DÁIL ÉIREANN

AN COMHCHOISTE UM AIRGEADAS, CAITEACHAS POIBLÍ AND ATHCHÓIRIÚ

JOINT COMMITTEE ON FINANCE, PUBLIC EXPENDITURE AND REFORM

Dé Céadaoin, 22 Aibreán 2015

Wednesday, 22 April 2015

The Joint Committee met at 2 p.m.

MEMBERS PRESENT:

Deputy Richard Boyd Barrett,	Senator Paul Coghlan,
Deputy Tom Barry,	Senator Aideen Hayden.
Deputy Ciarán Cannon,	
Deputty Michael Creed,	
Deputy Jim Daly,*	
Deputy Regina Doherty,	
Deputy Stephen S. Donnelly,	
Deputy Timmy Dooley,	
Deputy Robert Dowds,*	
Deputy Sean Fleming,	
Deputy Michael McGrath,	
Deputy Michael McNamara,*	
Deputy Paul Murphy,	
Deputy Kieran O'Donnell,	
Deputy Pat Rabbitte,	
Deputy Peadar Tóibín,	
Deputy Brian Walsh,	

* In the absence of Deputies Alan Farrell, Ciarán Lynch and Arthur Spring, respectively.

In attendance: Deputy Shane Ross.

DEPUTY LIAM TWOMEY IN THE CHAIR.

The joint committee met in private session until 2.05 p.m.

Overview of the Banking Sector in Ireland: Allied Irish Banks

Chairman: The committee is discussing the banking sector in Ireland with Allied Irish Banks, AIB. I welcome Mr. David Duffy, chief executive of AIB, who is accompanied by Mr. Mark Bourke, chief financial officer, Mr. Bernard Byrne, director of retail and business banking, and Mr. Brendan O'Connor, head of the financial solutions group. The format of the meeting will be that Mr. Duffy will make some opening remarks. In advance of the meeting, we collected questions from members of the committee and submitted these to AIB. I thank Mr. Duffy and his staff for responding in writing to these, which we received on Monday. The responses have been distributed to members. Together with the input of our witnesses today, I hope that all the key topics will have been covered. Nonetheless, a question and answer session will follow to clarify any matters after Mr. Duffy has made his opening statement.

Before I proceed further, I express the committee's regret to Mr. Duffy and his staff that his opening statement and answers to the committee questionnaire were given, unknown to the committee, to the media before he had an opportunity to discuss them in person with the committee today. I now ask Mr. Duffy to make a short opening statement.

Mr. David Duffy: I thank the Chairman for his comments. Once again I thank the committee for providing AIB with this platform to give the Oireachtas and, ultimately, the public a detailed update on the bank's progress. This is my fifth opportunity since I became AIB's chief executive to meet this committee and, as the committee knows, it is likely to be my final meeting. I am sure the committee will have some support with that, but I have enjoyed these meetings and the dialogue we have had here. The meetings over the past three years have been robust, but always constructive. These engagements allowed my team and me to explain as openly and frankly as possible our strategy to stabilise the bank and ultimately to move to a position of sustainability. Our discussions with the committee informed and helped frame our subsequent decision-making. We did not always necessarily agree but we have held a common goal to rebuild AIB from its distressed state after the crisis into a profitable bank equipped to support the Irish economy, to prioritise professional service for our customers and, over time, to seek to return to the Irish taxpayers the support they provided in such large measure. My colleagues have been introduced by the Chairman so I will not repeat those introductions.

I am prepared to leave AIB in the confidence that the management team will continue to lead the bank towards delivering our strategic objectives, putting our customers at the heart of our business and playing a pivotal role in Ireland's economic recovery. After a period of transformation over the past three years, the bank's financial performance has improved, with profits before tax in 2014 of €1.1 billion. The bank's impaired loan balances have been reduced by 23% to €22.2 billion during the year and lending approvals stand at over €13 billion. Progress has been made in reducing mortgage arrears with a 22% reduction in arrears for private dwelling homes in Ireland in 2014 and the bank is in a position for the first time to make a €280 million cash payment to the State on the preference shares.

AIB's recovery over the past number of years has had to be a fine balancing act. Most obvious, it had to be done in tandem with implementing solutions for customers in financial difficulties while protecting taxpayers' capital and, at all times, attempting to return the financial metrics of the bank to sustainable levels both in terms of margin and the bank's cost base. It is particularly appropriate that AIB has this forum, at this time, to set out its perspective in terms of a number of issues that are currently the subject of widespread public debate. We have already sent the committee detailed responses to its advance queries but I would like to highlight a number of issues.

Let me begin with the mortgage interest rate charges and, in particular, the standard variable rate. First and foremost, let me explain that AIB's mortgage pricing reflects consideration of a number of points, the first being the cost of risk attached to a loan. The impact of the recession on the mortgage market in Ireland triggered one of the highest loan arrears and default rates in Europe and, unfortunately, as a result, the level of risk in lending to Irish mortgage customers is proportionally higher than the rest of Europe and has to be factored into our pricing decisions. Thankfully this cost of risk is declining as economic conditions improve and arrears levels reduce. The bank remains focused on further reducing the level of arrears and impaired loans on its balance sheet in the coming period.

The operating costs of running AIB were €1.4 billion in 2014. This represents a reduction of €350 million compared to 2012 levels, following a significant reduction in head count, general administrative costs and progress towards a more efficient operating model. The bank remains focused on ensuring the group is run as efficiently as possible from a cost perspective, while ensuring its customer service levels are appropriate and its systems and processes are robust.

Given its credit rating, the cost of funding for AIB is different to the simple average of other banks across Europe. The narrative that AIB is able to fund itself at the ECB base rate is simply not the case and is an overly simplistic assessment of a much broader set of circumstances. It is important to note that only 3% of AIB's funding is sourced from the ECB. This is an important point to consider in regard to the debate later today. The bank's funding costs have certainly improved over the past number of years and it remains focused on further reductions, based on market conditions.

On the need to generate sustainable and viable returns for shareholders, AIB as a commercial and systemically important institution must ensure that lending is at sustainable rates to ensure it is able to generate a return for shareholders but also to rebuild its capital in order to insulate against any future adverse shocks. AIB's net interest margin in 2014 of 1.69%, excluding ELG costs, increased in the year, but was still below average bank levels across Europe. Given AIB is currently 99.8% owned by the State, the majority of any profits generated by the bank are ultimately to the benefit of the State. In incorporating lessons learned from the recent painful past, the bank cannot return to a situation where its lending decisions are being undertaken on any basis other than a medium to long-term view of sustainability and viability.

Over the past number of years, the bank has worked to improve all of these metrics in the context of creating a sustainable business model capable of supporting economic recovery while also seeking to create an investable model so that over time the bank can start to return capital to the State. As a result of the bank's underlying positive performance and improvements in funding costs and the cost of risk, in December 2014, AIB, EBS and Haven implemented a number of reductions to mortgage rates. For example, the move meant savings of approximately €330 per annum for customers with a mortgage of €200,000 on a 25 year term. If a customer with a similar mortgage chose to move to a two or three year fixed rate option of 3.8%, this would have resulted in savings of €800 per annum. Importantly, the reductions we implemented benefited both new and existing customers.

Further rate reductions for AIB customers, existing and new, are something that my team and I continue to consider. However, it is critical to bear in mind just where this bank has come from. In just over a three year period, AIB has moved from reporting multi-billion euro losses to €1.1 billion in profit in 2014 - into profit for the first time in a number of years. Considering all of the factors outlined, when the appropriate opportunity arose late last year, we moved to cut variable mortgage interest rates for our customers. We must maintain a balance between securing the bank's present and future financial health, preserving and building capital to fuel the economy and repaying the State the sums invested in the bank, while all the time providing our customers with appropriate and sustainable lending rates in the market.

The bank is carefully monitoring the variable components that influence interest rates and will act accordingly in favour of our customers on mortgage rates. We did so after looking at the facts involving all of the elements I have outlined in this letter. There is no ECB rate. It is just not relevant to AIB and we are not funding at some cheap rate in Europe. That is just 3% of our funding. We have a much higher funding rate and in addition we have the cost of risk and the cost of running the bank. We can only charge a rate above those costs if we are to maintain a margin. If we charge below those costs, we will have a loss making bank. Previous tracker rates are an example of that, where the cost of funding, the risk cost and the management of the bank costs were higher than the rates charged on tracker mortgages. We do not want to go to that place again.

That said, as we looked at the four elements to which I referred earlier, the last variable rate cut we made was when we looked at those elements and asked whether if we made a rate cut we would still maintain a position of sustainable profitability in the bank. If so, we could pass on that rate cut to our customers. Our principles have been to run the bank on a commercially viable basis, with sustainable profitability and yet to be fair and equitable in the treatment of our customers. That is how we arrived at our decision of December 2014. As we look at the variables, we see a continuing positive trend this year. We will consider those four variables and if we see that trend continue over the next couple of months, towards our half year financial year, we will consider making a further rate cut. However, that will be decided on the basis of those variables, cost of funding, our cost to manage the bank and our risk operating costs. If all of those costs reduce, as they have in the past, we will be willing to consider another rate cut in the next couple of months. We will look at our financial performance in that window.

This completes my additional supplement, which I make for the sake of clarity, as our position seems to have been defined in the media. I would rather it be clear today, but we can discuss it further.

I also want to refer to the question of mortgage arrears. Apart from dealing with the commercial impact of distressed loans on the bank's balance sheet, we absolutely share concerns at the societal consequences of the ongoing difficulties associated with legacy debt. Reflecting this concern, our trained staff deal with customers who continue to experience financial stress and we work tirelessly to arrive at sustainable solutions that will allow them to emerge from arrears. I have said it many times before and reiterate again today that AIB aims to keep people in their homes where possible, if customers engage with us. With that as our primary motive, we have put in place what we believe to be the most comprehensive set of permanent arrears solutions in the market. Where there is no affordability of any form of mortgage repayment, a loss of ownership may be the appropriate solution, but we believe we have a pragmatic approach to residual debt, recognising that one cannot restructure where there is no affordability.

We have engaged with third party channels such as the IMHO for those customers who feel they cannot come directly to the bank. We pause the legal process when customers engage with us and enter a sustainable restructuring arrangement. While we have much more to do, the success of this approach is borne out in our most recent set of results, with overall arrears levels in our mortgage portfolio in the Republic reducing by 18% in 2014 and owner-occupier arrears falling by 22% and buy-to-let arrears down by 7%.

Similarly, as we seek to protect employment and viable businesses, solid progress was achieved for non-mortgage customers who typically have exposures across a number of asset classes, including SME debt, associated properties and buy-to-let mortgages. At the end of last year, a total of €4.7 billion of non-mortgage loans were subject to forbearance and we continue to constructively engage to offer restructures to our customers in 2015. The improving economic climate in Ireland is translating into an increased appetite for credit, with growth in the personal, business and corporate banking segments of the market. In 2014, we approved over €13 billion of lending in Ireland and our lending draw downs to our customers were 42% higher than the previous year, including our mortgage and business customers. We continue to have capacity to lend and we remain focused on supporting our customers, jobs and the broader Irish economy. These figures are reflective not only of the improving economic backdrop in our main markets of Ireland and the UK but also speaks to the underlying ability of the bank to lend prudently to our customers in the future.

While the bank has made enormous progress in recent years, we are planning for the challenges that lie ahead. We continue to focus on rebuilding the trust and confidence of our customers and improving customer service levels. We have previously indicated that we are in discussions with the Department of Finance over the future capital structure of the bank and while I am not in a position to discuss this in any detail, these considerations are continuing.

On behalf of AIB, I want to express thanks to the committee for inviting us here today and for the huge support the State has given this bank. On a personal level, I want to acknowledge the help of the Oireachtas in the course of my work as chief executive of AIB over the past three years. The bank will continue to approach with vigour the challenges ahead. As a public company with a commercial mandate, AIB has to balance the requirement of generating value for our shareholders, most principally the Irish taxpayer, with the requirements of our customers who also need the support of the bank.

In summary, AIB today is a profitable business, generating capital for shareholders. It has received EU approval for its restructuring plan, has passed the ECB stress tests, is reducing arrears levels and overall levels of impaired loans and is well positioned from a funding, capital and liquidity perspective to prudently lend over time and support the country's economic recovery. We look forward to any questions.

