Yale SCHOOL OF MANAGEMENT
Program on Financial Stability

Lessons Learned Oral History Project Interview

Interviewee Name and Crisis Position	Patrick Honohan Governor, Central Bank of Ireland, 2009-15
Interviewer Name	Maryann Haggerty, Interviewer Yale Program on Financial Stability
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Introduction:

Patrick Honohan, an economist, was governor of the Central Bank of Ireland and a member of the Governing Council of the European Central Bank (ECB) from September 2009 until November 2015. Early in his tenure, he led a team that investigated the causes of the Irish banking crisis that broke out in 2008 during the Global Financial Crisis. Resolving the problems of bank failure and over-indebtedness that emerged in that crisis dominated his term of office. In late 2010, Ireland had to request financial assistance from the "troika" of the International Monetary Fund (IMF), the European Commission, and the ECB. The resulting €85 billion rescue program helped stabilize the economy, which returned to growth after 2012. His book, *Currency, Credit and Crisis: Central Banking in Ireland and Europe* (Cambridge University Press, 2019) analyzes the crisis in detail.

Honohan, whose research has focused on financial crises and on monetary and fiscal sector policy, has worked for the World Bank, the IMF, and Irish public sector, and research organizations. He served as an economic advisor to the Taoiseach (Irish Prime Minister) in the 1980s. Immediately prior to his term leading the Central Bank of Ireland, he was a professor of international financial economics and development at Trinity College in Dublin.

At the time of this interview in February 2021, Honohan was a nonresident senior fellow at the Peterson Institute for International Economics and an honorary professor of economics at Trinity College.

This transcript of a Zoom interview has been edited for accuracy and clarity.

Transcript

YPFS: **Just to set the stage for this discussion, we're going to focus on lessons learned through the Global Financial Crisis, and then the ensuing years, from your perspective in Ireland. For most of your career, you were an economist in positions that include the World Bank, the International Monetary Fund (IMF), and also an advisor to the Irish prime minister back in the 1980s. You worked at the Irish National Economic and Social**

Research Institute. You were and are on the faculty at Trinity College in Dublin.

In 2009, you were named governor of the Irish central bank, and your appointment came after the national and international financial events that came to a head in mid-2008. In Ireland, the government on September 30, 2008, guaranteed the liabilities of the nation's major banks. Eventually, two of those banks were nationalized. The nation was still in a deep recession, and the financial system continued to need government backing. Is that an accurate broad picture of where we are in 2009?

Honohan: Pretty much. The Irish banks were even a bit worse that you said, because only one of them managed to stay out of majority government hands right through – so that one was a little bit lucky. But other banks ended up either withdrawing from the market altogether, as did the foreign banks, or majority government.

YPFS: Ireland took on a full guarantee of the bank liabilities, unlike a lot of other countries. Looking back at the decade between then and now, what can you say about the decision to guarantee the liabilities of the banks, and about the risks the government took on with that policy?

Honohan: Yeah, well at the time, of course it was seen as a very dramatic and vigorous policy by a triple-A country. "We're a triple-A country, we can guarantee anything." And in fact, that's the way it was taken up in many other countries around Europe, who were also facing difficulties in their banking system. This was just two weeks after Lehman Brothers, and all of the banking systems were in trouble, and the sense that, as I've been told by many of the participants in other countries, they said, "Wow, Ireland's guaranteed all their banks, we're going to have to do the same too! Because this is setting the scene."

But very soon, the attitude changed. When people realized, "Actually, the position of the Irish banks is much more grievous, relative to the size of the population, than in most of the other countries, and this guarantee could cause terrific problems."

Not clear the Irish government had any good options at that point; the Irish banks had relied very much on borrowing in the international financial markets, and these borrowings needed to be rolled all the time. And on the week of the guarantee, the banks had effectively lost access to those international financial markets.

Within days, not just one or two, but probably the whole system... Well, a few banks didn't need to roll for a while, but within a very short period of time, it was likely that the banks would not be in a position to meet the depositors' claims. They had even run out of the collateral that was eligible for the normal borrowing facility from the European Central Bank. That's the normal thing to do: you go to your central bank if you're short of... If you're a sound bank but you're just…the market doesn't trust you… You go to the central bank.

One option that wasn't seriously considered, but could have been available within the Eurosystem rules, was emergency liquidity, which could have been provided by the national central bank.

YPFS: **By that you mean the Irish central bank?**

Honohan: The Irish central bank, yes. But at that point, that would have been quite an unusual maneuver, and it wouldn't really have taken the government off the hook, because in order for a bank to secure such a loan, the Irish government would have been asked to countersign in some way or another.

The government might have done a few things around the edges of the guarantee to reduce the risk or the cost. They needn't have guaranteed the old debt. Debt which still had two, three, four years to run, and which had already been issued, why guarantee that? That's not going anywhere.

Also subordinated debt. Debt that normally ranks below depositors and other debt in the bank. They didn't need to guarantee that; none of that was coming due for a while yet. So, around the edges, they could have limited the risks to some extent. But… they were in trouble.

YPFS: **So, a year after that, in September 2009, you take over as Governor of the Irish central bank. How did that happen? What was the situation you were coming into, and what were your charges and priorities?**

Honohan: One of the things I'd worked on in my previous career had been banking crises: banking crises in developing countries and in other countries—historical events and others around the world. So I guess it was known that I was somebody who knew a bit about banking crises, and the minister for finance would have asked about people... Well actually, I did contact the Minister at one stage, about nearly a year before….well, seven or eight months before I was appointed, pointing out something that I thought was a flaw in a measure that he had proposed. And he obviously got interested in me as a potential successor to the retiring Central Bank governor.

Anyway, there I was landed with this... One of the weakest banking systems in the world. And with great uncertainty over, "How deep was the hole?" We knew that the property boom had taken the banks out of their comfort zone.

They thought they were in their comfort zone, but they weren't! And that had ended, well, already, at the end of 2007. Property prices were falling, because of the general downturn. And, because the property market had collapsed, the government's revenues were collapsing, and therefore the government's spending was being constrained, and unemployment was soaring.

