Tithe an Oireachtais
Houses of the Oireachtas

Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

William Slattery

Strictly Private & Confidential

As indicated on its cover page, the document(s) contained within are confidential unless and until the Joint Committee decides otherwise including where the Joint Committee publishes such document(s). For the avoidance of doubt, "documents" include witness statements in this context. Further to section 37 of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013 ("the Act"), while the documents remain confidential, you must not disclose the document(s) or divulge in any way that you have been given the document(s), other than:

> "(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."[1]

Serious sanctions apply for breach of this section. In particular, your attention is drawn to section 41(4) of the Act, which makes breach of section 37(1) a criminal offence.

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

STATEMENT OF WILLIAM SLATTERY
Prepared pursuant to Direction of the Joint Committee of Inquiry into the Banking Crisis dated 15 July 2015

I joined the Central Bank of Ireland in December 1973 as an Executive Officer. In the 12 years between then and March 1985, I served in various positions in the Central Bank, in the Currency Department, the Accounts Department and the Human Resources Department, having been promoted successively to Senior Executive Officer and Senior Administrative Officer respectively. During that time I studied at night, getting a Bachelor of Commerce Degree in UCD in 1978 and qualifying as a Certified Accountant in 1982.

In March 1985 I transferred to the Banking Supervision Department to take responsibility for the research and analysis relating to the collapse of the Insurance Corporation of Ireland. As well as this, I worked on other special projects.

When the concept of the International Financial Services Centre (IFSC) was conceived in 1987, I was given responsibility for the development of the supervisory policy relating to the IFSC firms and, as IFSC firms began to establish, for the actual supervision of those firms. At that time I held the position of Chief Policy Analyst, Banking Supervision Department.

In mid 1989 a separate Supervision Department was created called Securities and Exchanges Supervision. I moved from Banking Supervision to that Securities and Exchanges Department as Deputy Head with responsibility for all the activity of the Department, reporting to the Head of the Department. This department became responsible for the supervision of investment firms and for all non-banking firms located in the IFSC as well as for the collection and publication of the Monthly and Quarterly Money and Banking Statistics of the Central Bank of Ireland. Throughout my time in the Central Bank, I became immersed and very interested in monetary and macro-economics and on the economic development of the Irish economy. The responsibility for the compilation and publication of monetary statistics reinforced that knowledge. The responsibilities of the Securities and Exchanges Department expanded as the IFSC grew and various additional non-banking supervisory responsibilities were given to the Central Bank. In March 1995 I re-joined the Banking Supervision Department as Deputy Head of Banking Supervision. In that position I was responsible, reporting to the Head of Banking Supervision, for the supervision of all of Irish Banks and Building Societies. I was also a Member of the EU Banking Supervisors Group de Contact between March 1995 and March 1996.

In March 1996 I left the Central Bank after almost 23 years' service and joined Deutsche Bank in Ireland as Head of Legal and Trustee Services and Managing Director, Deutsche Custodial Services Limited. In November 1996, after the emergence of a major high profile and public event within the Deutsche Asset Management Group in the UK, in which, in my position as Head of Trustee Services I had a significant role in identifying, I took up the position of Head of Business Risk Management for Deutsche Asset Management in the UK, based in London. I spent 5 years working in London mainly involved in risk roles in the Asset Management Division in Deutsche Bank and in July 1999 I became a Managing Director of Deutsche Bank AG and Head of Global Risk Management for the Asset Management Division of Deutsche Bank. In January 2002 I returned to Ireland and took up the position of Managing Director of Deutsche International Ireland Limited with responsibility for the investment services business which Deutsche Bank had in Ireland. At that stage the business employed 350 people.

In January 2003 the Deutsche Bank Global Securities Services business was acquired by State Street Corporation, a significant US Bank based in Boston, which was one of the leading global custodian and asset servicing banks. I became responsible for the State Street Investment Servicing business in Ireland and ultimately Country Head for State Street in Ireland. In Feb 2007 I was appointed an Executive Vice President of State Street Corporation.

In June 2008 I also became responsible for the State Street business in Luxembourg and the Channel Islands. In November 2012 I moved to London and became Head of State Street's Investment Servicing Business in Europe, Middle East and Africa. This is the position that I currently hold.