Chairman: I remind members, witnesses and visitors in the Public Gallery that all mobile telephones must be switched off. I advise witnesses that by virtue of section 17(2)(*l*) of the Defamation Act 2009, they are protected by absolute privilege in respect of the evidence they are to give this committee. However, if they are directed by the committee to cease giving evidence in relation to a particular matter and they continue to so do, they are entitled thereafter only to a qualified privilege in respect of their evidence. Witnesses are directed that only evidence connected with the subject matter of these proceedings is to be given and they are asked to respect the parliamentary practice to the effect that, where possible, they should not criticise or make charges against any person, persons or entity by name or in such a way as to make him, her or it identifiable.

Members are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a person outside the House or refer to any official in such a way as to make him or her identifiable.

I propose that we proceed in ten minute slots. Given the large number of members who wish to contribute, I will, if necessary, cut off speakers mid-sentence when the slot concludes.

Deputy Michael McGrath: I welcome Mr. Duffy and his colleagues and thank them for the statement and information they provided in advance of the meeting.

The representatives of all the banks which come before the committee in the weeks ahead will all be challenged strongly on the issue of standard variable rates. Three weeks ago, Fianna Fáil, as an Opposition party, dedicated its Private Members' time in the Dáil to a full debate on the issue of variable mortgage rates. I will put a number of matters to Mr. Duffy to which I ask him to respond.

Most people on a variable rate mortgage understand that the interest rate they pay will move in line with market conditions. When conditions are bad, they expect the rate to increase and when they improve, they expect the rate to reduce. The standard variable rate is not like the tracker rate, which is linked to the rate set by the European Central Bank. There are approximately 300,000 variable rate mortgage customers in Ireland, of whom approximately 140,000 are with Allied Irish Banks. These customers are paying far in excess of the variable rates charged elsewhere in the eurozone where the average variable rate is 2.09%. AIB is not the worst offender in this regard and the bank has reduced its rates recently. I commend it on reducing its variable rate for existing and new customers, especially as some other banks have existing customers paying a standard variable rate of 4.5%. These banks will be challenged on that matter.

The cost of funds to Allied Irish Banks is declining and currently stands at 1.57% according to the bank's figures. Its net interest margin is increasing and currently stands at 1.69%. Will Mr. Duffy take us through the sources of AIB's funds and the cost of each source? Customer accounts provide 63% of the bank's funding. What is the cost of this saver and deposit base?

Mr. David Duffy: I will ask Mr. Mark Bourke to provide a build-up and help Deputy McGrath see through how we build our costs and ultimately how we charge for the rates. I will provide some context for Mr. Bourke. To put this in simple business terms, the way we look at this as a business is that one has a cost of risk. Even in good times, one has mortgages that do not work and different kinds of loan defaults. One then has the running costs to the bank and the costs of the funds one acquires. These three costs need to be considered when one tunes to one's total cost. That is normal business. The bank then charges a rate for its product. If one looks across Allied Irish Banks, we have those three costs. As I stated, the European Central Bank rate is simply not relevant because we only source 3% of funding from the ECB. When we add up the three costs to which I referred and then look at the rates across all our products, we arrive at a figure of 1.6% for the net interest margin, which is at the lower end of the average among our peers.

I want to provide context by stating that we are not trying to get to the point of making tremendous profits for a shareholder valuation. We are looking for sustainable profitability and wish to be fair. As was the case with the previous cut, if these costs come down, we will try to contribute by giving a rate cut to our mortgage customers.

Mr. Bourke will provide the science of how this builds up to provide some clarity for the Deputy.

Mr. Mark Bourke: The best way to break this down is probably to start with the 1.57% figure. Within this figure, we have customer accounts, which amount to approximately €50 billion and the rate for them is 1.3%.

Deputy Michael McGrath: That figure refers to savings and deposits.

Mr. Mark Bourke: Yes. We have other debt and subordinated liabilities which amount to about €3.5 billion and €18.6 billion, respectively. We then have deposits by other banks, which stand at a *de minimus* level of about €300 million. All of this adds up to the 1.57% figure. The important issue on which we must concentrate is that the difference between the yield on our loans, in other words, the rate at which we lend, and these costed funds is about 1.33%. Approximately 70% of this is to cover cost. In a normalised world, another 20% of that would be a normalised cost of risk. The remainder is our sustainable profit level.

Deputy Michael McGrath: Mr. Bourke indicated the net interest margin at the end of last year was 1.69%. What was the net interest margin on standard variable rates?

Mr. Mark Bourke: We do not break down our net interest margin on individual books. Our net interest margin is an overall balance sheet metric.

Deputy Michael McGrath: Would it be fair to say that AIB's net interest margin is depressed by virtue of tracker mortgages and is much higher in respect of variable rate mortgages?

Mr. Mark Bourke: I do not think so. One has to look at this as a total of our assets and lending. What is, on the one hand, the blended rate at which we charge out and what is the blended cost of funds? This gives us a net interest margin for the bank. Some things contribute to it being higher while others contribute to it being lower. That is in the presentation we forwarded to members.

Deputy Michael McGrath: How many standard variable rate mortgage accounts does AIB hold? I understand it is approximately 140,000.

Mr. Mark Bourke: They account for 52% of our overall mortgage customers.

Deputy Michael McGrath: What is the split between owner-occupier and buy-to-let mortgages?

Mr. Bernard Byrne: Approximately 135,000 mortgages are at the standard variable rate.

Deputy Michael McGrath: Those are owner-occupier standard variable rate mortgages.

Mr. Bernard Byrne: No, that is the total figure. There could be some buy-to-let mortgages in that figure. While I do not have the breakdown, I can get it. The vast majority of these mortgages are owner-occupier mortgages.

Deputy Michael McGrath: The trends are clear in that the cost of funds has come down in the past 12 months, the bank's net interest margin is increasing and the bank has returned to strong profitability. What is the profit forecast for 2015?

Mr. Mark Bourke: We would not disclose a profit forecast for 2015. I will reiterate what the chief executive said. He pointed out that there are four constituents to the pricing decision, namely, costs, the cost of funds, the yield on loans and the cost of risk. Taking each of those in turn, we have made considerable progress on managing our operating cost within the bank. We also believe the cost of risk is returning to a normalised level. Our cost of funds has declined from 1.70% to 1.57% over the past year. All of these are positive trends and if they are maintained, we will be in a position to examine passing some of it on in the short term.

Deputy Michael McGrath: Is it fair to say that if current trends continue, there will be downward pressure on standard variable rates in AIB?

Mr. David Duffy: Yes, that is the very important point. We have a strategic plan over multiple years. Last year, we knew that if we could deliver on all of those variables, we would be able to bring down the rate. As we look through this financial year as part of our strategy, we are saying that if those variables come down - not all of them are within our control - we expect to be able to pass on more of that benefit to our customers. This will become clear to us in the next month or two.

Deputy Michael McGrath: Mr. Duffy refers to a period of a month or two. Will that be close to the publication of interim results?

Mr. David Duffy: We will look at our half-year results, which could run until June, and try to understand within these results what is the forecast for the year. We will make a judgment at that point. The progress we are seeing today is positive. We will look forward those two months and if we see the same positive progress, we will then be in a position to further cut the rates.

Deputy Michael McGrath: Is Mr. Duffy reasonably optimistic that variable rate mortgage customers may benefit from a rate cut?

Mr. David Duffy: No CEO in the world is ever optimistic. However, if we see the trends continue, we will be in a position to do something.

Deputy Michael McGrath: Why is the level of switcher mortgages so low or "minimal" as the bank described it? We need a market in which banks try to persuade customers of other banks to switch their mortgage to them. This is how one creates dynamism and competition in the banking system.

Mr. Bernard Byrne: One of the key issues for us is to ensure we build a sustainable model. Encouraging switcher activity at the front end through very cheap forward rates is not where we want to be at. One of the driving forces behind the change we made in December was to make sure we benefited front book and back book customers. The change meant our existing customer base got the benefit of the reduction. That philosophy is one we will take into anything else we do from a pricing point of view in order that we are fair to the entire customer base. It is much easier to put out an attractive rate in the front of the market and not suffer the cost into the back book. Our view is that we should try to be fair to all our customers, whether they have been with us for a long time or just about to come to us, so that the customer will know what he or she will get. In regard to switcher activity, our objective is to make sure that people know what they will get. It is a choice as to whether the customer moves to us or not. We are very open to it.

Deputy Michael McGrath: Does the bank have a view on the proposed reduction of the discharge period from bankruptcy in Ireland?

Mr. David Duffy: We have discussed that issue. Typically, we do not comment on political or Government policy, but just make sure we are compliant with the policy. With specific reference to the policy on bankruptcy, I do not see any fundamental problem from the bank's perspective with the reduction in the term.

Deputy Michael McGrath: I wish Mr. Duffy well in his future challenges.

Mr. David Duffy: I thank the Deputy.

Chairman: Deputy Kieran O'Donnell has ten minutes.

Deputy Kieran O'Donnell: I welcome Mr. Duffy and his colleagues. Mr. Duffy mentioned three components of mortgage pricing - cost of funding, the overhead costs of the bank and the cost of risk.

Mr. David Duffy: There are four components in making decisions. The Deputy has outlined the three costs but the fourth is the rate one sets for one's products, that is, the income, but the other three are the costs.

Deputy Kieran O'Donnell: In respect of the cost of funding, will Mr. Duffy state the reason the one year fixed rate for new customers at roughly 3.5% is lower than the variable rate, which ranges from 3.85% to 4.25%? That would not be the norm. Why is the fixed rate lower than the variable rate?

Mr. Bernard Byrne: We implemented that change in December. With a brand new product, a new offering in effect, one can secure marginal funding for it because it is a new funding cost. We were able to pass on the benefit in respect of that. At some points in time, the variable rate is lower and at other times, the fixed rate is lower. The reasons that people opt for fixed rates are certainty of cost and to secure cash when things are tight.

Deputy Kieran O'Donnell: Does that indicate that AIB expects the rates to come down? Ultimately, banks effectively make the fixed rate higher than the variable rate to factor in some element of risk. The fact is that one can get a loan on a fixed rate of interest at a price ranging from 3.5%. The lowest differential is 0.75%. Is it fair to say that AIB expects the rate to come down?

Mr. David Duffy: The Deputy can make that comment; that is fair. We do not control all the elements so one does not know, but we would say that based on what we know, we would expect the trend to be positive. Our two year fixed rate is at 3.8% and all of our existing customers can switch. When we look forward, we would expect the rates to be better.

Deputy Kieran O'Donnell: AIB has priced the existing customer rate at 4.15% and the fixed rate at 4.15% as well. There is no difference between the fixed and the variable rates. The cost of funding has definitely come down. Am I correct that in January 2015, AIB raised €750 million at a cost of 0.625% and in March 2015 the bank raised €500 million at 1.375%? Both rates are a good bit lower than the current 1.57% cost of funding that the bank uses at present. AIB has been restructured significantly and the rate of 1.57% that the bank is quoting for the cost of funding is basically the 2014 rate for the cost of funding. We represent the ordinary person who goes to the bank and sees that a fixed rate mortgage rate is lower than or equal to the variable rate, which on the face of it does not appear to make sense unless the bank knows that the rates are going to drop and they are possibly taking profit from the variable mortgages at the variable mortgage holder's expense.

The bank is raising funds in 2015 at significantly lower rates than applied in 2014. I cannot see why AIB Bank needs to wait until the announcement of the results for the first six months when it is clearly evident that the bank has factored in that the rates are coming down and the restructuring costs have come down. We meet ordinary people who have mortgages. A situation can arise where a number of people have the same level of mortgage, which is not very large, and the person on a variable rate may be paying €300 to €600 more per month than the person on the tracker mortgage. Mr. Duffy wants to be transparent and fair and my question is why AIB does not reduce the rate now.

Mr. David Duffy: We need to see all of the factors. It is not just the funding rate; it is the cost to the bank and the cost of risk. We need to see a little bit of confidence in all three of those factors, because they can change every quarter. It is only a month or two since December 2014 when we cut a rate. We are only five months into it.

Deputy Kieran O'Donnell: Mr. Duffy will appreciate that for the ordinary person, that could make the difference between having €400 per month extra, which would amount to €800 in the next two months.

Mr. David Duffy: That is right, Deputy.

Deputy Kieran O'Donnell: It is enormously significant to them.

Mr. David Duffy: It is, and that is why we also introduced the two year fixed rate at 3.8% and we encourage customers to avail of it. All our existing customers can switch to that rate which would be a very significant saving right now and they can do so today. We contact our customers and explain that to them. We are trying to manage the transition in the very short term as we have outlined. If all of our variable costs are coming down as we manage them and not all of them are within our control, we will pass on that rate cut to our customers and that is the principles we have set out to borrowers.

