Partner, Deloitte & Touche Ireland	2001 - present
Forde, Donal	Managing Director, AIB Bank ROI	2002 - 2009
Gallagher, Paul	Attorney General	2007 – 2011
Gallagher, Robert	Chief Executive, Corporate Markets Division, Ulster Bank	2005 – 2011
Gantly, David	Group Treasurer, Irish Life & Permanent	2000 – 2009
Gleeson, Dermot	Chairman, Allied Irish Banks plc	2003 – 2009
Goggin, Brian	Group Chief Executive, Bank of Ireland Group	2004 - 2009
Gormley, John	Leader of the Green Party & Minister for Environment	2007 - 2011
Gray, Alan	Economist, former Non-Executive Director, Central Bank and Managing Partner of Indecon Economic Consultants	2007 – 2008
Grimes, Tony	Director General, Central Bank of Ireland	2007 - 2011
Harney, Mary	An Tánaiste	1997 – 2006
	Leader of the Progressive Democrats	1993 - 2006 & 2007 - 2008
Herbert, Cathy	Special Advisor to former Minister for Finance, the late Brian Lenihan TD	2006 - 2011
Honohan, Patrick	Governor, Central Bank of Ireland	2009 – 2015
Horan, Con	Head of Banking Supervision, Prudential Director & other senior roles, Central Bank of Ireland/IFSRA	2003 - 2011
Hurley, John	Governor, Central Bank of Ireland	2002 - 2009
Kelleher, Liam	Director General, Construction Industry Federation	1993 - 2007
Kenny, Enda	Leader of the Fine Gael Party	2002 - 2007
McArdle, Pat	Group Chief Economist, Ulster Bank	2002 - 2009
McCague, Eugene	Managing Partner	1999 - 2003
	Chairman, Arthur Cox - Legal Advisor to the Department of Finance	2006 – 2013
McCarthy, Cormac	Group Chief Executive, Ulster Bank	2004 - 2011

Nexus Phase Public Hearing Witnesses		
Name	**Relevant Role(s)**	**Relevant Period (approx.)**
McCarthy, Dermot	Secretary General to the Government & at the Department of Taoiseach	2000 - 2011
McCarthy, John	Chief Economist, Department of Finance	2013 – present
	other senior roles [seconded from Central Bank]	2001 - 2013
McCreevy, Charlie	Minister for Finance	1997 - 2004
McDonagh, Brendan	Chief Executive Officer, NAMA	2009 – present
	Director of Finance, Technology & Risk, NTMA	2002 - 2009
McDonnell, John	Audit Partner, PWC	2010 - 2014
McGann, Gary	Independent Non-Executive Director, Anglo Irish Bank	2004 - 2009
McLaughlin, Dan	Chief Economist, Bank of Ireland	2001 - 2009
McNally, Donal	Second Secretary, Department of Finance	2000 - 2012
Merriman, Alan	Finance Director, EBS	2005 - 2009
Moran, Derek	Assistant Secretary, Department of Finance	2003 – 2014
	Secretary General, Department of Finance	2014 - present
Moran, John	Second Secretary, Department of Finance	2011 – 2012
	Secretary General, Department of Finance	2012 - 2014
Moran, Matt	Chief Financial Officer Anglo Irish Bank	2004 - 2008
	Finance Director, Anglo Irish Bank	2009 - 2009
Mulryan, Sean	Founder, Chairman & Group Chief Executive of the Ballymore Group	1982 - present
Murphy, Fergus	Group Chief Executive, EBS	2008 – 2012
Murphy, Ronan	Senior Partner, PWC	1992 - Present
	Managing Partner, PWC	2007 - 2015
Neary, Patrick	Chief Executive, Irish Financial Services Regulatory Authority	2006 – 2009
	Prudential Director	2002 - 2006
Nolan, Ann	Assistant Secretary, Department of Finance	2006 - 2010
	Second Secretary, Department of Finance	2010 - present
Noonan, Michael	Minister for Finance	2011 - present
O'Connell, Tom	Assistant Director General (Economics)/Chief Economist, Central Bank	2005 - 2010
O'Connor, Denis	Partner, PWC	1995 - present
O'Dea, Mary	Acting Chief Executive, Irish Financial Services Regulatory Authority	2009 – 2010
	Consumer Director	2002-2010
O'Flynn, Michael	Founder & Managing Director of O'Flynn Group	1978 - present
O'Reilly, Joe	Executive Chairman of Chartered Land and Castlethorn Construction	1991 - present
O'Reilly, Liam	Chief Executive Officer, Irish Financial Services Regulatory Authority	2002 - 2006

Nexus Phase Public Hearing Witnesses		
Name	**Relevant Role(s)**	**Relevant Period (approx.)**
Ó'Ríordáin, Pádraig	Managing Partner, Arthur Cox - Legal Advisor to the Department of Finance	2003 - 2011
O'Rourke, Terence	Managing Partner, KPMG	2006 - 2013
Parlon, Tom	Director General, Construction Industry Federation	2007 - present
Patterson, Brian	Chairman, Irish Financial Services Regulatory Authority & Non-executive member of the Central Bank Board	2003 - 2008
Purcell, John Stanley	Director & Secretary, Irish Nationwide Building Society	1986 - 2010
Quinlan, Derek	Executive Chairman & Founder of Quinlan Private	1989 - 2009
Rabbitte, Pat	Leader of the Labour Party	2002 - 2007
Roux, Cyril	Deputy Governor (Financial Regulation) Central Bank	2013 - present
Sheehy, Eugene	Group Chief Executive, Allied Irish Banks plc	2005 - 2009
Smith, Paul	Managing Partner, Ernst & Young	2000 - 2009
Somers, Michael	Chief Executive, National Treasury Management Agency	1990 - 2009
Tinney, Ethna	Independent Non-Executive Director, EBS	2000 - 2007 & 2008 - 2011
Torpey, Michael	Group Finance Director, Ulster Bank	2004 - 2007
Walsh, Aidan	Partner, PWC	1987 - present
Walsh, Michael	Chairman, Irish Nationwide Building Society	2001 – 2009
Went, David	Group Chief Executive, Irish Life & Permanent	2000 - 2007

Nexus Phase Non-appearing Witnesses		
Name	**Relevant Role(s)**	**Tenure**
Ahern, Michael	Chairman, Oireachtas Joint Committee of Finance and the Public Service	2008 - 2011
Allen, Bernard	Chairman, Oireachtas Committee of Public Accounts .	2007 - 2011
Barron, Liam	Director General, Central Bank of Ireland	2000 – 2007
	Director, CBFSAI	2003 - 2007
Barrett, Gerard	Group Chairman and Managing Director, Edward Holdings	Company established in late 1980s
Bennett, Kieran	Group Chief Credit Officer, Allied Irish Bank	2007 – 2010
Brennan, Niamh	Non-Executive Director, Ulster Bank	2001 – 2009
Broderick, Larry	General Secretary, Irish Bank Officials Association	2001 – present
Browne, Frank	Head of Monetary Policy & Financial Stability, Central Bank of Ireland	2003 – 2010
Buckley, John	Comptroller & Auditor General	2008 - 2012
Byrne, Adrian	Head of Banking Supervision, Central Bank of Ireland	1995 – 2003
	Personal Advisor to Liam O'Reilly, Assistant Director General, IFSRA	2003 - 2005
Cosgrave, Peter	Partner, Cosgrave Property Group	Company established 1979

Nexus Phase Non-appearing Witnesses		
Name	**Relevant Role(s)**	**Tenure**
Coughlan, Mary	An Tánaiste	2008 - 2011
Danaher, Gerard	Member of the Board, Central Bank of Ireland	1998 – 2010
	IFSRA	2003 – 2010
Dilger, David	Non-Executive Director, Bank of Ireland	2003 - 2009
Doherty, Colm	Managing Director, AIB Capital Markets	1999 - 2009
Donovan, Denis	Head of Capital Markets, Bank of Ireland	2006 - 2011
Elderfield, Matthew*	Deputy Governor (Financial Regulation), Central Bank of Ireland	2010 - 2013
Gannon, Gerard	Executive Director, Gannon Homes	Company established late 1970s
Farrell, Jim	Chairman of IFSRA	2003 – 2010
	Board Member of IFSRA and Central Bank of Ireland	2008 - 2010
Fleming, Seán	Chairman, Oireachtas Joint Committee on Finance and Public Service	2002 - 2007
Hayes, Tom	Chief Executive, Corporate Banking, Bank of Ireland	2006 - present
IMF*	International Monetary Fund	n/a
Kearns, Allan	Economist, Deputy Head Eurosystem Coordination and Deputy Head Risk Division, Central Bank of Ireland	2002 - present
Lynch, Merrill*	Legal Department, Merrill Lynch International	n/a
McCarthy, Seamus	Comptroller and Auditor General	2012 - present
McGrath, Michael J.	Assistant Secretary, Head of Economic and Fiscal Policy Unit, Department of Finance	2007 - 2014
McHale, John	Chairman, Irish Fiscal Advisory Council	2012 - present
McNamara, Bernard	Managing Director, Michael McNamara Construction	Company incorporated 1964
Moynihan, Michael	Chairman, Oireachtas Joint Committee on Economic Regulatory Affairs	2007 - 2011
Murphy, Ronan	Group Chief Risk Officer/Chief Governance Risk Officer, Bank of Ireland	2004 - 2010
Murray, David	Treasurer, Irish Nationwide Building Society	1994 - 2011
Nolan, Helen	Group Chief Internal Auditor, Bank of Ireland	2003 - 2009
	Group Secretary, Bank of Ireland	2009 - present
O'Brien, Nicholas	Head of International Relations Unit	2011 – 2014
	Assistant Secretary, International and EU Division, Department of Finance	2014 - present
O'Donovan, John	Group Chief Financial Officer, Bank of Ireland	2001 - 2011
O'Donnell, John	Finance Director, Allied Irish Bank	2005 - 2009
O'Leary, Jim	Independent Non-Executive Director, AIB Group	2002 - 2008
Purcell, Deirdre	Non-Executive Board Member, Central Bank of Ireland/IFSRA	2003 - 2010
Pye, Robert	Assistant Principal (Economist), Strategic Management Unit, Department of Finance	1997 - 2010

Nexus Phase Non-appearing Witnesses		
Name	**Relevant Role(s)**	**Tenure**
Ronan, John	Director, Ronan Group Real Estate	Company established 1970s
Ryan, Michael	Chief Executive Officer, Merrill Lynch International Bank Limited	2002 - 2009
Slattery, William	Chairman, Financial Services Ireland IFSC Ireland	2002 2010 - 2012
Woods, Maria	Economist & Senior Economist (Financial Stability), Central Bank of Ireland	2005 - present

* Voluntary

Appendix 7: Legislation sponsored by the Minister for Finance within the broad scope of the Inquiry Terms of Reference: 2000-2013

2000		
No	**Title**	**Purpose**
3	Finance Act 2000	An act to charge and impose certain duties of customs and inland revenue (including excise), to amend the law relating to customs and inland revenue (including excise) and to make further provisions in connection with finance.
32	ICC Bank Act 2000	An act to make provision in relation to ICC bank public limited company, including increasing the authorised share capital of the bank, the disposal by the minister for finance of shares in the bank and provision in relation to certain guarantees of the bank's borrowing, to provide for the repeal of the ICC bank acts, 1933 to 1997, and the provisions of certain other enactments and the revocation of certain statutory instruments and to provide for related matters.
33	National Pensions Reserve Fund Act 2000	An act to provide for the establishment of a fund to be known as the national pensions reserve fund and a body to be known as the national pensions reserve fund commission to control and manage the fund, to dissolve the temporary holding fund for superannuation liabilities, to amend the taxes consolidation act, 1997, and to provide for connected matters.
39	National Treasury Management Agency (Amendment) Act 2000	An act to provide for the delegation to, and the conferral on, the national treasury management agency of functions in relation to the management of certain claims against the state and certain other related functions, functions in relation to fund investment services, consultancy services and other services, the conferral on the minister for finance of functions in relation to central treasury services and the delegation of those functions to the national treasury management agency, and for those purposes to amend the national treasury management agency act, 1990, and the vocational education act, 1930, and to provide for related matters.

2001		
No	**Title**	**Purpose**
6	Trustee Savings Banks (Amendment) Act 2001	An act to amend and extend sections 57 and 64 of the trustee savings banks act, 1989, and schedule 12 to the taxes consolidation act, 1997.
7	Finance Act 2001	An act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
12	ACC Bank Act 2001	An act to make provision in relation to ACC bank public limited company including, increasing the authorised share capital of the bank, the issue of shares in the bank in connection with an employee share ownership trust for the benefit of its employees, the disposal by the minister for finance of shares in the bank and provision in relation to certain guarantees of the bank's borrowing, to provide for the repeal to the extent provided for of the ACC bank acts, 1978 to 1999, and the provisions of certain other enactments and the revocation of certain statutory instruments and to provide for related matters.
13	Valuation Act 2001	An act to revise the law relating to the valuation of properties for the purposes of the making of rates in relation to them; to make new provision in relation to the categories of properties in respect of which rates may not be made and to provide for related matters.

2001		
No	**Title**	**Purpose**
16	Euro Changeover (Amounts) Act 2001	An Act to make provision for the substitution, with effect from 1 January 2002, of convenient amounts expressed in euro and cent for amounts expressed in Irish pounds and pence in certain legislative provisions, to amend the economic and monetary union act, 1998, to amend the credit union act, 1997, to amend the bankruptcy act, 1988, to amend the central bank act, 1989, and to make provision for matters related thereto.
30	Oireachtas (Ministerial and Parliamentary Offices) (Amendment) Act 2001	An Act to amend and extend the Ministerial and Parliamentary Offices Act, 1938.
31	Standards in Public Office Act 2001	An Act to provide for the establishment of a Commission, to be known as the Standards in Public Office Commission, to confer on it the functions of the Public Offices Commission and certain other functions, to provide for the furnishing of tax clearance certificates to that Commission by persons upon election to either House of the Oireachtas or appointment to judicial office or senior office, to amend the statutory declarations act, 1938, the Ethics in Public Office Act, 1995, and the Electoral Act, 1997, and to provide for connected matters.
32	Dormant Accounts Act 2001	An Act to provide for the transfer of moneys from dormant accounts and the Intestate Estates Fund Deposit Account to a fund to be known as the Dormant Accounts Fund, to confer functions on the National Treasury Management Agency in relation to the control and management of the fund, to provide for the disbursement of moneys (including the repayment of moneys to persons entitled to them) from the fund, to establish a body to be known as the Dormant Accounts Fund Disbursements Board and to define its functions, to provide for the appointment of inspectors, to amend the State Property Act, 1954, and to provide for related matters.
33	Ministerial, Parliamentary and Judicial Offices and Oireachtas Members (Miscellaneous Provisions) Act 2001	An Act to amend the Ministerial and Parliamentary Offices Acts, 1938 to 1998, the Oireachtas (Allowances to Members) Act, 1938, and certain other acts to make further provision for the remuneration, allowances and superannuation payable to and in respect of certain holders and former holders of Ministerial, Parliamentary and Judicial Offices; to provide for the transfer of previous pensionable service of persons who hold such offices; and to provide for related matters.
47	Asset Covered Securities Act 2001	An Act to facilitate the establishment and operation of a market in asset covered securities, to provide for the registration of designated credit institutions, to amend the Building Societies Act, 1989, and certain other enactments, and to provide for related matters.

2002		
No	**Title**	**Purpose**
1	State Authorities (Public Private Partnership Arrangements) Act, 2002	An Act to make further provision in relation to the functions and powers of certain state authorities, in particular to enable them to enter into public private partnership arrangements, and to provide for related matters.
5	Finance Act, 2002	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
29	National Development Finance Agency Act, 2002	An Act to provide for the establishment of a body to be known as an Ghníomhaireacht Airgeadais d'Fhorbairt Náisiúnta, or in the English language, the National Development Finance Agency and to define its functions and to provide for connected matters.

2003		
No	**Title**	**Purpose**
1	Capital Acquisitions Tax Consolidation Act 2003	An Act to consolidate enactments relating to capital acquisitions tax.
3	Finance Act 2003	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
12	Central Bank and Financial Services Authority of Ireland Act 2003	An Act to amend the Central Bank Act 1942 for the purpose of reorganising and renaming the Central Bank of Ireland; to provide for the establishment and functions of the Irish Financial Services Regulatory Authority as a constituent part of that bank; to amend certain other acts consequential on the reorganisation; and to provide for related matters.
28	Houses of the Oireachtas Commission Act 2003	An Act to establish a body to be known as Coimisiún Thithe an Oireachtais or, in the English language, the Houses of the Oireachtas Commission, to provide for the funding, functions and composition of the Commission, to provide for the position to be known as Secretary General of the Office of the Houses of the Oireachtas, and to provide for connected matters.

2004		
No	**Title**	**Purpose**
7	Public Service Superannuation (Miscellaneous Provisions) Act 2004	An Act to remove the compulsory retirement age for certain categories of new entrants into the Public Service on or after 1 April 2004, to increase the pensionable age for certain categories of new entrants into the Public Service from that date, including members of either House of the Oireachtas and certain office holders, and to make consequential provisions, to provide for certain other categories of new entrants, for transitional matters and for the making of a scheme or schemes for the granting of superannuation benefits to or in respect of new entrants into the permanent defence force appointed on or after 1 April 2004, and to provide for connected matters.
8	Finance Act 2004	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
16	Committees of the Houses of the Oireachtas (Compellability, Privileges and Immunities of Witnesses) (Amendment) Act 2004	An Act to amend the Committees of the Houses of the Oireachtas (compellability, privileges and immunities of witnesses) Act 1997 and to provide for related matters.
21	Central Bank and Financial Services Authority of Ireland Act 2004	An Act to amend the Central Bank Act 1942 for the purposes of establishing the Financial Services Ombudsman's Bureau and prescribing the functions and powers of that Ombudsman, providing for the establishment of consultative panels to advise the Irish Financial Services Regulatory Authority on certain matters; to amend the Central Bank Act 1997 for the purposes of making further provision for auditing the accounts of financial service providers and providing for the regulation of money transmission businesses; and to make miscellaneous amendments to certain other Acts and Statutory Instruments relating to the provision of financial services.
26	International Development Association (Amendment) Act 2004	An Act to enable additional payments not exceeding in aggregate a specified total amount to be made on behalf of the Government to the International Development Association.

2004		
No	**Title**	**Purpose**
33	Public Service Management (Recruitment and Appointments) Act 2004	An Act to reform the recruitment and appointment processes of the Civil Service and certain other bodies in the Public Service and for that purpose, to provide for new management structures to replace the Civil Service Commissioners and local appointments commissioners, to establish the commission for Public Service appointments to oversee the implementation and development of those structures in the context of the public interest and the need to uphold the probity of the recruitment and appointment process, to provide for an office connected to that Commission, to provide for the establishment of the Public Appointments Service as the recruitment and selection body for the Civil Service and other bodies in the Public Service, to introduce flexibility into the recruitment process by enabling the licensing by that commission, in addition to the licensing of the public appointments service, of any part of those services to undertake their own recruitment in respect of one or more classes of employees and, generally, to enable licence holders to delegate some of their recruitment processes to persons or bodies specified by that commission from time to time, to enable those services to respond to changes in their recruitment needs and in the labour market, to provide for both permanent and temporary appointments and to provide for promotion processes, and for those purposes take account of the need to maintain, in the public interest, the integrity and probity of both the recruitment and selection processes for those services and to provide for connected matters.
37	Council of Europe Development Bank Act 2004	An Act to provide for the approval of the terms of the agreement for the Council of Europe Development Bank and to provide for matters (including payments) related to that agreement.

