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Crisis in the Irish Banking System

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Abstract

Ireland has had one of the most catastrophic experiences of financial crisis in the developed world, in the wake of the global financial crisis of 2008. Unlike the US or Britain though, Ireland's enormous banking exposure was almost entirely related to property speculation and to the unchecked domestic housing bubble of the preceding ten years. This paper analyses the conditions that led to the crisis, taking account of patterns of corporate governance, regulatory institutions and practices, and the linkages between the banking sector and the political system.

Introduction

Ireland has had one of the most catastrophic experiences of financial crisis in the developed world. Along with Iceland and Latvia, also small and open economies, Ireland saw a dramatic increase in bank lending, credit extension practices, and other banking activities in the years preceding the international crisis of 2008. And as in these other two countries, a great deal of this bank borrowing came from international markets.

The over-extension of domestic bank lending had already become apparent during 2007 and 2008, as bank share prices faltered even prior to the fall of Lehman Brothers in the US. In the face of the impending collapse of the domestic banking sector in late September 2008, at a panicked all-night meeting, the then Fianna Fáil-Green coalition government gave a blanket guarantee not only to depositors but to all bond-holders of the six main domestic financial institutions. At that point, the Minister for Finance, Brian Lenihan, claimed that this would constitute 'the cheapest bank rescue in history' (Carswell, 2008). But the government had stumbled blindly into unknown and rapidly escalating commitments. The enormous scale of the banks' losses unfolded over the following three years. The cost to the taxpayers of bank recapitalization was eventually estimated at approximately €62.8bn (Minister for Finance, 2011); Ireland's total GDP in 2011 was €155bn (Central Bank, 2012). Almost half of these losses are attributable to a single bank, Anglo Irish Bank, which (along with the Irish Nationwide Building Society) is now re-titled Irish Bank Resolution Corporation Limited (IBRC). Most of the remaining losses were incurred by the two oldest banks, the Bank of Ireland, and Allied Irish Bank. A London hedge-fund manager stated that 'Anglo Irish was probably the world's worst bank. Even worse than the Icelandic banks' (Lewis, 2011). The

incoming Governor of the Central Bank, Patrick Honohan, concluded in May 2010 that this was 'one the costliest banking crises in history' (Burke-Kennedy, 2011).

The collapse of the banking system caused confidence in the Irish economy to plummet. Ireland was forced to enter an EU-IMF loan programme in November 2010. By then, the systemic implications of the Irish financial sector liabilities for the European banking system meant that the Irish government came under extreme and sustained pressure not to reverse the bank guarantee (Beesley, 2011). The private debts of the failed banks were nationalized; the Irish taxpayers would be saddled with the crushing burden of debt. It has been argued that 'Other countries have benefited from the Irish socialization of a large share of bank losses, which has significantly contributed to the explosion of Irish public debt' (Darvas, 2011: 16). A large proportion of the non-performing loans of the struggling banks was taken into public management (through the National Asset Management Agency, or NAMA), at a sizeable discount, though still potentially over-valued: while the ultimate value of commercial property remained unknown, residential house prices fell by 47 per cent between 2007 and 2011 (CSO, 2012). The general public debt soared from 25 per cent of GDP in 2006 to 107 per cent at the end of 2011 (Central Bank, 2012). This figure was expected to peak at 118 per cent of GDP (and over 130 per cent of GNP[1]) in 2013 before starting to decline thereafter (International Monetary Fund, 2011: 14). This figure includes €30bn of promissory notes to distressed financial institutions. The national debt, net of the bank liabilities,

[1] GNP or GNI is generally taken to be a better guide to the state's fiscal capacity in Ireland, in view of the scale of transfer pricing and profit repatriation in the export-oriented multinational sector. See, for example, Hennigan, M. (2010a) Ireland: GDP or GNP? Which is the better measure of economic performance?, Finfacts, Thursday 10 March 2011. http://www.finfacts-blog.com/2011/03/ireland-gdp-or-gnp-which-is-better.html.

stood at 60 per cent of GDP in 2010 (Central Statistics Office, 2011: 152). The cost of servicing the national debt increased by over €1.1 billion in 2011 to reach €5.4 billion, accounting for 16% of overall tax receipts (Central Bank, 2012).

How had such a calamitous situation come about? In this chapter, we show first that the conditions that gave rise to the crisis, while precipitated by international events, were primarily domestic in origin. We then trace and evaluate a number of factors that contributed to these disastrous outcomes.

Understanding the crisis

Three official reports provide much of the framework required for understanding what happened in the Irish financial system[2]. The first report involved an examination of the conduct of the banking sector in the run-up to the crisis. Klaus Regling and Max Watson were commissioned by the Minister for Finance in February 2010 to conduct a preliminary investigation into the crisis in the banking system in Ireland. The objective of the investigation was 'to consider the international economic and financial environment, and indeed any broader social developments, which provided the context for the recent crisis in the banking sector.' A central part of their brief was to identify any factors particular to the Irish banking system which 'exacerbated the impact of the international financial crisis for Ireland' and to highlight the areas in relation to the conduct, management and corporate governance of individual institutions which required further investigation (Minister for Finance, 2010).

[2] For a note on the authors of these reports, see the Commission of Investigation into the Banking Sector in Ireland, http://www.bankinginquiry.gov.ie/Biographies.aspx

A second report was commissioned at the same time from Professor Patrick Honohan, an academic economist who had been appointed to the position of Governor of the Central Bank and Financial Services Authority of Ireland, as it was then titled, in 2009. His brief was to investigate the performance of the respective functions of the Central Bank and Financial Regulator over the period from the establishment of the Financial Regulator in 2003 to the end of September 2008. The Government indicated its intention to use these two reports to produce the terms of reference for a statutory Commission of Investigation, to be established pursuant to the Commissions of Investigation Act 2004. Both reports were published in May 2010 (Honohan, 2010; Regling and Watson, 2010).

In September 2010, the Commission of Investigation (Banking Sector) was established, comprising one member, Mr. Peter Nyberg, with a mandate to examine why a number of public and private institutions had acted in an imprudent or ineffective manner during the period 1 January 2003 to 15 January 2009. The Commission's Report was published in April 2011 (Nyberg, 2011).

All three reports address the international developments that facilitated the crisis, but they are also unanimous in identifying peculiarly Irish causal factors:

> Although international pressures contributed to the timing, intensity and depth of the Irish banking crisis, the essential characteristic of the problem was domestic and classic (Honohan, 2010: 22).

> Ireland's banking crisis bears the clear imprint of global influences, yet it was in crucial ways 'home-made' (Regling and Watson, 2010: 5).

> International developments, however, did not in themselves cause the crisis though they helped precipitate it. The problems causing the crisis as well as the scale of it were the result of domestic Irish decisions and actions, some of which were made more profitable or possible by international developments (Nyberg, 2011: ii).

The principal causes of the collapse of the Irish financial do not centre on the proliferation of complex financial products or of exposure to the US sub-prime mortgage market. Rather, this was 'a plain vanilla property bubble, compounded by exceptional concentrations of lending for purposes related to property – and notably commercial property' (Regling and Watson, 2010: 6).