Deputy Kieran O'Donnell: Does Mr. Duffy accept that, on the face of it, it comes down to AIB's cost of funding and the way the bank has raised money? In 2014, AIB raised money at 2.33% and 2.75%, raising a total of €1 billion in the two bids. In 2015, AIB has raised a total of €1.25 billion, of which €750 million was raised at 0.625% in January and €500 million was raised at 1.375% in March. AIB has control over the restructuring costs and the cost of funding is definitely coming down. I would contend that risk is also coming down.

I wish to make a point to Mr. Bourke. He said the bank does not provide specific detail on the margins the bank makes on mortgage holders, yet Mr. Duffy states the rate the bank charges is based on factoring in risk from mortgage holders. One cannot have it both ways. One cannot say in one breath that the bank does not provide the information and at the same time say that the rate AIB charges is based on the risk that it factored in.

I have two questions for Mr. Duffy. First, can we take it that there will be a reduction in the mortgage interest rate sooner rather than later? Second, will he indicate if he has a figure for the risk factor in terms of the mortgage holder?

Mr. David Duffy: I will ask Mr. Bourke to answer the second question. On the specific question of interest rates, if we see the variables change and continue to change through our actions and through market actions, then in the short term we expect to be able to make a rate cut. That is as specific as I can be - that is short term.

Deputy Kieran O'Donnell: When Mr Duffy states "short term", what does he mean?

Mr. David Duffy: Within the next month or two. I need to see the financial results coming through because they take a little while to put together and forecast for the year. That is the position. As we have stated, our principles are to run the bank commercially and sustainably and to be fair to the customers. We cut the rates in December, which is only a few months ago, and we did it for all of our customers.

Deputy Kieran O'Donnell: We commend that.

Mr. David Duffy: On top of that, as we see any improvement in the variable factors, we will consider it again, and that is within the next month or two.

Deputy Kieran O'Donnell: Does Mr. Duffy agree it is self-evident that there are improvements in AIB's cost of funding in terms of the way the bank has raised money, that we are seeing improvement in the risk and we are seeing improvement in the restructuring costs?

Mr. David Duffy: Yes. I will ask Mr. Bourke to take the Deputy through those matters. I want to make one comment, however, and that is that we have to be very careful. This bank has a margin of 1.6% on its total profitability. That has a very slim margin to it, as explained by Mr. Bourke earlier.

Deputy Kieran O'Donnell: That is based on the figures for 2014.

Mr. David Duffy: It is based on the total profitability of the bank for 2014. We are only a few months into 2015.

Deputy Kieran O'Donnell: The cost of funding has come down in 2015.

Mr. David Duffy: Some element of our funding did. The Deputy must look at the totality of our funding.

Deputy Kieran O'Donnell: I accept that, but the average has come down.

Mr. David Duffy: Yes, because it is coming down but it is not the only decision-making point. We see improvements in the cost of risk and we are reducing the bank's expenses continuously and it is on exactly that basis, as the Deputy says, that we are looking to make a final decision in the next month or two. I will ask Mr. Bourke to make a comment on the fund-raising.

Mr. Mark Bourke: What it does reflect is exactly my response to Deputy McGrath. When we look at €1 billion or €1.5 billion at a lower rate, that is contributing on an ongoing basis to a decrease in the cost of funding. It is very marginal. If one looks at the figures for last year, one will see our total debt issued at €8 billion. The cost went from 3.63% to 3.49%. It is very gradual and the effect is marginal. It is positive, but we have to have sustained trends in all four factors before we are able to give-----

Deputy Kieran O'Donnell: Is it fair to say the trends which are self-evident are moving in a direction where the bank will be in a position to reduce the mortgage rate?

Mr. Mark Bourke: That is exactly what we have said. If the trends are sustained, we will be very positive.

Deputy Kieran O'Donnell: I have a final question. What impact would a 0.25% reduction in variable mortgage interest rates have on profitability? There was a profit of just over €1.1 billion in before tax in 2014. That is most welcome and I commend-----

Mr. Mark Bourke: I do not think we disclose the impact in our financial results. Therefore, I would prefer not to comment.

Deputy Kieran O'Donnell: It could be encompassed in that level of profitability.

Mr. David Duffy: I will answer the final question. We will make the two decisions. If there is a benefit, we will pass it on to our customers, with the proviso that we must maintain a stable and sustainable level of profitability. That was how we made the last decision and is how we will make the decision in the next month or two. We are seeing positive trends in the numbers.

Deputy Peadar Tóibín: AIB made a pre-tax profit of €1.1 billion last year on what many say was a punitive interest rate. We can only take it to be the outcome of its policy. Given that its responsibility is to act on behalf of its shareholder, are we to take it as the outcome of the policy of the shareholder?

Mr. David Duffy: I would put it very simply. We run the bank on a commercial basis at arm's length from the shareholder. The decisions on cost and pricing are ours and nobody else's. The cost of risk is an input, but it is an observed input in the marketplace. When we examined the three cost elements mentioned and, therefore, the pricing of our products, we made the decisions. Where we have seen improvements in the three cost elements, we have passed them on to our customers. That is exactly how the model works.

Deputy Peadar Tóibín: Has the Government given the bank directions on profitability levels?

Mr. David Duffy: No. We discuss every component of the bank's performance with the shareholder, but we make the decisions with the board, at arm's length, through the shareholder agreement.

Deputy Peadar Tóibín: The decision is made without any direction.

Mr. David Duffy: We do not have those discussions.

Deputy Peadar Tóibín: If the Government was to give the bank directions on reducing or scaling back its level of profitability, while easing interest rates for those on variable interest rates, would it accept that?

Mr. David Duffy: We examine all of the factors under consideration. In the past, during banking crises, interest rates moved down rapidly and were not reflective of the other inputs and costs. We make that decision with the board under our fiduciary responsibilities rather than on direction.

Deputy Peadar Tóibín: The bank's responsibility is to act on behalf of its shareholder; therefore, it has a responsibility to act on behalf of the Government if it directs it to ease the burden on the figure of 100,000 mortgage holders.

Mr. David Duffy: That would be a matter for the board to discuss; it is not a matter on which there would be a direction.

Deputy Peadar Tóibín: It is a matter of fact that the board would have to act on the directions of the Government, as shareholder.

Mr. David Duffy: It is not the only shareholder.

Deputy Peadar Tóibín: It owns 99% of the bank.

Mr. David Duffy: One has to consider all shareholders; one cannot be selective.

Deputy Peadar Tóibín: Okay. There is also a view in society generally that the Government wants to offload AIB in the future and that there is a desire to fatten it in terms of the level of profitability, capitalisation and its attractiveness to the market. Is that part of the thinking behind the current policy?

Mr. David Duffy: No. Let us be very specific. The bank's margins, although it has a nominal number on which people focus, are at the lower end of the average figure for our European peers. We have a long way to go before we will have addressed all of the costs involved, the cost of risk and funding issues, to reduce them to a normal level. That is what we are doing. We are not looking at fattening the bank, rather we are looking at managing these areas to get back a normal level in order that we can return funds to the taxpayer.

Deputy Peadar Tóibín: Is the attractiveness of the bank to a potential seller in the future in any way part of the thinking on how this policy is being delivered?

Mr. David Duffy: We have a very simple approach. The bank was losing billions and we had to return it to profitability. We are on that journey, but we are not yet at the end. We do not look at other extraneous factors, rather we look at a stable banking business which is the largest in the country and systemic to return it to a below average level of profitability. That is what we have achieved to date. That is our primary focus, namely, making sure the taxpayer will never again have to put funds into the bank.

Deputy Peadar Tóibín: Is AIB required to deleverage at any level? A number of years ago it was required to do so. Has all of that happened, or is there more to happen?

Mr. David Duffy: No further deleveraging is required.

Deputy Peadar Tóibín: What percentage of business loans have been written down?

Mr. Brendan O'Connor: We do not give a breakdown of the percentage of business loans that have been written down. We have disclosed in the response we have given today that €4.7 billion of debt across the non-mortgage sectors of AIB was written down in the annual accounts for 2014.

Deputy Peadar Tóibín: There is a major crisis in the SME sector. Many have been tied to toxic loans. The functioning parts of businesses are being dragged down and jobs are being threatened as a result. What efforts are being made by the bank to try to resolve that issue?

Mr. Brendan O'Connor: We have a portfolio of SME loans which are largely property related. At the end of 2014 we had made offers in the form of written heads of terms to the vast majority of these customers, some 80% to 85%, proposing a solution or a restructuring solution to them. We also managed some customers who were distressed but not necessarily dealing with impaired loans. We made the offers at the end of 2014 and the results of these offers and the drawdown of the restructured loans manifested in the bank's books in €4.7 billion being written down. We continue to work our way through the process and will restructure loans during the course of 2015. A very significant effort------

Mr. David Duffy: Many businesses with which we have dealt have non-correlated property debt which is not linked with their core business. In our efforts to figure out how to protect jobs we have separated these property issues from the core business and tried to determine how to address the property share of viable businesses. That is the nature of the restructurings in which we have been engaged.

Deputy Peadar Tóibín: There is a lot of debate about the dysfunction within the property market. Property prices are increasing rapidly, while rent costs are spiralling. Part of the problem is on the supply side. The view is that the banks are not lending to builders or are lending at a percentage which makes things impossible. Do the delegates have any insight into that element of the market?

Mr. Bernard Byrne: There are two elements. One of the key issues is the availability of equity from third parties because the developers may not have it. A significant portion of the equity which traditional developers or builders had was eroded as a result of the economic crisis. We have learned the lessons from the crisis and the banks are putting proper structured debt arrangements in place, which reflect the appropriate amount of debt that can be taken. We will not put equity in or have equity-like instruments for such financing. Debt financing is generally considered to be available if one can put a structure together.

The second element which causes challenges for availability on the equity side is the uncertainty around some of the rest of the development pipeline and the time involved. The picture is complex. We have a €500 million fund available and are keen to deal with the issue. A significant number of developers have made good progress with us. We do not think the debt side presents a challenge, but we need a capital structure. The banks will not get back into the provision of the entire capital structure, as was the case in the previous economic cycle. Therefore, equity needs to be available.

Mr. Brendan O'Connor: Typically, a bank would fund about 65% of the cost of a building project with senior debt, with the remainder being equity. There was an issue with equity in the market in the past few years. It seems to have eased and there are now a number of funds which specifically provide equity for building projects. In our management of customers in difficulty we also provide working capital to finish off developments and have recently established a specialised property lending unit to make sure these funds are put into the productive sector for construction and development. There is a return of equity in the market.

Deputy Peadar Tóibín: Are there figures for volume and stock levels in lending to the building sector?

Mr. Brendan O'Connor: I do not have a breakdown to hand of the figures the Central Bank holds for lending, but we have financed between 1,200 and 1,500 residential units and quite a few more are in the pipeline. It is not just about senior debt lending for property or equity because there is also the issue of planning permission. It is not something one can kick-start particularly quickly as one has to obtain planning permission first. It is often modified planning permission because a development that may have been envisaged four or five years ago is not the one that would sell today.

Senator Aideen Hayden: I welcome the delegates in what must be their fifth or sixth time in front of the committee.

It is interesting to look at how the horizon has changed since we first started this process. I notice that, even though the figures are still quite low, the level of repossessions, including voluntary surrenders, has gone up substantially in the past few years. I get the impression that we might have been in a phoney war for the last 18 months, whereas now we are moving into its last stages. As I am sure the delegates understand, having read all of the reports in the media, there is huge concern, particularly about the number of repossession cases before the courts. We are facing what has been called a "tsunami of repossessions". They mainly involve family homes, but I would like to spend some time talking about the buy-to-let market also.

I am looking at AIB's own numbers for the actions it has before the courts. I speak regularly to a lot of people dealing with clients in distress and can say AIB is not the worst by any means and that where there is engagement between a financial institution and its borrowers in a way that is fairer than that engaged in by other financial institutions, it should be acknowledged.

Question No. 43 deals with the level of write-downs. The delegates say they cannot distinguish between residential mortgages for principal dwellings and buy-to-lets in terms of write-downs. According to my quick calculations, the number of residential mortgage write-downs in 2014 versus the number of surrenders works out at just above 40%. Would it be accurate to say AIB offers write-downs in approximately 40% of cases concluded with a voluntary repossession?

Mr. David Duffy: I will make one comment and Mr. O'Connor will then take the Senator through the figures for the repossession of buy-to-lets, as well as the average numbers. There was a lot of misrepresentation in the media this morning. Mr. O'Connor will speak about what is actually happening in the courts and then deal with the Senator's question about discounts.