In late 2002 I became Chairman of Financial Services Ireland, a representative group for Irish financial services firms who are members of the Irish Business and Employers' Confederation (IBEC). I was also a member of the IFSC Clearing House Group from early 2003 to October 2012. I was the founding Chairman of IFSC Ireland which was established in 2010. I was a member of the National Executive of the Irish Business and Employers' Conference from 2003 to 2012. I was a member of National Competitiveness Council from 2004 to 2010. I was a member of the Second Public Services Benchmarking Body established by the Government in 2006 and in December 2008 I was appointed by the Government to the Special Group on Public Service Numbers and Expenditure, chaired by Colm McCarthy. I participated in 77 meetings of this group in the first half of 2009 prior to the publication of its Report in June 2009.

I give this detailed background because it is relevant to the nature and content of the questions which I have been directed to answer by the Inquiry. There are two particular aspects to this background which I believe are particularly relevant. The first is that I left the Central Bank of Ireland to join Deutsche Bank in March 1996, almost 20 years ago, and spent most of the subsequent 6 years working in London, where my work was global in nature and where I didn't have responsibility for any of Deutsche Bank's business in Ireland. The second factor is, when I returned to Ireland in 2002, I became responsible for a business which had 350 employees, mostly in Dublin but also in Kilkenny, operating exclusively in the IFSC, in the area of investment fund servicing. In the subsequent period, until I took up my current position in November 2012, I had responsibility for a substantial and growing business within State Street in Ireland which currently employs in excess of 2,500 people. State Street's business in Ireland relies substantially on the ability of Ireland to be attractive as a domicile for international asset managers to establish investment funds for global distribution. Further, State Street's business in Ireland is part of an international financial services cluster, of which the Dublin Docklands is the core, but by no means the only location, which employs in excess of 30,000 people in Ireland. As the most senior officer in one of the largest employers in that sector, and as one of the most experienced international financial services CEOs, I regarded it as an important personal responsibility to advocate for responsible policies which would facilitate the success and growth of the sector. Indeed, I regard whatever role I played in the growth of the IFSC, including its extension to the rest of the country, as the single most significant accomplishment in my career and one which I look back upon with pride.

1. Line of Enquiry - R1a - Appropriateness of Regulatory Regime

Regulation level

What is your view of the nature and level of regulation with regards the financial services sector in the period to 2008:

a. For the domestic banks?

Ireland experienced a systemic banking crisis which substantially contributed to a severe economic crisis which had an enormous impact on a significant proportion of our population. Against that background, it would be difficult not to conclude that there were failures in the regulation of domestic banks and the broader banking system. (I elaborate on this in my answers to subsequent questions).

b. For the international/ IFSC banks?

I believe that IFSC banks in Ireland were regulated to a good standard pre-2008, based on the then prevailing international standards as promulgated by the relevant international authorities i.e. the European Commission and the Basle Committee for Banking Supervision. It is important to understand that substantially all the important standards applicable to the regulation of banks during the relevant period were laid down in European Union directives, which in turn generally followed global standards set by the Basle Committee.

2. CBFSAI

Do you believe that during the period from 2000 to 2008 the CBFSAI Boards had sufficient powers to take direct action against banks?

a. To avoid overexposure/ concentration risk?

The genesis of what occurred in Ireland and the attribution of responsibility for the problems, are highly complex subjects and, in my view, responsibility is quite widely distributed across a wide range of private and public sector actors and institutions. As I referred to in my answer to question 1(b), important technical issues, such as sectoral and individual concentration risk, appear to have been subsumed into common European standards over the decade leading up to 2008 and Ireland complied with those standards. However, those standards were clearly entirely inadequate for the purposes of adequately regulating the level of sectoral exposure to property and related sectors, both across the banking sector as a whole and within individual banks, in Ireland.

In the context of the enormous growth in property leading and the enormous scale of the individual and sectoral exposures which existed in Ireland, I believe the CBFSAI did have sufficient powers to take action, should there have been a will to do so. It needs to be remarked that any action which had the practical effect of significantly impacting on property prices and/or construction activity and economic activity generally would have been the subject of widespread, sustained and very strong opposition.

b. If it became necessary to avoid a financial stability crisis?

