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# **Joint Committee of Inquiry into the Banking Crisis**

## **Clarification Statement of**

**Patrick Neary**

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- “(a) with the prior consent in writing of the committee,
- (b) to the extent necessary for the purposes of an application to the Court, or in any proceedings of the Part 2 inquiry, or
- (c) to his or her legal practitioner.”<sup>1</sup>

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

Q.1a The Department of Finance was the originator of the “Financial Stability Issues—Scoping Paper” and the author of the paper was thus most likely a member of staff of the Department.

Q.1b In view of the fact that it was the Department of Finance that, to the best of my recollection, sought input to, and comments on, the paper from the Central Bank and the Financial Regulator, it is thus my understanding that the Department had overall ownership of the production of this paper.

Q.1c As I recall, the Secretary of the Financial Stability Committee of the Central Bank provided the joint response of the Central Bank/Financial Regulator directly to the Domestic Standing Group. This response reflected the workings and discussions of a number of sub-groups of the Financial Stability Committee which dealt with legal issues, deposit guarantee, emergency liquidity, communications, for example. As I recall, the scoping paper resulted in a number of workstreams being identified within the Domestic Standing Group to deal with crisis management issues. Apart from the collective and joint response from the Central Bank /Financial Regulator, I am not aware of any individual responses to the paper or responses by any other organisations.

Q.1d I am not aware of any formal sign off by any individual. As I understood it, the scoping paper was adopted by the Domestic Standing Group as a template for further work.

Q.1e I am not familiar with the internal procedures within the Department of Finance as to whether or how this paper was brought to the attention of the Minister for Finance.

Q.2 I note, from the quotation of Mr. McDonagh’s remarks, his surprise and concern at the “apparent” lack of information held by the Financial Regulator in respect of the banks. It is not clear, however, what those inadequacies were, or what steps Mr. McDonagh undertook, both to identify the information that was lacking and to escalate his concerns within the Domestic Standing Group and to the Central Bank/Financial Regulator members of that committee. 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. In the light of the foregoing, the question of addressing Mr.McDonagh’s concerns did not arise.

Q.3 As far as I can recall, there was no consideration or discussion of an in-depth examination of the banks by the Central Bank or the Authority prior to September 2008. I am unable to advise if any consideration was given to this matter by the Domestic Standing Group as I was not the designated participant at the meetings of that group; however, such a proposition, if indeed it did arise, was never escalated to me. Thus the question of deciding not to proceed with such an exercise did not arise.

Q.4 I am unable to provide details of the extensive range of EU and ECB committees in which there was participation by staff of the Authority, as I do not have any such records or information in my possession. It is also unclear from the question as to what particular years or timespan is involved. A brief review of the 2008 Annual Report of the Financial Regulator (Page 83), available on the internet, indicates that a total of 197 meetings were attended in 2008. It is likely that the information being sought under Question 4 in relation to these meetings—agendas, minutes, attendees—is available to the Inquiry from the Central Bank as the successor institution to the Authority.

Q.5 A number of assessments of the activities, performance and resourcing of the Financial Regulator was carried out in the period 2006 to 2009. These comprised----

1. February 2006—The Financial Action task Force published a positive assessment of the regulator in the context of the arrangements for preventing moneylaundering.
2. July 2006—The IMF/World Bank published a largely positive assessment of the stability of the Irish financial system and the Irish regulatory system.
3. May 2007—The Comptroller and Auditor general published its Value for Money report and concluded that the regulator had implemented all the Directives required by the EU Financial Services Action Plan (some 22 regulatory measures) on time and no particular weaknesses or concerns were brought to light by this report.

I also recall a number of “best practice” reviews carried out within individual departments (eg insurance supervision) of the Financial Regulator where the Irish regulatory approach was compared to that of other countries during onsite regulatory visits by Authority staff to those countries. While I do not possess details of such exercises, I do not recall any matter of material concern or any adjustment to the Authority’s approach arising from these reviews.

The most comprehensive review and benchmarking of the Authority was commissioned from Mazars and commenced during 2008. I understand a detailed report and recommendations was presented to the Authority in the early months of 2009. I have not had sight of this report or its final conclusions as my retirement from the Regulator predated its finalisation. It is likely that full details of this report are available to the Inquiry from the Central Bank.

Q.6 It is very difficult to address this question in the abstract and in the absence of an explicit question relating to the application of a particular power to a particular set of circumstances. In general, the imposition of conditions on bank licences or the issuance of directions to licence

holders, represented the main supervisory powers relating to the prudential supervision of banks. A decision by the Authority to invoke these powers in a restrictive or penalty sense would have to be viewed in the context of known breaches of formal regulatory requirements i.e. capital adequacy ratios, large exposure limits and liquidity ratios, none of which arose in the period prior to the emerging crisis. However, in the years before the crisis deepened, the Authority had imposed credit risk management requirements, strict liquidity requirements and higher capital requirements for property related lending through the imposition of conditions on domestic licence holders which were higher than the EU demanded.