2005		
No	**Title**	**Purpose**
5	Finance Act 2005	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
18	Civil Service Regulation (Amendment) Act 2005	An Act to provide for the amendment of the Civil Service Regulation Act 1956, to provide for the application of the Unfair Dismissals Act 1977 to certain civil servants, to provide for the application of the Minimum Notice and Terms of Employment Act 1973 to civil servants, to provide for the amendment of the Comptroller and Auditor-General Act 1923, to provide for the amendment of the Ministers and Secretaries Act 1924, to provide for the amendment of the Prosecution of Offences Act 1974, to provide for the amendment of the Ombudsman Act 1980, to provide for the amendment of the Superannuation (Prison Officers) Act 1919, to provide for the amendment of the Public Service Superannuation (Miscellaneous Provisions) Act 2004, to provide for the amendment of the Public Service Management (Recruitment and Appointments) Act 2004, to provide for the amendment of the Staff of the Houses of the Oireachtas Act 1959, to provide for the amendment of the Houses of the Oireachtas Commission Act 2003, to provide for the alteration of the title of the secretary to the president and to provide for matters connected with the matters aforesaid.
34	Development Banks Act 2005	An Act to provide for approval of the terms of the agreement establishing the Asian Development Bank, to provide for matters (including payments) related to that agreement, to amend the European Bank for Reconstruction and Development Act 1991, the Bretton Woods Agreements Act 1957, the International Development Association Act 1960, the Multilateral Investment Guarantee Agency Act 1988 and the Council of Europe Development Bank Act 2004.

2006		
No	**Title**	**Purpose**
6	Finance Act 2006	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
39	Houses of the Oireachtas Commission (Amendment) Act 2006	An Act to amend and extend the Houses of the Oireachtas Commission Act 2003 and to provide for related matters.

2007		
No	**Title**	**Purpose**
11	Finance Act 2007	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
13	Asset Covered Securities (Amendment) Act 2007	An Act to amend the Asset Covered Securities Act 2001.
16	National Development Finance Agency (Amendment) Act 2007	An Act to amend the National Development Finance Agency Act 2002 by providing for additional functions of the National Development Finance Agency and to provide for connected matters.
31	Finance (No. 2) Act 2007	An Act to provide for the amendment of the Stamp Duties Consolidation Act 1999.
33	Ministers and Secretaries (Ministers of State) Act 2007	An Act to provide for the increase in the number of Ministers of State who may be appointed by the Government under Section 1(1) of the Ministers and Secretaries (Amendment) (No. 2) Act 1977.
37	Markets in Financial Instruments and Miscellaneous Provisions Act 2007	An Act to make provision in relation to markets in financial instruments and to make miscellaneous amendments to financial services legislation and to the Ministerial and Parliamentary Offices Act 1938, the National Pensions Reserve Fund Act 2000, the Ordnance Survey Ireland Act 2001, and to the Freedom of Information Act 1997.

2008		
No	**Title**	**Purpose**
3	Finance Act 2008	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
18	Credit Institutions (Financial Support) Act 2008	An Act to provide, in the public interest, for maintaining the stability of the financial system in the state and for that purpose to provide for financial support by the Minister for Finance in respect of certain credit institutions, to amend the Competition Act 2002 and other enactments, and to provide for connected matters.
25	Finance (No. 2) Act 2008	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.

2009		
No	**Title**	**Purpose**
1	Anglo Irish Bank Corporation Act 2009	An Act to provide, in the public interest, for maintaining the stability of the financial system in the state, and for that purpose— (a) to provide for the transfer to the Minister for Finance or the Minister's nominee of all the shares in Anglo Irish Bank corporation public limited company, (b) to extinguish certain rights in Anglo Irish Bank, (c) to disapply certain provisions of the Companies Acts and other enactments in so far as they relate to Anglo Irish Bank, (d) to provide for the removal of persons from certain offices, positions or employment with Anglo Irish Bank and the appointment of persons to those offices or positions or that employment, (e) to provide for the appointment of an assessor to assess whether compensation should be paid to persons whose shares were transferred to the Minister for Finance or whose rights were extinguished, and if so to determine the fair and reasonable amount payable as such compensation, (f) to provide for the payment of any such compensation, (g) to make consequential amendments to certain other enactments, and (h) to provide for connected matters.
5	Financial Emergency Measures in the Public Interest Act 2009	An Act, in the public interest, to provide for the payment of a contribution by certain persons in the public service (including members of the Houses of the Oireachtas and certain office holders) who are members of an occupational pension scheme or pension arrangement (by whatever name called) which is provided for under the Superannuation Acts 1834 to 1963 or any other enactment or administrative measure to like effect or is required to be made, approved of or consented to (however expressed) by one or more than one Minister of the Government, to provide for the reduction of the amount payable, or rate of payment, out of money provided by the Oireachtas or the central fund or the growing produce of that fund to certain persons for certain services to or on behalf of the state, to provide for the amendment of section 4 of the Local Government Act 1998, the Income Tax Acts and part 4a of the Social Welfare Consolidation Act 2005, to provide for the deferral of liabilities, accruals or payments due under a scheme known as the farm waste management scheme and to provide for related matters.
7	Investment of the National Pensions Reserve Fund and Miscellaneous Provisions Act 2009	An Act to amend the National Pensions Reserve Fund Act 2000 in relation to certain investments in the public interest; to amend the Taxes Consolidation Act 1997 in relation to the taxation of such investments; to amend the Securitisation (Proceeds of Certain Mortgages) Act 1995 to facilitate the winding-up of a body established under that Act; to amend the Markets in Financial Instruments and Miscellaneous Provisions Act 2007 to provide for greater transparency in relation to certain kinds of trading in financial instruments; and to provide for connected matters.
12	Finance Act 2009	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
13	Financial Services (Deposit Guarantee Scheme) Act 2009	An Act to provide for the making of regulations regarding the amount payable to a person maintaining eligible deposits with a credit institution; to provide for the maintenance of the deposit protection account by the Central Bank and Financial Services Authority of Ireland; to provide for the maintenance by credit institutions of deposits in the deposit protection account; to provide for the amount of the deposit and its variation; to give further effect to Directive 94/19/EC of the European Parliament and of the council of 30 may 1994 on deposit guarantee schemes; to amend the Central Bank Act 1942 and to provide for related matters.

2009		
No	**Title**	**Purpose**
14	Financial Measures (Miscellaneous Provisions) Act 2009	An Act to provide for the continuation of certain direct debit mandates after the coming into operation of the single European payments area direct debit scheme, to provide for the transfer of the assets of certain pension funds to the National Pensions Reserve Fund, and the continued payment of benefits formerly payable from those funds, to make provision in relation to the giving of certain guarantees by the Minister for Finance, to amend the Central Bank Act 1989 so as to clarify its application to certain acquiring transactions, to amend the Credit Institutions (Financial Support) Act 2008 so as to allow the extension of the period in which financial support under that Act can be provided, to amend the Insurance (No. 2) Act 1983 and the Insurance Act 1989 in relation to life insurance and reinsurance, to amend the Netting of Financial Contracts Act 1995 so as to clarify whether certain persons are parties to a netting agreement, to amend the Taxes Consolidation Act 1997 in relation to the taxation position of the National Pensions Reserve Fund Commission in relation to certain assets transferred from pension funds to the National Pensions Reserve Fund, and to provide for related purposes.
29	Oireachtas (Allowances to Members) and Ministerial and Parliamentary Offices Act 2009	An Act to amend the Oireachtas (Allowances to Members) Act 1938 and the Ministerial and Parliamentary Offices Acts 1938 to 2001, to make further provision for salaries and allowances payable to members of either House of the Oireachtas and for the remuneration, allowances and pensions payable to former holders of Ministerial and other offices who are members of either such House or Members of the European Parliament, and to provide for related matters.
34	National Asset Management Agency Act 2009	An Act— To address a serious threat to the economy and to the systemic stability of credit institutions in the State generally by providing, in particular, for the establishment of a body to be known as the National Asset Management Agency for the purposes of— (a) the acquisition by that Agency of certain assets from certain persons to be designated by the Minister for Finance, (b) effecting the expeditious and efficient transfer of those assets to that Agency, (c) the holding, managing and realising of those assets by that Agency (including the collection of interest and capital due, the taking or taking over of collateral where necessary and the provision of funds where appropriate), (d) the taking by that Agency of all steps necessary or expedient to protect, enhance and better realise the value of assets transferred to it, (e) the performance by that Agency of such other functions, related to the management or realisation of those assets, as provided in this Act or as directed by the Minister, and (f) the facilitation of restructuring of credit institutions of systemic importance to the economy, and To provide for the valuation of the assets concerned and the review of any such valuation, To give the National Asset Management Agency certain powers and other functions in respect of land or an interest in land acquired by that Agency, including powers relating to the development of land, To provide for the issuing of debt securities by the Minister for Finance and by that Agency in the performance of its functions under this Act, To provide for certain legal proceedings relating to assets acquired by that Agency, to amend the Central Bank Act 1942, and to provide for related matters.

2009		
No	**Title**	**Purpose**
41	Financial Emergency Measures in the Public Interest (No. 2) Act 2009	An Act, in the public interest, to provide for the reduction of the remuneration of certain persons in the Public Service (including Members of the Houses of the Oireachtas and certain office holders), and to provide for related matters.
44	Houses of the Oireachtas Commission (Amendment) Act 2009	An Act to amend and extend the Houses of the Oireachtas Commission Act 2003 and to amend accordingly the references to the Office of the Houses of the Oireachtas in certain enactments.

2010		
No	**Title**	**Purpose**
5	Finance Act 2010	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
7	Euro Area Loan Facility Act 2010	An Act to facilitate in the public interest the safeguarding of the financial stability of the Euro Area as a whole and for that purpose to enable payments to be made out of the central fund or the growing produce of that fund so as to enable effect to be given in the state to the Intercreditor Agreement regarding the pooled bilateral loans for the benefit of the Hellenic Republic made by and between certain Member States of the European Union, including the State, and for that purpose and in accordance with article 2 of that agreement to enable effect to be given, in so far as it relates to the State, to the loan facility agreement referred to in that article, to provide for all receipts received in respect of moneys advanced under this Act to be paid into the exchequer and to provide for related matters.
16	European Financial Stability Facility Act 2010	An Act to facilitate, in the public interest, the financial stability of the European Union and for that purpose— (a) to provide for matters relating to the participation by the State in the European Financial Stability Facility, a public limited company incorporated under the laws of the grand duchy of Luxembourg pursuant to an intergovernmental agreement among certain member States of the European Union consequent on the conclusions of 9 May 2010 of the council of economic and Finance Ministers of the European Union regarding the preservation of financial stability in Europe and subject to the terms of the EFSF Framework Agreement entered into by certain member States on the one part and the European Financial Stability Facility on the other part, (b) to provide for matters relating to guarantees given by the State for the purposes of the agreement so entered into, (c) to provide for payments to be made out of the central fund or the growing produce of that fund so as to enable effect to be given to the agreement so entered into, (d) to provide for all receipts received under this Act, including receipts in respect of moneys advanced or guarantees given, to be paid into the exchequer, (e) to amend the Euro Area Loan Facility Act 2010, and (f) to provide for related matters.

2010		
No	**Title**	**Purpose**
23	Central Bank Reform Act 2010	An Act to establish the Central Bank of Ireland as a single fully-integrated structure with a unitary board — the Central Bank Commission — replacing the boards of the Central Bank and Irish Financial Services Regulatory Authority; to enhance the system of regulatory control and to confer additional powers on the Central Bank, the Governor and the Head of Financial Regulation to prevent potential serious damage to the financial system in the State, support the stability of that system and to protect users of financial services; to transfer certain functions of the Central Bank to the National Consumer Agency; to amend the enactments relating to the Central Bank and certain other Acts consequential on that reorganisation; to amend the law relating to the regulation of lending by credit unions; to extend the range of persons who can be authorised to investigate the affairs of an insurer; and to provide for related matters.
31	Value-Added Tax Consolidation Act 2010	An Act to consolidate enactments relating to value-added tax.
36	Credit Institutions (Stabilisation) Act 2010	An Act to make provision, in the context of the National Recovery Plan 2011 - 2014 and the European Union/International Monetary Fund Programme of financial support for Ireland, in relation to the stabilisation, and the preservation or restoration of the financial position of certain credit institutions; to amend the Building Societies Act 1989, the Central Bank Act 1971 and the Credit Institutions (Financial Support) Act 2008 for those purposes; to amend the National Pensions Reserve Fund Act 2000 to allow the Minister for Finance to give certain directions in relation to the National Pensions Reserve Fund; to make consequential amendments to the European Communities (Reorganisation and Winding-up of Credit Institutions) Regulations 2004 (S.I. No. 198 of 2004); and for related purposes.
38	Financial Emergency Measures in the Public Interest Act 2010	An Act, in the public interest, to provide for the reduction of the amount of the payment of pension or other benefits (other than lump sums) payable to or in respect of certain persons who are or were in the public service (including former holders of certain offices, Members and former Members of the Houses of the Oireachtas and former members of the judiciary) under an occupational pension scheme or pension arrangement (by whatever name called) which is provided for under the Superannuation Acts 1834 to 1963 or any other enactment or administrative measure to like effect, or is required to be made, approved of or consented to (however expressed) by one or more than one Minister of the Government; to amend the financial emergency measures in the Public Interest (No. 2) Act 2009 and the National Minimum Wage Act 2000; and to provide for related matters.

2011		
No	**Title**	**Purpose**
6	Finance Act 2011	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
8	Finance (No. 2) Act 2011	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance.

2011		
No	**Title**	**Purpose**
10	Ministers and Secretaries (Amendment) Act 2011	An Act to provide for the establishment of a department of state to be known, in the Irish language, as an Roinn Caiteachais Phoiblí agus Athchóirithe or, in the English language, as the Department of Public Expenditure and Reform; to provide for the transfer of certain functions of the Minister for Finance to the Minister of the Government having charge of that department; to confer functions on the said Minister of the Government in relation to the modernisation and development of the public service; to deem members of staff of the National Treasury Management Agency assigned to perform functions in the Department of Finance to be officers of the Minister for Finance for certain purposes; to provide that the revenue commissioners shall be independent in the performance of certain of their functions; for those and other purposes to amend certain enactments; and to provide for matters connected therewith.
18	Finance (No. 3) Act 2011	An Act to amend and extend the Taxes Consolidation Act 1997, the Stamp Duties Consolidation Act 1999, the Capital Acquisitions Tax Consolidation Act 2003 and the Value-Added Tax Consolidation Act 2010 in relation to the Taxation of Civil Partners and Cohabitants as a Consequence of the Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010 and to provide for connected matters.
25	European Financial Stability Facility and Euro Area Loan Facility (Amendment) Act 2011	An Act to further facilitate, in the public interest, the financial stability of the European Union and the safeguarding of the financial stability of the Euro Area as a whole and for those purposes— (a) having regard to the participation by the State in the European Financial Stability Facility, to enable effect to be given to the amendment to the EFSF Framework Agreement entered into by certain member States of the European Union on the one part and the European Financial Stability Facility on the other part, (b) to enable effect to be given, in so far as it relates to the State, to the amendment to the Eur 80 000 000 000 Loan Facility Agreement done in Brussels on 14 June 2011 and in Athens on 10 June 2011, (c) to amend the Euro Area Loan Facility Act 2010 and the European Financial Stability Facility Act 2010, and (d) to provide for related matters.
27	Central Bank and Credit Institutions (Resolution) Act 2011	An Act to make provision for an effective and expeditious resolution regime for certain credit institutions at the least cost to the State; to amend certain enactments; and for related matters.

2012		
No	**Title**	**Purpose**
6	Euro Area Loan Facility (Amendment) Act 2012	An Act to further facilitate, in the public interest, the financial stability of the European Union and the safeguarding of the financial stability of the Euro Area as a whole and for those purposes— (a) to enable effect to be given, in so far as it relates to the State, to the amendment to the Eur 80 000 000 000 Loan Facility Agreement done in Brussels on 27 February 2012 and in Athens on 24 February 2012, (b) to amend the Euro Area Loan Facility Act 2010 and the European Financial Stability Facility and Euro Area Loan Facility (Amendment) Act 2011, and (c) to provide for related matters.
9	Finance Act 2012	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.

2012		
No	**Title**	**Purpose**
20	European Stability Mechanism Act 2012	An Act to further facilitate, in the public interest, the financial stability of the European Union by establishing a permanent stability mechanism to assume the tasks of the European Financial Stability Facility and the European Financial Stabilisation Mechanism in providing, where needed, financial assistance to euro area member states and for that purpose— (a) to make permanent provision to provide for matters relating to the participation by the State in the European Stability Mechanism pursuant to the treaty establishing the European Stability Mechanism done Brussels on 2 February 2012 between the Euro Area Member States, (b) to provide for matters relating to the State's subscription to the authorised capital stock of the European Stability Mechanism in accordance with that treaty, (c) to provide for payments to be made out of the central fund or the growing produce of that fund so as to enable the state to give effect to that treaty, (d) to provide for all dividends or other moneys received by the State under that treaty to be paid into the exchequer, and (e) to provide for related matters.
39	Fiscal Responsibility Act 2012	An Act to make provision for securing that the rules in Article 3 of the Treaty on Stability, coordination and governance in the economic and monetary union take effect in the law of the State in accordance with paragraph 2 of that Article and that the rule in Article 4 of that Treaty takes effect in the State; to make provision in accordance with Article 3 of that Treaty in relation to a medium-term budgetary objective and a correction mechanism; to establish a body to be known as Comhairle Chomhairleach Bhuiséadach na hÉireann or, in the english language, the Irish Fiscal Advisory Council and provide for its functions; and to provide for related matters.
40	Credit Union and Co-operation with Overseas Regulators Act 2012	An Act to amend certain provisions of the Credit Union Acts 1997 and 2001, in particular, to amend the prudential requirements for credit unions, to change the governance requirements for credit unions by removing certain management functions from boards of directors of credit unions and providing for a separate management structure and to improve the oversight and general policy functions of such boards of directors; to provide for the restructuring of credit unions and for stabilisation support to credit unions, to provide for a fund to be known as the Credit Union Fund for the purposes of such restructuring and stabilisation and to provide for levies in respect of that fund; to provide for miscellaneous matters relating to credit unions; to amend the central bank acts 1942 to 2011, to provide for co-operation between the Central Bank of Ireland and overseas regulators and to provide for the appointment of authorised officers by the Central Bank of Ireland; and to provide for matters related to the foregoing.
52	Finance (Local Property Tax) Act 2012	An Act to provide for the imposition of an annual tax to be called "Local Property Tax" in respect of certain residential properties and for the establishment and maintenance of a register of residential properties in the State by the revenue commissioners and to provide for related matters.