Within the CBFSAI structure, the Central Bank of Ireland was responsible for financial stability. For that purpose it had authority to issue directions which were intended to avoid a financial stability crisis. The Irish financial crisis was arguably the most severe systemic crisis which has occurred in any OECD country since the foundation of the OECD. To my knowledge no such directions were ever issued. Similarly, the key conclusions in the annual Financial Stability reports were generally benign and reassuring, as to the potential risk to financial stability.

3. Line of Enquiry - R1b – Effectiveness and appropriateness of the supervision policy and powers

CBFSAI

One of the statutory objectives of the CBFSAI was 'the promotion of the financial services industry in Ireland'. In your view was there a conflict between this objective and the Financial Regulator's responsibility for prudential supervision from 2003 to 2008.

I do not believe there was any practical conflict between this statutory objective and the Financial Regulator's responsibility for supervision because nothing in either the statutory objectives or the industry engagement, had the practical impact of limiting the Financial Regulator's powers or authority vis a vis regulation of the banking sector or of individual banks. My personal view is that the phrasing of this objective as a proactive objective rather than an objective focussed on the facilitation of an environment based on good regulatory standards, where a high quality financial services industry could prosper and thus contribute to overall economic activity, was unnecessary and unfortunate. However, I do not believe it had any practical impact of the ability of the Financial Regulator to undertake its responsibilities.

4. Regulation Level

Do you believe that setting a level of regulation to attract foreign financial institutions to establish operations in the IFSC was a factor in how regulation for the entire financial sector was determined?

Some of the evidence to the Inquiry with which I am familiar appears to suggest that it was a factor in internal discussions in the CBFSAI as to whether certain additional restrictions could or should have been put on the domestic banking sector. I cannot comment whether that was or was not the case but 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.

5. **Line of Enquiry - R1d – Composition, skills, experience and number of resources at the Central Bank, Regulator and Department of Finance.**

Financial Regulator

In your view did the Financial Regulator have sufficient qualified staff to carry out its tasks in relation to prudential regulation, the introduction of the IFRS/ Capital directive and its statutory role in general prior to 2008?

In my view the Financial Regulator had some highly competent, qualified and professional staff. My answer to this question can really only be based on a personal impression rather than a highly informed position, as I had long left the Financial Regulator before the relevant time period.

There was a dramatic increase in the prudential supervisory responsibilities of the Financial Regulator, in addition to the consumer-related responsibilities, both in breadth, arising from new legislative responsibilities e.g. stockbrokers in the Irish Stock Exchange, insurance brokers and other financial intermediaries and in volume and scale. The volume and scale arose both from the growth in the IFSC in the period and, even more importantly, the enormous growth in the size of the domestic financial sector, especially banks, arising from the enormous annual growth in credit which incurred in the ten to fifteen years prior to 2008. My impression was both the organisation structure within the Financial Regulator and the volume of skilled resources did not change commensurately.

6. **In your experience, was there a mismatch with regards to the skills and experience between the Financial Regulator and the banking sector at senior level prior to 2008?**

In quality terms I would not draw a distinction in general between the quality of staff in the Financial Regulator and in the banking system, bearing in mind also that there was a gross failure of management, in the domestic banking sector in particular. However, for the reason stated in the answer to question 5, there clearly should have been more resources applied to financial regulation in the lead up to the crisis and that would include additional highly skilled and experienced staff.

If so, how did this affect the effectiveness of the regulatory supervision of licensed banks during that period?

If my conclusion with regard to the previous sub-question is correct, this would inevitably impact the effectiveness of regulatory supervision of licensed banks. As an example of the increase in scale of the banking system, domestic lending grew by €160 billion alone in the three years to the end of 2007 or 100% of GDP. I venture to suggest that no other example of such a rapid growth in credit in GDP terms in any OECD countries can be found looking back over an extended period.

7. R3a – Awareness and clarity of roles and accountability amongst the regulatory and supervisory institutions of the state.

Financial Regulator

In your experience, was there clarity on the responsibilities that should have been dealt with by the Financial Regulator and by the Central Bank? If not, what risks in your view did this present?