The economy was in terrible trouble. Nobody knew who would be able to repay their loans. Even the banks didn't know because they had done such a poor job of documenting and underwriting those loans. So they didn't really know how good the quality of the collateral they had was, and the recoverability of those loans. So that was the first big task: "How deep is the hole?"

YPFS: **And just to clarify, in Ireland, the property bubble was mostly residential?**

Honohan: The property bubble in Ireland was very strongly residential. It was both a construction and a property price bubble. Property prices went up, and the more the prices went up, the more people wanted to get onto that property ladder, and the more the developers built. This was in contrast to a number of other countries, for example in neighboring Britain, where there was a property price bubble but there wasn't a construction bubble.

` The banks sank into a huge morass, because first they financed the developers. Then when the houses were finished, they financed the residential purchasers. And then the office market started, with the developers saying, "Oh, we could build offices as well, we can't just build houses because the place is coming down with houses. We could build a skyscraper in Chicago."

The Irish banks became a soft touch for every Irish developer who thought that they had that magic touch.

YPFS: **So, your first thing is, you're going to determine: "How deep is the hole?" Let's talk about what else you're seeing coming in, and what are your priorities at that point?**

Honohan: At this stage, what I felt was, first of all, let's not underestimate the problem because typically, in these kind of crises, at first people think—"it's not too bad, it's an upset, but it's not too bad". And then after some time, with more and more evidence of losses and loan losses and difficulties, there tends to be an exaggeration. It's quite difficult to determine what the scale of the problem is. You would like to capitalize the banks adequately to meet whatever losses might emerge. You would like to have a situation where the banks had a lot more equity capital, risk-absorbing capital, in their balance sheet. And obviously in the environment where loss of confidence was general, such capital could only come from the state.

The state had guaranteed the liabilities of the banks, but it hadn’t given them the wherewithal to absorb the losses. Unfortunately, over the previous year or so, the finances of the state had suddenly gone into a tailspin; whereas, as I mentioned, previously they had been at triple-A, and the debt ratio was extremely low. So, the ability of the government to source the funds to inject into the banks to provide that capital was now quite limited. So you couldn't just say, "Well, we don't know how deep the hole is, but let's throw in as much... Let the government throw in enormous amounts of capital, far more than could possibly be needed." That wasn't really an option, so you start having to calculate that impossible-to-calculate element.

One of the structural features of the approach that was adopted to resolve this banking problem in Ireland—and I also had a role in discussing that development—was the creation of an asset management agency, which would take the developer loans, not the residential mortgages, but the developer loans and any property-related loan from the banks, and centralize them, and process them. Take them off the banks' books, leave the banks to get on with curing the residential mortgages and dealing with their non-property related business. Get the banks back into supporting the economy. And the National Asset Management Agency, NAMA it was called, would take all these loans. Some of the big developers had borrowed from three, four, five banks. And now suddenly, all their debt was in one place (NAMA). And people could see how much debt they had, and the property assets which had been the collateral could be packaged and sold and processed. So this was not only going to clear away the old problem from the banks—though not helping the banks' shareholders as the loans were transferred at a realistic valuation—but arriving at that valuation was going to tell us what the losses are.

So, loan by loan, NAMA would evaluate these big property developer loans, and say, "Look, let's look at this, this plot of land, this half-built set of houses, this half-built office block? Let's go and evaluate those." Very time-consuming, and with the European Commission looking over their shoulders, because the European Commission was determined ... Indeed, I too was not keen that the banks would be bailed out, the banks' shareholders would be bailed out by the government through an overvaluation of these loans, that were being bought by NAMA.

So NAMA, that was the first few months as we at the Central Bank started to build up our capacity to understand what was going on, NAMA was also making these calculations that would enable us to know how much was needed.

YPFS: And they're resolving the loans by resetting them, writing off what has to be written off. Selling, securitizing?

Honohan: Selling them. Well basically, that is a parallel story which is not even finished today. They still have a few left to sell. But they got through a very large... They were claimed to be the biggest property company in the world at a time, I don't know whether that's strictly true. But they had about 30-something billion euros' worth of loans. Actually, the face value of the loans was 70-something billion, but, after taking account of the fall in property prices, they paid only about 30 billion to the banks.

This is real money; this is serious stuff. When you consider that the Irish economy at that stage, was an economy of 150 billion euros GDP, so you're talking about a substantial block of money there.

And you want to know how did NAMA deal with these loans and the assets backing them? Well, they held onto them for a while, and then started to sell into a favorable market (here I am rushing way ahead to 2012, 2013, 2014); they sold them into a rising market. Very much to private equity funds, vulture funds as they're known in Ireland. Indeed, the banks did that too with some of their residential properties. So a lot of the processing of distressed loans was done in that way, sold to private equity firms. Names that you know, Cerberus, Apollo, and all those people.

YPFS: With that, like you said, that's a whole different story. So let's get back to the Central Bank and the Irish banking system in 2009, 2010. You're finding out how deep the hole is, and...

Honohan: And appointing a new head of financial regulation. An English man who came to us with a lot of varied experience. Big surprise to have somebody from abroad to come into such a, if you like, politically sensitive area, as dealing with bank regulation, in a situation where the banks are teetering on the verge of insolvency. So, he was appointed, Matthew Elderfield, was appointed in January 2010, shortly after I came on board.

YPFS: One of the first things that you did, though, was a more backward-looking thing. You led an investigation into the regulatory and financial stability policies leading up to 2008, and you looked at the actions of the Financial Regulatory Authority, the Central Bank, and the industry. First, how did the approach of the investigation, in terms of designing the scope and outcomes, what was that? Were there conflicts inherent in the Central Bank investigating the Central Bank? How did you overcome those conflicts? And then we'll get to what you found, but let's first start with the process.

Honohan: You know, so as governor for the central bank I would appear before Parliament from time to time, and as I went to my first such meeting, I thought, "What can I say? What's new that I haven't said in public, what could I say that's relevant to the Parliamentarians?" And it actually was the advice of a friend, who said, "Wow, you guys are going to have to have some kind of inquiry. Why don't you mention this?"

I thought, "This is a brilliant idea, I will say to them..." And I said to the Parliamentarians at the Parliamentary Committee, I said, "I am sure that you will want to have some kind of inquiry about all this?" It was just one of the things that I said at that meeting. Well, I'm not sure that the Government were very happy with this idea, because the government had already been in office during the runup to the crisis.