2013		
No	**Title**	**Purpose**
1	Euro Area Loan Facility (Amendment) Act 2013	An Act to further facilitate, in the public interest, the financial stability of the European Union and the safeguarding of the financial stability of the Euro Area as a whole and for those purposes— (a) to enable effect to be given, in so far as it relates to the state, to the amendment to the Eur 80 000 000 000 Loan Facility Agreement done in Brussels on 19 December 2012 and in Athens on 18 December 2012, (b) to provide for matters relating to subsequent amendments to the loan facility agreement which have been approved by Dáil Éireann pursuant to Article 29.5.2° of the Constitution, (c) to amend the Euro Area Loan Facility Act 2010, and (d) to provide for related matters.
2	Irish Bank Resolution Corporation Act 2013	An Act to provide for the winding up of IBRC and to provide for connected matters.
4	Finance (Local Property Tax) (Amendment) Act 2013	An Act to amend the Finance (Local Property Tax) Act 2012 and to provide for related matters.
8	Finance Act 2013	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
26	Central Bank (Supervision and Enforcement) Act 2013	An Act to further provide for the regulation and supervision of financial service providers and financial services; to further provide for the enforcement of financial services legislation; to provide for the protection of persons reporting breaches; for those and other purposes to provide for amendments to, and to further amend and extend, the Central Bank Acts 1942 to 2012 and certain other acts and statutory instruments, and to provide for related matters.
41	Finance (No. 2) Act 2013	An Act to provide for the imposition, repeal, remission, alteration and regulation of taxation, of stamp duties and of duties relating to excise and otherwise to make further provision in connection with finance including the regulation of customs.
45	Credit Reporting Act 2013	An Act to make provision for the establishment, maintenance and operation of a central credit register for the holding of information about credit applications and credit agreements and parties to them; to make provision about the information to be provided for entry on the register; to make provision for access to the information held on the register for the assessment of creditworthiness and other purposes; to impose duties on parties to credit agreements; to amend the Central Bank Act 1942; and the Central Bank (Supervision and Enforcement) Act 2013; and to make provision for related matters

Appendix 8: Powers of the Central Bank and Financial Regulator: 1992 to 2013

This Appendix sets out the powers of the Central Bank and/or the Financial Regulator in relation to its prudential policies in the period from 1992 to 2013.

It is based on a document created by the Central Bank[1] for the Banking Inquiry with respect to –

(i) powers of enforcement in relation to breaches of prudential supervision for credit institutions;

(ii) Bank's policy of enforcement in the areas of consumer protection, prudential supervision of credit institutions and other regulated firms; and

(iii) Administrative Sanctions Policy and Procedures and Guidelines.

1992-2003: The Central Bank of Ireland (CB) was responsible for financial stability and micro prudential policies during this period.

2003-2010: The Central Bank and Financial Services Authority of Ireland (CBFSAI) Act of 2003 established the Irish Financial Services Authority of Ireland (IFSRA) as an autonomous body within the CBFSAI, to deal with prudential supervision and consumer protection matters. The Central Bank retained intervention powers and through a Memorandum of Understanding was accountable for the Financial Stability consideration of the supervision outputs of banking Institutions and where micro prudential activity became a macro prudential issue.

2010-2013: "Back to the Future"- The Central Bank Reform Act, 2010, created a new single unitary body – the Central Bank of Ireland - responsible for both central banking and financial regulation. The new structure replaced the previous related entities, the Central Bank and the Financial Services Authority of Ireland and the Financial Regulator. This Act also created a harmonised system for the regulation of persons performing "controlled functions" and pre-approval controlled functions" i.e. individuals exercising significant influence on the conduct of the affairs of the financial services provider. The Act commenced on 1 October 2010. The Central Bank (Supervision and Enforcement) Act 2013 enhanced further the Central Bank's enforcement powers.

1 Item 12, Fourth Indent, CB05462 -001-018.

The table below summarises the powers available to the Central Bank and the Financial Regulator during these periods.[2]

Period 1: 1992 to 2003		
Relevant body	**Central Bank**	
Key Powers	**Details**	**Legislation**
Conditions on the issuing of a banking licence	This power could only be used to promote the orderly and proper regulation of banking. The Bank believed this was available to remove a director for fitness and probity reasons.	**Central Bank Act 1971 (CBA1971)**
Revocations	■ The Bank required the consent of the Minister for Finance to revoke a banking licence. ■ This power was available in certain circumstances, including insolvency, the conviction of the licence holder, or if circumstances had changed such that if banking licence application were now made it would be refused.	**Central Bank Act 1971 (CBA1971)**
Directions to Suspend	■ The Bank could direct the holder of a bank licence to, inter alia, suspend the carrying on of banking business, including the taking of deposits, the making of payments or the acquisition of assets and liabilities, where it was of the opinion that it was in the public interest or in certain other circumstances (e.g. if the licence holder was likely to be unable to meet its obligations). ■ The power to suspend was limited to an initial period of 6 months. ■ The exercise of this power could have the effect of preventing winding up or the appointment of a receiver. ■ If the circumstances were unlikely to be rectified, the Bank was required to apply to the High Court requiring the holder to prepare for the orderly termination of its banking business.	**Central Bank Act 1971 (CBA1971)**
Directions in relation to Advertisements	■ The Bank could give directions including a direction not to advertise for deposits, in the interest of the orderly and proper regulation of banking.	**Central Bank Act 1971 (CBA1971)**
Court Orders	■ The Bank had the power to apply for an order of the High Court to prohibit the continuance of certain contraventions of the CBA1971 e.g. contravention of sections 17 & 18 of the Act (i.e. in terms of the maintenance of records and the provision of information to the Bank), or the failure to comply with a condition imposed under section 10 of the Act.	**Central Bank Act 1971 (CBA1971)**
Summary Prosecutions	■ Section 58(1) (b) of the Act gave the Bank the power to prosecute a person who commits by act or omission a breach of a condition, or fails to comply with a direction.	**Central Bank Act 1971 (CBA1971)**
Winding Up	■ The Bank could petition the High Court to wind up a licence holder in certain circumstances (e.g. failure to comply with a direction under section 21 or if the holder was, in the opinion of the Bank, unable to meet its obligations to creditors.	**Central Bank Act 1971 (CBA1971)**
Other Supervisory Powers	■ Powers that might lead to the use of enforcement powers included a power of inspection, a power to require information, and powers to regulate ratios and the composition of assets and liabilities.	**Central Bank Act 1971 (CBA1971)**

2 Central Bank, breaches of prudential supervision by credit institutions were typically not taken, or powers not utilised, in three different periods (1992- 2002, 2003- 2010 and 2010- 2013), CB05464.

Period 1: 1992 to 2003 (continued)		
Relevant body	**Central Bank**	
Key Powers	**Details**	**Legislation**
Powers in respect of Building Societies	■ Powers with respect to Building Societies were broadly analogous to its powers for banks, but there were differences.	**Building Societies Act 1989 (BSA1989)**
Conditions on authorisation	■ If the Bank thought it proper to do so, it could impose conditions such as: ▸ Limit the issue of shares or debt instruments ▸ Require the society to take steps with regard to the conduct of business of any subsidiary or associated body ▸ Require the removal of any director or other officer ▸ Require the society to take certain steps or refrain from adopting a particular course of action	**Building Societies Act 1989 (BSA1989)**
Revocations	■ The Bank could revoke a building society's authorisation in the public interest or to protect the funds of shareholders or depositors. ■ The Minister for Finance did not have a statutory role in approving such revocations for Building Societies.	**Building Societies Act 1989 (BSA1989)**
Directions to Suspend	■ The Bank could, under section 40 of the BSA1989, issue a direction to suspend (for a period not exceeding an initial 6 months), the carrying of the ordinary business of the Society, the making of payments and the acquisition and disposal of assets or liabilities.	**Building Societies Act 1989 (BSA1989)**
Other Directions	■ The powers available to the Bank in respect of advertisements, Court Orders, Summary Prosecutions, Winding Up and Other Supervisory Powers for Building Societies were broadly similar to those for banks.	**Building Societies Act 1989 (BSA1989)**
Special Investigations	■ The Bank could, under Section 45 of the BSA1989 appoint inspectors to inspect the affairs of a building society, with powers to examine witnesses under oath and to prepare a report, which may be published. ■ On consideration of the Report, the Bank could petition for the winding up of the Society, bring proceedings in respect of fraud or misconduct, and could also refer criminal matters to the DPP.	**Building Societies Act 1989 (BSA1989)**

Period 2: 2003 to 2010		
Relevant body	**Central Bank**	
Key Powers	**Details**	**Legislation**
Imposition of specified ratios	■ The Bank may from time to time require a holder of a licence to maintain: (a) a specified ratio, (b) a ratio which does not exceed a specified ratio, or (c) a ratio which is not less than a specified ratio, between his assets and his liabilities and the specified ratio may be expressed as a percentage of the assets or liabilities concerned.	**Central Bank Act 1971 (CBA1971)**[3]
Issuing of guidelines to IFSRA	33D.— 1. Either the Governor or the Board may, with respect to the functions the Governor or the Board, issue to the Regulatory Authority guidelines as to the policies and principles that that Authority is required to implement in performing functions, or exercising powers, of the Bank. 2. The Regulatory Authority is required to comply with guidelines issued to it under this section. 3. Guidelines issued by the Governor or the Board under this section shall be in writing and the Governor or the Board, as the case may be, shall cause them to be published in Iris Oifigiúil as soon as practicable after they are issued.	**Section 33D Central Bank and Financial Services Act 2003**

3 Patrick Honohan, letter of 12 February 2015 to the Joint Committee of Inquiry into the Banking Crisis, CB07423

Period 2: 2003 to 2010 (continued)		
Relevant body	**IFSRA**	
Key Powers	**Details**	**Legislation**
Administrative sanctions: **A. Background**	■ The CBFSA2004 gave the Authority the power to impose administrative sanctions, without recourse to the Courts, for breaches of specified regulatory requirements which occurred on or after 1 August 2004. ■ These sanctions could include fines, a requirement to repay monies to customers and disqualification of directors and managers. ■ The Bank undertook extensive preparatory work producing an internal procedures manual, consulting externally, developing departmental policies and obtaining advice from Senior Counsel as required. ■ The Authority decided at its meeting in June 2005 that administrative sanctions should be brought into use progressively from 1 July 2005, with active consideration to the use of the powers in relation to consumer protection cases, to be followed by broader consideration of the option to use sanctions for other matters later. ■ The Authority issued statutory guidelines and published procedures in October 2005.	**Central Bank and Financial Services Act 2004 (CBFSA2004)**

Period 2: 2003 to 2010 (continued)		
Relevant body	**IFSRA**	
Key Powers	**Details**	**Legislation**
Administrative sanctions: **B. Overview**	■ If the Financial Regulator has a concern that a prescribed contravention may have been committed, an examination into the issue may be commenced. ■ Once the examination has been concluded, a decision will be taken as to whether an inquiry should be established once the financial services provider has had an opportunity to respond. ■ An inquiry may be held where there are reasonable grounds to suspect that there has been a prescribed contravention. The inquiry will decide if the prescribed contravention has occurred and determine the appropriate sanctions. ■ As an alternative, the Administrative Sanctions Procedure provides that the matter may be resolved by entering into a settlement agreement which binds both the Financial Regulator, and/or persons concerned in the management of the financial services. ■ Decisions of an inquiry may be appealed to the Financial Services Appeals Tribunal and the High Court.	**Central Bank and Financial Services Act 2004 (CBFSA2004)**
Administrative sanctions: **C. Enforcement**	■ Enforcement options include: a) Supervisory action (e.g. enhanced regime, supervisory warning) b) Agree a settlement. c) Refer the case to an inquiry for determination and sanction. d) Initiate a criminal prosecution or e) Refer to another authority or enforcement body ■ Enforcement action should promote compliance: a) by the regulated service provider b) within the industry or sector ■ The enforcement action should be proportionate, and be likely to support the economic, efficient and effective pursuit of the strategic objectives of the Financial Regulator. ■ Types of sanctions available include: a) Caution or reprimand. b) Direction to refund or withhold money to be charged. c) Monetary penalty (not exceeding €5,000,000 for a corporate and €500,000 in the case of a person). d) Direction disqualifying a person. e) Direction to cease the contravention if it is found to be continuing. f) Direction to pay all or part of the costs of the investigation and inquiry.	**Central Bank and Financial Services Act 2004 (CBFSA2004)**

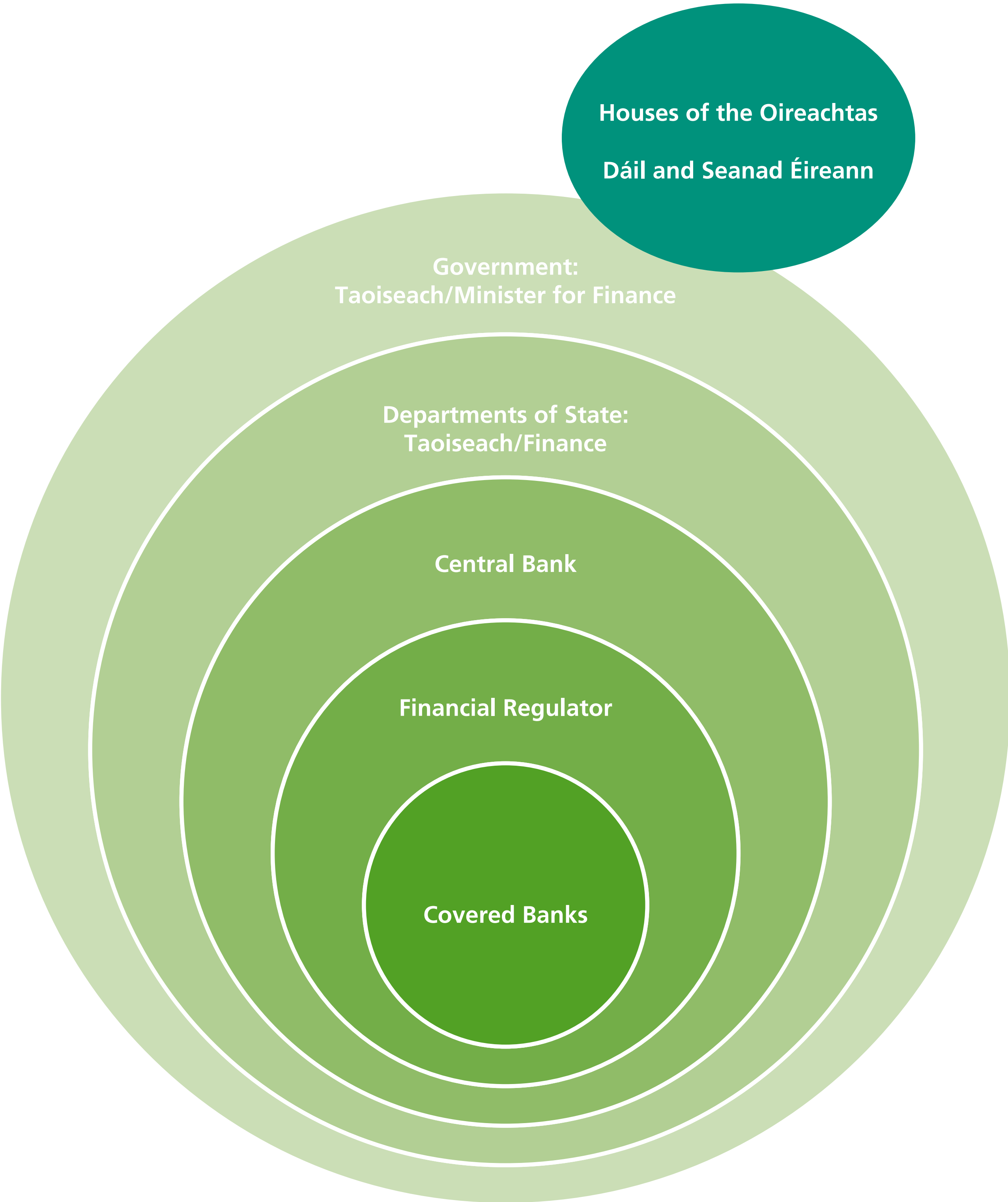
Period 2: 2003 to 2010 (continued)		
Relevant body	**Irish Financial Services Appeals Tribunal**	
Key Powers	**Details**	**Legislation**
Appeals against certain decisions of the Central Bank	■ The Irish Financial Services Appeals Tribunal, "The Appeals Tribunal" was established by the Central Bank and Financial Services Authority of Ireland Act 2003, but only constituted in January 2007. ■ The Appeals Tribunal is an independent tribunal which will hear and determine appeals from aggrieved parties against certain decisions of the Central Bank of Ireland. ■ The Appeals Tribunal aims to provide an accessible, efficient and effective method of appeal in an informal and expeditious manner.	**Section 28 of the Central Bank and Financial Services Authority of Ireland Act 2003**

Period 3: 2010 to 2013		
Relevant body	**Central Bank**	
Key Powers	**Details**	**Legislation/year**
Creation of a unified regulatory authority within the Central Bank		**Central Bank Reform Act 2010**
Creation of a harmonised system for the regulation of persons performing "controlled functions" and "pre-approval controlled functions" i.e. individuals exercising significant influence on the conduct of the affairs of the financial services provider.	■ The Central Bank has a "gatekeeper" role in respect of individuals seeking appointment to a pre-approved controlled function. A regulated firm cannot appoint an individual to such a role without the prior approval of the Central Bank. ■ In order to determine an individual's fitness and probity the Central Bank may request the individual (or the specified officer/employee of the applicant financial services provider) to produce certain information/documents, answer questions or attend for interview. ■ Controlled functions do not require the pre-approval of the Central Bank before appointment. However, all persons occupying such functions must comply with the Fitness and Probity Standards as published by the Central Bank in 2011. ■ From the commencement in December 2011 up to February 2015 some 10,857 applications for pre-approved functions had been approved and 422 applications were withdrawn.	**Central Bank Reform Act 2010 Part 3**
Introduction of New Regulatory Model	■ The Central Bank indicated in its Strategic Plan 2010 - 2012 that it was introducing a new regulatory model – risk-based, more intrusive and challenging. This was developed into what was known as PRISM (Probability Risk and Impact SysteM).	**2011**
Introduction of formal escalation procedure	■ In 2010, the Central Bank introduced a formal escalation procedure whereby regulatory issues were required to be reported to senior colleagues and, if sufficiently important, to the Supervisory Risk Committee of the Bank.	**2010**
Establishment of Enforcement Directorate	■ The Enforcement Directorate was established in June 2010 and its responsibilities are as follows: ▸ To take administrative sanctions procedure cases under Part IIIC of the Central Bank Act 1942 ▸ Advise on cases under the Market Abuse Regulations 2005 ▸ Advise on and assist with potential actions on fitness and probity grounds ▸ Refusals of applications for and revocations of existing authorisations and ▸ Summary criminal convictions ■ The Enforcement Division also issues private Supervisory Warnings to regulated financial service providers. This is a non-statutory device that is available where the Central Bank has reasonable cause to suspect that a "prescribed contravention" was committed but where it is considered that that an administrative sanction is not warranted. ■ Since 2011, the Central Bank has published "Enforcement Priorities" on an annual basis. ■ The Irish Financial Services Appeals Tribunal was set up as outlined by the Central Bank and Financial Services Authority of Ireland Act 2003. It acts like a court but is outside the normal court system. It is a forum that can hear appeals relating to some decisions made by the Financial Regulator and has the authority to decide them.	**2010**