Mr. Brendan O'Connor: Unfortunately, one cannot conflate the two numbers. When a write-off actually happens has a lot to do with when a property is sold because there is no certainty until then. We may agree to a write-off, but that may not be reflected in the numbers until the write-off actually happens. These are a set of financial accounts rather than a reflection of all of the agreements that may be in train with customers at any given time. The number of 40% does not hold true, but neither do we disclose what the number is.

Senator Aideen Hayden: What figure would hold true?

Mr. Brendan O'Connor: We do not disclose that number.

Senator Aideen Hayden: Mr. O'Connor cannot tell us what percentage of cases concluded with, say, a voluntary surrender, where somebody is in such a level of deep distress that he or she is willing to hand back the keys, qualify for a write-down. He cannot give any indication of how many cases there are in which the bank offers a write-down.

Mr. Brendan O'Connor: No. I can tell the Senator when we grant a write-down, but we do not disclose where we do it. To the extent that somebody is involved in a voluntary surrender, where he or she has no affordability and no cashflow such that we cannot construct a sustainable solution that will allow him or her to keep his or her home, we will look at the residual figure. To the extent that there is no affordability we will write an agreement that states the residual amount will be written off.

Senator Aideen Hayden: The write-down could be 100%, 40%, 60% or any figure.

Mr. Brendan O'Connor: It is rarely 100% because there is always some asset value, but it will depend on certain things. It is not about the value of the home but affordability for the individual.

Senator Aideen Hayden: I do understand that, but it would be useful to have an average figure for the cases the bank has concluded. It looks like it has offered a write-down in approximately 41% of cases.

Nearly 10,000 of the bank's buy-to-let loans are in arrears for more than 90 days. In Question No. 57 it is stated the bank appoints receivers for buy-to-let properties in certain circumstances and honours the former lease and the PRTB rules and regulations in the residential tenancies Act. I have raised this issue on a number of occasions and there is a lot of concern about the activities of receivers appointed for buy-to-let mortgages. I accept that the bank does honour leases, as it should under the law, the PRTB rules and the regulations in the residential tenancies Act, but does it have any service level agreement with the receivers appointed by it covering how they behave, particularly towards tenants? We are aware of tenants being treated appallingly.

Mr. Brendan O'Connor: Yes, we do have service level agreements with all of our receivers. As we have a small group of receivers, we can ensure there is consistent interaction between us and the receiver and between the receiver and the tenant, if one is involved. We review these service level agreements on a regular basis. Receivers are aware of our protocol that if a formal lease is in place, we honour it and that where there is no formal lease in place, we give people the maximum notice period allowable under the Act, regardless of their tenancy arrangements. Therefore, if they are only in the building six months, we use the longest notice period in the graduated scale which is, I believe, 118 days.

Senator Aideen Hayden: What about communication with the tenant? We see situations where tenants come home knowing nothing about what is happening.

Mr. Brendan O'Connor: In all cases we try to communicate with the tenant. We will always try to find out if somebody is in residence in the property, although we have to balance this with the issues around strangers knocking on doors. We will hold our hands up and say sometimes it does not work. Sometimes we go around - this is particularly the case with an apartment - and there is no visible sign that somebody is living there. We have made our mistakes which we try to resolve as best we can, but our policy is to identify if there is a tenant and communicate what we can within the bounds of the law. There are privacy and confidentiality issues as regards the borrower, but we certainly aim to put the tenant on notice.

Senator Aideen Hayden: Does Mr. O'Connor believe an instruction from the Central Bank, similar to the code of conduct on mortgage arrears for tenants, would be useful to establish commonality across lending institutions?

Mr. Brendan O'Connor: Yes. We will comply with both the letter and the spirit of whatever regulation or law is in place. I would not have any fundamental issue with this.

Senator Aideen Hayden: I was struck by Mr. O'Connor's comments on whether the mortgage arrears resolution targets had caused the bank to engage more forcefully with some borrowers than it might otherwise have done. I was also struck by his comment on the use of legal action to bring reluctant borrowers to the table.

I want to ask Mr. Duffy a further question. There is a narrative that were it not for the courts, we would still have people swanning off on three holidays a year, not engaging with the process and so on. I personally think that is way overstated. Mr. Duffy appears to be agreeing that in some instances, legal actions seems to bring people to the table in a way that other activities on AIB's part have not. On AIB's relationship with the IMHO, overall, in terms of the number of court actions, AIB's numbers are reasonably low in comparison with some other lenders. Does Mr. Duffy think that having the IMHO as a body independent of the bank has been helpful for borrowers who may be fearful of engaging with a lending institution?

Mr. David Duffy: We had an Oireachtas discussion here where one of the Oireachtas Members brought up the point that there is a fear. That is why we introduced the IMHO, whereby the person can go, not to the bank, but indirectly to somebody else who would represent their interests. In answer to the Senator's question, I believe it has been very helpful to have that independent body which represents more of a consumer-friendly interest, and to then engage with us in trying to sort something out. That has been very successful.

The other issue that was raised was the tsunami of repossessions. That was misrepresented in the media today. For anybody to be in the position where we are in a court repossession discussion or in the court process would require them to not have engaged or repaid us anything in a number of years. In those cases, significant numbers will not end up in repossession territory at all because I think we have about 50% who re-engage.

Mr. Brendan O'Connor: There are some interesting re-engagement levels. We are actively seeking an adjournment in 50% of cases where there is a court date because we have had re-engagement. At certain stages in the process, we tend to get re-engagement and, certainly after we give the regulatory letters, we get re-engagement of about 50% at every stage. We actually have 800 people in the court process at the moment who are on a test period, so while they will appear in the legal numbers, they have re-engaged. They are on a test payment period and when that test payment period is over, we would expect them to come out of the legal process. We have brought 2,000 people back from more than two years in arrears who are no longer in arrears when, previously, they would have been in the legal process. It does drive an intensity of engagement and our observation is that it leads strongly to people coming back to the table.

Deputy Stephen S. Donnelly: Mr. Duffy and his team are very welcome. I want to start by recognising some things that the bank has achieved and has done. First, I want to recognise the improved performance of the bank. A noticeable turnaround has been achieved by the bank, by the management of the bank and, no doubt, by all of the employees of the bank over the last few years. As the owners of the bank, I think we need to recognise there has been a very significant turnaround. I would like to also recognise the introduction of the debt-for-equity product. I know the numbers are still small but my understanding is that they are growing and it is obviously something we raised at the committee some time ago. AIB's look at the post-retirement period is also something that was raised at this committee and was something AIB acted on, which was very welcome.

The joint venture with the IMHO is very welcome and I am glad to hear that Mr. Duffy considers it a success. AIB also deserves recognition for a progressive approach to residual debt in comparison to one bank in particular, Bank of Ireland, and maybe some of the others. I think AIB has taken a progressive approach to this. While I do not want to put words in his mouth, I am delighted to hear Mr. Duffy say today that the bank would not have anything to fear from moving from a three-year to a one-year bankruptcy period. That is also very welcome.

Does AIB have a current market cap value on the bank?

Mr. David Duffy: Mr. Bourke is engaged in that process.

Mr. Mark Bourke: A valuation has been carried out on behalf of the NTMA, so it is somewhere between €12 billion and €13 billion, I think, but we do not ourselves value the bank as that is-----

Deputy Stephen S. Donnelly: However, AIB has advice that the best guess is that, were the bank sold tomorrow, the State would get about €12 billion or €13 billion for its stake.

Mr. David Duffy: That is technically the State's valuation.

Deputy Stephen S. Donnelly: Mr. O'Connor mentioned earlier that €4.7 billion has been written off in non-mortgage debt, presumably since about 2008. Is that right?

Mr. Brendan O'Connor: No, that €4.7 billion was in 2014.

Deputy Stephen S. Donnelly: Just to be clear, €4.7 billion was written off in non-mortgage debt last year.

Mr. Brendan O'Connor: Correct.

Deputy Stephen S. Donnelly: Does Mr. O'Connor have the figure for mortgage debt?

Mr. Brendan O'Connor: It is just short of €500 million; I think it is €460 million.

Deputy Stephen S. Donnelly: I want to move on to the mortgage rates. I took a look back at October 2012 when we had this conversation at the finance committee. AIB's rate was 3.5% and it has gone up to €4.15%, so it has gone up by 65 basis points. At the same time, the ECB rate has come down by 70 basis points. I appreciate it is only 3% of the funding but, at the same time, risk has obviously fallen dramatically for a variety of reasons, including the significant increase in house values, operating costs are down, provisioning requirements are down and, I imagine, there will be a significant rewind this year. I think it was Bank of Ireland that had a €280 million release of provisioning, so I presume AIB will also have a reduction in provisioning. Obviously, with quantitative easing happening, the direct cost from the ECB at only 3% is minimal in terms of leverage but wholesale funding is falling across the eurozone. Therefore, if all of the drivers of cost bar one seem to have fallen significantly at the same time that the variable rate has increased significantly, is it reasonable to conclude that the sole driver of the increase in the variable rate is to drive shareholder funding?

Mr. David Duffy: I am not sure I follow the Deputy. The answer would be that, no, there is not a sole driver. If the Deputy looks at the funding we have at 3% from the ECB, which is so limited that it does not materially affect our rate, if he looks at what Mr. Bourke said earlier about the marginal cost of our funding having improved, but very marginally in its totality over that period, and if he looks at the fact we have reduced our costs but we have further to go on that, taking all of that together, four months ago we made a reduction based on what we have been able to achieve thus far, and we are looking in the next couple of months at considering something similar. There is no sole driver.

Deputy Stephen S. Donnelly: I appreciate that. I am going back further, to October 2012. The variable mortgage rate is now significantly higher than it was in October 2012, so AIB's mortgage rate has gone up but all of the drivers of cost associated with that have gone down. On the basis that the rate has gone significantly up and the costs have gone significantly down, is it fair to say the only reason the mortgage rate has gone up, while all of the bank's costs are going down, is that it is being driven by shareholder funds, which is the only remaining driver Mr. Duffy has identified?

Mr. Mark Bourke: The best way to answer that is to say that, in 2012 and 2013, one would see cumulative losses or losses in each period of €2.5 billion, €4 billion and €1 billion, and our first year of profitability was 2014, two-thirds of which was enhanced by things that are once-off and not necessarily sustainable. In that sense, we had to get the business back to profitability. Yes, it is down to not eroding shareholder funds or having an unsustainable bank.

Deputy Stephen S. Donnelly: I would like to ask about the margins specifically on the variable rate. I appreciate the witnesses have stated that blended margin, or the average net margin for the bank, is below industry standard. Let us say the variable rate is 4.15%. The last report we have for the blended cost of funding for the bank was 1.57%, and while it is probably slightly lower now, let us use that. That would suggest the margin on variable rates is about 2.7 percentage points. Does Mr. Duffy know if that is higher than, lower than or at about industry norms for the eurozone?

Mr. David Duffy: I think Mr. Bourke will want to make a comment on that. We must remember that is one element of the cost, which is comparable in the eurozone, but there is then the cost of risk, which is significantly more expensive than the eurozone, and then there are the operating costs. Those are all of the elements that come to the margin between the cost and the rate one charges.

Mr. Mark Bourke: At a total level, our net interest margin, 1.69%, is certainly in the lower quartile among European banks. I cannot give the Deputy the comparative data with other countries for this specific book but what one is seeing is the reflection of the cost to serve and the cost of risk which is actually better but is historically far worse in this country for a number of reasons specific to it.

Deputy Stephen S. Donnelly: Will AIB come back to the committee with those figures? AIB has 50% of the entire standard variable mortgage market. These mortgage holders are not interested in whether the net margin for the bank overall is reasonable but if the net margin on variable rate mortgages is reasonable. I have no idea whether it is or it is not. On the same basis that the bank was able to tell the committee that the net margins across all of its banking activities are below the industry norm, will the bank come back to the committee to let us know how that 2.7 percentage point margin on the variable rate mortgage compares to others? If it is competitive, then fair enough. However, it may not be competitive and those with variable rate mortgages would like to know that.

Mr. Bernard Byrne: The variable rate mortgage product does vary across every jurisdiction, so there is not a like-for-like comparison. The closest example is the UK marketplace, a marketplace in which we operate so we are very familiar with it. The average standard variable rate in the UK is 4.85%. Obviously, the base rate is 50 basis points, meaning there is a slightly higher base rate. The actual customer rate for a standard variable mortgage is 4.85%.