In my experience, there was clarity on the responsibilities of the Financial Regulator and the Central Bank respectively. It was clear that the Central Bank was responsible for matters relating to the overall stability of the financial system in Ireland and the Financial Regulator was responsible for the regulation of individual institutions. Further, there was a very close institutional relationship between the two organisations, as reflected in overlapping Directors and in the fact that both organisations were housed in the same premises and that the offices of the management of both organisations were side by side within the Central Bank building.

8. R3b – Nature and appropriateness of the relationship between the Central Bank (including the Financial Regulator), Department of Finance and the banking institutions

Financial Regulator Initiatives

The Financial Regulator proposed a number of initiatives to impose more explicit requirements on banks (e.g. the Director's compliance Statements, Corporate Governance Guidelines and the Fit and Proper Requirements).

a. **Were you involved in the consultation process?**

Depending on the precise requirement and the timing of the process, I was involved to various degrees in the consultation process. My involvement and my interest was exclusively around IFSC companies. The IFSC contains a large number of companies which are highly diverse in regard both to their size and scale of activity and the nature of their business. In particular, my focus was on ensuring that regulatory requirements were aligned with international norms and were reflective of the nature and scale of the activities of the companies for which they were intended to apply rather than a one size fits all approach. In particular, regulations which were suitable for large listed companies or companies otherwise owned and controlled in Ireland, were not necessarily suitable for entities which were subsidiaries of international financial institutions which were themselves subject to high standards of international regulation and governance, in my opinion.

Patrick Honohan in his May 2010 report referred to the protracted consultation process and the subsequent decision not to implement the original proposals in full.

b. **In your view, what did lead to this unsatisfactory outcome?**

I am not familiar with the detail of the internal consideration which was given within the public sector institutions to the representations made by various industry bodies or by individual institutions. However, at all times, the decision making bodies in the official sector had complete freedom to proceed with or amend the original proposals in a manner which retained the desired public policy impact which was the objective of the relevant policy.

Throughout the period, as reflected in Questions 12-15, I was very concerned about the growth in property related bank lending, the concomitant growth in residential and commercial property values and construction activity to levels which were wholly unsustainable. On many occasions throughout the period I articulated these views in public and privately to various banking and public sector fora. Nothing in terms of my own personal contribution to the public policy discussions was ever intended or, I believe, had the practical effect of limiting the ability of the regulatory authorities to regulate the domestic sector.

9. <u>IFSC Clearing House</u>

a. **What level of influence, if any, did the IFSC Clearing House Group have on the Government's financial, regulatory and prudential policy between 2003 and 2008?**

The IFSC Clearing House Group was established in 1987 and I became a member, I believe sometime in 2003, following my return to Ireland from London. The CHG was designed as a public / private sector forum where issues relating to the development of the IFSC were discussed and agreed policy approaches formulated. It was a transparent and open forum with a large membership, often in excess of 20 people from a large number of different public and private sector organisations. Meetings were minuted and all members contributed views on their own behalf and on behalf of their own organisations as appropriate. I believe the IFSC Clearing House Group and the relevant sector and sub-committees (Funds, Banking and Treasury, Insurance and Asset Management) played an important role in formulating policy relating to the IFSC. Indeed, I know it was a model adopted in Scotland where the mirror committee was chaired by the First Minister. I believe that the Clearing House Group played an important and positive role in the development of policy relating to the financial sector in Ireland. In particular, the creation and maintenance of 30,000 jobs in the international financial sector should be regarded as a successful outcome of the public and private sector partnership which was fostered by the Clearing House Group. Any public policy proposals which emerged from the consideration of the

Clearing House Group were subject to normal due process within the relevant public authorities and where primary and secondary legislation were concerned, were subject to the scrutiny of the Oireachtas. Legislation considered and passed by the Oireachtas relating to financial services was essential to the creation and maintenance of the 30,000 jobs which developed in international financial services in Ireland during this period. The reality is without appropriate legislation and underpinning regulation, a large proportion of those jobs would not have been created.

