

**DISCLOSURE OF DIRECTORS' LOANS IN COVERED
INSTITUTIONS**



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DISCLOSURE OF DIRECTORS' LOANS IN COVERED INSTITUTIONS

1. INTRODUCTION

The Financial Regulator has conducted a review of loans to directors and connected parties at six of the credit institutions covered by the Government Guarantee Scheme (“the Review”). The Review was instigated following the discovery of issues relating to the removal and reduction at year-end of directors’ loans at Anglo Irish Bank. It also sought to assess whether this practice might be taking place in any of the other covered institutions, namely Allied Irish Banks p.l.c., Bank of Ireland, EBS Building Society, Irish Life and Permanent plc, Irish Nationwide Building Society and Postbank Ireland Limited. Directors’ loans in Anglo Irish Bank are the subject of a separate, on-going investigation and Anglo Irish Bank is therefore excluded entirely from this report.

The results of the Review are summarised in this report. The Financial Regulator has decided to publish this report in accordance with its powers under Section 33C(5) of the Central Bank Act, 1942 (as amended) which provides:

“So far as consistent with Part II and this Part, the Regulatory Authority has power to do whatever is necessary for or in connection with, or reasonably incidental to, the performance of its functions.”

The Review focused primarily on the accuracy of disclosures in relation to directors’ loans in the financial statements of the parent institutions in accordance with the

requirements of the Companies Acts, the Building Societies Acts and IAS 24, the International Accounting Standard in this area. Details of the loan balances reported in the financial statements of each institution since December 2005 are set out in Appendix 1.

This report presents the findings and results of the Review to date and outlines the actions being taken by the Financial Regulator on this issue. Some further lines of inquiry are being pursued.

2. EXECUTIVE SUMMARY

- For each of the six credit institutions identified above, the Review involved an analysis of documentation submitted in response to a request from the Financial Regulator for data in respect of directors' loans for the period December 2005 to December 2008. This was followed by an on-site investigation to validate the data submitted and to assess the controls and procedures for the approval of directors' loans, the processes for the preparation of the disclosure of directors' loans and information on individual loan files. The Review also considered the adequacy of the process employed by external auditors when reviewing the disclosures in the financial statements.

- **Main findings:**
 - No evidence was found in the six covered institutions of the removal or reduction of loans at the year-end to avoid disclosure in the financial statements.

- None of the directors' loans was impaired, in arrears or otherwise non-performing for the period 31 December 2005 to 31 December 2008.
- All of the directors loans reviewed were in compliance with the financial Regulator's limit of 2% of own funds.
- Disclosures in annual financial statements for most covered institutions contained some inaccuracies during the review period, with some 10% of declarations signed by directors being incorrect.
- One institution was found to have omitted two small loans of less than €16,000 from the data submitted to the Financial Regulator in response to its letter of 24 December 2008.
- The Review found no evidence of loans other than loans that are available to all staff members (e.g. staff mortgages), that were issued with preferential terms.

Follow-up Actions:

- In order to deal with the findings of this Review and the issues that gave rise to it the Financial Regulator has introduced new disclosure requirements with immediate effect, to be made in the audited annual financial statements, regarding directors' loans and loans to connected parties of a director:
 - the amount owed at the beginning and end of the period covered by the financial statements;

- the maximum amount of the liability during the period;
 - the amount of any unpaid interest; and
 - the amount of any provision that has been made in respect of any failure, or anticipated failure, to repay all or part of the loan.
- These credit institutions will also be required to maintain a register of all such loans at their registered offices for review by shareholders.
- In addition, the Financial Regulator will:
- Require all credit institutions to improve their processes and systems in relation to the preparation of the disclosures of directors' loans.
 - Inform other relevant authorities of the issues arising from the Review that are of relevance to them.
 - Consider the appropriate action to be taken in the case of one credit institution that failed to disclose loans in the data submitted to the Financial Regulator in response to its letter of 24 December 2008.
 - Require all credit institutions to perform an annual reconciliation between the regulatory returns for directors' loans and the disclosures in financial statements.
 - Require all credit institutions in which issues were discovered in respect of the interrogation of loan databases to re-interrogate those databases for loans to their directors when the Financial Regulator's requirements have been implemented.
 - Review the limit on directors' loans of 2% of own funds with a view to reducing it.