In order to put this into context, we need to consider the rather modest origins of banking in Ireland, and the consequences of the banks having almost unlimited access to credit after Ireland joined the Euro in 1999. We need to understand how the expansion of the financial services sector shaped the regulatory regime and its implementation. We also need to consider why property loomed so large as an investment product in Irish life, and the broader political context in which banks were not only permitted but enabled to take huge risks: we shall return to this briefly at the end of the chapter.

The role of the banks in the Irish economy

The financial services sector was a relatively new phenomenon in the Irish economy: until the 1980s, the principal banks were domestic in ownership, running relatively small-scale operations by international standards (though they were among the larger companies in the Irish economy). The six main domestic financial institutions over the last thirty years were Bank of Ireland, Allied Irish Bank (AIB), Anglo Irish Bank ('Anglo'), Irish Nationwide Building Society (INBS), Irish Life and

Permanent (IL&P) and Educational Building Society (EBS). A key preoccupation of Irish policy-makers prior to the boom of the 1990s, following 'vocal criticism from consumer groups', was the danger of too little competition in the domestic banking market leading to too little credit (Nyberg, 2011: 28).

Indeed, credit rationing was long a familiar feature in both the domestic mortgage and commercial lending markets. Ireland has unusually high levels of home ownership, and therefore high levels of demand for personal mortgages. The historian J.J. Lee has noted a 'possessor principle' as a recurring trait in Irish public discourse, which he traces to older remembered experiences of dispossession and the land-hunger associated with agricultural consolidation in the wake of the mid-nineteenth century Famine (Lee, 1989). Whatever the deep-seated cultural reasons may be, investment in property, both private and commercial, has conventionally been taken to be a prudent strategy yielding long-term gains in value. In Ireland even more so than in Britain, people took to heart the notion that an undertaking could be 'as safe as houses'. Moreover, close connections between the state and the construction industry had been established early on in the life of the independent Irish state, led by the dominant political party, Fianna Fáil (Dunphy, 1995). Public housing projects were not only a popular investment in quality of life, but they were a recurring source of stimulus in an economy that, until the early 1990s, lagged at about 60 per cent of average European GDP (Bradley, 2000; FitzGerald, 2000).

During the 1980s, the international trend toward liberalization of capital controls began to change the policy context of banking in Ireland in two ways. Firstly, the Building Societies Act 1989 permitted building societies to expand the scope of their lending activities. Two building societies – INBS and EBS – which had previously focused on providing residential mortgages, were now

empowered to make loans for, *inter alia*, residential housing development. INBS, and to a lesser extent EBS, entered the development finance market where interest margins and fees were greater and greater profits could be earned. A third building society, IL&P, reacted to the increased competition and falling margins by increased lending volumes. The 1989 Act and subsequent amendments facilitated such expansion by permitting building societies to raise wholesale funding, allowing them to increase their loan books at a faster rate than their deposit funding would have permitted (Nyberg, 2011: 23).

Secondly, in the late 1980s, Taoiseach (that is, Prime Minister) Charles J. Haughey saw an opportunity to take advantage of the liberalization of financial services that had begun to accelerate in the wake of the deregulation of the City of London, and the growing volumes of internationally mobile speculative and investment capital then becoming available. He extended the country's preferential corporate tax regime to the financial sector, and created the Irish Financial Services Sector (IFSC) as an international hub of traded financial services (Cooper, 2010). This proved a highly successful strategy, and within a few years the IFSC included subsidiaries of a broad range of the major international financial institutions. Many of these were providing ancillary services to London headquarters. Relatively few were providing services to the domestic Irish market. But the significance of the IFSC was considerable, as we shall see later, in shaping the priorities of the Irish regulatory regime.

By the mid-1990s, Ireland had begun to emerge from the recession that had dominated the 1980s. A combination of benign conditions following the ratification of the Single European Act in 1992 allowed Ireland to engage in a period of very rapid economic growth: the 'Celtic Tiger' era lasted from about 1994 until the crash in 2008 (Honohan and Walsh, 2002; Barry, 1999). Ireland had

stabilized its earlier macroeconomic imbalances; social partnership contributed to keeping wage increases under control. The long-standing policy mix favourable to foreign direct investment created new opportunities for footloose foreign capital in growing high-tech sectors, especially pharmaceuticals and information and communications technology, to locate in Ireland in order to gain access to European markets (MacSharry and White, 2000; Ó Riain, 2004).

But the Celtic Tiger phase in Irish economic history falls into two phases. The first phase runs to about 2002, by which time it was already becoming apparent that the domestic economic was overheating, and house prices were starting to rise rapidly. The second phase, from 2002 to 2008, is a period during which economic activity came to be dominated much more by property-related activity. What made the key difference was the availability of cheap credit that followed upon Ireland's membership of the Euro.

The Euro and access to cheap credit

In January 1999, Ireland together with ten other members of the EU including France, Italy, and Germany, adopted the Euro as their common currency. Regling and Watson posed the somewhat rhetorical question, 'Was it a coincidence that Ireland's economic fundamentals began to deteriorate when Ireland joined the Eurosystem?' (Regling and Watson, 2010: 33). As early as June 2001, the Bank of International Settlements (BIS) observed in its annual report that 'the expansion of credit is an essential ingredient in the build-up of imbalances in the financial system and in any concomitant excessive accumulation or misallocation of real capital' (D'Arista, 2006: 222). There is no doubt that the huge property boom that developed in Ireland during the 2000s was fuelled by the greater availability to the Irish banks of cheap finance. Membership of the Eurozone led to a decrease in nominal and real interest rates and also removed the exchange risk

previously associated with European borrowing. As a result, Irish banks became increasingly reliant on wholesale short-term borrowing in the Euro area. By the end of 2006, wholesale borrowing by Ireland in the Euro area markets for the aforementioned six Irish financial institutions reached about 39 per cent of the combined loan books. The growth in short-term borrowing increased at an even greater rate, such that 'securities of one year remaining maturity or less amounted to €41bn at end 2006 for the two largest banks, up from €11.1bn at end 2003' (Regling and Watson, 2010: 33).

The other side of borrowing, of course, is lending. The countries of the European periphery – Ireland, Spain, Portugal, and Greece – which as impoverished regions had previously been in receipt of Structural Funds to assist their development, now appeared to offer handsome returns on investments. These countries in effect became akin to emergent economies in the Eurozone context, and lenders were more than willing to accommodate their borrowing requirements. Given the shortage of other good investment opportunities, the money was channelled predominantly into property development in Ireland; Spain experienced a similar phenomenon The absence of Euro-wide regulatory and oversight arrangements meant that lenders as well as domestic borrowers were vulnerable to the illusion that has preceded all property-related financial crashes, such as in East Asia in 1998 for example, that 'this time is different' (Reinhart and Rogoff, 2009).

Consumers expected that the combination of lower interest rates and increased competition in the market would increase choice, create more flexible financing packages, reduce the likelihood of overcharging, and improve what was perceived to be a protracted and cumbersome loan approval process for mortgages. All the main Irish banks began to make tracker mortgages

available, as well as 100 per cent loan-to-value loans. Interestingly, it was noted that 'these developments were viewed by the authorities overwhelmingly in terms of a benign shift to a modernized and competitive market – one that was in tune with developments in the UK and US' (Regling and Watson, 2010: 29).