b. **Did this relationship change since the crisis?**

The crisis was a traumatic experience for Ireland and private and public sector institutions alike. This created an inevitable additional caution within the policy making process. I left the CHG in 2012 but prior to that the CHG continued to meet and to consider relevant subjects professionally and openly as it had done in the previous 10 years of my membership.

c. **What is the nature of the current relationship between IFSC Ireland and the CBI with regard to the banking sector and financial regulation?**

The thinking behind the establishment of IFSC Ireland was to establish an organisation to give a single point of public focus to the IFSC, and to create an IFSC brand impact especially via the appointment of a President with a strong and credible public profile to lead international marketing visits. IFSC Ireland was not established as a representative organisation for the purposes of making policy submissions to the public authorities as that was the role fulfilled by Financial Services Ireland and the various individual IFSC sector bodies such as Irish Funds Industry Association, Federation of International Banks, Dublin Insurance Managers Association etc. IFSC Ireland therefore had no relationship to my knowledge with the CBI. Certainly I cannot recall meeting the CBI as Chairman of IFSC Ireland.

10. <u>Tax Income</u>

In your opinion, was the tax income (corporation tax, payroll taxes) generated by the combined domestic and international banking sector a factor in setting the standards for banking regulation?

I don't believe tax income generated by the domestic and international banking sector was a factor in setting the standards for banking regulation. The substantial tax revenue generated by international financial services entities was often highlighted by the sector itself as part of the argument why the successful development of international financial services businesses should be fostered, but this was just one factor, and by far the largest factor in the arguments put forward by the private sector, was the direct and indirect employment contribution. In my opinion this is just as valid today as at any time in the past and the maintenance of the employment in the international financial services sector throughout the crisis was not an insignificant factor in the maintenance of economic output in Ireland during the depths of the crisis and which lead to the subsequent recovery.

11. **Regulatory environment**

In your view, how effective was the financial services sector in ensuring that the Central Bank and Financial Regulator operated a flexible regulatory environment in the period up to 2008?

The interpretation of the word flexible is very important in the context of this question. Flexibility should not be interpreted as meaning an overly lenient or permissive regime which led to significant regulatory failures either in individual sectors or in individual institutions. The word flexibility was used in the IFSC in the context of the need to evolve technical regulatory requirements to cater for new types of products or new types of structures as new businesses were established or existing businesses wanted to develop new products. The nature of internationally exporting firms is, almost by definition, one where new product development is essential to their survival. This is because firms do not have a domestic market to rely on and have to rely on new market opportunities that are identified across the global economy. If the regulatory regime is not sufficiently flexible to allow such new products to be developed and appropriately regulated, a successful exporting financial services sector would not be possible.

It is my opinion that, as a general observation, the industry worked successfully with all the public authorities, including the Central Bank and the Financial Regulator, so that a regulatory regime based on good international standards was developed across a range of different sectors. This is reflected today in a wide range of sophisticated, international financial services activity in Ireland and a very large volume of sophisticated regulatory provisions based on international best practice.

In your view, as a former senior Central Bank official, what could have been done to strengthen the domestic banking supervision prior to 2008 to avoid the banking crisis?

This is a very broad and complex question. The elements leading to the Banking crisis built up over more than a decade prior to the eruption of the crisis in 2008. It is widely recognised that the Irish banking crisis was one of the most severe ever experienced by an OECD economy, by some important measures, probably the most severe.

Were the crisis to have been successfully avoided, bank lending when the crisis crystallised at the time of the failure of Lehman Brothers in September 2008 would probably have had to have been something like 100-200Bn Euros less than it actually was or more than 100% of GDP. This in turn would mean that economic output in Ireland, circa 25% of which at the time of the crisis was based on the construction sector, would have been materially lower. This would have required a sustained, determined and highly controversial effort by both the Central Bank and the Financial Regulator to restrain the growth of bank lending and construction activity. It is also important to note that for the crisis to have been avoided, sustained action would have had to be taken far earlier than 2006/7 when activity reached a peak. I first raised concerns about the unsustainable dynamic in 2000. After a downturn in 2001 associated with the bursting of the dot.com bubble and 9/11, rapid growth and credit took off again in 2002 and continued until the failure in Lehman's. None of the economic commentary from relevant domestic and international institutions drew attention in a meaningful way to the dangers of that. In practice, for this to have been successful, there would have had to be buy-in across our broader political, civil and economic society. Such buy-in is far from assured, even today, after the horrific experience of the last seven years.

