Oireachtas Committee on Finance, Public Expenditure and Reform

Wednesday, April 22nd, 2015

Opening Statement by Allied Irish Banks, p.l.c. -- Chief Executive

Chairman and Members of the Committee, once again thank you for providing AIB with this platform to give the Oireachtas – and the Irish public – a detailed update on the bank's progress. This is my fifth opportunity since I became AIB's Chief Executive at the end of 2011 to meet this Committee and, as you know, it is most likely my final meeting with you in my present role as I leave shortly to take up another position outside Ireland.

Our meetings over the past three years or so have been at times robust, but always constructive; these engagements allowed my team and me to explain as openly and frankly as possible our strategy to stabilise the bank and ultimately move to a position of sustainability.

Our discussions with your Committee informed, and helped frame, our subsequent decision-making. We did not always necessarily agree but we have held a common goal: to rebuild AIB from its distressed state after the crisis into a profitable bank, equipped to support the Irish economy; prioritise professional service for our customers; and, over time, seek to return to the Irish taxpayers the support they provided in such large measure.

With me today are the following members of my management team:

- Mark Bourke – Chief Financial Officer
- Bernard Byrne – Director of Retail and Business Banking
- Brendan O'Connor – Head of the Financial Solutions Group

I prepare to leave AIB in the confidence that the management team will continue to lead the bank towards delivering our strategic objectives, putting our customers at the heart of our business and playing a pivotal role in Ireland's economic recovery.

After a period of enormous transformation over the last 3 years, the bank's financial performance has improved with:

- Profits before tax in 2014 of €1.1 billion
- The bank's impaired loan balances reducing by 23% to €22.2 billion during the year
- Lending approvals of over €13 billion
- Progress made in reducing mortgage arrears with a 22% reduction in arrears for private dwelling homes in Ireland in 2014
- The bank in a position for the first time to make a €280m cash payment to the State on the Preference Shares

AIB's recovery over the last number of years has had to be a very fine balancing act. Most obviously, it had to be done in tandem with implementing solutions for customers in financial difficulties while protecting taxpayers' capital – and all the time attempting to return the financial metrics of the bank to sustainable levels both in terms of margins and the bank's cost base.

It is particularly appropriate that AIB has this forum, at this time, to set out its perspective in terms of a number of issues that are currently the subject of widespread public debate. We have already sent you detailed responses to your advance queries but I would like to highlight a number of issues.

Let me begin with mortgage interest charges, and particularly the Standard Variable Rate.

First and foremost, let me explain that AIB's mortgage pricing reflects consideration of the following points:

- the cost of risk attached to a loan
    - The impact of the recession on the mortgage market in Ireland triggered one of the highest loan arrears and default rates in Europe and unfortunately as a result, the level of risk in lending to Irish mortgage customers is proportionally higher than the rest of Europe and has to be factored into our pricing decisions
    - Thankfully this cost of risk is declining as economic conditions improve and arrears levels reduce. The bank remains focused on further reducing the level of arrears and impaired loans on its balance sheet in the coming period
- the operational costs involved in running the bank
    - The operating costs of running AIB were €1.4bn in 2014. This represents is a reduction of c.€0.35bn compared to 2012 levels following a significant reduction in headcount, general and administrative costs and progress towards a more efficient operating model
    - The Bank remains focused on ensuring the Group is run as efficiently as possible from a cost perspective while ensuring its

customer service levels are appropriate and its systems and processes are robust

- the cost of funding
    - The cost of funding for AIB, given its credit rating, is different to the simple average of other banks across Europe. The narrative that AIB is able to fund itself at the ECB base rate is simply not the case and is an overly simplistic assessment of a much broader set of circumstances
        - It is important to note that only 3% of AIB's funding is sourced from the ECB
    - The bank's funding costs have certainly improved over the last number of years and AIB remains focused on further reductions based on market conditions
- the need to generate sustainable and viable returns for shareholders
    - AIB, as a commercial and systemically important institution, must ensure that lending is at sustainable rates to ensure it is able to generate a return for shareholders but also to rebuild its capital in order to insulate against any future adverse shocks
    - AIB's net interest margin in 2014 of 1.69%, excluding ELG costs, increased in the year but was still below peer bank levels
    - Given AIB is currently 99.8% owned by the State, the vast majority of any profits generated by the bank are ultimately to the benefit of the State