But the Taoiseach, as you know the Prime Minister, he said, "Well, I think that's a very good idea, and Professor Honohan is going to have to do it." So he hoisted me with my own petard, so to speak. As you implied, it was, in a way, delicate because it was an investigation into the regulatory arrangements, and, in fact, into the Central Bank, because the financial regulator was an arm of the Central Bank. (It had a separate board but it was an arm of the Central Bank.) So basically, I was to investigate the organization that I was running.

Now, it wasn't actually as difficult as you might think, because actually, they knew they'd messed up. Many actually really welcomed the opportunity to speak about in what way they had messed up, or why they hadn't got... I think that was the sense. Morale, obviously, in many parts of the central bank was low because the Bank was being blamed, and rightly for a lot of what had gone wrong, I mean not all of the staff were to blame, but particular people in particular positions.

So, there wasn't as much pushback as you might have expected on that, or a conflict of interest. Actually, it gave a great mechanism to have me doing it, cut through a lot of the confidentiality, and the banking secrecy issues that normally arise in this sort of situation. If you had an outsider coming in, you know they would say, "Well, could I have this document?" Officials would have to respond: "Oh, no, under Section 33 AK of the Banking Act you can't." But as Central Bank Governor, I of course had full access to all necessary documentation. So that really allowed me to dig in around it and to be also quite explicit and detailed in the findings, although with the advice of lawyers they said, "Oh, maybe naming individual banks in your report is unnecessary? The message is clear, and you might... It just might cause problems."

And that's probably true that you don't want to get caught up in legal issues for years. So, all the names of people were turned into A, B, C, D, X, Y, Z, W.

YPFS: **And you did it as "Bank A", but then "Bank A" wasn't always "Bank A" later in the report?**

Honohan: That's right. It is not possible—some people thought, and probably still think that, "Oh, I know, that's that bank!" No, not necessarily, they're all rotated in different ways. I do have a little note of it just in case somebody wants to know in a hundred years' time, I do have a note.

YPFS: **The result of that investigation, which was called the Honohan Report, came out in 2010. It's 200 pages, plus appendices, and research, dozens of interviews. But, taking into account it's big, can you characterize some of the key findings, and then maybe we can walk onto what lessons you found there, that might help people going forward?**

Honohan: Well, I think possibly the most important finding was that the regulators had adopted a sort of deferential and trusting approach to almost all of the banks. They didn't really expect to find that a bank was doing something terribly risky, and going to get into trouble, and therefore they didn't find it. And even if they did find evidence, they didn't realize what they had.

To give an example, in late 2007, this is what I found: the central bank had realized, "Things are quite seriously wrong now, so let's find out what banks are lending to the big property developers." They took the five biggest property developers, well-known who they were, and the five biggest banks. And they asked each of the banks, " Tell us what you have lent to each of these five named companies."

They pooled the information, but they didn't really do anything with the startling finding that each of the banks grossly underestimated what the other banks had lent to their clients. So, off the top of my head, I can't remember the numbers, but it's something like, they would ask one bank, "Well, how much have you lent to this person?" The bank would answer, "Well, I've lent 200 million to him." They'd ask, "How much do you think other banks have lent?" The bank would say, "Well, maybe another 200 million?" But the other banks would have lent around 1,000 million.

YPFS: **Don't they want to see the balance sheet before they give me 200 million?**

Honohan: You'd think. You'd think. So these things were done more by word of mouth, with banks and regulators often assuming without sufficient verification that they were dealing with a very solid company. And I suppose that balance sheets are more complicated, and it's not just a simple and straightforward thing. The quality of the underwriting was very poor.

But, beyond the banks, my point about this special survey was that the Central Bank regulators, even when they found this dynamite information, did more or less nothing with it. They were too trusting.

Actually, it also reflected a sort of methodological approach to bank supervision, which had been championed in Britain as well, by the Financial Services Authority—or whatever they were called at the time?

This approach basically said, "We can’t get into the details of banks, what we should look at is the governance structure of banks, and if the structure of decision-making in the banks is orderly and follows a good procedure, then after all, the banks don't want to go bust. So, if we've checked that, we've checked enough to make sure that the banks don't go bust." And not looking into the business models of the banks or their financials in enough detail.

That regulatory methodology was taken onboard fully in Ireland. And then you could say, "Well, we're just going and seeing how your committees are structured, and whether there was proper reporting lines, and whether there's adequate documentation of approval of loans?" So, they never discovered what was going on.

That 2010 report went far and wide beyond the banks and the regulatory structure, into general society and Government's attitudes to the growing boom. Actually, the government had stoked up the boom with incentives for construction and so forth.

There was a sense that, for Ireland, which had had a long run of economic success from the early 1990s, nothing could go wrong, and this was just something that you should sit back and enjoy the boom. Whereas, from the early 2000s, what had been truly a good advance in competitive, export-driven growth had morphed into a property boom. The property boom was the economy by the mid-2000s. And that had not been fully absorbed by policymakers in Ireland.

For the 2010 report we dug into that to some extent. And then we dug into to some extent, into the banks themselves. It wasn't really our remit, it was another review committee, another person was asked to look at those issues of, "Why did the banks go so wild?" And I sort of regret that I didn't push harder at the time to... I did offer him support. I said, "Look, we [at the Central Bank] could do some digging into this question of understanding the banks for you, and feed it into you." And he -- and I could understand why -- responding, "Well no, I'd like to do my independent report."

But I think it would have been... Something that it still lacked, is that an understanding why the... I know one or two of the banks were run by buccaneers, but the big established, 200-year-old banks, how could they have got everything so badly wrong? We only glimpsed what actually went wrong in the banks. We know the decisions they made wrong, but we don't know why such clever, able people, the directors, captains of Irish industry, how did they get it wrong? We don't really understand that part.

Of course, the banks were caught up in the global boom of financialization. They had easy access to finance, especially since we joined the euro, interest rates very low, and they were making huge profits, and they were being told by analysts all over the world, "You've got the best banks, best risk management systems in the world." And all that sort of thing, so they believed it.