Period 3: 2010 to 2013 (continued)		
Relevant body	**Central Bank**	
Key Powers	**Details**	**Legislation/year**
Requirements of firms and auditors	■ The CB can issue a notice to require a financial services provider to furnish a report on any matter by a skilled person. ■ It can also require an auditor of a bank to provide a statement on compliance of a firm with obligations.	**Central Bank (Supervision and Enforcement) Act 2013**
Administrative sanctions: **Enforcement penalties**	■ On Enforcement, this Act increased the maximum penalties that could be imposed under Administrative Sanctions (to €10m or 10% of turnover for firms, and €1m for individuals.).	**Central Bank (Supervision and Enforcement) Act 2013**
Customer redress	■ The CB can direct a Regulated Provider to make appropriate redress to customers where there has been "widespread or regular relevant defaults".	**Central Bank (Supervision and Enforcement) Act 2013**
Directions/regulations	■ The CB has wide-ranging powers to give written directions to a firm, and make a broad range of regulations for the "proper and effective regulation" of Regulated Providers; the latter is subject to an obligation to consult in advance with the Minister for Finance.	**Central Bank (Supervision and Enforcement) Act 2013**
Orders	■ The CB can apply to the High Court for an order restraining a person from engaging in conduct which would contravene financial services legislation.	**Central Bank (Supervision and Enforcement) Act 2013**

Period 3: 2010 to 2013 (continued)		
Relevant body	**European Central Bank (ECB)**	
Key Powers	**Details**	**Legislation/year**
Direct supervision of significant credit institutions **(with effect from 4 November 2014)**	■ In Ireland, as at January 2015, the following are significant credit institutions: 1. Allied Irish banks plc, 2. Permanent TSB Group Holdings plc, 3. The Governor and Company of the Bank of Ireland, 4. Ulster Bank Ireland Ltd. ■ The ECB is able to take direct enforcement and sanction proceedings against significant credit institutions and can instruct the Central Bank to use its supervisory powers or open proceedings against such institutions.	**European Union (Single Supervisory Mechanism) Regulations 2014**

Appendix 9: Key Roles 2000-13: State, Regulators, Banks



Dáil Term: 2002-2013

28th Dáil	29th Dáil	30th Dail	31st Dáil
to April 2002	June 2002 to April 2007	June 2007 to Feb 2011	March 2011 to Dec 2013

Government: Taoiseach and Minister for Finance: 2000-2013

Position	28th Dáil	29th Dáil	30th Dail	31st Dáil
Taoiseach	Bertie Ahern	Bertie Ahern	Bertie Ahern *(to May 2008)* Brian Cowen *(to March 2011)*	Enda Kenny
Minister for Finance	Charlie McCreevy	Charlie McCreevy *(to Sept 2004)* Brian Cowen	Brian Cowen *(to May 2008)* Brian Lenihan	Michael Noonan

Secretaries General of Departments: 2000-2013

Department	28th Dáil	29th Dáil	30th Dail	31st Dáil
Taoiseach	Dermot Gallagher *(to July 2001)* Dermot McCarthy	Dermot McCarthy	Dermot McCarthy	Dermot McCarthy *(to July 2011)* Martin Fraser
Finance	John Hurley *(to March 2002)* Tom Considine	Tom Considine *(to June 2006)*	David Doyle *(to January 2010)* Kevin Cardiff	Kevin Cardiff *(to February 2012)* John Moran

Main Opposition Party Leaders: 2000-2013

Party	28th Dáil	29th Dáil	30th Dail	31st Dáil
Largest Opposition Party				
Fine Gael	John Bruton *(to Feb 2001)* Michael Noonan *(to June 2002)*	Enda Kenny	Enda Kenny	
Fianna Fáil				Micheál Martin
Second Largest Opposition Party				
Labour	Ruairi Quinn	Pat Rabbitte	Eamon Gilmore	
Sinn Féin				Gerry Adams

Dáil Term: 2002-2013

28th Dáil	29th Dáil	30th Dail	31st Dáil
to April 2002	**June 2002 to April 2007**	**June 2007 to Feb 2011**	**March 2 011 to Dec 2013**

Central Bank Board: 2000-2013

	2002	2002-7	2007-11	2011-13
Governor	Maurice O'Connell *(to March 2002)* John Hurley	John Hurley	John Hurley *(to Sept 2009)* Patrick Honohan	Patrick Honohan
Director General/ Deputy Governor	Liam Barron	Liam Barron *(to August 2007)*	Tony Grimes	Tony Grimes *(to July 2011)* Stefan Gerlach (Central Banking) Matthew Elderfield (Financial Regulation)

Financial Regulator Board: 2003-2010 (merged into Central Bank in October 2010)

	2002	2002-7	2007-11	2011-13
Chairman		Brian Patterson	Brian Patterson *(to April 2008)* Jim Farrell	
Chief Executive		Liam O'Reilly *(to Jan 2006)* Patrick Neary	Patrick Neary *(to Jan 2009)* Mary O'Dea (acting) *(to Jan 2010)* Matthew Elderfield	
Prudential Director		Patrick Neary *(to Jan 2006)* Con Horan	Con Horan	
Consumer Director		Mary O'Dea	Mary O'Dea	

Dáil Term: 2002-2013

28th Dáil	29th Dáil	30th Dail	31st Dáil
to April 2002	June 2002 to April 2007	June 2007 to Feb 2011	March 2011 to Dec 2013

Bank Boards (Six Covered Banks): 2000-2013

Allied Irish Bank	2002	2002-07	2007-11	2011-13
Chairman	Dermot Gleeson	Dermot Gleeson	Dermot Gleeson *(to July 2009)* Dan O'Connor *(to Oct 2010)* David Hodgkinson	David Hodgkinson
Chief Executive Officer	Michael Buckley	Michael Buckley *(to June 2005)* Eugene Sheehy	Eugene Sheehy *(to Nov 2009)* Colm Doherty *(to Nov 2010)* David Duffy	David Duffy
Finance Director or equivalent	Gary Kennedy	Gary Kennedy *(to Dec 2005)* John O'Donnell	John O'Donnell *(to Aug 2009)* Maeliosa O'hOgartaigh *(Acting to May 2010)* Bernard Byrne	Bernard Byrne *(to May 2011)* Paul Stanley *(Acting to Aug 2013)* Myles O'Grady (Acting)
Anglo Irish Bank	**2002**	**2002-07**	**2007-11**	**2011-13** **IBRC from 1 July 2011**
Chairman	Anthony O'Brien *(to Dec 2001)* Peter Murray	Peter Murray *(to Jan 2005)* Sean Fitzpatrick	Sean Fitzpatrick *(to Dec 2008)* Donal O'Connor* *(Chairman to June 2010)* Alan Dukes	Alan Dukes *(until Special Liquidation)* Kieran Wallace and Eamonn Richardson – Joint Special Liquidators *(Feb 2013)*
Chief Executive Officer	Sean Fitzpatrick	Sean Fitzpatrick *(to Jan 2005)* David Drumm	David Drumm *(to Dec 2008)* *Donal O'Connor** *(Executive Chairman to Sep 2009)* Mike Aynsley	Mike Aynsley *(until Special Liquidation)*
Finance Director or equivalent	William McAteer	William McAteer	William McAteer *(to Jan 2009)* Matt Moran *(to Jan 2010)* Maarteen van Eden	Maarteen van Eden *(to May 2011)* Jim Bradley *(to Special Liquidation)*

* Temporarily the Executive Chairperson carrying out the roles of both Chairman and CEO

Dáil Term: 2002-2013

Bank of Ireland	2002	2002-07	2007-11	2011-13
Governor	Laurence Crowley	Laurence Crowley *(to July 2005)* Richard Burrows	Richard Burrows *(to July 2009)* Patrick Molloy	Patrick Molloy *(to June 2012)* Archie Kane
Chief Executive Officer	Maurice Keane *(to Sep 2001)* Michael Soden	Michael Soden *(to May 2004)* Brian Goggin	Brian Goggin *(to Feb 2009)* Richie Boucher	Richie Boucher
Finance Director or equivalent	Paul D'Alton *(to Sep 2001)* John O'Donovan	John O'Donovan	John O'Donovan	John O'Donovan *(to Dec 2011)* Andrew Keating

EBS	2002	2002-07	2007-11	2011-13 Became a subsidiary of AIB plc on 1 July 2011
Chairman	Brian Joyce	Brian Joyce *(to Dec 2006)* Mark Moran	Mark Moran *(to Mar 2009)* Philip Williamson	Philip Williamson *(to June 2011)*
Chief Executive Officer	Ted McGovern	Ted McGovern	Ted McGovern *(to Sep 2007)* Fergus Murphy	Fergus Murphy *(to Nov 2012)* Des Fitzgerald *(Managing Director)*
Finance Director or equivalent	John Cullen	John Cullen *(to May 2005)* Alan Merriman	Alan Merriman *(to Mar 2009)* Emer Finnan	Emer Finnan *(to Dec 2011)*

IL&P Group/ptsb[1]	2002	2002-07	2007-11	2011-13
Chairman	Roy Douglas	Roy Douglas *(to June 2004)* Gillian Bowler	Gillian Bowler	Gillian Bowler *(to May 2011)* Alan Cook
Chief Executive Officer	David Went	David Went *(to May 2007)* Denis Casey	Denis Casey *(to Feb 2009)* Kevin Murphy	Kevin Murphy *(to Dec 2011)* Jeremy Masding *(CEO ptsb from Feb 14 2011 and Permanent tsb Group Holdings plc from June 2012)*
Finance Director or equivalent	Peter Fitzpatrick	Peter Fitzpatrick	Peter Fitzpatrick *(to Feb 2009)* David McCarthy	David McCarthy *(to June 2012)* Glen Lucken

1 For IL&P the Chairman and Executives listed had a Group role including the oversight of ptsb up to the formation of Permanent tsb Group Holdings plc in June 2012 when the Group split and Irish Life was sold to the Government for further onward sale to a third party ultimately occurring in July 2012.

Dáil Term: 2002-2013

INBS	2002	2002-07	2007-11	2011-13 IBRC from 1 July 2011
Chairman	Michael Walsh	Michael Walsh	Michael Walsh (to Feb 2009) Daniel Kitchen	Daniel Kitchen Kieran Wallace and Eamonn Richardson – Joint Special Liquidators *(Feb 2013)*
Chief Executive Officer	Michael Fingleton	Michael Fingleton	Michael Fingleton *(to Apr 2009)* Daniel Kitchen (Interim CEO to June 2011) Gerry McGinn	Gerry McGinn *(to Aug 2011)*
Finance Director or equivalent	John Stanley Purcell	John Stanley Purcell	John Stanley Purcell *(to Apr 2009 – New CFO appointed and then retired in Mar 2010)* John McGloughlin	John McGloughlin

Appendix 10: European Responses to the Crisis: Budgetary, Fiscal and Banking Changes

As part of our Terms of Reference, the Joint Committee heard evidence on reforms of EU budgetary and fiscal structures. The limited number of witnesses who gave evidence on this aspect did not lead us to make any conclusions or findings. We have however decided to include a narrative summary of the evidence which we heard, which may be of public interest, in conjunction with our publication of witness statements and transcripts.

Categories of reform introduced since the crisis

The reforms introduced since the crisis may be broadly categorised into three areas:

- Reforms to monitor the economic performance of Member States more closely, and enforce the fiscal rules agreed at European level.
- Reforms to mitigate the sovereign debt crisis within the Eurozone.
- Reforms in the supervision and regulation of the banking system, including measures aimed at firstly preventing and secondly mitigating the effects of any future crisis.

Failings identified

Some of the shortcomings in EU policy in the years prior to the crisis were outlined by Marco Buti[1]:

- Within the EU it had been assumed that macroeconomic stability could be ensured through two main policy instruments. These were the control of inflation, which was entrusted to the ECB, and the maintenance of a prudent and sustainable fiscal policy.
- The focus of the European Commission was on ensuring that countries complied with the terms of the Stability and Growth Pact[2] with little consideration given to other macroeconomic policy areas. Important areas such as the financial sector, house price developments and national current account imbalances were not sufficiently monitored.
- Financial stability risks were mainly treated as relating to individual banks, and not the economy as a whole. The EU had therefore adopted a principles-based approach based on minimum harmonisation.
- The working assumption was that the supervisory authorities in each jurisdiction would be capable of addressing any stability risks within their own banking sectors.

Other witnesses gave evidence on the inherent weaknesses of the pre-crisis framework. Paul Gallagher, highlighted the oversight weaknesses arising from the separation of monetary matters from both fiscal policy and banking supervision:

"…the European legal architecture, which was provided for in the Maastricht Treaty and which set up the European Monetary Union, was significantly lacking in important respects. Control of money

1 Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, CTX00057-005 to 008.

2 The Stability and Growth Pact required countries to maintain a budget deficit of less than 3% and a maximum debt of 60%, both measured against national GDP.

matters and, in particular money supply, rested with the ECB. However, the legal responsibility for each member state's financial system rested with that state. Interest rates were set by the ECB having regard to the overall situation in Europe and not by reference to the individual situation of any member state … Each state, however, was at the time individually in control of, and responsible for, its banking system."[3]

Donal Donovan, provided an explanation for the shared failure to identify the growing structural deficit in the Irish economy in the lead up to the crisis:

"In Ireland's case, the IMF, together with the Department of Finance, went along with the common EU methodology used to calculate the CAB [cyclically adjusted fiscal balance]… The problem was that this methodology assumed that the high output levels reached by Ireland in the first half of the decade of the 2000s, which in turn reflected the massive reliance on the construction sector, were permanent structural features."[4]

Marco Buti said:

"It was the incompleteness of the tools to monitor surveillance that we had at the time. Now we are much better equipped. The strengthening of the monitoring system and the co-ordination system have been put in place since the crisis, through the so-called tool box on the banking side and the banking macro balances procedure. We had an incomplete set of tools."[5]

He further explained the reforms undertaken since 2008 to correct the deficiencies:

"…the EU immediately launched an important and far-reaching reform process to upgrade and complete its economic governance structure. First, the EU surveillance framework has been strengthened with the so-called six-pack. Secondly, the scope of EU surveillance has been extended to include all relevant instruments beyond public finances; this was achieved with the introduction of the macroeconomic imbalances procedure...Third, the banking union was introduced, including in particular the Single Supervisory Mechanism and the Single Resolution Mechanism."[6]

Economic reforms: Fiscal Compact Treaty

Derek Moran, described shortcomings in the Stability and Growth Pact and the changes subsequently made to enhance its effectiveness. He said:

"…prior to the crisis the EU tended to give the Irish budgetary position a broadly clean bill of health it shouldn't have had….. It also fell short of pushing other countries through the various levels of the excessive deficit procedure, which may have had a strong signalling effect across the Union"… and *". The changes to the pact have been very significant, its principal elements are enshrined in domestic and constitutional law in member states and it [is] has become much more automatically enforceable - it now has real teeth."*[7]

3 Paul Gallagher, former Attorney General, transcript, INQ00110-004.

4 Donal Donovan, former International Monetary Fund Deputy Director, transcript, PUB00296-005.

5 Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, CTX00057-031.

6 Marco Buti, Director General for Economic and Financial Affairs, European Commission, transcript, CTX00057-008.

7 Derek Moran, Secretary General and former Assistant Secretary Department of Finance, statement, DMO00001-012, transcript, INQ00114-004.

The reforms referred to comprise the Fiscal Compact Treaty and two initiatives referred to colloquially as the "Six Pack" and "Two Pack".

Brian Cowen described the purpose of the Fiscal Compact Treaty and it effects post-crisis. He said:

"In the aftermath of the crisis the European institutions and individual Member States examined the existing fiscal rules and how they could be improved to help limit the possibility of imbalances in the public finances which developed during the 2000s from reoccurring.

We began work aimed at introducing a domestic fiscal framework that would establish fiscal rules, multi-annual fiscal planning and performance budgeting for expenditure. This national process got overtaken by the negotiations on the reform and strengthening of the Stability and Growth Pact… The present Government took up this process of negotiations when it took office in March 2011 which culminated in the strengthening and reform of the Stability and Growth Pact."[8]

The Treaty was adopted by Ireland in the Fiscal Responsibility Act 2012[9] having previously been approved by way of Referendum. The Act introduced a number of significant changes to the management of the national budget:

- A requirement that the budget must be either in surplus or in balance, or else must be moving towards that position in accordance with the rules set out in the Act.
- The creation of the Irish Fiscal Advisory Council, an independent body whose duties include independent assessment and endorsement of the macroeconomic and budgetary forecasts produced by the Department of Finance. It must also confirm that the Government's fiscal policy is conducive to ensuring adherence to the terms of the Stability and Growth Pact.
- A debt rule designed to reduce general government debt to within 60% of GDP by means of budgetary rules was encoded in the Act.
- Corrective actions which must be taken in the event that the European Commission issues a warning under its Excessive Deficit Procedures (i.e. if the Commission determines that Ireland is not complying with the rules of the Stability and Growth Pact). The Act requires a corrective plan to be laid before the Dáil within two months of such a warning being received.

Economic reforms: "Two Pack" and "Six Pack" initiatives

The objectives of the "Two Pack" and "Six Pack" measures were described by Derek Moran in his statement as follows:

"The six-pack: This is a set of five regulations and one directive that strengthened the sanctions regime and introduced additional features such as the expenditure benchmark that limits the growth in expenditure. Council decisions on interest bearing deposits and fine (0.2% of GDP) under the preventive arm now use reverse Qualified Majority Voting[10] *which increases the automaticity of such decisions.*

8 Brian Cowen, former Taoiseach and Minister for Finance, statement, BCO00002-032.

9 Fiscal Responsibility Act 2012 (No. 39 of 2012).

10 The application of Reverse Qualified Majority Voting means that a fine will be applied by the European Commission unless a qualified majority of 55% of countries representing at least 65% of total EU population vote against the fine being imposed. Article 7 of the Fiscal Compact Treaty.