The greatest demand for credit from the Irish banks and building societies came from builders and property developers. Competition between the Irish lending institutions intensified, as they strove to hold their share of a rapidly expanding market. This led to a significant change in the process of lending as domestic institutions, seeking to differentiate themselves, began to offer more streamlined loan approval processes. This was particularly marked at Anglo Irish Bank, where it was noted for example that 'the lending culture was such that when applications were problematic, the mindset was 'there is a "yes" in there somewhere' (Nyberg, 2011: 32). Considering itself 'a relationship lender', Anglo was clearly reluctant to refuse loans to its top customers, particularly when competitors were all to ready to take over these loans. As Anglo's profits soared, the larger and more traditional commercial banks, Bank of Ireland and Allied Irish Bank, came under intense pressure to relax their own loan approval and risk assessment practices in a struggle to keep pace with Anglo's performance. Nyberg indicated that in an environment where the supply of credit available exceeded good quality loan demand, banks relaxed their lending standards. He found evidence in Anglo of deviations from lending guidelines, resulting in approval of loans unsupported by appropriate cash flows and secured by non recourse personal guarantees or guarantees supported by equity in other already leveraged property (Nyberg, 2011:
32).

The result of these lending strategies was a threefold concentration of assets on the balance sheets of the Irish banks. This featured 'loans to the property sector in general; loans to commercial property specifically; and within this latter group, development loans to interests associated with a limited number of key developers of commercial property' (Regling and Watson, 2010: 31). Property-related lending soared between 2002 and 2008.

> Domestic property-related lending increased by almost €200bn which represents 80 per cent of all growth in credit. This raised the share of property-related lending from under 45 per cent of total credit in December 2002 to over 60 per cent in December 2008 (Nyberg, 2011: 14).

The effect was to give an enormous boost to the construction industry. The second half of the Celtic Tiger period, which ran from 2002 to 2008, was exceptionally dependent on construction activity as a classic property bubble developed. 'Competitiveness didn't matter – from now on we were going to get rich building houses for each other', economist Morgan Kelly commented with heavy irony (Lewis, 2011). The construction sector accounted for about 20 per cent of GNP in 2006, compared with an OECD average of about 10 per cent, and employment in construction soared to about 20 per cent of the workforce, also twice the international average. House prices rose rapidly, even as planning permission was granted for a rash of new housing developments (Kelly, 2009b). 'Irish banks were lending forty per cent more in real terms to property developers alone in 2008 than they had been lending to everyone in Ireland in 2000, and seventy-five per cent more as mortgages' (Kelly, 2009a: 2).

The banks over-extended their lending on a vast scale. Net foreign liabilities of Irish banks stood at 10 per cent in 2003, but 60 per cent in 2008. All this activity generated a boost in revenue flows to the government: at its peak, revenues directly related to property accounted for some 15 per cent of total revenues, more than twice the OECD average. Government used the bonanza to narrow and weaken the income tax base as part of its ongoing commitment to a strategy of reduction in personal tax liabilities (Dellepiane and Hardiman, 2012). This left it particularly exposed to the emergence of a significant fiscal deficit when the crash eventually came.

Explaining the fall of the Irish banks

How had things gone so badly wrong? A number of considerations need to be taken into account. The most obvious place to start is to consider the role of market disciplines in keeping corporate performance on track: evidently something in the Irish experience proved defective. Furthermore, the spectacular crash of the Irish banks suggests something was seriously problematic in the regulatory regime governing the financial sector, whether in the regulatory powers, the institutions, or their implementation. Finally, consideration of these issues leads us to reflect upon the wider political context of the expansion of the financial sector, noting in particular the close relationships between politicians, builders, and bankers that developed during the 2000s.

The market for corporate control as a disciplining force

The market for corporate control theory ('MCC'), first proposed by Henry Manne in 1965, suggests that mismanagement is reflected in share price because shareholders sell their shares rather than replace management (Manne, 1965). An opportunity thus arises for a bidder to acquire the

company cheaply, replace the inefficient managers and turn the company around. The MCC suggests that takeovers have a disciplinary effect on managers. As recently as 2008, Manne has argued that if there is a competitive market for corporate control, there will be no need for any of the other mechanisms for corporate governance other than those voluntarily adopted by contracts and norms (Manne, 2008).

Share ownership in Ireland is relatively widely dispersed. Applying MCC to the credit institution market suggests that the share prices of the listed institutions should have dropped to reflect their increasingly poor risk management and corporate governance and consequently the institutions should have been acquired and improved. Yet this did not happen in Ireland or indeed abroad until the latter part of 2007. It has been argued elsewhere that the fundamental prerequisites for the operation of this disciplinary force were not in place (Clarke, 2009). The share prices of the banks did not reflect the inefficiencies which subsequently proved so costly to the global market. Investors did not act in a rational fashion, and there was evidence of 'irrational exuberance' and information asymmetries. Lord Turner, the Financial Services Authority Chairman, in his report on bank regulation to the British Chancellor of the Exchequer, acknowledged that all liquid traded markets are capable of acting irrationally, and can be susceptible to self-reinforcing herd and momentum effects. He commented that 'A reasonable conclusion is that market discipline expressed via market prices cannot be expected to play a major role in constraining bank risk taking, and that the primary constraint needs to come from regulation and supervision' (Lord Turner, 2009: 47).

It is interesting to note, however, that some commentators suggest that the market for corporate control operated in a perverse manner. Lord Turner himself suggested that falling spreads and

volatility prices drove up the current value of a range of instruments marked to market value on the books of the banks and the hedge funds. This led to higher book profits and reinforced management and trader certainty that they were 'pursuing sensible strategies' (Lord Turner, 2009: 25). It thus appears that the challenging competitive conditions encouraged rather than restricted management, and that the herd mentality referred to above prevented most institutions from stepping out of line. Similarly, the Nyberg Commission found that:

> Bank management and boards in some of the other covered banks feared that, if they did not yield to the pressure to be as profitable as Anglo, in particular, they would face loss of long-standing customers, declining bank value, potential takeover and a loss of professional respect (Nyberg, 2011: v).

The Irish Takeover Panel is the supervisory authority responsible for monitoring takeovers of Irish 'relevant companies'.[3] The vast majority of these companies are Irish registered PLCs listed on the Irish Stock Exchange. Takeover activity in Ireland varies from year to year, but overall there is a reasonable level of activity. Since its establishment in 1997, there has been an average of 5.3 takeovers a year, from an annual average of 75 relevant companies. In that time, there have been only seven hostile takeover offers (an average of 0.5 a year), and none of these has been successful.[4] In three cases, control did not pass and the targets remained independent. On the

[3] As defined in section 2 of the Irish Takeover Panel Act, 1997 as amended.

[4] These figures do not include statements of intention to make a possible offer which were not welcomed by the target companies and did not lead to offers being made.

basis of this evidence, it would appear that the market for corporate control may not be particularly robust in Ireland.

Good corporate governance

Although market pressures on banks' activities may have been relatively weak, it might be anticipated that self-governance by the banks would ensure that good standards of risk assessment prevailed, and that prudential attention was paid to balancing of assets and liabilities relative to capitalization.