Chairman: Is AIB aware of the credit review register operated by the Central Bank?

Mr. David Duffy: Yes.

Chairman: If an individual asked the bank for a lower rate, would it use the register to negotiate one?

Mr. Bernard Byrne: Our engagement with the Credit Review Office is based on cases where a customer disagrees with a credit decision we have made. It could be that they view the rate we have offered as declinatory, namely a rate that is damaging to their business. In such cases, they have the option of going to the Credit Review Office.

I am not aware of instances where that has been the case, however. Normally, if someone was uncomfortable with our credit decision, they could appeal to us first, as we have a separate independent internal process. In the event they were uncomfortable with the decision at that point, they could then go to the Credit Review Office. The number of appeals that go to the office is very small. Over the past four years, out of 150,000 SME credit decisions made by all banks, fewer than 1,000 have gone to the Credit Review Office. Our portion in that would only be several hundred.

Chairman: Regarding the bank's decisions on repossessions, has the bank taken into account the Government's policy in this regard and the changes to insolvency legislation?

Mr. Brendan O'Connor: We make our decisions based on affordability. The only criterion we use is how much somebody can pay. Is there enough there to structure a sustainable mortgage solution? We do not go into matters of policy but affordability for the individual in question. There is always an individual set of circumstances in such cases.

If somebody has some level of affordability that allows for a mortgage restructure, we have a product to allow that to happen. Where someone does not have it, we have a process which allows a voluntary sale for loss and will not pursue the residual debt. The only way we can sustain a restructure is if we have the customer's information, that they are willing to talk to us and willing to make a payment in line with affordability.

Those with mortgages over 720 days in arrears represent a large cohort. In AIB, 60% of those have made no payment at all, which represents 7,000 accounts. If that is their maximum affordability, it will not be possible for us to restructure the mortgage. Our responsibility is to help the customer exit the property and we will not go after the residual debt if it is not there. We actually can do nothing unless we have that level of engagement.

All of the statistics for mortgage arrears relate to accounts. When one sees 10,000 accounts, this is most typically 8,000 properties. It is usually 1.25 to 1.5 accounts per property due to top-up loans on mortgages.

Deputy Sean Fleming: I welcome Mr. David Duffy and his colleagues to the committee today. Will the bank give me a figure for what it expects its write-backs will be for 2015?

Mr. Mark Bourke: We have not got an estimate in the marketplace for the level of write-backs for this year. Our net write-backs last year-----

Deputy Sean Fleming: I am talking about 2015.

Mr. Mark Bourke: I cannot give the Deputy that because I do not have the figure. Last year, we had a net write-back of €188 million. All of the backdrop economics are an improvement on this. I would expect it to be in excess of that figure for 2015.

Deputy Sean Fleming: Last year, €76 million of that €188 million was for mortgage accounts and the other was broken down between the other headings. The bank is now expecting a higher level of write-back. In layman's English, the bank overprovided for bad debts on those mortgage accounts for €76 million in 2014 and will have a higher figure for 2015. Essentially, it will be €150 million that the bank has presumed it might not get back. I know the bank changed the factors regarding house prices from their drop from the peak. There is a minimum of €150 million of overprovision for mortgage losses in the bank's figures for 2014 and 2015. Variable interest rate mortgage holders pay for this overprovision. The bank has been excessively hard on the variable mortgage rate holders with that level of overprovision. It has overstated how bad these accounts were and has penalised them accordingly.

Mr. Mark Bourke: The Deputy is correct on the first point. When we provide for mortgages, it is across the full volume of mortgages on the basis of that peak to trough drop. If that improves - there has been an improvement in the market - we will have overprovided and it writes back. As long as the economy keeps getting better, one will get a better result on these provisions.

However, the second point does not necessarily follow. The fact that we have provided is the critical issue for us to be able to tackle borrowers in distress. If we have provided, then essentially we have the facility to restructure and in many cases write off the debt.

Deputy Sean Fleming: The bank could use some of that funding not for restructuring but to reduce the interest charged on variable rate mortgages. It is clear this year it will be higher because the house price fall from the peak will improve this year. It is inevitable that there will be another increase this year and Mr. Bourke is changing his assumptions. His assumptions may have been valid at the time, but in light of current experience, they are a little severe. I ask that some of the write-back he is giving on mortgage accounts be given to those mortgage holders on the variable rate. That is a request. He can take it or leave it because my time is limited. I can discuss it with him but I think he gets my message.

Mr. Mark Bourke: Yes.

Deputy Sean Fleming: Second, tracker mortgages make up 34% of the bank's owner-occupier mortgages whereas in the buy-to-let area it is 62%. The bank targeted the buy-to-let market with tracker mortgages, and everyone knows the profitability on the variable rate is much higher than on the tracker, so the bank is losing more money on the tracker-----

Chairman: The Deputy must conclude.

Deputy Sean Fleming: The three minutes is very short. Only 3% of the bank's funding comes from the European Central Bank funding rates but it has much more than that out on tracker mortgages on its buy-to-let side. The variable mortgage rate customer is carrying not just the loss of owner-occupiers with tracker mortgages but also an excessive cost of tracker mortgages on the buy-to-let side, of which the bank has a disproportionate amount.

The bank wrote off €461 million last year on residential mortgages. It seems to be saying it will write off the negative equity.

This is my last question. Mr. Bourke said the bank is in a position to make a €280 million cash payment to the State. In view of the fact that the bank is still overcharging its customers, is it not premature to be making that payment to the State, which is on the back of its mortgage holders? I believe it is premature. When will it make that payment and for what reason? Has the bank been asked by the Government to make a payment or is it doing it to keep in with the Minister?

Chairman: Can we have a brief answer to that?

Deputy Sean Fleming: On the last question only-----

Mr. David Duffy: My relationship with the Minister-----

Deputy Sean Fleming: -----why is the bank paying this €280 million? Why is it taking that out of income it is earning excessively from the variable rate mortgage holder to hand over to the State?

Mr. David Duffy: I will ask Mr. Bourke to comment on that. Clearly, my relationship with the Minister is of no consequence going forward, nor would we ever make a decision about something as material as that with regard to any personality. We will make that commercially independent decision.

Deputy Sean Fleming: I mean a working relationship.

Mr. David Duffy: Mr. Bourke might like to comment on that.

Mr. Mark Bourke: In regard to the dividend, for all of the previous years we were not in a position to pay any cash back to the Government and the taxpayer as our owner. This was our first time in profitability and therefore that profitability was almost immediately transferred by dividend to the State. It was a singularly important moment in returning AIB to being a sustainable enterprise.

Chairman: Thank you, Mr. Bourke.

Deputy Sean Fleming: Whose decision was that?

Chairman: Sorry-----

Deputy Sean Fleming: Was it the bank's own decision?

Chairman: I have let that-----

Mr. Mark Bourke: That is entirely a board decision.

Senator Paul Coghlan: The gentlemen are welcome and I commend them on what they have achieved in getting the bank back on a stable, profitable footing. I have five quick questions which they might take together, if they will bear with me. First, would the bank be open to third-party review of the applicable standard variable rate in circumstances where a consumer can demonstrate that this rate is inflicting hardship in their circumstances? Would there be a role for an external agency to arbitrate in this matter as it applies to individual borrowers in much the same way as the Credit Review Office assists small and medium businesses with credit challenges? This would be in an extreme case. I salute what the bank has done but are there some cases where an independent, objective assessment would assist?

Second, on repossessions, I appreciate what the witness said about 50% re-engagement. That is tremendous, but what is the bank's practice on voluntary assisted sales where the home owner surrenders the house and assists in the disposal process? Does the bank write off the balance of the debt once the asset has been sold?

Third, has the bank done any analysis of the people in persistent arrears where they are failing to engage with the bank? That would be a hard core case.

Fourth, what is the total amount of the current level of loans in arrears where the bank expects to repossess the property?

Fifth, has AIB sold any of its non-performing loans to debt investors or vulture funds, as they are often known? What steps has the bank taken to ensure customers are protected on such a transfer? Those are my questions, and I am grateful to the witnesses.

Mr. Brendan O'Connor: I will take them in the order-----

Senator Paul Coghlan: That is fine. Any order will do.

Mr. Brendan O'Connor: We have sold some commercial loans to a third party. We have not sold any residential, personal or consumer loans to any third parties, and it is not our intention to do so at this time.

Senator Paul Coghlan: Very good.

Mr. Brendan O'Connor: In terms of the value of what we expect to repossess, I will round up that question and answer another one the Senator asked. He asked if we would mind having an independent review in terms of someone's rate. We have a pre-arrears protocol. If someone has difficulty with their mortgage today, whether that is from a rate or whatever caused it, under the Central Bank protocols, we have a pre-arrears unit, they can identify their difficulty and we will run the affordability.

In terms of an independent assessment, the only independent assessment of affordability would be done through the Insolvency Service of Ireland, ISI. I suppose that is the only one that could look at someone's case and apply reasonable expenses guidelines to it. We do that. We also add between 20% and 25% on top of that. An independent assessment of affordability could be done. The one that exists today by proxy is the ISI, but we have a level of reasonable living expenses in excess of that. Would I personally mind if there was an independent check of affordability? No. I have seen it suggested, and I do not think it is a bad idea at all.

Regarding voluntary assisted sales, where someone has no affordability post the sale of the property, we do not go after people for the residual debt. There is not much point. However, we do look at residual debt on the basis of affordability, so to the extent that someone can afford to make some payment to the residual, within those reasonable living expense guidelines etc., we will seek it, and typically a payment for a period that is less than the insolvency period.

The last question was whether I could give the Senator an estimate of the value of the arrears in terms of properties we will repossess. I am afraid I cannot because at this stage I cannot tell him the number of properties I believe will ultimately end up in repossession. It will be significantly less than what was reported in the newspapers this morning, if we consider the levels of engagement that take place. The bank has said that where someone cannot afford their mortgage we will not go after them for the residual debt if they sell the property. In effect, that is the outcome we get if a house goes to possession. It makes more sense for the individual, the borrower and the bank to do that consensually and achieve that outcome rather than go through a possession process. However, I would like to find out how many are in this queue that we can restructure, and that is why we try to get the re-engagement.

Senator Paul Coghlan: I thank Mr. O'Connor.

Deputy Brian Walsh: I thank the gentlemen for their engagement. On the mortgage repossessions issue, most reasonable observers would agree that to have a functioning mortgage market the bank must have entitlement to enforce or realise its security, but I am sure the witnesses would agree that there are many desperate cases that need special attention. They will be aware that the Government will shortly announce initiatives in this regard to support those who are still in mortgage arrears and in negative equity. Have the witnesses had any engagement with the Department of Finance on this? Has it sought any advice or have officials spoken to the witnesses about it? Are there any specific areas they would like Government to examine?

The witnesses mentioned that with regard to voluntary disposals, in most cases they look at the financial status of the borrower and will write off on the basis of what that shows up, and perhaps write off all the residual debt after the sale of the property. Do they engage with borrowers before it comes to that in terms of arriving at what is affordable for them if that meets what the property might achieve on an open market sale, perhaps write down the mortgage at that stage, allow them stay in their home and retain ownership of the property without having to agree to voluntary disposal? Is that something in which they engage?

Deputy Fleming mentioned the bank's write-backs and write-downs. Many of the losses generated in AIB and in the other banks were as a result of losses that crystallised when it had to sell some of its loans to NAMA, but there was significant provisioning as well. Given the capital appreciation in property prices over recent years, I would have thought AIB would have significantly higher write-backs than €150 million last year out of the total amount written down. How does AIB arrive at a write-back? Is that when a mortgage or property is finally sold and the price realised was higher than AIB expected? Can AIB take a general view of its asset book and state that markets have improved significantly over recent years, the bank probably made too large a provision on its general loan books and take a figure there as opposed to realising individual write-backs when deals are settled?

In terms of AIB's engagement, I am sure other members received correspondence today from a lady in Waterford who is concerned about an agreement she had with the bank which was reneged upon in terms of legal action that is being taken against her. She was distraught when I spoke to her this morning. She asked me to raise that with AIB. Although I do not want to get into the specifics, is Mr. O'Connor available to meet members on specific issues?