Two-pack: These are two regulations that harmonised the budgetary timeline and introduced the requirement for Member States to submit a draft budgetary plan by 15 October each year as well as introducing a requirement that fiscal planning must be based on macroeconomic projections that are produced or endorsed by an independent body (assigned to Irish Fiscal Advisory Council)."[11]

While the combination of the Six Pack, Two Pack and Fiscal Compact Treaty means that the EU now employs a more comprehensive surveillance of national budgets than previously, the willingness of the Commission to follow through and enforce the new rules has yet to be properly tested, according to Derek Moran's evidence. He said:

"The one thing about rules is they're there to be gamed and the real risk is a political risk. What happens when a major European country gets themselves in trouble? How sustainable are they? ...... I've been around long enough to know that these things will evolve and not always evolve in the right direction."[12]

The view was echoed by the evidence of Philip Lane, who said:

"I think those restraints are not fool proof. If a government really wants to ignore the fiscal council and ignore the fiscal rules, it probably can get away with that for quite a bit. It depends on the political system buying into that rules-based framework. That is for the members, as politicians, to work out."[13]

Brian Cowen said: "the domestic fiscal rules were not proceeded with in favour of those that were being devised at EU level so as to ensure there would be no conflict between domestic and EU requirements".[14]

The sovereign debt crisis

A further problem which had to be tackled by the EU, and more particularly the Eurozone Member States, was the sovereign debt crisis which began to emerge in late 2009 following on from the financial crisis of 2008. Philip Lane said:

"During 2010-2012, one source of speculative pressure related to redenomination risk, by which investors feared that some countries might leave the euro and redenominate sovereign debts into new national currencies."[15]

The fear of countries exiting the euro was driven by the scale of sovereign budget deficits arising from the crisis. Kevin Cardiff said:

"Since the previous May 2010, led by the difficulties in Greece, markets were taking increasingly sceptical views of a number of countries and were less and less willing to lend to them. Interest rates on their bonds had to rise to provide a sufficient reward for investors willing to invest in these

11 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, statement, DMO00001-012.

12 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-019.

13 Philip Lane, Professor of International Macroeconomics and Director at the Institute of International Integration Studies, Trinity College Dublin, (Now Governor of the Central Bank of Ireland), transcript, CTX00059-029.

14 Brian Cowen, former Taoiseach and Minister for Finance, statement, BCO00002-032.

15 Philip Lane, Professor of International Macroeconomics and Director at the Institute of International Integration Studies, Trinity College Dublin, (Now Governor of the Central Bank of Ireland), statement, CTX00041-012.

countries' "risky" sovereign bonds."[16]

The EU response to the growing crisis was described in a paper prepared by the NTMA, in which it was stated:

"In May 2010 the EU also agreed a general stabilisation mechanism for the eurozone until mid-2013 for an amount of €750bn. This comprised:

- *the European Financial Stability Facility (EFSF): €440bn*
- *the European Financial Stabilisation Mechanism (EFSM): €60bn*
- *IMF funds: €250m*

In addition, it was agreed that the ECB could purchase eurozone countries' sovereign debt on the secondary markets."[17]

The EFSM[18] and EFSF[19] were subsequently utilised to fund assistance programmes for Ireland, Portugal and Greece before being superseded by the European Stability Mechanism (ESM) in 2012. The ESM is now the permanent stability mechanism for Eurozone Member States with a lending capacity of up to €500 billion.[20]

In his evidence, Alan Gray, said:

"EU fiscal rules provide some constraints on fiscal policies but there is a question mark over their effectiveness in preventing governments in times of economic growth from over expanding an economy. Existing EU rules may be designed to suit larger EU states and this may imply a weakness for smaller open economies. This can lead to boom-bust policies.

For a small open economy such as Ireland, inappropriate fiscal policy can be particularly damaging. Consideration could therefore be given to: Securing all-party agreement on new binding rules to ensure fiscal responsibility."[21]

Regulatory reforms

The European Commission Director of Regulation and Prudential Supervision, Mario Nava, said:

"… [the] deficiencies … revealed important shortcomings in the governance of the institutional framework for supervision itself and it sparked a period of unprecedented reforms in the EU, backed by an international consensus on the causes of the financial crisis and responses needed to address it."[22]

16 Kevin Cardiff, former Secretary General and Second Secretary General, Department of Finance, statement, KCA00002-133.

17 NTMA Advisory Committee paper entitled European Debt Crisis: Resolution Mechanism, NTMA00353-003.

18 The European Financial Stabilisation Mechanism (EFSM) provides financial assistance to all EU Member States in financial difficulties. (Source: Europa.eu).

19 The European Financial Stability Facility (EFSF) was created as a temporary crisis resolution mechanism by the euro area Member States in June 2010. The EFSF has provided financial assistance to Ireland, Portugal and Greece. The assistance was financed by the EFSF through the issuance of bonds and other debt instruments on capital markets. (Source: Europa.eu).

20 Source: European Stability Mechanism http://www.esm.europa.eu/assistance/FCC/index.htm.

21 Alan Gray, Economist, former Non Executive Director, Central Bank, and Managing Director of Indecon Economic Consultants, AGR00025-009.

22 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-003.

He described the first phase of reforms which were implemented in 2009 and 2010 as an immediate response to the banking crisis. These reforms, which were mostly of a regulatory nature, prescribed a more intrusive regulatory approach. He said:

"… there has been … a pronounced shift to a more rule based approach, introducing a more detailed guidance in the regulatory framework for the supervisors to ensure that they step up their supervisory scrutiny….[including] liquidity management, large exposures, remuneration, management of securitisation, trading exposures and supervisory cooperation. For example, banks were required to develop robust strategies, policy, processes and systems for the identification, measurement, management and monitoring of liquidity risks and funding positions."[23]

The second phase of regulatory reform:

"was adopted in 2013 and represented a more fundamental revision of the regulatory framework, responding in particular to the review of international prudential standards in the Basel III framework…. This includes new rules regarding the quality and quantity of banks' regulatory capital, more detailed and harmonised rules dealing with liquidity, funding risks and excessive leverage, and measures improving banks' corporate governance, including rules realigning incentives."[24]

The role of supervisors was also further enhanced. Mario Nava said:

"Supervisors have obtained enhanced sanctioning powers and are required to carry out their duties in a more intrusive, intense and forward-looking manner. Particular attention was given to measures improving supervisors' capacity to take appropriate remedial action at an early stage by putting more emphasis on macro prudential consideration."[25]

The aforementioned prudential and regulatory reforms reflect only one part of the *"period of unprecedented reforms"* as described by Mario Nava.[26] The wider process also included structural changes, along with reforms to assist the future resolution of banks in difficulty, as set out in the next two sections.

Structural reforms and the single rule book

New EU institutions were created to better manage the supervision of financial stability and prudential risk. Ann Nolan said:

"The 2009 de Larosiére report recommended the establishment of a new European Systemic Risk Board and three new supervisory authorities, the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authorities. These bodies set technical standards, resolve disputes between supervisors and assist in developing consistent interpretation of European law."[27]

Two of these institutions are of particular importance: the European Systemic Risk Board and European Banking Authority.[28]

---

23 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050- 004.

24 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-004.

25 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-004.

26 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-003.

27 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-005.

28 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-005.

European Systemic Risk Board (ESRB): Chaired by the President of the ECB, this board was established in 2010 with the task of identifying and prioritising systemic risks, issuing appropriate warnings, and recommending measures to be taken in response to the risks identified. Its creation followed recognition that national regulators across the EU had paid insufficient attention to the build-up of macro systemic risks prior to the crisis.[29]

European Banking Authority (EBA): This was created *"to promote convergency of supervisory practices in the EU and to improve communication and mutual trust among supervisors."*[30]

One of principal tasks set for the EBA at the outset was the creation and maintenance of the single European banking *"rule book"* - a unified set of banking regulations and supervisory practices effective throughout Europe. The importance of that in the context of the Single European Market was underscored by Mario Nava, who said:

"…a single rule book…respond[s] to the need for a more harmonised set of rules across the Single Market, to provide a true level playing field on which EU banks can compete. The degree of flexibility previously granted to member states and national supervisors … had led to divergent transposition of EU rules into national law. This created opportunities for regulatory arbitrage and hampered legal clarity. To achieve greater convergence, various options and discretions have been removed."[31]

Banking union and future crisis management

The lack of an EU-wide approach to banking recovery and resolution had been laid bare during the financial crisis, not least in the isolation felt by Ireland as described in the build up to the guarantee decision. Within the Euro area, the reforms went one stage further with the creation of a Banking Union.

Ann Nolan said:

"….the banking union proposal….centralised banking supervision and resolution for euro area countries, with a possible opt-in for non-euro countries. The Single Supervisory Mechanism, SSM, was set up as a new branch of the ECB with responsibility for supervising the top 130 banks in Europe. The bank restructuring and resolution directive, BRRD, was also agreed to provide for a single resolution mechanism to resolve financial institutions in difficulties."[32]

Introduced into law in 2013 and fully operational from November 2014, the Single Supervisory Mechanism (SSM), a pillar of the European Banking Union, has placed responsibility for Eurozone banking supervision directly with the ECB. In this expanded capacity it now directly supervises around 120 of the largest *"significant"* banks in the Eurozone, while smaller, *"non significant"* banks continue to be regulated on a day-to-day basis by the relevant national authority.[33]

29 This description of the ESRB was provided to the Inquiry by Klaus Regling, Managing Director, European Stability Mechanism, transcript, CTX00060-009/029.

30 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-005.

31 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-004.

32 Ann Nolan, Second Secretary General, Department of Finance, transcript, INQ00076-005.

33 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-005.

The Single Resolution Mechanism, through the establishment of the Single Resolution Board, has also created a framework for dealing with banks getting into financial difficulty.

Patrick Honohan gave his view of the Single Supervisory Mechanism (SSM):

"I am a great believer in taking banking regulation away from national pressures and perspectives. It is always risky changing regulatory structures. It is somewhat bureaucratic; it is somewhat slow in its decision-making, though when there were crucial decisions that we have needed to have taken, we have managed to accelerate them. I am cautiously optimistic."[34]

Matthew Elderfield said:

"The Single Supervisory Mechanism (SSM) is a welcome innovation for Ireland and the Euro Zone. The SSM is valuable in that creating some distance between supervisors and the banks they regulate has helped to improve the capacity for challenge and ensure a broader, more detached, perspective on problems. Moreover, the SSM offers an opportunity to develop a best practice framework, broader skill set and more diversity of experience to strengthen supervision."[35]

Protecting the taxpayer

As stated in Mario Nava's evidence, the cost of any such resolution procedures would in future be paid by the private sector rather the taxpayer.[36] Thus a key objective is to ensure that any future banking crisis would result in minimum impact on taxpayers. Furthermore, he said that EU-level reforms in their totality provide a number of important safeguards to prevent a similar reoccurrence: *"a more robust set of tools making a future crisis less likely and, if one were to happen, less costly"*. [37]

These reforms are summarised as follows:

Structural and prudential reforms: The numerous such reforms are designed to ensure that banking and systemic risks are better identified and rigorously regulated on a consistent, European-wide basis. These may be described as the preventative reforms, aimed at avoiding any future excessive build-up of risk within the banking system.

Centralised risk management: In the event that one or more banks do get into difficulty, the existence of the Single Resolution Board should now provide an efficient, centralised structure and methodology for dealing with events, particularly on a cross border basis.

Enhanced capital requirements: Should losses occur, the enhanced capital requirements implemented under Basel III[38] and subsequent EU Directives will ensure a much larger pool of shareholders' equity to absorb these losses in the first instance.

---

34 Patrick Honohan, former Governor, Central Bank, transcript, PUB00352-111.

35 Matthew Elderfield, former Deputy Governor, Central Bank, statement, MEL00001-006.

36 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-005.

37 Mario Nava, European Commission Director of Regulation and Prudential Supervision, transcript, CTX00050-005.

38 Basel III: A global regulatory framework for more resilient banks and banking systems December 2010 (rev June 2011) http://www.bis.org/publ/bcbs189.pdf.

Bond 'bail in' capacity: The Single Resolution Regime has also now placed into European law the ability to *"bail in"* bondholders in cases where shareholder equity is insufficient to fully absorb losses. This can include a write down in the value of bonds, or conversion of bonds into equity as part of a restructure.[39]

Single Resolution Fund: Should losses extend beyond that which can be covered by shareholders' equity and bondholders, a final layer of protection within the Banking Union is the Single Resolution Fund. This fund is to be built up over a period of 8 years from fees levied on banks regulated within the Single Supervisory Mechanism. By 2024, when the scheme is fully funded, a reserve of approximately €55 billion, equivalent to 1% of deposits held, will be available if needed to assist any resolution scheme.[40]

39 Banking Resolution and Recovery Directive 2014/59/EU http://eur-lex.europa.eu/legal-content.

40 Council Implementing Regulation (EU) 2015/81 of 19 December 2014. http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0081&from=EN.

Appendix 11: Structural and Cultural Changes in the Central Bank and the Department of Finance

As part of our Terms of Reference, the Joint Committee heard evidence on the extent of changes in the Central Bank and the Department of Finance since the crisis. This evidence was primarily based on self-assessment by witnesses on behalf of those two institutions and only a limited number of external witnesses gave evidence on this issue.

Due to the limited number of witnesses, we did not have sufficient external, balancing evidence on which to base conclusions or findings. We have, however, decided to include a narrative summary of the evidence which we heard, which may be of public interest, in conjunction with our publication of witness statements and transcripts.

Section 1: The Central Bank

Corporate governance code for financial institutions

One of the reports previously prepared on the crisis is the report entitled *"A Preliminary Report on the Sources of Ireland's Banking Crisis"* (the *"Regling and Watson Report"*). The Regling and Watson Report identifies failures in corporate governance as one of the primary causes of the financial crisis: *"Errors of judgement in bank management and governance contributed centrally to Ireland's financial crisis."*[1]

Patrick Honohan was also critical, particularly in respect of the absence of effective codes for both corporate and internal governance or fitness and probity reviews.[2]

Alan Gray, former board member of the Central Bank, observed that: *"Regulatory systems did not cause the crisis, but did not prevent the practices which led to the crisis."*[3]

In response to such failings, a concerted effort was made to strengthen the corporate governance framework for financial institutions.

In June 2010, the European Commission issued a Green Paper on corporate governance in financial institutions and remuneration policies.[4] The Commission noted that, because of the systemic nature of many of the main players in the financial services sector, corporate governance requirements should take into account the interests of all stakeholders including depositors, savers and policy holders, as well as the stability of the financial system.

---

1 Regling and Watson, A Preliminary Report on The Sources of Ireland's Banking Crisis, PUB00168-029.

2 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-054/057.

3 Alan Gray, Economist, former Non Executive Director, Central Bank, and Managing Director of Indecon Economic Consultants, statement, AGR00001-011.

4 European Commission Green Paper Corporate governance in financial institutions and remuneration policies, KPMG00938.

In the Irish context, the Central Bank issued a paper on 21 June 2010 on a new approach to banking supervision.[5] This paper proposed new principles guiding governance of financial institutions, fitness and probity requirements for directors and senior management requirements and remuneration standards. Following on from the publication of this paper, the Central Bank issued the Corporate Governance Code for Credit Institutions in November 2010 (the Code).[6]

The Code set out minimum statutory requirements on how banks should organise their governance. It contained provisions on the membership of the board of directors, the role and responsibilities of the Chairman and other directors and the operation of various board committees. The Code provided that it was to apply to existing directors and boards from 1 January 2011.[7] The largest banks became subject to additional requirements under the Code, reflecting their significance from a risk perspective[8].

New fitness and probity standards

EU and Irish law now require that the directors and senior managers of financial institutions must meet prescribed standards of competence and probity – generally referred to as the *"fit and proper"* standards.[9] These standards primarily fulfil a *"gatekeeper"* role in ensuring that key positions at board and senior management level within financial institutions are filled by people of competence and integrity.[10]

In May 2006, the Irish Financial Regulator issued *"Fit and Proper Requirements"* which became effective from 1 January 2007, but only for new office-holders or those changing position ("the Requirements").[11] The *"fit and proper test"* in the Requirements provided for the completion of an *"Individual Questionnaire (IQ)"* by applicants.

On 1 December 2011, Matthew Elderfield introduced new statutory regulations and standards of fitness and probity, which set the requirements for entry into and removal from senior positions within entities regulated by the Central Bank (for existing and new office holders).[12]

Under the Central Bank Reform Act 2010 (the 2010 Act)[13], the Central Bank received enhanced new statutory powers to veto senior appointments (CEO, Directors, Company Secretary and other Controlled Functions). The 2010 Act also provided for the suspension or removal individuals from senior positions across the financial services sector. The 2010 Act further provided that, where appropriate, the Central Bank could also prohibit individuals from working in senior industry positions entirely.

5 Central Bank & Financial Services Authority Paper dated 21 June 2010 "Banking Supervision: Our New Approach"; Annual Performance Statement (Financial Regulation) 2010-2011, Annex 2, PUB00057-053.

6 The Central Bank's policy efforts during the period 2003-2010, CB00069-005.

7 The Central Bank's policy efforts during the period 2003-2010, CB00069-006.

8 The Central Bank's policy efforts during the period 2003-2010, CB00069-006.

9 Central Bank, Fit and Proper Requirements May 2006, CB07235.

10 The "Fitness" standard requires that a person appointed as a director or manager must have the necessary qualifications, skills and experience to perform the duties of that position. "Probity" requires that a person is honest, fair and ethical.

11 Central Bank, Fit and Proper Requirements May 2006, CB07235.

12 Central Bank, Fitness and Probity Standards 2011, RBO00001-002.

13 The 2010 Act was commenced on 1 October 2010.

Notably, the Central Bank also commissioned reviews of governance and risk management standards at the two largest banks, AIB and BOI.[14]

Cyril Roux, Deputy Governor of the Central Bank said: *"The EBA conducted a review of our fitness and probity performance in 2014 and out of all the countries in the EU, only eight were fully compliant and were at the highest standard of fitness and probity surveillance, and Ireland was part of that. Now, I think we can get some comfort on this bit."*[15]

Central Bank Reform Act, 2010

According to a paper prepared by the Central Bank,[16] the 2010 Act was the first of a three stage legislative process to create a new fully-integrated structure for financial regulation consistent with best practice in the EU and internationally. The 2010 Act was also intended to enhance the powers and functions of the Central Bank and to consolidate existing banking-related legislation.

The key objective of the 2010 Act was the establishment of a new single fully-integrated institution to be known as the Central Bank of Ireland with a unitary board, known as the Central Bank Commission, to be chaired by the Central Bank Governor. The stated purpose of the new structure was to ensure that the domestic regulatory framework for financial services would meet government objectives for:

- maintaining the stability of the financial system.
- effectively and efficiently supervising financial institutions and markets.
- safeguarding the interests of consumers and investors.

The 2010 Act also:

1. Set out new powers for the Central Bank to ensure the fitness and probity of nominees to key positions within banks and other financial service providers and their key office-holders (e.g. board members and senior management).
2. Provided for the transfer of responsibility for consumer information and education functions to the Competition and Consumer Protection Commission.
3. Removed the Central Bank's statutory function of promoting the development within the State of the financial services industry.
4. Set out new enhanced accountability and oversight mechanisms including:
    - A specific focus of the Competition and Consumer Protection Commission on regulatory performance, including development of performance benchmarks.
    - Annual Performance Statements on regulatory performance prepared by the Central Bank, presented to the Minister for Finance and laid before the Houses of the Oireachtas. This was additional to the Central Bank's strategy statement (prepared at least every three years) and to its annual report and accounts.