Prior to the crisis, a number of different initiatives had been considered, aimed at formalising and enforcing good corporate governance. The first involved mandatory directors' compliance statements. This idea had been suggested by a parliamentary committee examining serious and sustained misconduct by banks in facilitating tax evasion (Public Accounts Committee, 2001). Upon the specific recommendation of the Review Group on Auditing (Report of the Review Group on Auditing, 2000: 25), section 45 of the Companies (Auditing and Accounting) Act, 2003 was introduced, requiring company directors to report annually to shareholders on their company's compliance with its obligations under company law, taxation law, and other relevant statutory or regulatory requirements. As a result of concerns expressed by interested parties, the Company Law Review Group were invited to produce a report on the section and this report highlighted inter alia the prescriptive nature of the section, difficulties of interpretation and the financial costs of compliance (Company Law Reform Group, 2005). It was noted that the benefits on implementation would be "intangible" and that it would be "difficult to point to any particular mischief that its introduction [would] remedy" (Company Law Reform Group, 2005, 5). The risks of implementation were described as unacceptable and the Group recommended either repealing the section or, as a

compromise, limiting its application. The report emphasised and evidenced "the very real engagement with the issue" and "the suspension of sectional interest" which informed its deliberations (Company Law Reform Group, 2005, 5). This section has not been commenced. A related regulation is section 25 of the Central Bank Act, 1997 as substituted by Section 26 of the Central Bank and Financial Services Authority of Ireland, Act, 2004 which gives discretionary power to the Financial Regulator to require regulated financial service providers to prepare compliance statements. Although this was more flexible in its application than section 45, subsequently, private consultations took place between IFSRA, the Department of Finance and industry representatives, during which concerns were expressed about the section's lack of a materiality threshold, its vulnerability to constitutional challenge and its potential detrimental impact on competitiveness. As a result of what Honohan described as deference to 'industry pressure', a decision was taken not to implement the section (Honohan, 2010: 50-51, note 6).

A second initiative involved the introduction of more robust 'fit and proper' requirements. This stemmed from the finding in 2005 by the Joint Committee on Finance and the Public Service of numerous incidents of failure by the banks to comply with 'acceptable standards of behaviour' with respect to prudential consumer and fiscal obligations in the context of customer charges and interest rates (Report of the Joint Oireachtas Committee on Finance and the Public Service, 2005: 9). Patrick Neary, then Chief Executive of IFSRA, commenting on Irish practices of principles-based regulation (discussed in greater detail later), accepted that '[i]n a principles-based system of supervision, the competence and probity of those who direct and manage firms is a critical element' (Neary, 2006). Rules were issued by the IFSRA in 2007 requiring directors and managers of regulated market operators to have the necessary qualifications, skills and experience to

perform the duties of their position and to be honest, fair and ethical. The requirements varied by type of financial institution; fitness and probity reviews were not conducted on a statutory basis for all firms.

The third initiative mooted by the Central Bank in 2005 was to introduce a corporate governance code for credit institutions and insurance undertakings. The Central Bank prepared a consultation paper, and engaged in a pre-consultation with credit institutions in 2005 and 2006. However in early 2007, it decided to delay this code, citing the need to develop and possibly incorporate within the code organizational requirements arising from recent EU-wide discussions (Honohan, 2010: 54, note 6). This was unfortunate, as the introduction of the code even at this late stage might have shone light on the serious corporate governance deficiencies in some of the institutions prior to the Government's decision in September 2008 to provide blanket guarantees to the banks. [5]

Across the world, poor corporate governance was identified as a key contributor to the global financial crisis. Failures were identified in Ireland, as elsewhere, in terms of risk control and remuneration, but the small market and the lack of diversity on the boards appears to have exacerbated the problem. Regling and Watson identified four key areas in which bank management and governance contributed to the Irish banking crisis. First, management failed to appreciate the risk entailed by the significant concentration of bank assets in activities related to property, and especially non-household based commercial property, as described above. Secondly, lending guidelines and processes appeared to have been quite widely circumvented.

[5] A *Corporate Code for Credit Institutions and Insurance Undertakings* was introduced and came into effect in January 2011.

The authors referred rather benignly to the 'tidal wave of uncritical enthusiasm … to participate in financing the property boom and to maintain market share' (Regling and Watson, 2010: 35).[6] The Nyberg Commission noted that 'adhering to either formal or traditional, often voluntary, constraints and limits on banking and finance, does not seem to have been greatly valued in Ireland during the period' (Nyberg, 2011: 96-7). While these two issues point to ineffective corporate governance and ineffective risk management within the banks, Irish bankers were clearly not unique in this regard (Plath, 2008; Kirkpatrick, 2009; The White House, 2008). A third contributing factor involved 'very specific and serious breaches of basic governance principles concerning identifiable transactions in specific institutions that went far beyond any question of poor credit assessment.' These included allegations of practices on the part of Anglo Irish Bank of undisclosed loans to directors, creative accounting, and loans to investors to purchase their own shares.

By the time Anglo was nationalized in January 2009, the Government accepted that these 'unacceptable corporate governance practices' were a triggering factor in the nationalization (Department of Finance, 2009). Yet the aforementioned governance failures happened at a time when guidelines and processes applied to those financial institutions with a listing on the Irish Stock Exchange. The Listing Rules of the Irish Stock Exchange required such companies to comply with the Principles set out in the UK Combined Code on Corporate Governance ('the Combined

[6]While they asserted that poor liquidity management and funding policy abounded, they accepted that this was harder for managers to determine at the time.

Code'), and to make a disclosure statement either confirming compliance with the provisions or explaining any non-compliance.[7] The Combined Code set out main and supporting principles relating to directors, remuneration, accountability and audit and relations with shareholders. It envisaged 'an effective board' operating 'within a framework of prudent and effective controls which enables risk to be assessed and managed' (Financial Reporting Council, 2006: note 14, section 1A, Supporting Principles 3). Evidence gathered by the Irish Stock Exchange and the Irish Association of Investment Managers ('the ISE/IAIM Study') indicated a high level of compliance by Irish listed companies with the Combined Code (Irish Stock Exchange and Irish Association of Investment Managers, 2010). The reason why the Code proved ineffective in this context lies in another finding of the ISE/IAIM Study to the effect that much of this compliance involved 'box ticking', and that frequently there was no real adherence to the spirit of the Combined Code. This is consistent with the conclusion of Regling and Watson that 'the failings of corporate governance seem to have been much more a problem of deficient implementation than defective guidelines and processes' (Regling and Watson, 2010: 35, note 8).

The fourth key corporate governance failure identified by Regling and Watson was poor remuneration policies which encouraged and rewarded risk-taking. In particular, they criticized management bonuses and awards of substantial stock options to top and middle management (Regling and Watson, 2010: 35, note 8). This is consistent with research from the UK Financial Services Authority which indicated that the structure of bonuses in UK financial institutions

[7] The original version of the Combined Code was published in 1998 by the Financial Reporting Council and amendments were introduced in 2003, 2006, 2008, and 2010. In 2010, the Code as re-titled the UK Corporate Governance Code.

allowed management to benefit from risk-taking whilst ensuring that any losses were borne by long-term shareholders and society (Financial Services Authority, 2009: par. 2.4). In common with boards internationally, remuneration in Irish institutions became 'a driver for excessive risk-taking'. This policy was not caught by the existing corporate governance rules – while the Combined Code emphasized the need for a clear link between pay and performance, it did not build in a risk assessment consideration (Financial Reporting Council, 2006: note 14, section B1, Main Principles). This explains in part why, despite the fact that it was already suffering a decline in its share price, the 2007 Annual Report of Anglo Irish Bank reported that its Chief Executive David Drumm held 1.4 million options to subscribe for ordinary shares, and that his total pay for the year was €3.3 million, which included a €2 million annual performance bonus.