YPFS: And the risk managers are saying, "You've managed."

Honohan: Yeah, until it ended.

YPFS: So, you come out of this report on 2003-08, it's 2010. Irish banks are still in crisis. Let's look lessons as we move through history.

Honohan: Around the same time as the report was being written, so you're talking March, April of 2010, we made a first evaluation of how much capital the government would really have to put in. They had put in a little bit in 2009 already, but we knew that we needed more, especially for the bank that they had already nationalized, Anglo Irish Bank, which was the third largest bank. It ended up losing about 40 percent of its total assets. It is almost unheard of to have such a badly run bank.

But we knew that more capital would have to be put in. NAMA had made its first evaluation, so we'd hoped they'd have done most of the evaluations by the end of March, which was our deadline. But by then, they only had evaluated, maybe one-tenth of the portfolio. So we said, "Okay. These are the biggest loans, you've looked at the biggest loans, we know the loss ratio on the biggest loans. I suppose the biggest loans are going to be the ones with the biggest loss ratios? So let's assume, we have no basis for any other assumption, let's assume that that loss ratio is going to apply right across the system, and let's work out how much capital that is, to put in, to give a comfortable capital margin." Now, we were not overcapitalizing to the extent that we would have liked if the government had infinite amounts of money. But we were aiming for a comfortably safe amount, higher than the required international minimum.

And that's what we announced, on March 31. We said, "Here's the amount of capital that has to be put in." I can't remember off-hand what the number was. It was a big number, €20 billion, or something? And the government committed to putting that in, over a period of six months if the banks hadn't raised the money themselves.

Well, the problem then arose, and here we're starting to move into the summer and autumn of 2010, that led to the bailout by the IMF. What was happening during that period: NAMA was continuing to value the loans. And what they found for the smaller loans, the next tier down, was "Oh, actually, these are even worse."

YPFS: **Oh, great.**

Honohan: Ah, so the whole basis on which we had calculated what needs to be put in is not quite right. It's only a little bit short, little bit... Not too bad, but it's not nice, it's bad news, it's drip, drip bad news. And that drip, drip continued through the summer. There were announcements, sometime in August was the first one, then in September there was another one. That's fairly bad news to have two bad drops in a row.

At the same time, that initial guarantee, the September 2008 guarantee, was a two-year guarantee. And so it was coming to an end at the end of September 2010, and a lot of people out there were saying, "Wait a minute, the Irish government now is in a very serious situation. It's got to push in a lot of capital into the banks. We know how much they said in March and April, how much capital they had to put in, but it's got worse since then, so it's open-ended, we don't know how much capital they're going to have to put in. And, I wonder, are they going to actually honor that guarantee? Maybe they will just say, 'We're not going to.' So, we'd better pull out our money before the end of September, anyway."

So, the money started to flow out of the banks, accelerating during September 2010. They had got back into the market, thanks to the government guarantee. But now, there was a sense that a crunch was coming at the end of September. So, all that bad news... and the government's finances generally continuing to deteriorate, because the economy in general, and no tax revenues, and higher unemployment rates, and so on. So, by September, it was pretty clear to everybody that there was going to have to be some assistance, probably an IMF program. It's very unlikely that with that bad attitude and opinion about Ireland…

Our attempt to put a floor under it in March, April, with that initial capitalization, had failed. We had thought there was enough money, that we could probably make it through, but not if confidence was against us. So, from about September, it was pretty evident.

YPFS: **Before we go into the big bailout: You're at that point in 2010. Are there things that you've then learned that if you could have gone back to 2007, 2008, would have structured the first rescue differently?**

Honohan: Well, I mean I won't repeat what I said about, around the margins, that could have been done. Maybe use a little bit of emergency liquidity and use the time of the emergency liquidity to negotiate with the European Central Bank, and with other European political levels to say, "We've got a banking system in trouble here. We're in the European Union, are you not going to help us out? Because if you don't help us out, we could actually have to let these banks fail, and then you won't like that." So, there could have been some kind of hard-nosed bluff and negotiation vis a vis European partners, to see if they would chip in. I've suggested that. And most people who were there at the time (which I wasn't), say, "That's cloud cuckoo land, and nobody was going to help us." And they may be right. But it was worth more of a try than they gave it. The other thing, of course—okay, yes, one of the things I would do, would have done, is something that we did do, subsequent to the IMF program—which was to do a real root-and-branch evaluation of the financial condition of the banks. A much faster root-and-branch evaluation of the banks' portfolios than we were able to do on our own in the spring of 2010. And we can come to that in a minute. That's certainly something that I would have done.

And actually, around mid-2010 I remember some friends in the sort of international circuits of economists who know about these things say, "Why don't you get BlackRock, (the big investment firm, with a research and sort of consultancy arm as well), who had a track record in doing this in one or two other places very successfully, to do a deep dive on the banking system?" And I'm: "We're not in a position to do that. The Government is actually not now in a position to put any more money into the banks. On the contrary, all it wants to know is that it doesn't have to put money into the banks, because it doesn't have any money. It is losing access to the market."

YPFS: **So, we come to late 2010. Eventually, Ireland agrees with the EU and the IMF for an 85 billion euro rescue package. I think you only drew down 67 billion? Only 67 billion! So, what's going on leading up to this arrangement, what does Ireland want, and what do your counterparties want?**

Honohan: We drew it all down because the €85 billion was to include the Irish government's cash balances.

YPFS: **Ah, okay, thank you.**

Honohan: So, all of that money was actually drawn down, but... And partly, people... I don't know why people do things. First of all, some of the negotiators wanted to make sure that the Irish government would use their cash balances, which is not a good idea. Because it's always good to have cash balances, if you're trying to convince the market that they don't have any reason to worry about lending to you. However, that was only one of the lenders' thoughts. The big thought was, "We need to have a big package to convince the market that the IMF and the European institutions are behind Ireland, and there's no reason for investors to worry."

By some measures, it was the second largest loan ever made by the IMF. So this was big stuff, even for the IMF. In conversations I'd had in the previous weeks, September, October, with IMF, the people were saying, "We're not sure we have the headroom." Because they have limits on what they can lend. "We're not sure we have the headroom to deal with Ireland, and with whatever else is coming down the track." But in the end, they had enough money.