Q.7a The Administrative Sanctions Regime was introduced by the Authority within 18 months of the establishment of the new regulator. This new regime was the culmination of extensive preparatory work within each Department of the regulator dealing with the identification of “prescribed contraventions” and training of staff involved in the operation of the new approach, as well as wide consultation with legal and industry bodies to develop best practice for the day to day implementation of the framework. The introduction of this new system within 18 months from a zero base during a time when the new authority was embedding considerable organisational change and integrating new responsibilities and new departments has to be seen as a significant achievement. In this context it is difficult to regard the 18 month timeline as a delay.

Q.7b When the Administrative Sanctions Regime was introduced, the Authority believed that the existence of a detailed and precise consumer focussed Code of Conduct relating to the broad spectrum of financial services—banking, insurance, investment services—made consumer related (mis)conduct more conducive to the identification of prescribed contraventions than prudential matters, the latter being viewed by the Authority as more subjective and more attuned to its “principles-led” approach to prudential supervision. The Authority was of a mind to prioritise the consumer side, having in mind that its own establishment had its genesis in consumer protection weaknesses some years earlier and was of the view that the ongoing established prudential supervisory relationships would allow compliance to be maintained until such time as the prudential departments had finalised their arrangements. This prioritised approach thus allowed for the significant burden of work which stretched the resources of the banking supervision department at that time arising from the introduction and implementation of the Basel 2 supervision regime. As I recall the position at that time, this approach was taken by the Authority as an interim measure to provide time for the prudential departments, especially banking supervision, to finalise their policies and procedures. I have no recollection of any indication or decision by the Authority not to apply the administrative sanctions regime to prudential related activities in the fullness of time.

Q.8 When viewed in the context of the time, it was considered that the Authority had sufficient powers to supervise banks within a “principles-led” approach to supervision, which essentially placed Boards and Management of banks at the centre of responsibility for the prudent conduct of business. This approach was consistent with the broad approach to supervision across the EU which, in the case of prudential supervision, was also principles based. With hindsight, it is clear that the difficulties and issues brought to light by the crisis have called into question that model of supervision and that a more intrusive approach and more robust powers may have been called for,

which may have involved, for example, the prescription of loan to value ratios for commercial and property loans, tighter limits on loans to individual clients and groups of clients with severe penalties for breaches of such limits by a bank. The question of closer integration of economic forecasting of the quantum of risk in each bank may also have had to be considered. In this regard, it is worth noting that it was a basic aim of Basel 2 to relate each bank's capital requirements to its total risk quantum. Clearly this did not happen before or during the financial crisis in Ireland or anywhere else in Europe.

Q.9 No new legislative requirements were sought during this time apart from that required to implement the EU Directives arising from the Financial Services Action Plan. It is worth noting that during these years, extensive regulatory resources were placed at the disposal of the Department of Finance to assist it in its program to consolidate, modernise and reduce the legislative requirements applied to banks and financial services entities as opposed to any program to amplify the legislation. I understand, anecdotally, that, subsequent to the crisis, the main demand for legislative change from the Central Bank related to increased powers to sanction individuals and to strengthen fitness and probity standards.

Q.10 I am not in a position to advise as to what arrangements Mr.Grimes had put in place to ensure he kept himself informed of the various meetings and matters arising that took place during the crisis. It was routine procedure for senior executives (Governor, Director General, Deputy Director General/Secretary, Chief Executive, Prudential Director) in both the Central Bank and the Financial Regulator to maintain close ongoing joint contact and exchange of views on all significant matters. This was to ensure that all executives were kept abreast of emerging issues. For my part, while I did not have a direct reporting line to Mr. Grimes, I can offer no reason why I would not advise Mr. Grimes or any other colleague of a matter of this nature or , indeed, why Mr.Grimes was not kept informed by other senior colleagues.

Q.10a The question of liquidity support for INBS from AIB and Bof I should be viewed in the context of an erroneous report issued on 4 September 2008 by Reuters that INBS was seeking to come to terms with creditors to avoid liquidation. At that point in time, there was no pressing liquidity issue with INBS, nor did one emerge in the ensuing days or weeks. A meeting between the three parties (INBS, AIB, B of I) was suggested by the regulator to examine the possibility of short term liquidity being provided to INBS by the 2 banks in the event that the Reuters report, which was immediately withdrawn, might have precipitated a need for extra liquidity to be available to meet customer withdrawals. It was felt that the 2 banks could accommodate this possible requirement by lending against collateral transferred from INBS (e.g. customer loans) which would not have been eligible for liquidity borrowing from the Central Bank/ECB. The meeting did not prove to be fruitful. As I recall, there was a general reluctance on the part of INBS to make disclosures regarding its loan books to competitors while at the same time there appeared to be a preconceived reluctance on the part of the 2 banks to assist INBS. At its meeting in mid September 2008, the Authority agreed a range of preferred options for the regulatory approach to INBS in the event of a serious threat emerging to its survival as a going concern. These options ranged from a trade sale, to the provision of liquidity by commercial banks with State backing or by the State itself. The ultimate option was nationalisation.