Financial regulation

It is clear that norms of professional conduct have not always provided a sufficient incentive for directors to adhere to corporate governance guidelines, and that certain boards were unwilling or unable to challenge the executive or to prevent excessive risk taking. For example, in Anglo, the bank with the most spectacular record of failure, Seán Fitzpatrick moved directly from the position of Chief Executive to Chairman of the board in contravention of the Combined Code, was a party to some questionable accounting in respect of Anglo's balance sheet, and had multiple conflicts of interest in his various business activities (Ross, 2009; McDonald and Sheridan, 2009).

As noted above, market forces appear to have been exerting weak pressure on banks to perform to standards that would have averted catastrophe. Voluntary compliance with standards of good corporate governance proved singularly ineffective. This prompts us to consider the regulatory

regime in place during the 2000s. We shall look first at the structure of the financial regulation system in Ireland, to consider whether the institutional design left something to be desired, such that the reconfiguration of regulatory powers in the late 1990s created a gap in regulatory oversight. We shall then consider the powers of the financial regulator, and the enforcement of regulatory requirements. In our view, all of these factors played a role in accounting for the crisis in the Irish banking system. But they also need to be understood in a broader political context, which we shall return to in the final part of this chapter.

The structure of the regulatory system

The scope of financial regulation in Ireland had been progressively increased during the 1990s in response to EU Directives (Westrup, 2012). But as there was no EU-mandated institutional form of regulation, diverse practices had evolved across EU member states to give effect to the Directives. The shortcomings of the pre-1990s regime in Ireland had become apparent on a number of occasions. Banks had turned to government for financial rescue, for example in 1984, following the collapse of the Insurance Corporation of Ireland, a wholly-owned subsidiary of Allied Irish Bank. Relations between bankers and politicians had also become a matter of public comment at that time, for example when merchant banker Patrick Gallagher was prosecuted for fraud in Northern Ireland, but not in the Republic, where he enjoyed close financial and business links with Charles J. Haughey. The dominant issue during the 1990s was the evidence of the banks' role in facilitating systematic tax evasion on the part of their customers, which as noted above was subject to a high-profile investigation by the Public Accounts Committee (Public Accounts Committee, 2001).

In 1998, the Government, then composed of a coalition between the dominant Fianna Fáil party and the small liberal-leaning Progressive Democrats, agreed in principle to the establishment of a single regulatory authority for the financial services sector, and appointed a working group under the chairmanship of Michael McDowell (a barrister and prominent Progressive Democrat) to advise it on implementation. The report recommended that prudential and consumer protection regulation of almost all financial firms should be assigned to a single regulatory authority which would be established as an entirely new independent organization (McDowell, 1999). In reaching this conclusion, the Group was influenced by the lack of international precedent for combining such a large range of regulatory responsibilities within a conventional Central Bank. A new entity, it concluded, would provide for clarity of purpose in relation to both regulation and customer protection in financial services, and would provide a coherent, robust and transparent approach to financial regulation. A minority of the Group disagreed and advised that the single regulatory authority should be located within a restructured Central Bank. They advised establishing a separate division for prudential and consumer regulation headed up by a person with equal rank to the Director General of the Central Bank. Upon consideration of the report, a compromise was reached by the Government, which amounted to a hybrid system. Rather ominously, Regling and Watson would later characterize this report as 'an interesting experiment' (Regling and Watson, 2010: 36). A new structure, the Central Bank of Ireland and Financial Services Authority (CBIFSA), was established8 under the chairmanship of the Governor. This body linked a monetary authority carrying out functions related to the European System of Central Banks (ESCB), and a single regulatory authority entitled the Irish Financial Services Regulatory Authority (IFSRA).

The latter was responsible for licensing, prudential regulation of both the banking and insurance sectors, and consumer protection. It had its own Board, with an independent Chairperson, Chief Executive and Consumer Director. The two former post-holders, together with some board members of IFSRA, sat on the CBFSAI Board. Members of both boards were drawn from a cross-section of professional and public sector groups rather than being 'expert Central Bankers' (Honohan, 2010:
39-40). IFSRA was subject to a duty to act in a manner consistent with the performance by the Governor and the Board of their CBFSAI functions (including the Governor's role in contributing to financial stability). The CBFSAI Board was responsible for the efficient and effective co-ordination of the constituent parts of the organization as a whole, and for the exchange of information between them. [9] Another of its duties, which was to prove controversial, was 'to promote the development within the State of the financial services industry (but in such a way as not to affect the objective of the Bank in contributing to the stability of the State's financial system).'[10]

Honohan has suggested that 'the division of responsibilities between the Governor, the CBFSAI and IFSRA was novel and contained the hazard of ambiguous lines of responsibility especially in the event of a systemic crisis' (Honohan, 2010: 36). It encouraged the establishment of institutional silos, creating difficulties in ensuring coordination between the economists and the regulatory staff involved in regulatory responsibilities.

[8] Central Bank and Financial Services Authority of Ireland Act 2003.

[9] S.5A(1)(a) Central Bank Act 1942 as amended.

[10] S.5A(1)(b) Central Bank Act 1942 as amended. See also Honohan 2010, 37.

This problem is highlighted by the view expressed to the Nyberg Commission that:

> it was not the primary responsibility of the [CBFSAI] to evaluate possible problems in domestic financial markets emanating from the behaviour of individual institutions. [CBFSAI] legislation provides that while the [CBFSAI] was charged with overall financial stability matters, the [IFRSA] was responsible for identifying and bringing to the attention of the [CBFSAI] any bank-specific/prudential matters of potential system-wide significance. Therefore, according to this view, the [CBFSAI] should not question, or be seen as questioning, the [IFRSA's] activities. As the [IFRSA] did not raise any such concerns with the [CBFSAI], the [CBFSAI] could therefore not have been expected to detect existing or emerging problems. Indeed, it was even suggested that detailed enquiries by the [CBFSAI] regarding the basis for the [IFRSA's] assessments could have been regarded as an unacceptable intrusion into the autonomous status of the [IFRSA] (Nyberg, 2011: 66).

Honohan also suggested that the overlap between IFRSA and CBFSAI board membership meant that issues within the remit of the IFRSA that fell to be considered also at CBFSAI Board meetings would normally have been discussed by the overlapping members beforehand. This, he argued, facilitated IFRSA members voting as a block on matters of importance to the CBFSAI. Finally, he suggested that the 'unduly hierarchical CBFSAI culture' discouraged challenge (Honohan, 2010: 16).