So, what were the negotiations like? The government people, of course, Minister for Finance that I was dealing with, wasn't all that excited about getting an IMF loan, because it's a loss of autonomy. A loss of sovereignty, as they say. But he actually felt that he could turn it to advantage, that he could say, "I'll take this as a standby. A standby. So I'll still be able to work on my own basis and it'll just be a kind of, a block of money there to be used in case of need." The IMF said, "Well, that might have been a good idea a year ago, but you're beyond that stage now. There's no standby, you're taking the money, you're going to take a loan."

So that was the first disappointing news. Second disappointing news was that the negotiators on the other side said, "Well, here's the sort of money that we're thinking about—65 billion and so on, and the way we're arriving at this is, we think you need to have enough money to cover your borrow..." I'll be oversimplifying this now, but, "You need to have enough money to be refinancing yourself for the next three years of the program, plus, we think you need another 35 billion to capitalize your banks to an ample extent." So, a little bit like the idea I'd had early on: put a lot of capital into the banks. But 35 billion is a big sum; are they saying we really need 35 billion more for the banks? Well actually, it did include some of the, what we had promised in March, that hadn't yet been put in, but we were rather concerned-

YPFS: **Were they trying to get the banks to the international Basel standards, or more, or what?**

Honohan: They wanted to go way beyond that. And of course, the global trend was to move up the standards, all the time. So nobody was now considering the Basel standards as being enough to convince the markets. In particular, of course, the only way you measure capital, is to know how much your assets are, and how much your liabilities are. Now the liabilities are clear enough, because you can see, people have deposits and bonds. But the assets, what are they worth? In a big downturn, you don't know.

At least NAMA had taken away, or was in the process of taking away, some of the banks' most doubtful assets. But still, you didn't know how good their remaining assets are. I mean, the loans to hotels, the loans to residential mortgages, the loans to small businesses, catering for the domestic economy, which was in a tailspin. So if you don't know what your assets are, you don't know what your capital truly is. You produce a balance sheet, but you really don't know how trustworthy those numbers are. And so, to pile on more capital just to be on the safe side is a natural thing to do—if you have the resources to do so.

But we were worried that they wanted the government to take on more commitments than it could afford... So, the lenders said, "Look, what we want you to do is to do another assessment of the assets, and therefore of the capital of the banks, a deep dive." And we did engage the famous BlackRock company, who I have to say were pretty effective. They didn't know the answer either, but they had a good sense of how much information you should pull from the banks. So they said, "The banks got to give you loan by loan information." Now, even in the United States at that stage, banks were not providing that level of detailed information to regulators. But they were able to say, and we were able to say to the banks then, "Okay, you must give us loan by loan data."

And they said, "Well we don't actually have that data; we don't collect it like that. I mean, we have done somewhere, but there's masses of documentation; we don't have it in a readily available form." "Well, if you don't have it, this is going to end up much worse for you, because you're going to have to put in even more capital, because there's an unknown there." Oh, suddenly, a couple of the banks were able to say, "Well, actually, if we do this and this and this, we can actually give you more or less what you're looking for."

And so now for the first time, we had a granular picture of the asset portfolio of the banks. Okay, you still don't know whether that supermarket chain is going to be able to repay the loan? But you know who has those loans, and what their nature is. And this data was analyzed with the help of a number of outside firms, with whose teams we integrated our own Central Bank staff with them, so that our staff at the Central Bank knew what was going on. Actually, I set up a special team of Central Bank data experts. I said, "Okay, I know you think you're out of the picture, but you're not. I want you to watch what BlackRock and the other consultants are doing. I want you to reverse engineer what they're doing, so that we can do it ourselves in the future." And that indeed has led to a much greater knowledge, lots of research papers enabling us to take more finely tuned policy decisions in subsequent years.

So, that whole business of digging deeper into the banks was one of the things that the IMF people wanted to insist on. And we agreed to. The banks didn't need 35 billion; they needed about half of that, but we didn't know for six months.

YPFS: **Would that sort of digging in be done outside of a crisis situation, without the IMF telling you, "You must do that"?**

Honohan: With our legal system, yes. Once the banks had built up their own systems to do it, they continued to do it, they continued to provide that information. Now, I do know that in other countries people say, "Well, I wish we had that kind of legal system, but you know this law says that banking secrecy..." And so on and so forth, and so it can be difficult in some countries. The legal autonomy of the commercial banks in some countries prevents it from happening. And it's possible that if they had any alternatives, and it wasn't a crisis, the banks might have said, "No." But it was a crisis, and it was life or death for them, so they said, "Yes." To the extent that they could.

The other thing of course, that the troika—as they were called because there were three entities, the European Central Bank, the European Commission, and the IMF—wanted was assurance from the government that they would bring their fiscal deficit down, over a period of time. And that, although the government would have rathered not bring it down… Governments hate having to cut back on public services and increasing taxes.

Nevertheless, it was understood: It's not the troika that are telling us this, it is the financial markets. We have been reliant on borrowing, we continue to be reliant on borrowing. If we can't get our borrowing down, they won't give us any loans at all, nobody will. Not the troika, not the markets. So we've got to find a path that allows us to manage this down in an orderly manner. And actually getting the money from the IMF loan was allowing spending programs to continue that would otherwise have had to have been axed, because the access to financial markets of the government was... Well it was almost at nil at that stage. So those are the early days of the program.

YPFS: **Now, you're going to be working through this for three years, because money's got to be paid back. But as we're still in the negotiation stages, did the lessons that you took from 2003 to 2008 come into play in 2010? And affect how you approached the bailout negotiations? Again, what we're trying to get here is lessons for somebody else who has to do this again.**

Honohan: I mean, we changed the whole way that we as regulators dealt with the banks. We were much more intrusive, and much more questioning of their business models, and demanding to be convinced that what they were doing was safe and was not going to mislead us as to their viability. So, that involved internal reconfiguration, restaffing of the regulatory function. Which was inspired by what we'd learnt from what happened in 2003-2008. But actually, the problems in banking during the later period 2009-13 were not so much, "Don't be making foolish loans." Because they were no longer making foolish loans. Actually, they were not making any loans at all.

