

Patrick Honohan: Examining the Irish banking system

Introductory statement by Mr Patrick Honohan, Governor of the Central Bank & Financial Services Authority of Ireland, to the Joint Oireachtas Committee on Finance and the Public Service, Dublin, 2 March 2010.

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As you know, I have been asked by the Minister for Finance to prepare one of the two reports proposed by the Government as the first stage of an investigation into the banking system. I have been informed that the context for these reports is that “the Government considers it essential to thoroughly examine the conduct of the banking sector in recent years in order to arrive at a fuller understanding of the root causes of the systemic failures that led to the need for extraordinary support from the State to the domestic banking system.” This seems to me to be a good basis for proceeding.

The two-stage approach to the investigation speaks of “preliminary reports” which will provide a basis for the Government and the Oireachtas to prepare the terms of reference for the second stage, which will involve the establishment of a Statutory Commission of Investigation.

The report which I am preparing is on “the respective functions of the Central Bank and Financial Regulator”, and it is to have regard in particular to their work “in assessing and responding to risks to the stability of individual institutions as well as to the banking system as a whole”. The report is described as “preliminary”, and of course is being prepared against a tight deadline, yet I believe it will be possible for me to establish a fairly clear and comprehensive understanding of the matters in question. I am hopeful that satisfactory conclusions can be reached on many issues, leaving only a relatively limited number of open questions of significance requiring further investigation.

In parallel with my report, Mr Klaus Regling and Mr Max Watson, who appeared before this Committee last week, are looking (among other things) at the performance of the banks and banking system generally. Evidently, the full picture requires that dimension also: after all, it is to the directors of banks that we look in the first instance for safe and sound operation of their firms; official prudential regulation can best be seen as a backstop designed to restrain the behaviour of imprudence or recklessness. Clearly in this case neither the first line defence nor the backstop worked.

The issues that I have been asked to examine include the performance of the respective functions of the Central Bank and the Financial Regulator over the period from the establishment of the Financial Regulator to the end of September 2008. In addition, I have been asked to consider the inclusion of any matter that I feel should be brought to the Minister’s attention which might help or inform the preparation of the terms of reference of the statutory inquiry. I intend to submit my report no later than the end of May 2010.

I have assembled a small team of experts to help me prepare this report. (If the members of the Committee are interested, I can furnish them with particulars of the staff helping me in this work). Already in train is an examination of the most relevant files, beginning with the documents prepared both for the Regulatory Authority and for the Board of the Central Bank, and drilling down from these to trace the pattern of work of the relevant units. Following this it is intended to interview a number of officials of the Regulator and the Bank who were intimately involved over the period under examination. I also intend to discuss the key issues with members of both the Regulatory Authority and the Board of the Bank.

I met with Mr Regling and Mr Watson last week and we agreed to cooperate as our parallel work proceeds. This cooperation is to ensure that there is no overlap and duplication of work in our respective reports. My team will be meeting Mr Regling and Mr Watson later this week.

It might be considered surprising that it falls to me to enquire into my own organisation. Obviously any surprise will be tempered by the consideration that I am in place for less than six months. Still, it is not the easiest of balancing acts to ensure that I find out what needs to be known, without damaging the functioning of the organisation. Nevertheless I am confident that I can do the job effectively, and it is on that basis that I agreed to the Minister's request.

I have begun this task with a presumption that the situation that has emerged in our banking system does reflect a failure of the regulatory system. However, I would like to stress that the organisation which I lead, the Central Bank and Financial Services Authority of Ireland, has over the years delivered a wide range of key services to the Irish economy, including consumer protection, consumer information, effective electronic payments systems, avoidance of excessive inflation as part of its Eurosystem objectives, the supply of liquidity to the banking sector, and the production and issuance of bank notes and coins, to mention just a few, none of which is called into question by the terms of reference of this report.

When I last appeared before an Oireachtas Committee in December, I said that "we understand some of what happened, but some of it is still hard to understand". We are already putting in place new procedures and arrangements that take account of what we have learnt to date. I hope that my report can help develop that understanding further and help us all emerge from our current difficulties with a degree of restored confidence.