While this system of regulation can be seen to have had a number of weak points, it secured the confidence of international observers. The IMF 2006 Financial Sector Assessment Program Report, for example, was very positive in its assessment of the new integrated supervisory framework, noting that the organizational structure was likely to enhance financial stability (International Monetary Fund, 2006). Honohan noted this would have had a significant dissuasive effect on concerns that might otherwise have been raised about 'prudential supervision and the risks to financial stability' (Honohan, 2010: 91).

Nevertheless, despite these structural problems, Honohan concluded that it would be hard to show that the complexity of this regulatory structure materially contributed to the major failures that occurred. We need thus to probe deeper into the regulatory regime, to consider the priorities it adopted, the scope of its powers, and the way these were implemented.

Principles-based regulation

Regling and Watson concluded that 'the structure of regulation seems to have been less important in explaining Ireland's banking crisis than the way in which supervision was implemented in practice' (Regling and Watson, 2010: 36). While the structure of the regulatory system changed in 2003, the regulatory approach did not. In common with many other jurisdictions, including the UK, the Irish regulatory regime was based on 'principles-based regulation'. Although this term has various meanings (Black, 2008), as applied in Ireland it refers to a system where 'the prudential

regulator is not prescriptive in terms of product design, pricing and the specific risk decisions adopted by a firm, as long as that firm has a robust governance structure and an effective oversight and control system' (Honohan, 2010: 44). It was also referred to as 'light-touch regulation' or market-based regulation.

Such a policy was consistent with the Irish Government's 'Better Regulation' policy, one of the principles of which stated: 'We will regulate as lightly as possible given the circumstances, and use more alternatives' (Department of the Taoiseach, 2004). It is important in this context to note that the supervisory approach in Ireland did not become lighter during the 2000s, but that 'it remained very accommodating in a radically changed environment' (Regling and Watson, 2010: 38).

A problem identified by the Honohan report which was perhaps not so commonplace was that 'the underlying philosophy was oriented towards trusting a properly governed firm; it was potentially only a short step from that trust to the emergence of a somewhat diffident attitude on the part of the regulators so far as challenging the decisions of firms was concerned' (Honohan, 2010: 44). In describing the regulatory approach of the Bank prior to the crisis, the word 'trust' appears repeatedly. The Chairman of IFSRA was reported as stating that 'for the principles based approach to work there must be mutual trust, between ourselves and industry and a shared aspiration to do our best together' (Honohan, 2010: 44). This led to a regulatory approach which was 'excessively deferential and accommodating; insufficiently challenging and not persistent enough' (Honohan, 2010: 16).

This in effect inhibited the IFSRA from taking quick and decisive action against banks with governance issues or with obvious liquidity concerns. While acknowledging that the Banking

Supervision Division of the IFSRA may have been under-resourced, the Nyberg Commission suggested that resource limitations alone would not account sufficiently for the lack of action:

> The essential information was readily available in the banks' regulatory returns and (publicly available) in annual reports. Also…the serious governance and procedural problems in INBS (the Irish Nationwide Building Society), and to a lesser extent in Anglo, were known to the [IFSRA] for years. Furthermore, there are no signs of the [IFSRA] requesting increased resources. What unfortunately seems to have been lacking is professional scepticism or suspicion on the part of the [IFSRA] that all things might not be as well as they seemed on the surface (Nyberg, 2011: 63).

This problem was exacerbated by two considerations facts referred to earlier: the statutory objective of the CBFSAI to promote the financial services industry in Ireland, and the increase in competition in the marketplace. The buccaneering attitude to loan approval adopted by Anglo Irish Bank, short-circuiting normal risk assessment practices, enabled it to grow at astonishing rates. In its 2006 Annual Report, Anglo boasted of a 'Ten year compound annual growth rate in profit before tax of 39 per cent' (Hennigan, 2010b). This put tremendous pressure on Bank of Ireland and AIB; one former bank executive interviewed by financial journalist Michael Lewis reported that they succumbed by 'writing checks to Irish property developers to buy Irish land at any price'. Former Anglo Irish executives 'spoke of their older, more respectable imitators with a kind of amazement. "Yes, we were out of control", they say, in so many words. "But those guys were *****ing nuts*"'(Lewis, 2011).

This created an environment which was described by Honohan as one which placed 'undue emphasis on fears of upsetting the competitive position of domestic banks and on encouraging the Irish financial services industry even at the expense of prudential considerations' (Honohan, 2010: 16). The Nyberg Commission also concluded that 'concerns about a loss of market share by Irish banks to potentially less regulated foreign competitors may have inhibited forceful action by the [IFSRA]' (Nyberg, 2011: 65).

Finally, Honohan described an unwillingness on the part of the CBFSAI to acknowledge the real risk of a looming crisis and to pre-empt it. There appeared to be a great fear that 'rocking the boat' would lead to a potential adverse public reaction, thus 'spoiling the party' (Honohan, 2010: 16). Let us remember too that Anglo in particular was widely viewed domestically and internationally as a success story by the marketplace, rating agencies, politicians and the media. The Nyberg Commission suggested that this communal lack of judgment stemmed from the tendency to widespread group-think (including 'disaster myopia') in Irish banks during this period (Nyberg, 2011: 87). Interestingly, it expressed the view that there was no evidence that this was more prevalent in Ireland than elsewhere (Nyberg, 2011: 49). This view of market pressure is consistent with the comment by former Citigroup CEO Chuck Prince that 'as long as the music is playing, you've got to get up and dance' (interview in the *Financial Times*, 9 July 2007). But clearly the role of the regulator is to turn off the music before the party gets out of hand.[11] Instead, as the financial situation worsened and the credit institutions became less sound, 'the earlier desire – not to rock

11 William McChesney Martin Jr., one-time Chairman of the Federal Reserve (1951-1970), was quoted as characterizing his role thus: 'I'm the fellow who takes away the punch bowl just when the party is getting good.'

the boat – was overtaken by a fear of frightening the horses' (Honohan, 2010: 96). It is the scale of the myopia that is distinctive in Ireland though. The Nyberg Commission noted that 'the extent to which large parts of Irish society were willing to let the good times roll on until the very last minute (a feature of the financial mania) may have been exceptional' (Nyberg, 2011: ii).

It may be therefore that the regulatory regime was not faulty in design, but that the very point of the system of regulation was to lower the burden of compliance, and to ensure that the legal requirements of risk regulation were light (Taylor, 2011: 8). Ireland sought to be a player in the globalized market for financial services. The International Financial Services Centre (IFSC) was a significant provider of employment and of tax revenues, employing over 30,000 people and yielding some two billion Euro in tax revenues in 2011. Its reputation as a place in which it was easy to do business had to be protected, indeed so much so that it had acquired the reputation during the 1990s as the 'Wild West of European finance' (O'Toole, 2012; Lavery and O'Brien, 2005). One of the first European banks to fail in the wake of Lehman's was Depfa Bank, an IFSC-based subsidiary of a German bank. Its liabilities were the responsibility of its German parent; but the liquidity problems it experienced in 2008 were understood to have developed because of the freedoms available to it through its incorporation under Irish law. The IFSC's shadow banking system continued to be largely unregulated even after the collapse of the domestic banking system, and its securitization practices were relatively unaffected by the global crash. The importance of the IFSC to Irish policy-makers coloured their sense of the importance of maintaining a regulatory distance from financial services, and this is likely also to have affected their sense of the regulatory requirements appropriate to the domestic banks too.