The problem is, they weren't doing anything except filling in requests from us so that we could find out what they had. They weren't even collecting on, and dealing with the mortgage debts, and the other... They weren't sorting out the problem loans that they had. They were hoping that somehow, everything would come right. So you had huge rising loan delinquencies, people not paying or not fully paying their interest and amortization on mortgage debt. Very rapid rise in that. And banks more or less frozen in the headlights, like a deer, frozen in the headlights, with no mechanisms for taking a loan and saying, "Okay, I see your situation. I don't think you're going to be able to repay this. I think you're going to be able to repay a portion of this, here's a deal, if you agreed with this and this?"

That sort of negotiation was foreign to the banks; they weren't able to do it. They were afraid of giving write-downs to people, partial write-downs, because they assumed that everybody else would come and say, "My neighbor just got half of his loan written off, so I don't want to pay either." So, this became the difficulty.

They'd never had anything like this before. In previous times, there had been a very, very good payment discipline, because people could afford to pay. But as happened in the United States, the income levels at which loans were being given by banks had dropped during the boom, so you're lending to people who don't have much of a cushion, and were going to get into trouble, as well as people who actually have quite a lot of cushion.

So, loan recovery was a problem, trying to make sure the banks developed their capacity to deal with that, and so on. And then they also started to... Well, that was a big story, subsequently. They had kept such poor records. You see, when interest rates went up, just before the crisis, a lot of borrowers who were on tracker mortgages (whose interest rate tracked the European Central Bank's lending rate, or some other international lending rate) said, "Oh, this is terrible, interest rates are going up. I'd like to maybe get off this tracker and go onto a fixed rate at a lower rate for a while."

And then when that period of going off for a while ended, they saw that the tracker rates had gone down again to even lower levels than before, so they said, "Can I go back on my tracker?" The bank said, "Oh, no you can't go back on your tracker." "Oh, I thought I could?" "Oh, no, no, no, no." Because it didn't suit the banks at that stage to put them on a very low tracker. And the borrowers said, "But you never told me, 'Oh, no you can't go back on the tracker.'"

Subsequently, it turned out that banks in many, many, many cases exceeded their—there was an ambiguity that they hadn't told the customer, or they had told the customer and they were reneging on it. So there was a huge problem, which started to be dealt with in my time, but it's still not ... I think it's more or less finished now. Where the banks have had to give back huge sums of money to people who were overcharged, because they weren't put back on their admittedly very advantageous tracker rates. Some people even lost their houses over it, because they were put back on the high interest rate, couldn't afford to keep the high interest rate, lost their houses. Anyway, so the banks were not well run, then, before then, and during that period.

YPFS: **So, you've got those three years. How do the banks work through that? There's 85 billion that people want back?**

Honohan: Well, the banks got it. The banks, as I say got half of 35 billion, they got maybe 18 billion in capital.

Deciding how much additional capital had to be put into the banks on this second occasion (March 2011), was done in a more systematic and upfront way. We used the basis, the analytical basis that BlackRock and the other consultants had provided, and made a judgment, "This is how much we ought to put in." Put it into the banks, and the markets said, "Okay, we trust, we see you're being open with us, you've shown the methodology more or less, what you're doing... Not in any great detail, but you've shown the methodology. We trust what you're doing, we think you're serious people."

In other words, the government now became the, effectively, 100 percent shareholder of one of the two big banks. The government ended with only 16 percent of the second bank, a result which was managed because... Well, we might come to that in a minute. And the third bank was also 100 percent, for a while, government owned. So, the government put in that money; that wasn't repaid. It has not yet been repaid; the government still owns those banks in large part.

For the rest, the government worked down their deficit, brought it under control along the promised path. And of course, since the financial markets saw that that was happening, the financial markets said, "Oh, Ireland is back. There's no problem; we can lend to Ireland. What rate of interest? Well, not too much of a spread over the best rates of interest. Banks are sorted; government deficit is under control. We're going to lend to you, no problem. Crisis is over."

And so, very soon, and I think already we're talking—I'll mix up years now, but I think already we're talking 2013? The government is starting to pay back the IMF ahead of time. It doesn't pre-pay the European loans, because they are at much more favorable interest rates than the IMF loans. They're on a very long payment schedule.

YPFS: **So, was the package successful?**

Honohan: The package was successful, but I have to say one thing about it. Namely that, initially, the rates of interest were way too high. I know you've forgotten interest, there's no interest now, interest is zero now, but in those loans... The rates of interest were, in the first instance were something like 5.8 percent, roughly that, something like 5.8 percent. So that's not too bad, I remember in the 1970s when people were paying 15 percent. Yeah, but this was a huge block of money, and that was going to weigh on the government's finances and make it very difficult for the government's finances to come right.

And how did the troika arrive at the rate of 5.8 percent? Well, it arose because the IMF has their schedule, you can go online and see what the schedule is. And it depends... Each country has a quota, and if you're just borrowing your quota, then it's quite a low rate of interest. But if you're borrowing twice your quota, there's a tiered surcharge, and then if you're borrowing three times... And I can't remember how many times our quota... But we're up in a high level, and it's an IMF schedule, and the European lenders said, "Yeah, that's the schedule, IMF schedule, and since we haven't done lending like this before, we'll adopt that."

So, the interest rates were far too high, and most analysts, and internally ourselves, the senior civil servants and myself, we said, "This looks iffy. It looks not clear that the government can do what's necessary to bring it back on path." So I think this was a mistake on the part of the lenders. We, the officials, said to the government, "Go ahead with this loan because it's better than not doing it. Not doing it, means an immediate crunch on public finances. Doing it? If it's not going to work, we'll go back to them and say, 'Look, this isn't working.'"

And actually, within six months, partly because of what was happening in Greece—they had some of the same problem there, they were borrowing at too-high interest rates, the European finance ministers said, "We have to lower the rates of interest on our part of the lending to Greece." And of course naturally, the Irish minister said, "We'll have that too." And the Portuguese said that, "We'll have that too."