- Incorporating lessons learned from the recent, painful past, the bank cannot return to a situation where its lending decisions are being undertaken on any basis other than a medium to long term view of sustainability and viability

Over the last number of years the bank has worked to improve all of these metrics in the context of creating a sustainable business model, capable of supporting economic recovery whilst also seeking to create an investable model so that over time the bank can start to return capital to the State. As a result of the bank's underlying positive performance and improvements in funding costs and the cost of risk, AIB, EBS and Haven in December 2014 implemented a number of reductions to mortgage rates. For example, the move meant savings of c. €330 per annum for customers with a Standard Variable Rate mortgage of c.€200k on a 25 year term. If that customer chose to move directly to the 2 or 3 year fixed rate option of 3.8%, this would have resulted in savings of c. €800 per annum. Importantly, the reductions we implemented benefited both new and existing customers.

Further rate reductions to AIB customers, existing and new, are something that my management team and I continue to consider. But it is critical to bear in mind just where this bank has come from. In just over a three-year period, AIB has moved from reporting multi-billion Euro losses to €1.1 billion in profit -- for the first time in a number of years in 2014. Considering all of the factors outlined above, when the appropriate opportunity arose late last year, we moved to cut variable mortgage interest rates for our customers.

We must maintain a balance between securing the bank's present and future financial health, preserving and building capital to fuel the economy and repaying the State the sums invested in the bank – while all the time providing our customers with sustainable lending rates in the market.

The bank is carefully monitoring all the variable components that influence interest rates and will act accordingly in favour of our customers where it makes commercial sense to do so.

I also want to refer here to the question of mortgage arrears. Apart from dealing with the commercial impact of distressed loans on the bank's balance sheet, we absolutely share your concerns at the societal consequences of the ongoing difficulties associated with legacy debt. Reflecting this concern, our trained staff deal with customers who continue to experience financial stress and we work tirelessly to arrive at sustainable solutions that will allow them to emerge from arrears. I have said it many times before and reiterate it again today, AIB aims to keep people in their homes where possible if customers engage with us.

With that as our primary motive, we have put in place what we believe to be the most comprehensive set of permanent arrears solutions in the market. Where there is no affordability of any form of mortgage repayment a loss of ownership may be the appropriate solution but we believe we have a very pragmatic approach to residual debt, recognising that one cannot restructure where there is no affordability.

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

Similarly, as we seek to protect employment and viable businesses, solid progress was achieved for those non-mortgage customers who typically have exposures across a number of asset classes including SME debt, associated properties and buy-to-let mortgages. At the end of last year, a total of €4.7 billion of non-mortgage loans were subject to forbearance and we continue to constructively engage to offer restructures to our customers in 2015.

The improving economic climate in Ireland is translating into an increased appetite for credit with growth in the personal, business and corporate banking segments of the market. In 2014 we approved over €11bn of lending in Ireland and our lending drawdowns to our customers were c. 42% higher than the previous year, including our mortgage and business customers. We continue to have capacity to lend and we remain focused on supporting our customers, jobs and the broader Irish economy.

These figures are reflective not only of the improving economic backdrop in our main markets of Ireland and the UK but also speaks to the underlying ability of the bank to lend prudently to our customers.

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

In summary, on behalf of AIB, I want to again express thanks to you for inviting us here today – and for the huge support the State has given this bank. On a personal level, I want to acknowledge the help of the Oireachtas in the course of my work as Chief Executive of AIB over the last 3 years. The bank will continue to approach, with vigour, the challenges ahead. As a public company with a commercial mandate AIB has to balance the requirement of generating value for our shareholders, most principally the Irish taxpayer, with the requirements of our customers who also need the support of this bank.

In summary, AIB today:

- Is a profitable business, generating capital for shareholders
- Has received EU approval for its restructuring plan
- Has passed the ECB stress tests
- Is reducing arrears levels and overall levels of impaired loans
- Is well positioned from a funding, capital and liquidity perspective to prudently lend over time and support the country's economic recovery

Thank you and we look forward to your questions.