We might conclude therefore that not only a consequence but also a central priority of principles-based regulation was to maintain the threshold of intervention at a high level. It is reported that 'the bankers loved it, it was regulation without rules' (Ross, 2009). Even this extraordinarily light regulatory regime was too much for Seán Fitzpatrick, former CEO and Chairman of Anglo Irish Bank, who argued in 2007 that:

> It is time to shout stop. The tide of regulation has gone far enough. We should be proud of our success, not suspicious of it. Our wealth creators should be rewarded and admired not subjected to levels of scrutiny which convicted criminals would rightly find intrusive (Hennigan, 2010b).

It would not be too long before Fitzpatrick was himself arrested on suspicion of fraudulent behaviour. But it was too late to prevent his bank from causing enormous damage to Irish public life.

Regulatory enforcement

An essential component of any regulatory regime is an enforcement strategy to ensure compliance. In the period preceding the financial crisis, Honohan acknowledged that the preferred approach to regulatory implementation on the part of IFSRA was to seek voluntary compliance with legislation, codes and rules (Honohan, 2010: 43): 'there were no sanctions imposed on credit institutions and none that might be said to have reflected significant prudential concerns' (Honohan, 2010: , note 6 58). While IFSRA had the capacity to utilize its powers of administrative sanction, there was clearly a marked reluctance to apply those powers in relation to micro-prudential functions.

The hands-off role of the financial regulator in the run-up to the crisis has raised many questions about awareness in the regulator's office of the extent of over-reach in the banks' balance sheets, and of the scale of their reliance on the short-term interbank lending market. Honohan commented on the thin staffing available to the financial regulator Patrick Neary between 2006 and early 2009. But this situation seems to have been consistent with reports that the regulator deliberately 'kept on-site inspections of the banks' books down to a minimum and gave prior notice in advance of such inspections'; he declared on his appointment in 2006 that 'we will seek to implement the rules to the minimum extent necessary' (Ross, 2009: 79). There was little evidence of the organizational and social distance normally required for effective regulatory enforcement. Career mobility between the boards of the Central Bank and the commercial banks was not uncommon, and indeed directors of both AIB and Bank of Ireland held simultaneous appointments on the board of the Central Bank (Clancy et al., 2010: 14; Clancy and O'Connor, 2011: 19). Regulatory staff and bank directors often socialized together. In September 2008, against the backdrop of this deliberate policy of light touch regulation, Neary nevertheless:

> insisted that Anglo was not insolvent and that it had enough assets to cover its debts: 'there is no evidence to suggest Anglo is insolvent on a going-concern basis. It is simply unable to continue on a current basis from a liquidity point of view', he told the Taoiseach (Brennan and Oliver, 2010).

From the establishment of the office of the financial regulator in 2003 to October 2008, not a single Irish bank had been fined as a result of an inspection. In contrast, in Britain over a comparable time-period, the Financial Services Authority had imposed over £14m in fines to banks and building societies (Ross, 2009: 81).

On the other hand, some commentators have gone further and suggested that the financial regulator tacitly condoned some of the questionable practices of the board and senior managers in Anglo. In September 2008, 'when Anglo official Willie McAteer told Patrick Neary that the bank would have its books in order by the end of [2008], it is claimed the former Financial Regulator said: "Fair play to you, Willie"' (Oliver, 2009). At that time, the share prices of the Irish banks were already under sustained attack, and it was only a matter of days before the banks would find themselves in danger of outright insolvency. By the time the regulator began to take a tougher approach with the banks and indeed with their auditors, toward the end of 2008, the damage had long since been done.

Nyberg suggests that the financial regulator's reluctance to adopt a tougher line sooner can be explained in terms of fear of litigation – of the legal cost and reputational damage entailed by pressing a case against a financial institution and losing (Nyberg, 2011: 62). But potential reputational damage of this sort pales before the real loss of confidence in the efficacy of the system caused by Neary's appearance on the current affairs programme, Prime Time, two weeks after the fall of Lehman Brothers. Michael Lewis comments on his performance, and quotes economist Colm McCarthy's reaction to it, as follows:

> Neary, for his part, looked as if he had been dragged from a hole into which he badly wanted to return. He wore an insecure little mustache, stammered rote answers to questions he had not been asked, and ignored the ones he had been asked…. Here he was, on their televisions, insisting that the Irish banks were 'resilient' and 'more than adequately capitalized' … when everyone in Ireland could see, in the vacant skyscrapers and empty housing developments around them, evidence of bank loans that were not merely bad but

insane. 'What happened was that everyone in Ireland had the idea that somewhere in Ireland there was a little wise old man who was in charge of the money, and this was the first time they'd ever seen this little man,' says McCarthy. 'And then they saw him and said, *Who the **** was that??? Is that the ****ing guy who is in charge of the money???* That's when everyone panicked' (Lewis, 2011).

The political context of the property bubble

Much has been written about the persistent tendency of Irish governments to engage in pro-cyclical fiscal policy. There are many weaknesses in the institutional design of decision-making: governments have displayed a propensity to overheat the economy for electoral purposes during periods of growth, resulting in a need to take corrective action during the ensuing downturn in a manner that intensifies the impact of recession (Lane, 2010; Benetrix and Lane, 2009; Lane, 1998; Conefrey and FitzGerald, 2010; Hardiman, 2010a; Hardiman, 2010b; Honohan, 1999). By the early 2000s, Ireland was already in the grip of another such upswing. But this time, it was amplified by the scale of the cheap credit available as a result of Eurozone membership.

Government took some initiatives in the early 2000s to dampen the housing market through tax increases, but these were overturned as the 2002 election approached; soon afterwards, a new round of fiscal tightening by then Minister for Finance Charlie McCreevy was over-ruled by Taoiseach Bertie Ahern, again with electoral considerations in mind.. Tax incentives for property purchase, for commercial development as well as for individual residential purchases, were left in place until after the 2007 election. 'From 2003, property seemed a one-way bet' (Taylor, 2011: 4).

Why was the speculative bubble allowed to grow so rapidly, and why was government so slow to recognize the risks associated with untrammelled lending for property development? Two puzzles arise here. The first concerns the nature of the relationships between politicians, bankers, and builders that intensified during the housing boom. The second issue is why no-one shouted stop.

Golden circles and the 'cement economy'

During the 2000s, in Ireland as in Spain, construction activity gave a significant fillip to economic growth. Notwithstanding some political concern that house prices were escalating very rapidly, and that this even risked destabilizing the social partnership wage agreements of the early 2000s, the Fianna Fáil-led governments between 1997 and 2008 welcomed the employment generated, the revenue streams created, and the apparently unstoppable rise of Irish builders and property developers as major players not only at home but across Europe. This sector of Irish economic activity had been actively encouraged through a series of budgetary incentives (TASC, 2010). Tax reliefs for construction in some instances ran counter to other declared policy objectives, such as concentrating population growth in key towns to ensure balanced spatial development.