YPFS: **So, did they readjust it down?**

Honohan: They adjusted all the interest rates down. Right down, only a small margin over the best interest rates that the European funds were borrowing at. So that solved the interest rate problem, and, at the same time, that led to a huge surge in confidence. A few other things were happening at the same time. For example, the Bank of Ireland, the second commercial bank, they used that wave of confidence to sell shares to private equity firms in the United States and Canada. And that kept them out of government majority ownership, just at that moment, in the middle of 2011.

So, it was a good program, with that important flaw. There was another flaw. Actually, there were two more flaws. The second flaw was, that there were some debts of the banks, of the failed banks, Anglo Irish Bank which was the worst bank, and another one, which were old debts, old bonds, they had now come out of guarantee, they had been issued before the guarantee was made. They were guaranteed for two years, now they were no longer guaranteed. But they were falling due.

Some people thought, "Well, these banks are effectively bust, so why should these debts be repaid?" Now, there are some legal complexities, but if you've got smart lawyers, you're going to get around these legal complexities. And we felt we could get around those. But the IMF, ECB, Commission, said, "No. You do this, no loan." Why did they say that? Well, they were afraid of a spillover onto other banking markets in Europe. "If some big Irish bank is not paying its debt, then somebody's going to say, 'Well, what about an Italian bank, or a Portuguese bank? We don't trust any European banks, we just learnt that an Irish bank has not been paying its debt.' So, you're not going to do that."

Now, that might have made sense for the system as a whole, but it meant a block of money. Maybe three, four, five billion? Depending on how you would have done it. Which is not peanuts, which was to be paid basically by the Irish government, which was basically behind those banks. Not by Europe. If this is a problem for Europe, then Europe should have paid for that. But there wasn't any mechanism for imagining that. So, they forced the payment of this five billion, which would not have been done by the government.

In fairness, in the end, two, three years later, a complicated transaction with Anglo Irish Bank, which owed the Central Bank of Ireland a lot of money, that was all sorted out in a very complicated way using the structures of the euro system to make it very, very cheap for the government to honor that debt. And I think that the decision to allow that arrangement to go ahead was made by the Europeans because they realized that they had been on the wrong side of the earlier argument. I admit this is pretty complicated, but…

YPFS: Yeah. I'm watching the moral hazard move around the system that you're describing. And landing up with the Europeans taking it? Okay?

Honohan: The Europeans took it, in the end in that sense. Although some people said, "Well they should've taken a lot more." Partly as well, they, at that stage, 2013, "Look at the Irish. They've pulled things around. They can be trusted. We're okay with this. We might not really like it, but we're okay with it."

The third thing that was wrong with the program? And this could be important for the future, for future programs in other countries. One of the big issues, as we said at that time, was the uncertainty. "How bad is it going to be in Ireland? They still haven't bottomed it out." I'm talking about the end of 2010, "How bad is it going to be?" If that was the problem, then why wasn't the program, why didn't the program have a risk management component in it? For example, why did the program not envisage, "Okay. We'll insure, or even provide capital directly from Europe into the banks. Or insure the asset portfolio of the banks?" That way, the Irish government doesn't have to overcapitalize the banks, and Europe can easily afford to absorb any losses; it might make gains.

That kind of risk management element, we thought they might come up with something like that. And I put that to the negotiators, and they said, "Patrick, we come with loans, that's all we do: loans. And quickly now, make up your minds!" So, there was no appetite among the lenders to think about financial engineering on the wider front, that could have reduced the risk at a lower cost. And I think this could have been done for Greece as well.

YPFS: What lessons does the Irish experience hold for others in the international community, and other countries? The Greeces, the Portugals, the Italys of the world.

Honohan: Well, that's the one I would really point to. The big international organizations have the capacity to absorb risk, and loans are not the only instrument that can be used in such operations. You can have GDP-linked loans, or some kind of risk absorption like that. That has not been brought into any big program so far. There have been a couple of attempts, I suppose, but not from the IMF.

YPFS: Let's move closer to now, and talk about the 2020 coronavirus panics, the coronavirus crisis, and their effect on the economy and financial system. You can talk from an Irish perspective, you can talk from a European perspective. Did we learn anything relevant from the previous decade that carried through to this?

Honohan: Well, I think that the important thing is greater European solidarity. And that's certainly been evident in this crisis. We won't go into details about the mobilization of the block of funding to be used, mobilized by the European Commission and various European institutions, to be provided to the countries most adversely affected by the pandemic and most in need of that.

And that's something that just wasn't—it was talked about, but it was brushed aside at the time of the last crisis.

This time people say, "Well, this is a crisis, we're all in together, we're all hit by the pandemic." Whereas last time, some countries were treated as delinquents and others as well-behaved. And I think that was not a good way to proceed. This time there is greater awareness that there are spillover effects in Europe. If countries are in trouble, and if insufficient help is provided, then that spills over to economic performance more generally.

There are very technical things about the March 2020 money market disruptions. Which I really don't have anything to say on from the Irish point of view.

YPFS: **They're complicated.**

Honohan: Well, they are complicated, but they're also matters on which we can learn nothing from the Irish banking crisis. Although some of them spill over into Ireland, which has a big asset management, international asset management part of its financial system. So Ireland was not completely insulated from it. But they really don't have much to do with our experience in the Irish banking crisis.

YPFS: **So, your asset managers are buying Treasury repo, but your banks aren't doing that.**

Honohan: Yes, so they caught up in all that stuff. I could talk about that, but it would be…

YPFS: **No, no. I don't want to keep you here all day. I do want to hit one or two things before I let you go. One is currency. This came up in some discussions about Iceland and Ireland. I've heard people say that one of the ways Iceland was able to attack their crisis, which you couldn't do, was by controlling the currency. Can you comment on the limits that being part of the eurozone might have had in your approach to your crisis? Again, this is sort of a tangent.**

Honohan: That's more or less 70 percent wrong, I think. First of all, Iceland didn't control their currency, they lost control of their currency! But I suppose what people think is, "Well, the Icelanders had a devaluation, and that allowed them to make a quick recovery." Now, I would say the Icelanders did three things that were quite different from Ireland. On the currency front, yeah. The currency devaluation may have helped them, it may have helped in the recovery of the tourist industry, though I think there are other factors there, and we could talk about the Icelandic tourist boom for a long while, but it helped a little bit for that.