Following on Senator Hayden's point on receivership, the conduct of some receivers is an area about which I would be gravely concerned. I wrote to the bank previously about one family in Galway which had fallen out with the bank and where receivers were appointed. I refer to the figures in terms of what is being deducted from rents. This is a buy-to-let situation and there were multiple properties. Gross rents over a two-year period were close to €400,000 but the amount credited back to their accounts was less than €50,000. Therefore, there were significant amounts being reduced. They had made the case to the bank on several occasions that the return to the bank would be much stronger if they were allowed to retain the management of the portfolio of assets. I wrote to the bank about this. I got a rather condescending response, not from the bank but from the bank's legal representatives, suggesting that I should have more interest in a return to the taxpayer than the borrower. In this case, the proposals that were put to the bank would have resulted in a significantly better return for the bank and, ultimately, the taxpayer. Is there an ability for us and these families to meet these bank representatives to engage? Has the bank cases which have come out of receivership where the bank has allowed the individuals to manage the assets? In the case I mention, there is no doubt it would result in a better return for the bank.

Chairman: Most of Deputy Walsh's time is gone and I would ask for brief responses.

Mr. Brendan O'Connor: Typically, we appoint a receiver to properties because we are not getting paid any rent. That is why we appoint the receivers. It is because the cashflow has been diverted somewhere else. I do not know the specifics of the case, but that is why we appoint receivers. I cannot see any circumstance - I would like to know the detail - where €400,000 would be the receivers' fees, but I can tell Deputy Walsh we have never paid a percentage in receivers' fees that even remotely approaches a number like that. Absolutely, we are willing to engage on the circumstances of the case.

Deputy Walsh asked about engagement with Government initiatives on arrears. We generally speak about it in the context of the Banking and Payments Federation Ireland, formerly known as the Irish Banking Federation, IBF. I have seen some suggestions that are out there. We have tried to be as constructive as possible. We will support, both in the spirit and in the letter, whatever initiatives issue. We deal with whatever legislation is in front of us and that is what we will do. I am in favour of anything that constructively helps to resolve the arrears issue. That is as blanket a response as I can give.

I think that is it.

Mr. David Duffy: There was also voluntary disposal and engagement prior to reaching that point.

Mr. Brendan O'Connor: On voluntary disposal or engagement prior to that, we do so automatically. The week a borrower goes into arrears, he or she receives a letter informing him or her of being in arrears with a standard financial statement, SFS, which we ask him or her to fill out. That is the process by which we judge affordability. If we get an SFS, we will make an offer to the borrower based on the financial detail that come out of that.

Throughout the entire process, to the extent that the borrower does not follow that up, we send out another letter, known as a Provision 28 letter, which states that we need to keep this moving to the extent that if the borrower does not engage with us, we will have to deem him or her non-co-operating. That is followed by what is called a P29 letter. Approximately 50% of those who get a Provision 28 letter engage then.

A P29 letter states one is non-co-operating. At that stage, approximately 50% of those who are still left in that bucket engage. If a person has not engaged by then, at which point he or she has had a quite significant amount of time, he or she will go into the legal process. Approximately 50% of the borrowers engage before it gets to civil bill stage, and after civil bill stage, as I stated earlier, in approximately 50% of the cases that go to court, we are actively seeking adjournments.

It is all about engagement. We ourselves have various channels in the Irish Mortgage Holders Organisation. To the extent that one engages, one will get an offer.

Deputy Brian Walsh: One does not have to agree to a voluntary disposal to avail of write-downs. Does the bank have cases where borrowers remain in their homes and avail of a write-down at the same time?

Mr. Brendan O'Connor: We have a product that allows for that.

Mr. David Duffy: There was a question on how one determines a write-back and I will ask Mr. Bourke to answer.

Mr. Mark Bourke: In relation to provisioning, two circumstances drive write-backs. The first is where we have worked through restructuring and one gets to an end point where we have visibility on cashflows and additional assets of the borrower. In the second, where we have large portfolios, such as mortgages and personal lending, we estimate the change in market value through the peak-to-trough estimation and that drives a level of the write-backs. The other side of it is the specifics that arise from each case, as Mr. O'Connor referred to.

Deputy Michael Creed: In his opening remarks, Mr. Duffy stated, "Given its credit rating, the cost of funding for AIB is different to the simple average of other banks across Europe." He went on to state that only 3% of AIB's funding is sourced from the ECB. Perhaps he could elaborate on the bank's credit rating when it goes to market to raise funds. AIB is a profitable bank which has restructured and is working through bad loans. Deputy O'Donnell referred to AIB going to market in early 2015 and how the cost of funds had dropped substantially over 2014, and it is likely, according to the bank, to drop further. Is there someone out there who gives the bank a credit rating and how, for example, would that credit rating be impacted, adversely or otherwise, if it were felt that the bank was but a puppet bank to be manipulated by political considerations in terms of the range of issues that impact on individual customers of the bank? I am conscious that I have four other questions and perhaps the witnesses could try to condense the replies as much as possible.

Mr. Mark Bourke: It is the rating agencies, such as Fitch and Standard & Poors, which give us a rating. What would have driven our ratings over a long term is the history of the bank and, in particular, the fact that we have a singularly large proportion of non-performing loans versus the total loans that the banks have. That means that our rating would be lower than the premium banks, for instance, across Europe, and that translates into our cost of funding when we issue debt securities in the markets. Everyone's cost of funding has come down but ours is still consequently higher as we have lower ratings across the board as a result of our history.

Deputy Michael Creed: Given the progress the bank has made, does Mr. Bourke expect that credit rating to improve? Is there any indication? The State, because of its improved credit rating, has been getting better deals for the taxpayer for State loans. It has extended terms and has reduced interest rates. Is AIB working aggressively to reposition itself? Why is it that only 3% of AIB's funding is coming from that cheap source of funding at the ECB? Can AIB restructure its loans and, therefore, impact positively on the cost of funding?

Mr. Mark Bourke: On the question of whether we are working on the rating, there is a constant engagement with the rating agencies to give them a deeper understanding of the progress the bank is making in its path to normalisation. That involves, first, working through a large portfolio of non-performing loans and, second, having a sustainable business model. That is ongoing and we have improvement on that.

Accessing low-cost ECB funding is very much driven by the TLTRO, where the-----

Deputy Michael Creed: Sorry?

Mr. Mark Bourke: I refer to the ECB programme to give quantitative easing, QE, into the market. That is much more a function of one's activity and the increase of one's book. We have availed of the maximum we can in TLTRO in the second half of the year. The reason I say, "TLTRO", is I cannot remember the exact words.

Mr. David Duffy: On Deputy Creed's issue of a board, the independence of a bank does have a bearing on its credit rating. It needs to be run as a commercially sustainable entity. That is an important factor when the rating agencies look at a bank and then they move to the components of the bank's performance beneath that. It is all of the above.

Deputy Michael Creed: In terms of the cost of funding and risk, the losses at the bank and the provision it must make for bad losses impact on the standard variable rate and interest rates generally. What is the quantified impact of those who are the beneficiaries of tracker mortgages on the cost of funds to the standard variable rate mortgages?

Mr. Bernard Byrne: In looking at this issue we do not specifically look at cross-subsidisation between portfolios.

Deputy Michael Creed: I am sure that is not cross-subsidisation. There is a loss on the balance sheet on tracker mortgages.

Mr. Bernard Byrne: Where that manifests itself is in the total return the bank will deliver and not the return we will seek to make from individual portfolios.

Deputy Michael Creed: I accept that, but as a proportion of the total loss, surely it should be possible to quantify what load the standard variable mortgage holder is carrying as a consequence of that proportion of the bank's total loss.

Mr. Bernard Byrne: I am saying the answer is none. The only way it bears a load is if the bank says it is not making it enough money and therefore it needs to make more money out of another. This is the only way a load can be borne and this is not what we are trying to do.

Deputy Michael Creed: I have several questions on the return to shareholders. If there was less obligation to make a return to the shareholder or shareholders, would the bank be in a position to deliver more with regard to the standard variable rate? One of the suite of options offered to mortgages in distress is mortgage-to-rent, and the bank clearly states there is zero take-up of this option. To me this is very disappointing because in theory it is the best solution whereby people stay in their home. They surrender ownership, which is painful, but they can remain in their home and pay rent according to capacity. Given the €220,000 threshold that applies, it is an option available to very few people in the greater Dublin area because of property prices. Does the issue of value need to be significantly examined?

Mr. Brendan O'Connor: Yes, there have been problems with mortgage-to-rent but good work has been done recently to try to get pilot schemes to make it work. Since the report was issued on 31 December, three cases have been fully booked; another case is about cash received, which makes four; 27 are at the legal stage, which brings the total to 31; and another 253 are in progress, of which 132 are with housing associations to determine whether they wish to buy the property. Much work was done in the fourth quarter by the housing bodies, banks and others. It is still very complicated to try to simplify it, but the number has increased to 30 in recent months, with another 130 with housing associations to determine whether they wish to buy the house. It has improved but it is still very complex. For it to be more widespread, greater capital values are required and some of the rules about affordability and the various other rules attached would need to be reviewed.

Deputy Paul Murphy: I thank the witnesses for their presentation. In 2014, AIB made a pre-tax profit of €1.1 billion. How much corporation tax did it pay?

Mr. Mark Bourke: We did not pay corporation tax in 2014 because the bank had losses carried forward of almost €20 billion. The shareholder being the State, it is almost a non-issue in the sense it owns the entire amount anyway.

Deputy Paul Murphy: Obviously the shareholder is not likely to be the State for much longer. The 2014 accounts list the deferred taxation as an asset of €3.5 billion, and it is now listed as €3.24 billion. This is accumulated losses made from the transfer of loans to NAMA, as far as I know in particular, and in general-----

Mr. Mark Bourke: It is all the losses made during the period.

Deputy Paul Murphy: Page 220 of the report states that assuming a sustainable return on equity, it will take in excess of 20 years for the deferred tax asset to be utilised. Does this mean AIB will not pay any corporation tax for 20 years?

Mr. Mark Bourke: If the current tax rules remain in place and we have a 12.5% tax rate, the bank must earn €20 billion before tax is paid to the State. The tax rules are entirely up to the State. We must account for it on the basis of the current rules.

Deputy Paul Murphy: Does it not strike Mr. Bourke as obscene that the banks, and it is not just AIB which at least is in State ownership, made huge losses and those losses are now counted as assets on the balance sheet for which the State will pay again through not receiving corporation tax?

Mr. Mark Bourke: In tax systems where losses are carried forward, tax relief for them is a well-honoured principle and it serves an economy well. With regard to this particular bank, whether we pay tax or whether the Government capitalises on the value of the business is the Government's choice. Our job is simply to create the value in order that we have a sustainable bank and we can return funds to the State.

Mr. Bernard Byrne: Deferred tax is part of our capital structure. If we did not have a deferred tax asset, we would have to have incremental capital from another source which would have been the State. It is likely that if we did not have deferred tax, we would have other capital from the State. I do not think the sum is quite as straightforward.

Deputy Paul Murphy: If AIB is privatised in one or two years time, the fact it made losses previously will mean it will not pay corporation tax for an extended period. Is it also the case that prior to budget 2014, the bank could only use half of it each year and write-down half of the profits? It paid some corporation tax each year before the budget changes in 2014.

Mr. Bernard Byrne: The answer is yes, but it goes back to the same point which is the choice of where the capital came from was made simpler in that instance. Whether the State on a long-term basis has granted the benefit of tax losses to an entity or whether it has decided to upfront it, the State was going to have to write the cheque, and it has managed in effect to avoid this position. It is part of the capital structure of the bank, so I do not think it is quite as straightforward.

Mr. Mark Bourke: When and if the bank is actually privatised, if there was a deferred tax asset, it would be part of the valuation.

Deputy Paul Murphy: I am making a more general point which applies to all the banks, which includes those banks which are overwhelmingly privatised.

Mr. Mark Bourke: That is a matter for the Revenue Commissioners.

Deputy Paul Murphy: With regard to privatisation, is it the case that AIB is in effect being fattened up and prepared for privatisation?

Mr. David Duffy: The answer is simply "no". We do not run it on that basis.

Deputy Paul Murphy: How does Mr. Duffy explain the increase in the number of write-downs and the amount of write-down? In 2013 it was €1 billion and in 2014, when privatisation was being prepared for, it was €4.5 billion.

Mr. Brendan O'Connor: It probably speaks to process. By the time one gets to a write-down, it is two years after one started to restructure the loan. In 2012 and 2013, when we stabilised customers and found out their sustainable earnings, we went through a process of engagement to come to an agreement and went through the legal and contractual write-down. We get to the point of write-down 18 months to two years after this. The bank has had a non-performing loan book of SMEs and mortgage customers and there is a process. What we see in 2014 is the culmination and the manifestation on the balance sheet of work that began back in 2012 long before anyone had a timetable for any initial public offering, and it will continue into 2015 and 2016 as the work that began in 2013 works through the system.