Some local authorities, who controlled planning permission, proved to be the source of serious and systematic corruption, as developers and builders engaged in direct bribery to achieve their objectives (Tribunal of Inquiry, 2012; McDonald and Sheridan, 2009). But this was only one mode of operation. More visibly, builders and property developers sought the company of government ministers and others in positions of influence, socialized with them, and were conspicuously present at Fianna Fáil fund-raising activities such as the annual high-profile party hospitality suite at the Galway Races. The 'Galway Tent' became a byword for corrupt relations between politicians, banks, and property interests (O'Toole, 2010; Cooper, 2010; Leahy, 2009). A network of

those with related interests developed: many of these private sector individuals were placed on the boards of state enterprises, and politicians were ever eager to be included in their company (Clancy et al., 2010; Leahy, 2009).

A particularly striking feature of this new Irish elite was that many of them still regarded themselves as social outsiders. This chimed with one aspect of Fianna Fáil's self-presentation as the party of workers and small farmers, harking back to its early days in the 1920s and 1930s. Many of the builders and property developers were self-made men with relatively little formal education. Former Taoiseach Bertie Ahern, who stepped down in 2008 just as the crisis was looming, commented later on the enormity of the developers' losses. Since they were now bankrupt, their losses were close to bankrupting the whole country. Yet he spoke with unaffected sympathy about them as follows:

> Seán Dunne's lost a lot of money on it. Seán's just one of the guys. I know a lot of them, like (Jimmy) Flynn, (Noel) O'Flaherty and the Baileys. You meet the Baileys at Croke Park (the national stadium for Gaelic games) every time you go there. You can't avoid getting a slap on the back going in from them. Most of these guys lost their shirt. I feel sorry for them (Mackay, 2012b).

The sense of identification with the activities of Irish property developers, and of support for the banks who were facilitating them, also had a tinge of nationalist pride to it, particularly when Irish speculators engaged in high-profile British acquisitions such as the Savoy Hotel in London. One builder spoke of his pride in building a housing estate 'on what was once the great Ascendancy estate of Castletown in Co. Kildare: "It was time the Irish went through the front gate"', after the

dispossession of his great-grandfather who belonged to the class of impoverished tenant farmers many of whom had been evicted from their landholdings during the nineteenth century (O'Toole, 2010). Similarly, some of the self-made millionaires were said to feel more at home with the informal approach of Anglo Irish Bank than with the Bank of Ireland, which had been viewed until well into the 1970s as favouring employees who were members of the Church of Ireland over Roman Catholics (McWilliams, 2009:).

As author and journalist Fintan O'Toole has noted, 'If the control of land is left out of the equation, the sheer scale of the Irish property bubble is impossible to fathom' (O'Toole, 2010). The principal reason for the scale of the bubble in Ireland was the price of building land. In north county Dublin, a prime growth region, a mere 25 owners were shown to have controlled over 50 per cent of all building land in 2005, enabling them to control the release of land and thereby to manipulate the price of property. Land costs alone rose from 10 percent of the final cost of a house to up to 50 per cent at the peak of the boom. The cost of road development was similarly grossly distorted by propertied interests (O'Toole, 2010).

Ideas and debates: why no-one shouted stop

The Nyberg Report identified 'a conspicuous lack of timely critical debate and analysis' by bank analysts and the public at large, aligned with a sense of complacency in the Government, other authorities, banks and customers as a particularly Irish aspect of the crisis (Regling and Watson, 2010: 5). Part of this may be attributed to the fact that Ireland had never experienced a serious property crash, and the sustained period of success led investors and regulators to become complacent. What was described as 'a national speculative mania' (Nyberg, 2011: 94) took place in Ireland as 'an uncritical enthusiasm for property acquisition …became something of a national

blind-spot' (Regling and Watson, 2010: 34-5). There was an almost unanimous consensus that growth could be sustained in this manner. Dissenters were ignored, dismissed, and on occasion belittled. Some were even dissuaded by the apparent continued success of the credit institutions. It was also alleged that some stayed silent for fear of attracting possible sanctions. The Nyberg Commission voiced a suspicion 'that there may have been a strong belief in Ireland that contrarians, non-team players, fractious observers and whistleblowers would be informally (though sometimes even publicly) sanctioned or ignored, regardless of the quality of their analysis or their place in organizations' (Nyberg, 2011: 96-7).

The group-think involved had many willing participants and few to offer strong counter- arguments. External assessments of the Irish economy noted their concerns about over-heating and property prices. But in the absence of a European regulatory authority, they were in no position to warn about the dire exposure of the banking sector, and the tenor of the comments was on the whole favourable (O'Leary, 2010). Advice from the Department of Finance lacked input from skilled economic and other analysts, and although an official inquiry by Canadian Robert Wright gave officials the benefit of the doubt, accepting their claim that they had issued verbal warnings despite the signal absence of documentary evidence to this effect, other commentators were not so convinced (Independent Review Panel - Department of Finance, 2010; Lucey, 2011).

This is not to say that there were no dissenting voices at all. The signs were clearly visible; some economists and commentators gave them vigorous voice. But the political leadership, on the whole, simply did not want to hear. Bertie Ahern dismissed the gathering criticism testily, saying 'Sitting on the sidelines, cribbing and moaning is a lost opportunity. I don't know how people who engage in that don't commit suicide because frankly the only thing that motivates me is being able

to actively change something' (RTE News, 2007). Yet later he insisted 'I can't remember anyone at any level telling me, "The banks are giving hundreds of millions of euros to developers, and they're borrowing this at short rates, so if anything happens to them, they're caught"... I know some people say "you should have asked"' (Mackay, 2012a). But what the markets knew, the politicians should surely also have known:

> On March 17, 2007, hedge funds launched attacks on weaker quoted banks, like HBOS and Anglo Irish Bank. They had spotted fatal flaws in the balance sheets. The share prices of Ireland's financial shares plunged as opportunists in the market exploited the folly of a few bankers living a lie. They could read fantasy balance sheets. And yet European banks kept shovelling money at the guys who had gone walkabout. A stockbroker's report at the same time described Anglo as 'a building society on crack'; even the normally sanguine NTMA boss Michael Somers admitted that he had limited his agency's exposure to Anglo. The warnings were everywhere, if the overseas bankers were looking for them (Ross, 2010).

Conclusion

The scale of the Irish financial crisis represents the destruction of a whole model of development that had evolved during the 2000s. Because of the guarantees provided by government to the domestic banks, it is also a catastrophe for ordinary Irish citizens. At the core of the disaster is the utter failure of the 'light-touch' model of regulation.

We have considered a variety of explanations for the disasters that overtook the Irish banking system. Market-based corporate governance disciplines proved ineffective, and codes of practice associated with good corporate governance provided little resistance to the incentives to increase

risky lending practices. While the structure of the regulatory system and the powers and resources available to the financial regulator were contributory factors, a more fundamental problem was that tougher regulation was not viewed as either necessary or desirable, either by the regulator's office or indeed by government itself. The reasons why the regulatory failures took the form they did cannot be understood without acknowledging that this approach to regulation was tacitly endorsed by government and state officials themselves. The failures of the Irish financial system reflect the limitations of a particular approach to regulation. But a deeper truth emerges, which is that during a critical period in the 2000s, government priorities were more attentive to the interests of the bankers, the builders, and property developers, than they were to considerations of good governance.

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