12. **Could you outline your view as to why the Government ultimately decided to replace the IFSC Clearing House Group?**

I would prefer not to comment on why the Government ultimately decided to replace the IFSC Clearing House Group as I would just be speculating on the Government's intentions.

Could you comment on the view of journalists such as Elaine Byrne in the Irish Independent dated 6th May 2012 that the relationship between the IFSC banks and the CHG was too close and was detrimental to the State?

I strongly disagree with this view. The CHG, which had been in place since 1987, has contributed significantly to the success of the IFSC. International financial services in turn have made a material contribution to Irish employment and to the broader economy. Rather than the CHG being detrimental to the State, I believe that it contributed substantially to broader public welfare in Ireland and could serve as an exemplar for the proper engagement of other economic sectors with the public sector, for the benefit of the economy as a whole.

13. **R4c – Analysis and consideration of the response of contrarian views (internal and external**)

In 2000, you wrote an article which appeared in Finance Magazine predicting the possibility of a 30-50% drop in property prices.

a. **How and when did you arrive at that conclusion?**

In the late 1990s, from 1995/1996 onwards, the growth of bank lending in Ireland was rapid and became increasingly so as the decade went on. This was accompanied by rapid growth in residential property prices. From my time in the Central Bank I had studied and I was familiar with various banking crises which had occurred globally and the factors which led to those crises, specifically the Scandinavian banking crisis in the 1990s, the prolonged Japanese banking crisis of the late 1980s and 1990s and the Asian banking crisis of 1998. These had all been accompanied, to my knowledge, by prolonged high growth in credit and large and unsustainable increases in property prices and construction activity. In particular, I recall from various sources, including a document that was published annually by Standard and Poors at the time, which appears to have been subsequently discontinued, that the Scandinavian crisis in particular occurred when aggregate banking lending peaked at around 130% of GDP. I was concerned, at the start of 2000, that a continuation of Irish credit growth at the then prevailing levels would lead to similar levels of outstanding credit in

Ireland within the space of a year or two. I was concerned in particular of the impact on economic activity and on employment should credit growth come to an abrupt halt because of a disruptive economic event arising from credit quality or other factors. I had a concern that the impact of a sudden withdrawal of new bank lending would have a traumatic impact on economic sectors which relied on such lending such as construction, and on property prices.

b. **What reaction did this article generate? Was this view held by others?**

One notable reaction I recall was a strong rebuttal of my position in the following month's edition of Finance Ireland by the Chief Economist of Bank of Ireland. At the time there were also other cautious voices such as the commentator, David McWilliams in particular. I appeared on his TV3 television programme twice to discuss these issues and on his radio programme a number of times. The predominant view, which became more pronounced actually, in subsequent years, was that the dangers that I was concerned about were substantially overstated and that various factors such as demographics, economic growth and later, immigration etc. justified the growth in credit, construction activity and property prices which Ireland was experiencing. It was notable during that period that no independent economic institution, domestic or international, such as the Central Bank, IMF, OECD or academic economists supported this analysis.

c. **Did you discuss these views within banking/ economic/ political forums in the period up to 2008 eg IFSC Clearing House Group?**

As mentioned above, I participated in television and radio discussions on a number of occasions during the period on this subject.

I did discuss this view in various fora during the period to 2008. In particular I discussed it extensively in the National Competitiveness Council. I convened a sub-group of the banking members of Financial Services Ireland to consider what the broader views of the industry were. I discussed it at National Executive meetings of IBEC. I mentioned it as a significant factor in the discussions of the Second Public Sector Benchmarking Group in 2007. I discussed it with other members of the media. I gave an interview in the Irish Times in 2003 and in the Sunday Times in 2007 both of which mentioned my views on this subject. At the invitation of the Editor, in 2008 I published a follow on article in Finance Ireland, which is attached and which includes a brief analysis of the economic and monetary context. In January 2009, my first contribution to the deliberations of the Special Group on Public Services and Expenditure related to my view that it was important that the considerations of the Group took account of the liability of the State for the banking system guarantee. On the basis of some initial analysis, I advised the Group and the Department of Finance that in my view the cost to the State could be more than 30BN Euro. This view was not shared by either the Group or the Department at that time.