Deputy Paul Murphy: With regard to privatisation, we know that Goldman Sachs is advising for free, out of the goodness of its heart. How is the process going with regard to Goldman Sachs co-operating with AIB and looking at the assets and liabilities? Do guarantees exist that it does not receive information that would be profitable to it in other circumstances such as advising clients and everything else?

Mr. David Duffy: I shall ask Mr. Bourke to reply as he deals directly with the process.

Mr. Mark Bourke: In regard to the process, Goldman Sachs has been engaged by the Department to talk about and resolve the capital structure of the business. That is one piece of work. Those discussions are ongoing and will, ultimately, be resolved between the Department, the bank and the regulator. That piece of work involves an adviser and if that was not from Goldman Sachs it would be from one of the other investment banks.

In terms of profitability and profiting from insider information, that is governed by the law and by the fact that anybody who is conflicted cannot be on two sides of a transaction which means they cannot legally profit from that situation.

Chairman: There are six more contributors and we are quickly running out of time. I ask Mr. Duffy to extend his contribution by 20 minutes, if he does not mind, in order to allow everybody to comment.

Mr. David Duffy: Yes.

Chairman: I shall call people's names as they have been listed. Deputy Cannon shall be next and he will be followed by Deputies Boyd Barrett, Barry, Rabbitte, McNamara and Dowds. I urge members to stick to the five minutes allocated as rigidly as possible in order that everybody can leave the meeting on time.

Deputy Ciarán Cannon: I thank the witnesses for their helpful engagement. I wish to make two observations.

Mr. Duffy described a number of factors that play into the overall decision-making process. In terms of the interest rate that applied to variable mortgages, he said that operational costs were one of the factors. How significant a portion of the overall decision-making process is represented by the bank's operational costs? Does he regularly compare, with his peers across the eurozone, the bank's operational costs and analyse how they compare with others? If so, how do they compare? Is the bank at the point where there is no more latitude for its operational costs?

My next few questions are perhaps more suited to Mr. O'Connor. Earlier he described that most of the SMEs he engages with in Galway, that are in significant financial difficulty, diversified away from their core activity into property construction and management. He said that he tries at all times to create a separation between those two entities so that the core business, if it is viable and sustainable on its own, continues to trade, survive and thus retains and protects the jobs already employed in that core business. How distinct or distant is that separation? Ultimately, one is talking about one or two individuals who are deeply involved in both activities. Does the bank require, if the core business becomes substantially profitable, that some profits are diverted to the non-core business which is an asset that just sits there and is not worth a lot? How does the mechanism work? How is it determined which element of the core business's profits can be diverted towards the non-core construction activity?

Mr. David Duffy: I shall answer the first group of questions and Mr. O'Connor can respond to the second group.

On the cost issue, it is a material amount of all of our operating cost, risk cost, etc. It has reduced by €350 million in the past three years. We benchmark it regularly against our competitors. By any benchmark, one can see an improving trend. Banks are moving, ever more aggressively, to reduce their costs in a continuum. We will still continue to focus on ours and expect to be able to make further improvements. That will continue. My colleague shall comment on arrears.

Mr. Brendan O'Connor: I shall try to simplify a complex process as much as I can. We look at the totality of debt across a company which means it can be property and, as the Deputy is probably aware, it is pretty intertwined. We will look at the sustainable debt at a point in time without any forecast saying the business will grow by between 10% and 20% for the next however length of time. We will cut a loan at that level of sustainable debt.

Deputy Ciarán Cannon: As advised at that point in time.

Mr. Brendan O'Connor: Yes. One can assume some models but we have to forecast what it is going to look like. We will cut a loan at that level and the company will service that loan. We will also put in a "B" loan which will be the equivalent of equity. The Deputy asked how does one make sure some profit is not diverted and how we assess same. We do so by a very small piece which says, "If you do better we expect you to pay back that "B" loan." Then we will have a "C" loan to which we will say, "To the extent that you are compliant with the "A" loan, and have paid it down like you said you would", then at the end of the period we will write-off the "C" loan. That means the only recovery we have is through the "B" loan unless there is some excess on an asset sale, or something like that, and we contract that upfront. All of that means that when a person gets their agreement he or she knows exactly what must be done with the "A" loan, he or she understands exactly what the quasi equity piece looks like under the "B" loan and, under the "C" loan, he or she has a date that gets comprised to the extent that they he or she does not re-default or anything like that. That is how we operate.

Deputy Ciarán Cannon: In Mr. O'Connor's opinion there is no excessive drain on the resources of the core business in order to service the non-core construction activity.

Mr. Brendan O'Connor: It would not make-----

Deputy Ciarán Cannon: Is that what the bank strives to achieve?

Mr. Brendan O'Connor: That is what we strive to achieve. Sometimes we have to recut them.

Deputy Ciarán Cannon: That is okay.

Mr. Brendan O'Connor: I cannot figure it out. It does not make sense for us to put strain on it because, ultimately, we want to be repaid.

Deputy Ciarán Cannon: I thank the delegation.

Deputy Richard Boyd Barrett: I am not in the habit of being nice to banks given the role they played in the pretty awful situation the country has found itself in. However, I acknowledge Mr. Duffy's office and AIB on the issue of cases that I brought to their attention.

I wish to give some credit to the comments made by Mr. O'Connor that AIB seems to take a more reasonable approach to people in mortgage arrears which I put down to the fact that it is 100% owned by the State. Mr. Duffy has more or less acknowledged, in his statement, that because the bank's shareholder is the Government it is under more pressure to be a bit reasonable about these things in a way that some of the other banks that have come in here have not been. I am sure they are very nice people too but that is not the point. Certain other banks that have come in here have a very different attitude. They do not give a damn what we or the Government thinks about priorities, dealing with distressed mortgage holders, rates and such like. I welcome that fact.

I am worried about influences on the bank. Mr. Duffy said in his opening statement, in a number of different ways, that the other influences on the bank is "the need to generate sustainable and viable returns for shareholders" and, to use a particular phrase, "to create an investable model so that over time the bank can start to return capital to the State". That is a euphemism for privatisation. Am I correct? We are talking about creating a model where the State disposes of its holdings in AIB which are sold off to private interests. Is that the case?

Mr. David Duffy: Does the Deputy want to stretch that-----

Deputy Richard Boyd Barrett: I would prefer if we had a banking system which was under more public pressure, in the way that I think AIB has been, to be a bit more reasonable with people in mortgage distress. I want a system whose priorities are not solely about the bottom line and that its mandate is a bit more focused on the wider economy, keeping a roof over people's heads and all those kinds of things. Is it the inevitable direction that the bank seems to be taking and which Mr. Duffy's speech indicated one where we will move away from that?

Mr. David Duffy: The Deputy might be referring to a different speech from mine. Given all the leaks today, I am not so sure. However, I will be explicit. Shareholder ownership does not decide how we run the bank. I can tell the Deputy that explicitly and that I would not take the job if that were the case. Let us be clear about that upfront.

The principles which we operated were much more than those based on one's shareholder. They are about the long-term viability of this bank and this country, which starts with two things. A sustainable profitability because one has to be able to generate capital in order to repay the State and to lend. The lending was our biggest obligation on one level.

The second thing we have articulated from the outset is to treat customers fairly. If one does not do so then all of the other issues we have talked about are nonsense. The bank will not be sustainable because one's customers will remember. What we have said from the outset is to keep people in their homes who have distressed mortgages, wherever possible, and protect jobs in the SME world, wherever possible. That is a lot of what we have talked about today. There is no shareholder direction that gives us the answer. If we do not do those two things then two generations of people will have a very negative view of this bank. If we do them well, they will have a very positive view of this bank. Our whole philosophy is not about whether we are owned or not by one group or another but about that issue.

Deputy Richard Boyd Barrett: I do not really accept that. There is a marked difference between the demeanour of AIB and that of some of the other banks. I attribute that to the fact that AIB is publicly owned. If it is not the case-----

Chairman: The Deputy's time is up.

Deputy Richard Boyd Barrett: I have only just started. I am not asking Mr. Duffy about his personal relationship with the Minister but about his working relationship in terms of what directions the Minister gives him. The Government says it wants relief for variable interest rate mortgage holders and fairness for people in mortgage arrears but when we complain about the banks not offering such support, the Minister says there is nothing he can do about it because the banks are independent entities. I want to try to square the circle. What is the actual relationship? How often do the Minister and bank representatives meet? To what extent does the Minister ask the bank to do something about variable rate mortgages? Could Mr. Duffy explain the nature of the relationship to us?

Mr. David Duffy: It is defined very simply. It is governed by a shareholder agreement, which creates independence for the bank in all commercial decisions. That responsibility and those commercial decisions are the responsibility of the board of AIB. Therefore, we engage with the Department of Finance, our shareholder, as with any shareholder, on all matters concerning the performance of the business but we make and have made all the decisions on commercial issues, including mortgages, increases and decreases, and the branch closures in the past, at board level in AIB and independently of our shareholder. That is what the shareholder agreement defines as the operating model.

Deputy Tom Barry: The representatives from AIB are very welcome. I banked with AIB for many years and I am very familiar with its workings. I will not go back over some of the points that were made. Mr. Duffy might give me some answers in writing if he cannot answer all my questions now.

The Strategic Banking Corporation of Ireland has not been mentioned. What is the typical rate the bank will lend at through this vehicle? What is the percentage cost of this? Many SMEs would benefit from the vehicle. I have been hearing rates of approximately 4.5% plus but I have a feeling that if the rate becomes too high, it will not be practical. We need to ensure the product is as cheap as possible to get the SMEs back working. We can review it in time.

A question raised with me and many others concerns how loyal customers believe the bank is imposing high interest rates on them by comparison with new businesses. They feel aggrieved. That is why a stir is being created. The customers want their loyalty rewarded. There must be some way of dealing with this. Since this is becoming an issue, it needs to be dealt with.

Mr. Duffy said the average interest margin is 1.69%. I do not like margins. One of Mr. Duffy's Munster lenders, whom I will not name, stated one could have one's tail end in the fire and one's head in the fridge but one's average would not be too bad although the extremes would be poor. I am sure Mr. Duffy heard that. My point is that the percentage is masking a lot of items. It is creating a fog that I cannot get around. There is a myriad of factors in the background.

Some people are saying AIB is not engaging with the mortgage holders. I heard about the whole list of forms. The forms and numbers need to be in language that people can understand if there is a pre-arrears case. I acknowledge that the bank does deal with this but the information needs to be communicated better.

I recently witnessed bank representatives in a courtroom seeking orders. A particular bank, not AIB, wanted a committal order to be extended. The judge threw out the case. He was very frustrated because one either seeks a committal or not.

How many repossession cases will AIB deal with this year? How many will proceed to full completion? I would like to see more engagement to keep people in their homes until the bitter end. I acknowledge that I heard Mr. Duffy refer to this many times. I understand that we are dealing with a legacy issue. There is a perception that there is not enough contact being made. Many people are e-mailing me about this.

A bugbear of mine, another legacy issue, is Belfry. I would like to be told that no more Belfry-type funds will ever be issued in any form and that people will not be given cheese and wine and asked to invest because they are valued customers. What occurred was wrong and it will be wrong if it is ever done again. Will AIB do anything for those customers who have had to bear a full 100% loss on their investment?

With regard to the restructuring of businesses, how much is new lending? Mr. Duffy mentioned all the new lending. Many of the restructurings involve new lending, by definition, but they are already in place. There is nothing wrong with it but I wish to know the percentage.

With restructuring, there is a hidden cost. I would like to see the bank bearing some of the burden of the restructuring debt. There are all the costs that go with it and securities being perfected, etc., but the burden is landed on the customer. It should be shared a little more equally. Mr. Duffy will understand where I am coming from on that.

What are Mr. Duffy's views on the new Central Bank rulings regarding equity for mortgages? Why has there been a 27% reduction in Central Bank and bank deposits, as mentioned in AIB's report? There is a view that the banks, but not just AIB, are mopping up equity a little too diligently. How does Mr. Duffy feel about that? The figure for impaired loans, €22 billion, is still huge. How much of this will actually be realised? What will it crystallise out to in the end?

I appreciate that the bank has a mess to tidy up, and that it is doing so. It has done a very good job in many respects. It surely represents a cost on the bank. Do the delegates know the cost at present? The cost will obviously be reducing as the bank becomes a normal functioning bank. Will the reduction be passed on to customers or will it go back to shareholders? There are many issues to be addressed and we could do with a second meeting. I would appreciate a written response if Mr. Duffy cannot answer my questions in detail.