---

14 Address to the Chairpersons' Forum Institute of Public Administration by Matthew Elderfield, PUB00410.

15 Cyril Roux, Deputy Governor (Financial Regulation), Central Bank, transcript, INQ00099-012.

16 Central Bank of Ireland & Financial Services Authority Paper "Banking Supervision: Our New Approach", PUB00411.

- Regular international peer reviews of regulatory performance with the report of same forming part of the performance statement for the relevant year.
- Provision that a Committee of the Oireachtas would have the ability to call the Governor and/or the heads of functions to be examined on the Performance Statement.[17]

New approach to supervision

In the Paper entitled *"Banking Supervision: Our New Approach"*, the Central Bank proposed a transformation in its approach to banking supervision and sought to institutionalise the lessons learnt from the financial crisis.[18] The Central Bank intended to implement a more *"intrusive"* approach to the prudential supervision of banks. In broad terms, the changes outlined by the Central Bank were:

1. changes to supervisory structures.
2. changes to supervisory culture and approach.
3. changes to the regime within which we supervise.
4. a greater focus on international supervisory cooperation.[19]

Having reviewed the evidence furnished to the Inquiry in relation to this period, it appears that, following the enactment of the 2010 Act, changes did take place at the Central Bank Commission (the Central Bank board) level as well as at the most senior level of the Central Bank (Director level). Examples of the more significant organisational changes were as follows:

Patrick Honohan, the tenth Governor of the Central Bank of Ireland, was appointed in September 2009. In a departure from the profile of his predecessors who, for more than 60 years, had been senior civil servants drawn from the Department of Finance, Patrick Honohan was Professor of International Financial Economics and Development at Trinity College Dublin and spent almost a decade at the World Bank, where he was Senior Advisor on financial sector policy.

Matthew Elderfield, formerly the CEO of the Bermuda Monetary Authority, took up his position as Head of Financial Regulation in the new Central Bank of Ireland in January 2010 and became Deputy Governor in 2011.

Changes to supervisory structures

The main organisational changes provided for under the Central Bank Paper were as follows:

1. The two frontline banking supervision departments were restructured as a Retail Banking department and a Wholesale Banking department, grouping banks with similar models and associated risks within the respective departments.
2. A new team, Prudential Analytics, staffed by quantitative specialists, financial analysts and business model experts, was established to support supervisors.

17 Memorandum for Government, Draft text of the Central Bank Reform Bill, DOF06657.

18 Central Bank of Ireland & Financial Services Authority Paper "Banking Supervision: Our New Approach", PUB00411-035.

19 Central Bank & Financial Services Authority Paper dated 21 June 2010 "Banking Supervision: Our New Approach"; Annual Performance Statement (Financial Regulation) 2010-2011, Annex 2, PUB00057-053.

3. A dedicated Enforcement Directorate was set up to have investigative expertise and deliver a credible threat of enforcement action.
4. The Policy and Risk Directorate addressed the need to overhaul the domestic framework for regulation, in line with international recommendations and best practice. [20]

Changes to supervisory culture and approach

The changes introduced under the 2010 Act sought to address the weaknesses identified in the Honohan Report[21] through:

1. the delivery of a more assertive, risk-based and challenging approach to banking supervision.
2. a commitment that supervisors would be more strategic and examine carefully banks' commercial direction.
3. the recruitment of specialists with industry experience to ensure frontline supervisory staff had access to the requisite expertise and support.
4. the insistence on action by regulated financial service providers to mitigate identified risks.[22]

Changes to the supervisory regime

The five principal change categories provided for in the Central Bank Paper were:

1. risk-based supervision
2. a probability risk and impact system called *"PRISM"*
3. enforcement
4. greater focus on international supervisory cooperation
5. changes in staffing

Risk-based supervision

From 2010, the Central Bank's stated approach to regulating financial services providers was based on a model of intrusive risk-based supervision underpinned by a credible threat of enforcement.[23] The Central Bank publicly stated that it intended to focus on the financial institutions which are most significant and on the risks that pose the greatest threat to financial stability and consumers.[24]

PRISM

In November 2011, the Central Bank launched PRISM (Probability Risk and Impact SysteM), which was designed to enhance the Central Bank's ability to deliver judgement-based, outcome-focused regulation. The Central Bank's stated intent was to provide a unified and systematic risk-based framework, to allow banking supervisors to challenge the financial firms they regulate, judge risks

---

20 Central Bank of Ireland & Financial Services Authority Paper "Banking Supervision: Our New Approach", PUB00411-002.

21 Honohan Report, The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, May 2010, PUB00075-044/081.

22 Central Bank Annual Performance Statement (Financial Regulation) 2010-2011, PUB00057-006.

23 Cyril Roux, Deputy Governor (Financial Regulation), Central Bank, transcript, INQ00099-018/021.

24 Central Bank Annual Performance Statement Financial Regulation 2011-2012, PUB00059-005.

and take action to mitigate those risks.[25] PRISM has subsequently been replaced by the prescriptions of the SSM supervisory manual, which Cyril Roux said *"are guided by a similar, if not more tough intrusive and sceptical ethos."*[26]

Enforcement

The Central Bank and Financial Services Authority of Ireland Act 2003 (CBFSAI Act 2003), implemented in 2005, gave the Financial Regulator the power to take action against financial institutions by way of administrative sanctions.[27] However, in practical terms, these sanctions were not used against financial institutions for breaches of prudential regulations in the pre-crisis period (see Chapter 4).

The Enforcement Directorate was established within the Central Bank in June 2010[28] to address a gap in the regulatory regime, namely to provide the capability to take action against financial institutions where they failed to manage their risks adequately[29]. The Directorate is organised into two divisions:

1. The Enforcement I Division - established to enforce actions under the administrative sanctions and market abuse regimes, special investigations and fitness and probity cases.
2. The Enforcement II Division - established to monitor, inspect, report and enforce Anti-Money Laundering (AML), Counter Terrorism Financing (CTF) requirements and EU Financial Sanctions. This Division is also responsible for investigation of unauthorised business activity.[30]

International supervisory cooperation

In 2013, the Central Bank contributed technical assistance in the formative processes that ultimately established the framework for the ECB's Single Supervisory Mechanism (SSM). The principal objectives of the SSM are to ensure the safety and soundness of the European banking system and to increase financial stability in Europe. The SSM introduced a new system of financial supervision in Europe, comprising the ECB and the national supervisory authorities of participating EU countries. The ECB assumed its new role as supervisor of the larger Irish banks[31] and Euro area banks in November 2014.[32]

Staffing

According to the evidence of a number of witnesses from the Central Bank, banking supervision was significantly under-resourced in the run-up to the banking crisis. This was independently verified in a Mazars Report published in February 2009.[33]

25 Central Bank Annual Performance Statement Financial Regulation 2011 – 2012, PUB00059-038.
26 Cyril Roux, Deputy Governor (Financial Regulation), Central Bank, transcript, INQ00099-005.
27 http://www.irishstatutebook.ie/eli/2003/act/12/enacted/en/html
28 Part IIIC of the Central Bank Act, 1942, as amended.
29 Central Bank, Annual Performance Statement (Financial Regulation) 2010-2011, PUB00057-042.
30 Central Bank, Annual Performance Statement (Financial Regulation) 2010-2011, PUB00057-042.
31 AIB, BOI, PTSB and Ulster Bank Ireland.
32 Central Bank, Annual Performance Statement Financial Regulation 2013 – 2014, PUB00063-005.
33 Towards a "Best Practice Organisation" Mazars, February 2009, PUB00271.

In the period following the banking crisis, it was planned to increase staffing numbers involved in banking regulation within the Central Bank from 349 in 2009 to 725 by 2012. The objective behind this increase was to enable the Central Bank to execute its powers and responsibilities effectively.[34] However, at the date of this report, the staffing issue remains a challenge for the Central Bank.

In his evidence, Cyril Roux said:

"So I would say for prudential supervision, we have some vacancies. We have 124 people when we have our approved complement ... or we have estimated we need 140. But I think, here, where we are an outlier is mostly in terms of supervisory experience."[35] *… "So I think it's a continuous challenge to staff adequately ... not even to lose people, just to replace people who are leaving is the challenge."*[36]

Central Bank Supervision and Enforcement Act, 2013

The Central Bank (Supervision and Enforcement) Act, 2013 came into effect on 1 August 2013 (the 2013 Act). [37] The 2013 Act significantly enhanced the capacity of the Central Bank to supervise regulated entities, including banks, and to enforce financial services legislation.

The 2013 Act strengthened regulation in a number of ways, provided better tools for risk assessment, increased enforcement sanctions against firms and individuals, set clearer regulatory and policy making powers, provided a new best practice whistle blowing standard and increased the level of sanctions it may impose.

The 2013 Act also provided the Central Bank with the ability to pass new types of regulations, the power to issue wider-ranging directions, wider powers for authorised officers and the ability to require skilled persons reports from regulated entities. Skilled Persons reports require a regulated entity to produce a report, at the entity's own expense, on matters specified by the Central Bank. The decision to commission such a report is usually prompted by a specific requirement on the part of the Central Bank for information, analysis of information, assessment of a situation, expert advice or recommendations.

The 2013 Act doubled the administrative sanctions, increasing the maximum fine for individuals and bodies corporate to €1 million and €10 million (or 10% of annual turnover) respectively. In his evidence to the Inquiry, Cyril Roux provided an overview of the principal fines levied by the Central Bank on banks for offences committed prior to 2014:

"Banks entered into a settlement with us for failing to ensure the accuracy of its liquidity reporting and to have internal controls in place ... Allied Irish Banks admitted to the contraventions, they accepted a reprimand and penalty of €490,000. Citibank Europe entered into a settlement with us on contraventions of liquidity requirements and also paid a monetary penalty of half a million."[38]

34 Annual Performance Statement (Financial Regulation) 2010-2011, PUB00057-042.

35 Cyril Roux, Deputy Governor (Financial Regulation), Central Bank, transcript, INQ00099-007.

36 Cyril Roux, Deputy Governor (Financial Regulation), Central Bank, transcript, INQ00099-008.

37 Central Bank (Supervision and Enforcement) Act 2013 (Commencement) Order 2013; See Department of Finance, Narrative on Reports into Financial Crisis and actions taken, DOF02474-002.

38 Cyril Roux, Deputy Governor (Financial Regulation), Central Bank, transcript, INQ00099-013.

Consumer Protection

Amid efforts to improve the supervision and prudential regulation of banks, the Central Bank had to remain cognisant of the severe impact of the financial crisis on the customers of the financial institutions. While all categories of consumer borrowing deteriorated, the area of principal concern related to home loan arrears.

In response, the Financial Regulator introduced the Code of Conduct on Mortgage Arrears in February 2009 (updated most recently in 2013)[39] in order to ensure fair and consistent treatment for borrowers who fall into arrears on their home loans. The Central Bank also introduced an updated version of its Consumer Protection Code[40] in January 2012.

The Central Bank Consumer Code applies to all financial services products and providers. It includes both general principles and specific requirements for regulated product providers and covers topics such as arrears handling, errors and complaints resolution procedures, amongst others.[41]

Although not within the remit of the Central Bank, a further important reform for customers suffering from the financial fallout of the crisis was the introduction of the Personal Insolvency Act 2012 (the 2012 Act).[42] The 2012 Act introduced a number of new measures for dealing with borrowers in financial distress, with the aim of making the majority of cases quicker and easier to deal with, rather than resorting to bankruptcy, which previously was the only fall back option. The 2012 Act also introduced measures to update the bankruptcy legislation, the most significant being a reduction to the bankruptcy term from twelve years to three in the majority of cases.

Reviews of the Central Bank's performance

In his evidence, Cyril Roux drew attention to two reviews.[43] The first review was a balance sheet assessment carried out by the Central Bank of the three remaining Covered Institutions, conducted as part of the 2013 Financial Measures Programme.[44] This review concluded that the Covered Institutions were mostly in financial working order and required only moderate strengthening of their provisions, which were addressed by actions taken in their year-end accounts.

The second review which Cyril Roux mentioned was one conducted by the IMF.[45] That IMF review found that, since the crisis had begun, the Central Bank had taken substantive steps to rebuild its functions in financial regulation and supervision. These steps included changes in the institutional setting, changes of senior staff, and increases in the quantity (albeit from a very low base) and calibre of supervisory staff.

39 Financial Regulator Code of Conduct on Mortgage Arrears, February 2009; Annual Performance Statement (Financial Regulation) 2011-2012, PUB00059-068/069.

40 Central Bank of Ireland, Consumer Protection Code 2012 Annual Performance Statement (Financial Regulation) 2011-2012, PUB00059-068/069.

41 Central Bank of Ireland Consumer Protection Code, 2012, PUB00059-068/069.

42 Draft Press Release Minister Shatter publishes Scheme of Personal Insolvency Bill, DOF06841-001.

43 Cyril Roux, Deputy Governor (Financial Regulation), Central Bank, transcript, INQ00099-003.

44 Central Bank Annual Performance Statement Financial Regulation 2013 – 2014, PUB00063-005.

45 IMF Detailed Assessment of Observance of Basel Core Principles for effective Banking Supervision April 2014, PUB00283.

The IMF acknowledged the design and implementation of a proactive and intensive approach to supervision, the expansion of prudential requirements and improvements in enforcement powers. Overall, the IMF ascribed to the Central Bank and to Ireland, as of 2013, a satisfactory level of compliance with the Basel Core Principles for Effective Banking Supervision.

The Central Bank Reform Act 2010 also requires that the Central Bank make appropriate arrangements for an international peer review of its regulatory performance to be carried out at least every four years. The first such review was scheduled to be undertaken in 2014 but, as at the time of writing of this report, the output of that review had not been made public.

Summary of regulatory changes at EU and national levels

Michael Noonan summarised the suite of regulatory changes adopted since the financial crisis occurred as follows:

"…The effectiveness of the current governance regime has been enhanced by a suite of reforms to the Irish banking and regulatory system, initiated at both an Irish and EU level. Such reforms include the European banking union, which will provide for centralised supervision and will help to rebuild trust and confidence in the European banking sector. Importantly, the link between the banks and the sovereigns has been broken and the bailout of banks has been replaced with bail-ins".

"At the domestic level, a significant amount of reform was undertaken in the financial regulation … These reforms will form the foundation of a strong and effective governance structure, which will go a long way to making sure a boom and bust-type of cycle will not reoccur…"[46]

Section 2: Department of Finance

The Department of Finance plays a lead and central role in the formulation and management of Ireland's economic affairs, especially with regard to macro-economic matters and fiscal stewardship. Thus, along with the regulatory authorities and the banks, the Department is entrusted with a special responsibility.

While oversight of the financial system is not the Department's responsibility, it nonetheless has a role to play. This is particularly so in the context of bank debt becoming entwined with sovereign debt.

In the wake of the financial crisis, Brian Lenihan commissioned a review of the Department of Finance's policy, advice and performance over the previous ten years and on how best the Department might adapt to meet challenges in the future (commonly known as the Wright Report).[47] A number of reforms were recommended on foot of the Wright Report and this section seeks to provide an overview of the proposed reforms that were implemented.

46 Michael Noonan, Minister for Finance, transcript, INQ00102-007.

47 Report of the Independent Review Panel, Chaired by Rob Wright (former Deputy Minister for Canada), 'Strengthening the Capacity of the Department of Finance', (commonly known as the Wright Report), published in December 2010, PUB00175.

The Wright Report

The Wright Report was published in December 2010 and provided an assessment of performance of the Department before and during the financial crisis. At the time of writing the Wright Report, the financial crisis had entered its second substantive phase, with the Troika Bailout agreed almost simultaneously with completion of the Report.

The Wright Report contains 50 recommendations across a wide range of topics, including risk analysis, economic and fiscal forecasting, the budgetary process, policy advice, internal structures, and human resources and skills requirements. The findings of the Wright Report related to the Department of Finance as it was structured and resourced at the time of the writing of the Report. Thus, it covered a number of functions which were reassigned months later to the new Department of Public Expenditure and Reform, established after the 2011 General Election.

The newly established Department of Public Expenditure and Reform was assigned the dual goals of reducing public spending to sustainable levels and reforming public services.[48] Although key to improving the efficiency and effectiveness of the public service, thereby acting as a driver of stability and growth, the Department of Public Expenditure and Reform's policies and actions do not impact directly on the financial system and accordingly are outside of terms of this Inquiry.

Follow-up by the Department of Finance to the Wright Report

The Department of Finance submitted its own assessment of the changes implemented since the publication of the Wright Report to the Inquiry.[49] The Department's assessment provides a detailed response on, *inter alia*, actions taken in respect of the 50 Wright Report recommendations. Amongst the principal actions outlined in the Department assessment document are:

More structured interaction: Internal and external interaction are now on a more structured footing, internally between divisions and externally between the Department and other Departments, as well as the Central Bank, NTMA, ESRI and external experts.

Expanded 'Principals Group': The *'Principals Group'* (which replaced the Domestic Standing Group) involves key officials from the Central Bank, the NTMA and the Department. This group was used on bank restructuring and the Bailout negotiations, meeting weekly or more frequently, where required.[50]

Memorandum of Understanding: The Department now has in place a Memorandum of Understanding (MOU) with the NTMA setting out the roles and responsibilities of each party in relation to the compilation of debt data and servicing forecasts.[51]

Shareholding Management Unit: The Department's oversight of NAMA is now managed by the Shareholding Management Unit (the Unit), which is staffed with banking specialists on secondment from the NTMA's banking division. The Unit is responsible for ensuring that Ministerial

48 www.per.gov.ie/en/what-we-do-2/

49 Department of Finance, Report of the changes made in response to the Wright Review, created for the Banking Inquiry, DOF02844.

50 John Moran, Secretary General & former Second Secretary General, Department of Finance, statement, JMO00002-013.

51 Department of Finance, Report of the changes made in response to the Wright Review, created for the Banking Inquiry, DOF02844-006.

responsibilities under the NAMA legislation are fulfilled and that the NAMA's objectives are met. There is now regular interaction with senior executives of NAMA, both on a formal and informal basis, involving frequent meetings.[52]

Codified governance: The Department has formally codified its governance structures and processes in a single document.[53]

Improved external consultation: There is an increase in the Department's engagement with other Departments and bodies on the identification and management of risk, including fiscal and economic risks. This engagement is not supported by a legislative mandate.

Improved internal risk analysis: The Department has engaged with the development of the National Risk Assessment process (including identification of economic and financial risks in the 2014 NRA document). It is working with the Department of the Taoiseach in progressing a methodology for managing and mitigating the identified risks.[54]

In his evidence, Derek Moran, Department of Finance, said: *"I went through all 50 recommendations of the Wright report, Regling-Watson and the Governor'[s] [Report] and so on … I'm fairly well satisfied that, you know, we've pretty much implemented them all"*.[55] Derek Moran added *"… this is never a finished project. You need to keep doing more and more and more and to the extent possible, benchmark what you're doing against best practice elsewhere"*.[56]

Changes of Approach within the Department of Finance Post-Crisis: Tax Policies and Fiscal Matters

Evidence was provided to the Joint Committee by a number of witnesses on behalf of the Department of Finance in relation to the changes that have occurred in respect of taxation and fiscal matters in the aftermath of the financial crisis.