But what the currency movement did was to change the distributional effect of the Icelandic crisis. It meant that every wage earner shared in the loss of income in Iceland that was associated with the crisis. Whereas in Ireland there was no currency movement and no inflation surge. True, public sector workers did have pay cuts. They were mandated pay cuts, which surprises outsiders, but it is true that civil servants', public servants' salaries were actually lowered. But generally speaking, those who held their jobs did not suffer big losses in their real income.

In Ireland, loads of people lost their jobs, unemployment went to 15 percent, 16 percent I think, and there was massive emigration. So actually, unemployment in a way was higher, because the people weren't there to be counted because they'd gone to different places. In that way the distributional effect was felt by the people who lost their jobs, and to some extent by the public servants (though the public sector pay cuts were not all that great). But many other salaried people, and people who kept their jobs, didn't lose out. So the distributional pattern was quite different. And that is the main, I think, effect of the devaluation in Iceland.

The two other things that Iceland did were, they walked away from the banking liabilities. They even reneged on the deposit insurance scheme, as far as it applied to branches of Icelandic banks abroad. In effect, they said, "Well, sorry, we're not going to pay out to depositors in branches of these banks in London and... Sorry, we don't have enough money, we're not going to do it." And they just made no attempt. This was not a default of the government, which had no liability for the debts of the banks, but rather of the deposit insurance fund. So, the bondholders lost out.

That left the government’s finances much healthier in Iceland. At first, it seemed that the government's finances were still badly hit. The Icelandic banking system was much bigger in relation to the economy than the Irish one, much. And the losses were much bigger, I mean eight, nine times, something like that. So they couldn't possibly have paid all that stuff. They paid some, essentially covering Icelandic creditors, and this left the public finances stressed at first, but not as badly stressed as in Ireland.

And then the third thing that happened, which they hadn't really planned on at all, they had some exchange controls as part of their attempt to manage the currency after the devaluation so it wouldn't fall too far. And they discovered, after a couple of years, that some of the creditors of the failed banks were now entitled to assets which sat in Iceland, behind the exchange controls. So, these creditors were saying, "Oh, can we have our money, then?"

And Iceland was saying, "Sorry, exchange controls, you know, we're in a crisis, we can't..." So for several years, the creditors couldn't get their money out. And they started to think, "We wish we could get our money out." And eventually, to cut a long story short, the Icelandic government said, "Well of course, if you paid a contribution, a stability contribution to the state, we wouldn't have to do anything like impose a special tax on you." And that was what was agreed. A very, very large stability contribution, quasi-tax was paid. And that meant that the cost of the banking crisis, the cost of the losses of the banks to the Icelandic government, was nil in the end.

So, there's much more than the devaluation of the Icelandic krona. And the Icelandic krona devaluation had this distribution effect.

Now, there were some benefits for Ireland of being in the euro area. Having given that bank guarantee, how was Ireland going to meet the withdrawals from failing banks? In fact, the European Central Bank lent a lot—well at its peak, it was more than 100 percent of Ireland's GDP—to the banking system. So that was what kept stability in the Irish financial system.

A lot of the foreign-owned companies in Ireland, manufacturing companies, service companies, your Googles and your Intels and Microsoft, may have wondered whether they would be badly affected by the Irish banking crisis. But if you asked them, they would say, "Well, we haven't noticed. We haven't noticed, there's nothing... no problem, our banking transactions are okay." And this was deliberate policy of the official sector in Ireland, to convey the message that "There's a little problem in the banking and property sector. But the rest of Ireland continues in a stable manner."

And that couldn't have been done without the support, or without being in the euro area, and therefore being able to have money flowing from the European Central Bank. Even though it was only short-term money, and the ECB wanted their money back, and I could spend a lot of time moaning and complaining about the ECB's keenness to be first in the queue to get the money from the IMF and European funds.

But, in fact, though the ECB talked a lot, at the end of the day, they did provide the money. They kept saying, "Now, we don't want to do so much lending to Irish banks." There was even a famous letter—a very, very poorly planned letter from the President of the European Central Bank to the Minister of Finance a few days before the bailout loan was agreed. In this letter, he said, in effect, "Now, as far as the emergency liquidity that is being provided to the Irish banks, we will not approve its continuation next week unless you have agreed to the troika loan." The ECB shouldn't have done that.

But anyway, they always approved those loans in the end. And that kept the monetary situation stable.

YPFS: **Just to wrap up here. What lessons would you underline going forward for policymakers, regulators, others, that you can take from these really big, bad things that happened? And may happen? You've done a lot of work on crises of the past. You know they're coming.**

Honohan: You know, you have to have a lot of common sense in approaching a boom. Booms are risky things. Booms are when people have decided that they'll take a chance, and booms can end very badly. So, restraining overexcited financial institutions, overexcited politicians from getting overextended is the key. Then, if a crisis comes, it'll only be a small crisis. In Ireland, and in Iceland, and in Greece, and in Cyprus, these booms were allowed to continue well beyond... There were booms everywhere, but these ones were allowed to continue well beyond survivability. Even in the United States, people moan and complain, and they say, "Oh, the banks were bailed out." To which the answer can be, "Yeah, the US banks were bailed out, but actually, how much did it cost the public in the end? How much did it cost the federal budget?" Nothing, it was all paid back.

I'm not saying that that justified all the measures that were done, but it was... The over-lending situation in the US had not got anything like as bad as in Ireland in quantitative terms. And so, just a little bit of restraint can have huge benefits. Don't let things get out of hand. Be aware of the scale of possible collapses.

YPFS: **Looking forward, any other warnings, anything else you'd like to say before I let you move along here?**

Honohan: Well, I mean you asked about the pandemic, and of course, we don't know how long this is going to last, and we know that many, many firms all around the world are stressed, but... I don't know which country's most affected, but lots of countries are affected. Lots of firms affected, some firms not as badly affected as we thought at first. Some firms doing very well.

But there will undoubtedly be losses, which have not yet been fully recognized. And so there does need a stock-taking. And choosing the moment of stock-taking, because of course, we're at a situation where there are firms that had perfectly good business models, and which will still have perfectly good business models when the pandemic is over, but who now have accumulated debts which cannot be supported.

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