More generally, during the period I had many conversations on this subject with senior Central Bank and Financial Regulator employees and other public sector employees as well as senior employees in the domestic banking sector.

14. **R7c – Effectiveness of the current regulatory and supervisory structure**

Regulation Level

What is your view of the level of regulation currently applicable to international banks operating in IFSC?

I don't have specific information or knowledge about the level of regulation currently applicable to international banks operating in IFSC. I have a general concern about the procyclical nature of international banking regulation post the financial crisis and the impact of such regulation on the broader monetary system, including the willingness and capacity of banks to lend and the cost of lending and banking products generally. The Governor of the Bank of England in a speech to an international banking conference in Singapore in October 2014 estimated that the capital requirements of global systemically important banks have been increased by between 7 and 10 times taking all the relevant measures into account. All other things being equal, this will require banks to earn 7 to 10 times more revenue from the same services to generate the same return on capital. This is the principle explanation for the increase in the cost of lending, which has been such a high profile issue not only in Ireland but in other countries in recent years.

15. **Supervisory regime**

In your opinion, is the current supervisory regime robust enough to prevent another crisis?

e.g. i) in the event of a rapid rise of market interest rates, and its impact on household and commercial debt,

The current level of interest rates and the related value of interest rate investment assets, especially of Sovereign Bonds, represents as extreme a level of valuation as I can recall in any financial assets during my career. It is well known that a significant proportion of short and medium term treasury notes and bonds in Europe carry a negative interest rate, i.e. investors in those bonds pay interest to the Government issuers who hold such bonds rather than receive interest which has been the norm throughout financial history. It is very difficult to practically foresee the impact of the unwinding of this extreme situation for many reasons, not least because it is impossible to realistically estimate the timing and speed of such an unwind and the extent to which interest rates in Europe and globally will rise in the future. It is almost inevitable that at some stage this unwinding will create significant risk issues in the financial system including potential systemic issues either in specific parts of the financial markets or in specific financial institutions or more broadly. The levels of capital requirements relating to financial institutions are now in many respects problematically high, as I mentioned in my answer to question 14. However, it is notable that holdings of Sovereign Bonds continue to be exempt from most capital requirements, yet in my opinion it is those Bonds that currently represent the most extreme valuation outlier relative to economic history. There has been significant declines in outstanding personal and corporate sector debt since the financial crisis both because of debt write offs and also substantial net debt repayments but the private sector in each year since the financial crisis (again this is practically unique in Irish economic history) and even as the economy recovers, net debt continues to be paid down. In my view this is positive because it represents the collective efforts of Irish, personal and corporate borrowers to repay debt which had obviously become wholly unsustainable in the lead up to the crisis. I expect this to continue for a number of years especially if interest rates continue to remain low and even if interest rates rise somewhat. This will substantially mitigate the impact of rising interest rates on Irish personal and corporate borrowers. Further I believe that the new capital requirements will be more than adequate in this particular context to deal with any credit issues arising from an increase in interest rates in the next 3-5 years in any event.

e.g. ii) in the case of a Euro-related crisis, such as Greece leaving the Euro.

Post the financial crisis there has been a substantial decline in all sorts of cross border financial exposures in Europe. For example, I expect that the Irish financial sector has very little exposure to Greece and other peripheral Eurozone countries. There is a non-trivial possibility of a widespread Euro related crisis whether triggered by an event relating to Greece or some other trigger. In the domestic sector at least I don't believe there are a lot of net exposures to individual Eurozone countries other than Ireland which would mitigate certain aspects of a broader European crisis. However, a Eurozone crisis which resulted in a complete break-up of the Euro could inevitably have significant financial consequences for Irish financial institutions. However, Irish banks are now capitalised to deal with a crisis significantly more severe than the Irish financial crisis of recent times and that was one of the most severe financial crises in history.

William Slattery
20 August 2015