Tax policy

The Tax Policy Division within the Department now has some 35 staff. As part of the budgetary process, the Division chairs and supports the high-level Tax Strategy Group which considers between 10 and 20 separate tax policy papers prepared internally each year.[57]

Fiscal policy

The Irish Fiscal Advisory Council (IFAC), which was placed on a statutory footing in December 2012, provides independent assessments of Department of Finance budgetary forecasts and proposed fiscal policy objectives.[58] In his evidence, John McHale, chairman of IFAC, said: *"under the leadership of the [Department's] Chief Economist, the quality of the Department's macroeconomic*

52 Department of Finance, Report of the changes made in response to the Wright Review, created for the Banking Inquiry, DOF02844-007.

53 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, statement, DMO00001-013.

54 Wright Report, Strengthening the Capacity of the Department of Finance, DOF02844-007.

55 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-025.

56 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-026.

57 These papers are published on the Department's website after each budget- Department of Finance, DOF02844-008/009.

58 John McHale, Chairman, Irish Fiscal Advisory Council, statement, JMH00001-003.

forecasting work is of a high level."[59]

However, he pointed to a deficiency in the Fiscal Responsibility Act 2012 in that it does not provide IFAC with a statutory right to information, a principle identified by the OECD for best practice for independent fiscal institutions:

"…not have the resources to produce a full set of our own benchmark budgetary forecasts…"[60] and he said *"the Fiscal Responsibility Act does not provide the Council with a statutory right to information. Such a right is also one of the principles identified by the OECD for best practice for independent fiscal institutions."*[61]

Michael Noonan said that the Fiscal Council must endorse the budget forecast and added: *"… otherwise I can't build the budget on the forecast that Finance produces. Now, that's an extremely strong power... an extremely strong power and it's mandatory….. [on] which we base the budget, they have to be endorsed by the Irish Fiscal Advisory Council."*[62]

John McHale said that *"the Council receives very good cooperation from the Department in its review work."*[63] He concluded that the framework now in place, which combines complementary domestic and European elements *"……. should help ensure that the budgetary policy mistakes that contributed to the vulnerabilities of the Irish economy in the past are not repeated"*.[64]

Contrarian views

The Department has identified the need for greater inclusiveness in Departmental management as one of its guiding principles specifically in respect of engaging at all levels within the Department, including more junior roles and across disciplines. A number of new standing subcommittees of the MAC[65], such as risk, policy, EU strategy and capital markets allow for greater in-depth analysis than could occur during MAC meetings.[66]

On the accommodation of dissenting opinions on economic matters, Secretary General, Derek Moran said that the process of developing a position on the economic policy *"would include discussions across the range of people"* and that the ultimate position *"would've taken on board very, very different views….."*[67]. He added that contrarian views are now incorporated *"dissent ... or contrarian views … are accommodated within that sort of dialogue that goes through the process."*[68] He concluded that the Department *"had in place procedures and processes that allowed an appropriate discussion, particularly of ... visions around housing and construction and so on."*[69]

59 John McHale, Chairman, Irish Fiscal Advisory Council, statement, JMH00001-005.
60 John McHale, Chairman, Irish Fiscal Advisory Council, statement, JMH00001-006.
61 John McHale, Chairman, Irish Fiscal Advisory Council, statement, JMH00001-007.
62 Michael Noonan, Minister for Finance, transcript, INQ00102-023.
63 John McHale, Chairman, Irish Fiscal Advisory Council, statement, JMH00001-005.
64 John McHale, Chairman, Irish Fiscal Advisory Council, statement, JMH00001-003.
65 Management Advisory Committee, Department of Finance.
66 Department of Finance, Report of the changes made in response to the Wright Review, created for the Banking Inquiry, DOF02844-014.
67 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-005.
68 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-005.
69 Derek Moran, Secretary General and former Assistant Secretary, Department of Finance, transcript, INQ00114-006.

Appendix 12: Glossary of Technical Terms and Acronyms

Asset Covered Securities (ACS)	As defined in the Asset Covered Securities Act 2001: (a) in relation to a designated or formerly designated mortgage credit institution, means mortgage covered securities issued by the institution, and (b) in relation to a designated or formerly designated public credit institution, means public credit covered securities issued by the institution.
Bailout, bailout programme	The EU-IMF financial Assistance Programme put in place in December 2010, when Ireland received financial assistance from the European Union, Euro area Member States, the International Monetary Fund and bilateral loans from the United Kingdom, Denmark and Sweden. The total package agreed was for €85bn with a €17.5bn contribution from Ireland through Exchequer funds and from the National Pension Reserve Fund (NPRF). Among the mechanisms used were the European Financial Stability Mechanism (EFSM) and European Financial Stability Facility (EFSF). Also referred to as the "Troika Bailout".
Banks	As used in this Report, refers to: ■ Allied Irish Banks, p.l.c. ■ Anglo Irish Bank Corporation plc ■ The Governor and Company of the Bank of Ireland ■ EBS Building Society ■ Irish Life & Permanent plc ■ Irish Nationwide Building Society ■ Ulster Bank Ireland Limited.
Bank Asset	A bank asset includes: 1. a credit facility i.e. a loan 2. any security relating to a credit facility, 3. every other right arising directly or indirectly in connection with a credit facility, 4. every other asset owned by a participating institution, and 5. an interest in a bank asset referred to in any of (1) to (4).
Bank Guarantee	The guarantee entered into by the Irish Government on 30th September 2008 in respect of the deposits and borrowings of six Irish-owned banks for the period of two years. Legislated under the "Credit Institutions (Financial Support) Act 2008. The banks covered by the guarantee were Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Life & Permanent Plc, Irish Nationwide Building Society and EBS. Initially Postbank Ireland was also included but this was subsequently deemed unnecessary. Certain subsidiaries of the banks were also covered.
Banking Crisis	The period between 2007 and 2010 when Irish banks initially began to report increasing arrears on their loan books and then faced liquidity issues. Also referred to as "the Crisis".
Banking Regulation	A form of government regulation which imposes on banks certain requirements, restrictions and guidelines. The regulatory structure aims to create transparency between banking institutions and their clients. The objectives of banking regulation include prudential (to reduce the level of risk to which bank creditors are exposed), systemic risk reduction (to reduce the risk of disruption resulting from adverse trading conditions for banks causing multiple or major bank failures), and rules about the fair treatment of customers.
Banking Supervision	The act of monitoring the financial performance and operations of banks in order to ensure that they are operating safely and soundly and following rules and regulations.
Basel Committee on Banking Supervision	A committee of banking supervisory authorities established by the central bank governors of the Group of Ten countries in 1974 with the objective of enhancing understanding of key supervisory issues and improving the quality of banking supervision worldwide. The committee frames guidelines and standards in different areas, such as the international standards on capital adequacy (Basel I, Basel II and Basel III).
Basel Process	Refers to the role of the Bank for International Settlements (BIS) in hosting and supporting the work of the international secretariats engaged in standard setting and the pursuit of financial stability.

Basel I	The International Convergence of Capital Measurements and Capital Standards published by the Basel Committee in July 1988. This Framework provided the basis for capital adequacy using a limited number of risk weightings (see Risk Weighted Assets).
Basel II	This Capital Adequacy Framework, which supersedes Basel I, was issued in June 2004, as implemented by directive 2006/48/EC and Directive 2006/49/EC. The Framework introduced new sensitivity risk weightings and revised supervisory requirements.
Basel III	Updated guidelines for capital and banking regulations were published on 16 December 2010, with implementation having commenced on a phased basis with effect from 1 January 2013.
Board of Directors, or Board	The governing body of a company or institution generally made up of members of the Executive Management and Non-Executive Directors.
Bond	An IOU issued by a borrower to a lender. Bonds can be issued by governments, local authorities or public companies on a fixed or variable interest rate basis. They will generally have a specified maturity date and the interest paid is called the coupon.
Bondholders	A person or company that owns a bond. The bond represents a debt that the bond issuer owes to the bondholder. Thus, a bondholder usually has the right to receive principal and interest on this debt. In the event of the bankruptcy of the issuer, bondholders have priority over shareholders in the liquidation of assets.
Broker	Intermediate third party who carries out an activity on a commission basis. The sector is colloquially known as the "Broker Market".
Building Society	A financial institution owned by its members as a mutual organisation
Bullet Repayment	The final repayment of a loan, which consists of the whole sum borrowed at the start. Any interim repayments are interest-only.
Burden-Sharing	The issue of finding an appropriate way to involve the private sector investors in crisis resolution. This would require that investors bear some or all of the losses associated with impaired assets.
Buy To Let	Purchase e.g. of a property specifically to rent it out for investment purposes. A buy to let mortgage is a mortgage specifically designed for this purpose.
Capital	Made up of equity (proceeds from issue of shares plus retained earnings) and certain debt instruments. There are various definitions, some broader than others, used by regulators and the financial market.
Capital – Core Tier 1	The narrowest sub set within Tier 1 Capital. It only includes "pure" equity capital (e.g. proceeds from issue of shares plus retained earnings) which is "loss absorbing" on a going concern basis. As the market/regulators increasingly focus on the quality of capital, this has become more important. See also *Tier 1 Capital* and *Promissory Note*.
Central Bank of Ireland, Central Bank	The Central Bank of Ireland is the financial services regulator. The institution was founded under the Central Bank Act 1942 which came into effect on 1 February 1943 when the Currency Commission was renamed the Central Bank of Ireland.In 2003 it was further renamed the Central Bank and Financial Services Authority of Ireland with a new constituent part called the IFSRA. (see *Irish Financial Services Regulatory Authority*).The Central Bank Reform Act 2010 created a new single unitary body – the Central Bank of Ireland - responsible for both central banking and financial regulation. The new structure replaced the previous related entities, the Central Bank and the Financial Services Authority of Ireland and the Financial Regulator. The Act commenced on 1 October 2010.
Charge	Includes: ■ a mortgage, judgment mortgage, charge, lien, pledge, hypothecation or other security interest or encumbrance or collateral in or over any property or other asset, ■ an assignment by way of security, and ■ an undertaking or agreement by any person (including a solicitor) to give or create a security interest in property or other asset;
Consumer Protection	The protection, especially by legal means, of the consumer. It is the policy of utilising legislation to protect consumers against unfair contract terms.
Coupon	The interest rate payable to a bondholder over the lifetime of a bond.

Covered Institutions	The following credit institutions or subsidiaries of credit institutions operating in Ireland which are covered by the Government's guarantee Scheme declared by the Minister for Finance on 30 September 2008 and given legislative effect in the Credit Institutions (Financial Support) Act 2008: 1. Allied Irish Banks, p.l.c. and its subsidiaries AIB Mortgage Bank, AIB Bank (CI) Limited, AIB Group (UK) plc and Allied Irish Banks North America Inc. 2. Anglo Irish Bank Corporation plc and its subsidiary Anglo Irish Bank Corporation (International) plc. 3. The Governor and Company of the Bank of Ireland and its subsidiaries Bank of Ireland Mortgage Bank, ICS Building Society and Bank of Ireland (I.O.M.) Limited. 4. EBS Building Society and its subsidiary EBS Mortgage Finance; 5. Irish Life & Permanent plc and its subsidiary Irish Permanent (IOM) Limited. 6. Irish Nationwide Building Society and its subsidiary Irish Nationwide (I.O.M.) Limited. 7. Postbank Ireland Limited.
Credit Default Swap (CDS)	A financial contract whereby a buyer of corporate or sovereign debt in the form of bonds attempts to eliminate possible loss arising from default by the issuer of the bonds.
Crisis	See *Banking Crisis*
Cross-Sale	Action of selling an additional product or service to a customer who has an existing relationship or a specific other product requirement. An example would be looking to sell home insurance to a customer taking out a mortgage for a house.
Debt security	A note, bill, bond or similar financial instrument.
Deposit Guarantee Scheme Directive (DGS)	Council Directive 94/19/EC, 30 May 1994 was the original EU Directive covering state guarantees of deposits. It was reviewed in 2005-06 but not revised and then in 2008 proposals were brought to amend the original directive and Directive 2009/14/EC was adopted on March 11 2009 raising coverage levels from €20,000 to €50,000 and €100,000. Ireland has a DGS for €100,000.
Director	Under the Companies Act 2014, includes any person occupying the position of director by whatever name called. Under the Taxes Consolidation Act 1997, means— (i) in relation to a body corporate the affairs of which are managed by a board of directors or similar body, a member of that board or body, (ii) in relation to a body corporate the affairs of which are managed by a single director or similar person, that director or person, and (iii) in relation to a body corporate the affairs of which are managed by the members themselves, a member of the body corporate.
Discount	The amount by which the market price of a security is below its par value. The amount of the discount consists of the interest calculated at the interest rate for the length of time that the security has to run. In the case of NAMA, the discount is the difference between the book value of the loan and the purchase price paid by NAMA based on their valuation of the underlying asset using a valuation methodology approved by the European Commission. See also *Long-term Economic Value (LEV)*.
Discount Rate	The rate used to discount future cash flows to their present values.
Emergency Liquidity Assistance (ELA)	Euro area credit institutions can receive central bank credit not only through monetary policy operations but exceptionally also through emergency liquidity assistance (ELA). ELA means the provision by a Eurosystem national central bank (NCB) of central bank money and/or any other assistance that may lead to an increase in central bank money to a solvent financial institution, or group of solvent financial institutions.
Equity	The residual balance in the assets of a company after deducting all liabilities. It is equivalent to "shareholders' funds", including minority interest. Movement through equity is equivalent to movement straight to reserves.
Euro	"Euro", "euro" and "EUR" each means the lawful currency of the member states of the European Union that adopt the single currency in accordance with the EC Treaty. The name of the European single currency adopted by the European Council at its meeting in Madrid on 15 and 16 December 1995.

European Central Bank (ECB)	The ECB was established on 1 June 1998 in Frankfurt am Main as the body at the centre of the European System of Central Banks (ESCB) and the Eurosystem. Together with the national central banks of the EU Member States whose currency is the euro, the ECB defines and implements the monetary policy for the euro area. Since the entry into force of the Treaty of Lisbon on 1 December 2009, the ECB has been an EU institution.
European Financial Stability Facility (EFSF)	A limited liability company established by the euro area Member States, on an intergovernmental basis, for the purpose of providing loans to euro area countries in financial difficulties. Such financial assistance is subject to strong conditionality in the context of joint EU-IMF programmes. EFSF loans are financed through the issuance of debt securities, guaranteed up to a total of €440 billion by euro area countries on a pro rata basis.
European Financial Stability Mechanism (EFSM)	The emergency funding programme reliant upon funds raised on the financial markets and guaranteed by the European Commission using the EU budget as collateral and aimed at preserving financial stability in Europe by providing financial assistance to Member States in economic difficulty. EFSM allows the Commission to raise up to €60 billion on behalf of the EU for lending to EU Member States experiencing, or being threatened with, exceptional circumstances beyond their control. EFSM lending is subject to strong conditionality in the context of joint EU-IMF programmes.
Eurozone	The member states of the European Union that have adopted the Euro as their currency.
Exchequer	Also known as the Central Fund, the Government Account into which all Government receipts are paid and from which all Government expenditure is funded, unless provided otherwise by law.
External Auditor(s)	Independent accounting or auditing firms and individuals hired to carry out an audit. An example is the statutory audit carried out on behalf of the shareholders of a public limited company.
Financial Crisis	The period between 2007 and 2012 when the Irish economy collapsed, the structural deficit became evident and the State was unable to meet its financial obligations.
Financial Institution(s)	A credit institution that provides financial services for its clients or members, and is licensed by the Central Bank of Ireland.
Financial Markets	A market in which people and entities can trade financial assets and liabilities. Money markets and capital markets are parts of financial markets.
Financial Regulator	See Regulator.
Financial Statements	The annual statements summarising a company's activities over the last year. They consist of a profit and loss account, balance sheet, statement of total recognised gains and losses and, if required, the cashflow statement, together with supporting notes. The accounts of all the institutions covered under the work of the Inquiry were audited externally.
Fiscal Balance	The difference between government total revenue and total expenditure – also called the "actual deficit" and/or "fiscal deficit".
Fiscal Compact Treaty	The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (Fiscal Compact Treaty). The primary goal of the Treaty is to foster long-term budgetary discipline in the European Union.
G20	An international forum for the Governments and Central Bank Governors from the following 20 economies: Argentina, Australia, Brazil, Canada, China, the European Union, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, and the United States of America.
Gross Domestic Product (GDP)	A measure of the monetary value of final goods and services—that is, those bought by the final user—produced in a country in a given period of time (say a quarter or a year). It counts all of the output generated within the borders of a country but not all of the incomes earned in the economy remain the property of residents (and residents may earn some income abroad).
Gross National Product (GNP)	A measure of the income from GDP which remains with domestic residents and it differs from GDP by the net amount of incomes sent to or received from abroad.

Group Think	A psychological process that reduces the likelihood of critical views being expressed or heard within institutions, due to a desire for unanimity which overrides the motivation to realistically evaluate alternative courses of action.
Guarantee	See *Bank Guarantee*
Haircut	In terms of securities and loans, the difference between the market value of an asset and the purchase price paid.
IAS 39	An accounting standard which sets out the principles for recognising and measuring financial liabilities and some contracts to buy or sell non-financial items.
Interest roll-up	The practice whereby any unpaid interest due on an interest payment date is rolled up into the outstanding loan balance where it accrues further interest but does not necessarily place the loan in default.
Internal Audit	The role of internal audit is to provide assurance - independent of the business - that an organisation's risk management, governance and internal control processes are operating effectively.
Irish Financial Services Regulatory Authority (IFSRA)	IFSRA was established as a constituent part of the newly named Central Bank and Financial Services Authority of Ireland in May 2003. Its role was to regulate the Irish financial sector. IFSRA was reintegrated under the Central Bank Reform Act 2010.
Large Exposure Limits	Core Principle 19 of the Core Principles for Effective Banking Supervision set by the Basel committee on Banking Supervision requires that local laws and bank regulations set prudent limits on large exposures to a single borrower or closely related group. Banks should monitor such positions and report appropriately to their boards and regulators.
Leverage	The extent to which an investor or business is using borrowed money or debt to finance assets. An entity with significantly more debt than equity is considered to be highly leveraged.
Liability Management Exercises (LME)	Liability management is the process of restructuring outstanding borrowings in order to improve the composition of the public debt, or institutional debt, portfolio. LME is a form of voluntary burden sharing undertaken where securities holders agree to sell back the bond, or debt, or agree to a restructuring, with the issuer at a price below the current perceived market level.
Liquidity and Illiquidity	Liquidity is the ability of a credit institution to meet its on and off-balance sheet obligations in a timely manner as they fall due, without incurring excessive cost, while continuing to fund its assets and growth therein[1]. Illiquidity is the opposite, meaning a lack of liquidity.
Liquidity Crisis	In terms of Financial Markets, a period of time where there is an acute shortage of liquidity available to market participants. In 2007/08 this manifested itself in the unwillingness of banks globally to lend to each other thus freezing the money markets.
Loan balance	The amount owned by borrowers at the loan valuation date.
Loan Loss Provisioning	An expense that is reserved for defaulted loans or credits. It is an amount set aside in the event that the loan defaults.
Loan-to-Deposit Ratio (LDR)	The ratio of customer loans to customer deposits. A key measure of a bank's funding strength.
Loan-to-Value ratio (LTV)	The ratio of the loan to the value of the asset purchased.
Long-term Economic Value (LEV)	The long-term economic value (or real economic value) of the property or other collateral underlying the loans (the "Property LEV"), defined as "the value, as determined by NAMA, that it can reasonably be expected to attain in a stable financial system when the crisis conditions prevailing are ameliorated and in which a future price or yield of the property is consistent with reasonable expectations having regard to the long-term historical average". As part of the set-up of NAMA, the Exchequer took a longer-term view on asset prices by acquiring assets from NAMA at their long-term economic value ("LEV)" in return for NAMA bonds. The LEV is made up of the current market value plus a premium where the property has potential for higher value in the future. The premium (where applicable) constitutes a percentage of the current market value. The original price paid for the asset is not taken into account.