Chairman: The Deputy's five minutes are up so I request that the answers be sent to the secretariat. We will forward them to the Deputy.

Deputy Pat Rabbitte: I have two quick questions. Many people would be surprised that the bank wrote down some €461 million in mortgage debt in 2014. That was significantly ramped up by comparison with the two previous years. Does this mean the delegates have in their heads the likely figure for 2015? If the rate of difficulty is increasing, does it mean the figure for 2015 will be at least the same or higher?

Mr. Brendan O'Connor: It is not information that we disclose. What we would say is that we are working our way through the book. There is a lag between the write-down and the agreement with the customer because there is quite a bit of legal documentation, etc., concerned. In some cases, the property has to sell. One might agree with a customer that the residual or a portion thereof is to be written down but the property must go on the market and there has to be closure and a sale. Therefore, there is a lag. One is actually accounting for some activity in 2013 that results in a write-down in 2014. However, I would say that we still-----

Deputy Pat Rabbitte: Could I tempt Mr. O'Connor to say whether he believes the figure for 2015 will be as high or higher than that for 2014?

Mr. Brendan O'Connor: No, I do not believe the Deputy could tempt me.

Mr. Mark Bourke: The analysts who follow the bank would all have figures in excess of our write-back from 2014 in their estimates for 2015, sometimes by an order of magnitude up to three.

Deputy Pat Rabbitte: My second question is on privatisation. The delegates may tell me it is a matter for the Minister rather than the bank but I presume they have views. Given the healthier position of the State's finances and that there is no great pressure to move to dispose of the first tranche in 2015, do the delegates have a view, in the context of the commercial interest and restoration of the bank so it can perform normally in the economy, on the timeframe that would be ideal in so far as there is what I describe is a reality in the commercial world?

Mr. David Duffy: It is hard to be definitive but we set out on a path to make it something that could happen at the end of the three years of restructuring in this phase. There are positives associated with doing it now and with doing it later; there is no right answer. Obviously, creating an impression across the world that the bank is a back-to-normal business that investors are paying for is a very good thing. Maybe there would be price differences on the different days on which one decided to sell but, on average, over the longer term, they would probably balance out. There is not necessarily a right or wrong answer because of those factors. Obviously, the sooner a point is reached where there are investors coming in and returning the value to the State, the better. However, we are not particularly concerned about when it happens. As the Deputy said, it is a matter-----

Deputy Pat Rabbitte: Is Mr. Duffy still of the view that the State's investment can be recouped?

Mr. David Duffy: Absolutely, but it will take time.

Deputy Regina Doherty: I apologise for stepping out; I had to go to another meeting very briefly. If my questions have been answered, the delegates might tell me and I will read the minutes. The newspapers on Sunday referred to standard variable interest rates, which everybody is very exercised about. It was stated the Government will increase the Government levy on banks if there is no movement. How much is the Government levy on AIB at present?

Mr. Mark Bourke: We expect the Government levy over the next two years to be between €50 million and €60 million.

Deputy Regina Doherty: Therefore, in the context of the bank's profit of €1.1 billion, it is very small.

Mr. Mark Bourke: It is the levy.

Deputy Regina Doherty: It is very small.

In 2014, how many offers by PIPs, individuals or representatives of individuals did the bank veto?

Mr. Brendan O'Connor: Where we control the vote?

Deputy Regina Doherty: Yes.

Mr. Brendan O'Connor: In 2014, we approved 78 of the 92 cases on PIA, so the percentages are 85% and 100% of the DSAs. In respect of the latter, I refer to 24 of 24. All told, we approved 88% of the cases put before us where we control the vote.

Deputy Regina Doherty: It is quite a high proportion. Regarding the 12% rejected, is there an underlying reason?

Mr. Brendan O'Connor: There is no commonality. In a particular set of cases, where somebody is party to a loan with somebody else, only one party might arrive in. There could be a joint mortgage. In some respects, one wonders why it goes to a vote because one cannot just tear up the mortgage contract of somebody else unless he or she is present. This makes it very different because there could be separation circumstances where somebody is trying to move on. However, one cannot just tear up the mortgage and recontract. A second reason concerns where the proposals from the PIPs seek to have some assets placed outside the arrangement. We had one case in 2014 — I do not want to get into the specifics — in which there were assets overseas that an individual wanted to leave out of the arrangement but we were just not going to agree to something like that. The third reason concerns the nature of the forbearance sought.

Regarding a mortgage, a certain type of forbearance may be sought although we will offer a different type. We are trying to remain consistent with people in terms of what restructuring arrangements we offer. People may seek a principal write-down although standard forbearance or a different type of mortgage restructuring would do. In all cases that we turned down, we offered an alternative, with the exception of one where we did not believe the mortgage was sustainable in any shape or form. In that case, we offered, on the basis that the house would be sold, to write off the residual in full. The mortgage could not be sustained otherwise. In all the other cases, all the offers we had allowed the person to stay in his or her home. In bankruptcy cases, this would not happen. I am happy about our interaction. We vote commercially across all of these cases.

Deputy Regina Doherty: In the 12% of cases where an alternative was offered, were the offers taken up?

Mr. Brendan O'Connor: No.

Deputy Regina Doherty: According to media reports, there is an unconfirmed suggestion that the Government is considering an appeals mechanism, potentially through the courts or, perhaps, some other arbitration body. What is the view of the bank on that? Does it believe it would be unconstitutional in light of its ownership of the asset? How would it affect the bank's ability to retain or recoup owed moneys that could not otherwise be recouped?

Mr. Brendan O'Connor: I do not have a view on the constitutionality of it; I will leave that to somebody else. From a commercial perspective, it is fine. I believe our decisions stand up to scrutiny. To the extent that somebody else wants to examine them and comply or explain — that is the language I have seen — that is fine. The decisions are pretty easy to explain. We do not have that many to explain. We say "Yes" in 88% of cases because it makes sense.

Deputy Regina Doherty: I thank the delegation.

Deputy Michael McNamara: The witnesses talked about lending being one of the bank's most important functions and duties within the State. I received a communication from a constituent associated with an SME. Obviously, SME lending is crucial to the future of the State. The SME employs approximately 100 people so it is quite big by the standards of a rural constituency such as Clare. It is a well-known and long-standing family business. Through the most difficult years of the recession, the business kept all loans within contract, paying all on a full interest and capital basis without exception. Approximately 20% of the loans were in a two-year review programme. Owing to this, the business had a very good relationship with its local bank and decided that it would seek additional funding for capital investment. It was not a huge amount. It was less than 50% of what it was paying down every year. The business was a bit surprised when its file was transferred to the Financial Solutions Group in Dublin. The group is a section of the bank dedicated to supporting businesses and personal customers in financial difficulties. A well-known accountancy firm was appointed to carry out an IBR to support the application but that firm also specialises in receiverships. That was another slight concern but there were no difficulties with the bank whatsoever. The bank then started examining the two-year review programme and effectively threatened the company, which was perfectly functioning, that it would appoint a receiver if it did not accept new loan terms and conditions. This involved an increase of approximately 2% on the margin on the loans. Of course, the term was also pushed out to make it stack up on paper.

At this stage, the SME sought legal and financial advice, which was that it made no sense to sign up to the arrangement. However, it posed the question as to what alternatives existed? When a bank appoints a receiver to a perfectly viable company, it cannot remain perfectly viable for much longer because the receivership will have a considerable impact on its reputation and credibility. An SME employing 100 people might be a big fish in Clare but it is a tiny fish compared to AIB. The bank will spend as much money as it takes; that is what banks do. Does AIB prey on its successful SMEs to help fund those that are not successful? Is there a deliberate policy of doing that in the bank? We all know that successful mortgage holders, or those who are fortunate to be able to repay, are paying over the odds to pay for those who are not as fortunate and unable to repay and, of course, those who refuse to repay. Does this apply to SMEs?

Mr. Brendan O'Connor: We do not prey on SMEs in any way, shape or form. I will have to get the details from the Deputy because he said the customer has always kept in contract. I do not legally have the right to appoint a receiver unless the customer has broken a contract. I cannot appoint a receiver to a customer whose loans are all in order. I have no legal basis for doing so.

Deputy Michael McNamara: My point was not on what the bank can legally do. It was on how-----

Mr. Brendan O'Connor: I cannot do it at all.

Deputy Michael McNamara: How does a small fish fight the bank when it decides to play hardball and exercise the option I described? One could appoint a receiver, whose appointment could be challenged, but-----

Mr. David Duffy: It is very straightforward. I can sit with the Deputy for half an hour or whatever it takes after this meeting, or at any time of his choosing, to go through this if he wants. There is no issue with that. I get letters of all kinds. We are not perfect; we make mistakes but we do not practice egregious behaviour in terms of damaging franchises. We have dealt with 153,000 loans and, to my knowledge, we have not received a letter of complaint about how that was done. Notwithstanding that, we do make mistakes. Every Member of this Oireachtas has sent me cases and we have managed to fix what was wrong in one way or another if there was a problem. That shows the value of asking for action to be taken. We are happy to get to the bottom of it because it sounds bad, if true, and if there is another side to it that we do not know, we will find it out.

Deputy Michael McNamara: The second question is very short. What interest rate does the bank charge on moneys the bank gets from the Strategic Banking Corporation of Ireland and reloans?

Mr. Bernard Byrne: It is 4.5%.

Deputy Michael McNamara: What is the normal rate?

Mr. Bernard Byrne: It is 6.5%.

Deputy Michael McNamara: There is a 2% saving.

Mr. Bernard Byrne: Some 1% comes from the funding benefit, given that we receive funds at 1% less than the market rate, and we match it with another 1%. That is how the 4.5% is derived.

Deputy Robert Dowds: I thank Mr. Duffy and his colleagues for attending. My question relates to the question posed by Deputy Ciarán Cannon and, to an extent, that posed by Deputy McNamara. In my constituency, a number of SMEs are in difficulty and I received complaints from them, to differing degrees, about how they are treated by banks. In one case that relates to AIB, the small business concerned is a shopping business that seems to be profitable but the fear of the person involved is that the shop will be closed down. The person concerned was foolish during the boom and purchased properties he should not have bought. He will say so himself and expects to get a big whack on the knuckles on that. He accepts that but it seems inappropriate that, if a business is viable, the core business should be closed down. Deputy Ciarán Cannon received a positive response to this but that is not the vibe I am getting from small businesspeople.

Mr. Brendan O'Connor: If the Deputy wants to give me the specific detail, he can do so. It does not make any sense for us to close down businesses that are sustaining debt. If the Deputy gives me the details, I am happy to look into it and revert to him.

Chairman: Deputy Shane Ross was not on the original list so we will squeeze him in briefly at the end.

Deputy Shane Ross: I am interested in Mr. Duffy's relationship with the shareholder, how often he communicates with him, what issues he addresses to Mr. Duffy and whether he communicates with the chairman and not with Mr. Duffy.

Mr. David Duffy: We deal with the whole Department of Finance shareholder management unit on a regular basis, monthly or *ad hoc* as required, to demonstrate how we are performing and whether we are meeting our budget targets. A handful of times a year, we will meet with the Minister at his direction and provide a summary update on how the business is performing.

Deputy Shane Ross: So he is not a passive shareholder but an active one.

Mr. David Duffy: He is a participant in the meetings but I do not know what the Deputy means by passive or active. At the end of the day, all commercial decisions are made by the board.

Deputy Shane Ross: If, as Deputy Peadar Ó Tóibín said, the Minister issued a direction, would Mr. Duffy do as he was told?

Mr. David Duffy: We run the business under a shareholder framework agreement, which allows us to make all commercial decisions on an independent basis and we discuss it with the board under the fiduciary responsibilities. That is how we manage the bank and we would not be in any other position.

Deputy Shane Ross: Has the Minister for Finance, Deputy Noonan, communicated about standard variable rates?

Mr. David Duffy: We have not had a discussion of those topics.

Deputy Shane Ross: The Minister has not approached Mr. Duffy at any stage.

Mr. David Duffy: We have not discussed anything about policy but just the continuing performance of the bank.

Chairman: On behalf of the committee, I thank representatives of AIB for participating at this meeting. Is it agreed to made all material available on the website? Agreed.

Sitting suspended at 4.25 p.m. and resumed in private session at 4.28 p.m.

The joint committee adjourned at 4.30 p.m. until 2 p.m. on Wednesday, 29 April 2015.