1 UK Financial Regulator 2006.

Macro-prudential supervision	Oversight that focuses on the stability of a financial system as a whole, rather than on its components. The need for macro-prudential regulation of the system arises because the actions of individual companies acting prudently within guidelines may collectively result in the system's instability, for example, if all lenders restrict lending or all companies sell assets at the same time.
Management Board	See *Board of Directors*.
Management Information System ("MIS")	A computerised database of financial information which provides managers, directors and staff with the information, tools and data to enable them to make informed decisions.
Market Abuse	Certain types of behaviour such as insider dealing and market manipulation. The Market Abuse Regulation (MAR) will apply across the EU from 3 July 2016.
Medium Term Note (MTN)	An instrument used by both banks and corporates to raise money in the public markets for periods greater than one year.
Memorandum of Understanding (MOU)	A formal agreement between parties which, although not legally binding, outlines the agreed line(s) of action the parties wish to undertake.
Micro-prudential supervision	Focuses on the stability of the component parts of a financial system. The focus of micro-prudential supervision is the safety and soundness of individual financial institutions.
Moral Suasion	An approach adopted where a regulatory authority uses argument and persuasion rather than coercion or legislation to influence the activities of the institutions it regulates.
Mutuals	Institutions or companies owned by their members or depositors. This is a term generally associated in Ireland with the Building Societies.
National Asset Management Agency (NAMA)	The National Asset Management Agency (NAMA) was established in 2009 as one of a number of initiatives taken by the Government to address the serious crisis in Irish banking which had become increasingly evident over the course of 2008 and early 2009. NAMA acquired 12,000 loans with 60,000 properties as security for land and development and associated loans accounting for 90% of all identified eligible loans from the participating institutions.
National Asset Management Agency Act 2009 (NAMA Act)	The National Asset Management Agency Act 2009 (the NAMA Act) was passed into law on 22 November 2009 and came into operation on 21 December 2009. The European Commission gave its approval for the establishment of NAMA on 26 February 2010. The Commission's approval was required by reference to its State Aid rules.
National Recovery Plan (NRP)	Published on 24 November 2010, this plan aimed to provide a blueprint for a return to sustainable growth in the Irish economy. It set out in detail the measures that were to be taken to put the public finances in order. It identified the areas of economic activity which would provide growth and employment in the next phase of Ireland's economic development. It specified the reforms the Government would implement to accelerate growth in those key sectors.
National Treasury Management Agency (NTMA)	A State body which operates with a commercial remit to provide asset and liability management services to Government.
Non-performing asset (under NAMA)	For the purposes of the NAMA Act, a bank asset is non-performing if: ▪ it is in the course of being foreclosed or otherwise enforced, ▪ principal or interest or both are in arrears, ▪ interest is being or has been capitalised or otherwise deferred otherwise than in accordance with its terms, ▪ payments are not being, or have not been, met, ▪ its covenants are not being, or have not been, complied with, or other obligations are not being or have not been complied with.
Nyberg Report	The report of the Commission of Investigation into the Banking Sector in Ireland, March 2011.
Oireachtas Committee	A Committee appointed by Dáil Éireann, Seanad Éireann or jointly by both Houses.
Opposition	Generally refers to Members of the Dail who are neither part of the Government parties nor Independent TD's in a voting pact with the government.
Own Funds	The amount of equity held by a bank in order to absorb any losses which it may incur.

Paper Collateral	The practice whereby the equity pledged by the borrower, when required, takes the form of unrealised paper equity from other transactions.
Par Value (of Bonds or Debt)	Face value or nominal value of a debt security or a loan. The price reflecting this is 100.
Participating Institutions	A credit institution designated by the Minister for Finance under Section 67 of the NAMA Act 2009.
Passported EU Banks	Directive 2007/64/EC on Payment Services in the Internal Market ('the Payment Services Directive') sets out the principle of a single authorisation for payment institutions and this provides that a firm may provide the services for which it is authorised in its home member state throughout the EU. This can be done either through the establishment of branch offices or by the engagement of agents in other EU member states or through the free provision of services on a cross border basis (i.e. without establishing a permanent presence). The competent regulatory authorities in Europe responsible for the supervision of payment institutions engage in practical co-operation for the purpose of facilitating the passport notification process for payment institutions. In that regard, a set of supervisory guidelines have been developed to support this process.
Pillar Banks	The two main banks resulting from the restructuring of the Irish banking system- AIB and Bank of Ireland.
Performing asset	A bank asset that is performing in line with the terms and conditions of its contract or approval.
Perpetual Bond	A bond with no maturity date.
Preference shares	Shares which provide a dividend that is paid before any dividends are paid to ordinary stock holders, and which takes precedence over ordinary stock in the event of liquidation. Unlike ordinary stock, preference shares pay a fixed dividend, though can similarly avoid paying this dividend (depends on the structure) if it lacks the financial ability to do so. As these instruments are treated as a form of "equity" rather than a debt, ability to pay the coupon (or distribution) is determined by distributable reserves on the balance sheet.
Programme for Government	A programme of actions agreed by the parties to government on its formation.
Promissory Note	A promissory note provided by the Minister for Finance to a credit institution providing for periodic payments by the Minister to the credit institution, and which constitutes Core Tier 1 Capital of the Credit Institution at the time of issue of the note – see also *Capital – Core Tier 1*.
Property Crash	Refers to a reduction in property prices following a property bubble, often leaving investors and owners in negative equity. [Also sometimes referred to as "the property market collapse"]
Prudential Capital Assessment Review (PCAR)	A prudential capital assessment review undertaken by the Central Bank.
Prudential Liquidity Assessment Review (PLAR)	A prudential liquidity assessment review undertaken by the Central Bank.
Prudential Regulation	An appropriate legal framework for financial operations to prevent or minimise financial sector problems.
Real economic value	The real economic value (or long-term economic value) of the property or other collateral underlying the loans (the "Property LEV"), defined as "the value, as determined by NAMA, that it can reasonably be expected to attain in a stable financial system when the crisis conditions prevailing are ameliorated and in which a future price or yield of the property is consistent with reasonable expectations having regard to the long-term historical average".
Recapitalisation	When a legal entity changes its capital structure (the proportion of equity to debt) with the aim of improving its debt/equity ratio.
Regulator	An institution which supervises and controls the financial system including the institutions and the markets themselves. Also referred to as "the Financial Regulator (FR)" and can be used to refer to an individual who holds the post of Financial Regulator.

Regulatory Capital	The amount of capital a bank or other financial institution is required to hold by its financial regulator. This is usually expressed as a capital adequacy ratio of equity that must be held as a percentage of risk-weighted assets. (also known as capital requirement or capital adequacy)
Risk Weighted Assets (RWA)	Loans and equivalent assets which have been adjusted for risk.
Scoping Paper	Generally refers to a paper outlining the issues and environment surrounding a particular task or subject. In this Report, refers to the Financial Stability Scoping Paper of January 2008 – the Bank Guarantee Issue. The purpose of this paper was to identify significant issues relating to the options available to the Irish authorities in the case of a systemic threat to financial stability, as well as consider any issues regarding the structures currently in place to oversee financial stability planning arrangements and also to manage a financial crisis. It examined the legal framework within which any crisis management operations must take place and any possible questions regarding the legal powers available to the Minister and the Central Bank and Financial Services Authority of Ireland (CBFSAI).
Sectoral Concentration Limits	Limits imposed by both institutions and the Central Bank on the proportion of exposure that any bank should have in its lending portfolio to specific sectors of the economy or industries. Generally expressed as a percentage of own funds set as a cap on such lending.
Secured/Unsecured Debt	Secured debt is a loan where a specific pledge on assets or some form of collateral is in place enabling the lender to take ownership of the collateral should the borrower default. An example of secured debt would be a mortgage. Unsecured debt is a loan not secured by an underlying asset or collateral. It is the opposite of secured debt. In the case of unsecured debt, a lender loans money without the security that an underlying asset provides. For this reason, unsecured debt carries more risk for the lender, which in turn makes the loan more expensive.
Securitisation	Pooling of assets such as mortgages and other debt into securities that are sliced up and sold to different types of investors. Securitisation allows individual mortgages to be pooled together into large bundles, the loans are then restructured and credit enhanced to be given a higher debt rating by the ratings agencies and then investors. Lenders pass on loans quickly, giving them few incentives to ensure they are repaid. Limited information on underlying assets makes them illiquid and hard to value.
Security	Includes ■ a charge, ■ a guarantee, indemnity or surety, ■ a right of set-off, ■ a debenture, ■ a bill of exchange, ■ a promissory note, ■ collateral, ■ any other means of securing— ▸ the payment of a debt, or ▸ the discharge or performance of an obligation or liability, and ■ any other agreement or arrangement having a similar effect
Senior Debt/Bonds	A Debt Security or Bond which has a prior and superior claim on the issuer's assets and income over other bonds issued by the same entity which are deemed to be Junior or Subordinated to it. Senior bonds can be issued on a secured or unsecured basis with the former having some form of pledge on specific assets of the issuer.
Short Selling	A situation where an investor sells a security, shares or bonds, which they do not currently own. They tend to hold the belief that the price of this security will fall and that they will be able to buy it at a lower price. Generally in such a situation the seller knows that they will be able to borrow the security elsewhere for a period of time to enable them to fulfil their initial sale and then buy the security at a lower level to return to whoever lends it to them at an agreed future date. Where the seller is not sure of their ability to borrow the security they are undertaking a "Naked Short" which a number of Governments have banned on occasion.
Single Supervisory Mechanism (SSM)	The system of financial supervision composed by the ECB and national competent authorities of participating Member States

SME	A small or medium sized enterprise. Under the standard EU definition, businesses are classed as an SME if they employ fewer than 250 persons and have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million.
Social Partnership	The process used to negotiate and achieve consensus on a range of social and economic policy issues. The process which began in 1987 was initially limited to the Government, Business, Trade Unions and Farmers and later included the Community and Voluntary sectors.
Solicitors' Undertaking	Any unequivocal declaration of intention addressed to a person who reasonably places reliance on it, which is made by a Solicitor in the course of his or her practice, either personally or by a member of the Solicitor's staff, whereby the Solicitor, or in the case of a member of his or her staff, his or her employer, becomes personally bound. (Regulation 2 S.I. No. 366 of 2010, Solicitors (*Professional Practice, Conduct and Discipline – Commercial Property Transactions) Regulations, 2010*)
Sovereign Debt	Also known as government debt, public debt or national debt. This is the debt owed by central government. The sovereign debt crisis relates to the difficulty or impossibility for some countries to repay or re-finance their government debt without the assistance of third parties.
Sovereign Debt Crisis	The difficulty or impossibility for some countries to repay or re-finance their government debt without the assistance of third parties.
Stability and Growth Pact (SGP)	The stability and growth pact (SGP) forms part of the rules and procedures for fiscal policy of the Member States of the Euro area. The SGP was agreed at the EU Summit in Dublin in December 1996. It built on the convergence criteria and lays out the rules for budgetary and fiscal discipline of the Member States. The focus of the SGP is to maintain the fiscal aspects of the converge criteria, namely the 3% deficit ratio and 60% of GDP public debt ratio. **The "Six pack" reforms (2010-2011)** In the wake of economic crisis, the Commission tabled proposals to reinforce the SGP with rules for economic governance and fiscal surveillance. The Six pack reforms, which consist of five regulations and a directive, entered into force towards the end of 2011. The six-pack reinforces both the preventive and the corrective arm of the Pact. The **"Two Pack"** are two regulations that harmonised the budgetary timeline and introduced the requirement for Member States to submit a draft budgetary plan by 15 October each year as well as introducing a requirement that fiscal planning must be based on macroeconomic projections that are produced or endorsed by an independent body (assigned to Irish Fiscal Advisory Council).
Statement of Affairs	A summary of a company's assets and liabilities. It states the net book value and amount expected to realise at the date of Insolvency of the business. Accompanying the balance sheet is a list of creditors and shareholders.
Strategic Development Zone (SDZs)	SDZs are designated by the Government. Special rules apply to planning and development in an SDZ, making it significantly easier to obtain planning permission for development which is consistent with a Planning Scheme in force for an SDZ, and prohibit planning permission for development which is not consistent with such a Scheme. There is no right of appeal to An Bord Pleanála against a decision, so the process of application is quicker and more certain.
Stress Testing	A simulation designed to assess the ability of a given financial institution to deal with an economic crisis. Stress tests are carried out with the objective of seeing how robust a financial institution is under different conditions.
Structural Deficit	The Government deficit after the factoring out of the current cyclical position (surplus or shortfall). The actual deficit differs from the structural deficit due to "cyclical factors" reflecting the fact that the economy is not operating at its equilibrium or due to one-off measures[2].

2 Definition from ESRI Special Article The Structural Balance for Ireland, Authors: Adele Bergin and John FitzGerald, April 11, 2014, Quarterly Economic Commentary.

Subordinated Bonds/Debt	Debts, bonds or claims that have a lower status than other debts or claims and are subordinate. Thus they are more risky for the lender and typically have a higher rate of return than senior debt. In some cases subordinated debt (both tier 1 and tier 2) has been bought back by the banks at a significant discount thus leading these bondholders to take a substantial loss relative to the face value of the bonds.
Tier 1 Capital	A key measure of a bank's financial strength from a regulator's point of view. Tier 1 Capital consists largely of shareholders' equity – the amount paid up to originally purchase the shares of the Bank, retained profits, and other qualifying Tier 1 capital securities. See also *Capital – Core Tier 1*.
Tier 2 Capital	A junior or subordinated form of capital. Divided into Upper Tier 2 (no maturity date) and Lower Tier 2 (have a maturity date) capital instruments.
Tracker Mortgage	Mortgages where the interest rate attaching to them is set at a fixed percentage 'margin' above the European Central Bank Base Rate. The interest rate on such a mortgage "tracks" the official ECB rate and only changes when that does.
Troika Bailout	See *Bailout*.
Unsecured/Secured Debt	See *Secured/Unsecured Debt*.
Wholesale Deposits	Large deposits obtained by licenced credit institutions from other banks, financial institutions or large corporations.
Wholesale Funding	Any bank funding that comes from the capital markets (be it short duration or long term in the form of bonds) that is not in the form of a bank deposit.
Wholesale Financial Markets	The markets where funding and capital are sourced by financial institutions and corporates. The wholesale market for short-term loans and debt instruments, generally less than one year, is called the Money Market.

Appendix 13: List of Abbreviations

ACS	Asset Covered Securities
ACC	ACC Bank Plc
AG	Attorney General
AIB	Allied Irish Bank
Anglo	Anglo Irish Bank
BED	Budget and Economic Division
BOI	Bank of Ireland
BSD	Banking Supervision Department
C&AG	Comptroller and Auditor General
CARB	Chartered Accountant's Regulatory Board
CB	Central Bank of Ireland
CBFSAI	Central Bank & Financial Services Authority of Ireland
CDS	Credit Default Swap
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGT	Capital Gains Tax
CIF	Construction Industry Federation
CIFS	Credit Institutions Financial Support Act 2008
CRD	Capital Requirements Directive
CRE	Commercial Real Estate
CRO	Chief Risk Officer
CSO	Central Statistics Office
DIRT	Deposit Interest Retention Tax
DOF	Department of Finance
DGS	Deposit Guarantee Scheme
DSG	Domestic Standing Group
EBS	Educational Building Society
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EFSF	European Financial Stability Facility
EFSM	European Financial Stability Mechanism
ELA	Emergency Liquidity Assistance
ELG	Eligible Liabilities Guarantee

EMU	European Monetary Union
ESCB	European System of Central Banks
ESRI	Economic & Social Research Institute
EU	European Union
FMP	Financial Measures Programme
FR	Financial Regulator
FRC	Financial Reporting Council
FSC	Financial Services Committee
FSAP	Financial Sector Assessment Programme
FSSA	Financial Systems Stability Assessment
FSR	Financial Stability Report
GAC	Group Audit Committee
GDP	Gross Domestic Product
GIA	Group Internal Audit
GNP	Gross National Product
GRPC	Group Risk Policy Committee
HRE	Hypo Real Estate
IA	Internal Audit
IAS	International Auditing Standards
IAS 39	International Accounting Standard 39
IAVI	Irish Auctioneers and Valuers Institute
IBF	Irish Bankers Federation
IBNR	Incurred But Not Recognised
IBRC	Irish Bank Resolution Corporation
ICAAP	Internal Capital Adequacy Assessment Process
ICAI	Institute of Chartered Accountants Ireland
ICTU	Irish Congress of Trade Unions
IFAC	Irish Fiscal Advisory Council
IFRS	International Financial Reporting Standards
IFSC	International Financial Services Centre
IFSRA	Irish Financial Services Regulatory Authority
IL&P	Irish Life & Permanent PLC
IMF	International Monetary Fund
INBS	Irish Nationwide Building Society

IPAV	Institute of Professional Auctioneers & Valuers
IT	Information Technology
JLL	Jones Lang LeSalle
LDR	Loan-to-Deposit ratio
LEV	Long-term Economic Value
LME	Liability Management Exercises
LOTS	Living-over-the-shop Scheme
LTV	Loan-to-Value
MAC	Management Advisory Committee
MIS	Management Information Systems
ML	Merrill Lynch
MoU	Memorandum of Understanding
MTN	Medium Term Note
NAMA	National Asset Management Agency
NBER	National Bureau of Economic Research
NED	Non-Executive Director
NPRF	National Pensions Reserve Fund
NRP	National Recovery Plan
NTMA	National Treasury Management Agency
OECD	Organisation for Economic Cooperation and Development
PAC	Public Accounts Committee
PCAR	Prudential Capital Assessment Review
PLAR	Prudential Liquidity Assessment Review
PTSB	Permanent TSB
PwC	PricewaterhouseCoopers
RBS	Royal Bank of Scotland
RWA	Risk Weighted Assets
SCS	Society of Chartered Surveyors
SDZ	Strategic Development Zone
SGP	Stability and Growth Pact
SME	Small and Medium-sized Enterprises
SRA	Single Regulatory Authority
SSIA	Special Saving Incentive Account
SSM	Single Supervisory Mechanism

TARP	Troubled Asset Relief Program
TMB	The Mortgage Bank (internal reference used by BOI)
TRS	Town Renewal Scheme
UB	Ulster Bank Ireland Limited
URS	Urban renewal scheme
USC	Universal Social Charge
VAT	Value Added Tax