- Require that all directors' loans should be approved by the group credit committee. Application for the loan should be made via the company secretary's office and the company secretary shall be kept apprised of all stages of the application and shall maintain comprehensive files in this regard. In addition any loan granted to a director that constitutes an exception to the credit policy shall require sign-off by the group chief executive. If the exception relates to the Chief Executive, it should be signed off by the Chairman. A copy of all exceptions should be forwarded to the Chairman of the audit committee.
- Require institutions to ensure that each director is fully informed and periodically reminded of their obligations with regard to disclosure of their loans and loans to connected parties and their responsibility to ensure that no inaccurate declaration is made when signing the annual disclosure forms.

3. SCOPE AND APPROACH

The purpose of this Review was to assess at group level whether loans to credit institutions' directors had been removed or reduced at year-end to avoid disclosure in the financial statements. In this regard, it also assessed the accuracy of the disclosures in relation to directors' loans in the financial statements. The Review began on 24 December 2008, when the Financial Regulator wrote to the chairman of each of the guaranteed credit institutions requesting details of loans to directors (including connected parties and investment vehicles) at each quarter-end from December 2005 to December 2008. Confirmation was required from the chairman that the normal loan approval process was followed and that the institution was satisfied that any

regulatory and public disclosures of directors' loans over the three-year period reflected the true level of such loans. In addition, credit institutions were requested to provide confirmation from the external auditors of procedures performed at each of the last three year-end dates to validate the accuracy of director loan disclosures and whether any issues or concerns had been brought to the attention of their Boards.

An on-site investigation was conducted during February 2009 to examine:

- Differences between the responses to the information request with data previously disclosed in the financial statements during the review period;
- The procedures for approval of directors' loans;
- The procedures for preparation of the disclosures of directors' loans; and
- The adequacy of the process employed by external auditors when reviewing the disclosures in the financial statements.

In the majority of credit institutions the on-site investigation examined all loans issued to directors that were identified in the response to the Financial Regulator's request for data on 24 December 2008. A sampling approach was adopted in two credit institutions as some directors held several small loans of the same type (e.g. car and equipment leases).

The on-site investigation comprised the following:

- Interviews with key personnel including, company secretaries, risk managers, loan officers and internal audit staff
- Review of directors' loan application files

- Review of the repayment schedules (or similar documentation) of directors' loans
- Review of directors' disclosure forms
- Review of communication files at the Company Secretaries' offices
- Review of policies and procedures relating to credit approval and the process for compiling disclosures.

Responsibility rests with the credit institutions and directors in respect of disclosure of directors' loans.

4. FINDINGS AND RESULTS OF THE REVIEW

4.1 Profile of Directors' Loans

All credit institutions subject to this Review provide loans to directors. The types of loan vary according to the business of the credit institution. Loans to directors are typically provided on the same terms and conditions as for other customers. Some credit institutions however provide a staff home loan scheme at preferential rates, which is also available to the directors.

Table 1 sets out summary data pertaining to directors' loans in the six credit institutions subject to on-site investigation. It should be noted that there is nothing inappropriate regarding the provision of loans to directors on commercial terms provided that there is adequate disclosure and, in particular, that institutions do not reduce loans at year-end to avoid disclosure in the financial statements. Our review found no evidence of such a practice.

Table 1: Profile of Loans to Directors and Connected Parties¹

	Total No of Directors (year end)	No. of Executive Directors (year end)	No. of Non Executive Directors (year end)	No of Directors with Loans (year end)	Largest Director's Balance Outstanding ²	Smallest Director's Balance Outstanding ³	Total Directors' Loans Outstanding ⁴
2006	56	17	39	21	€55,027,136	€124	€14,991,257
2007	71	20	51	24	€3,655,050	€792	€24,476,210
2008	70	20	50	26	€3,296,100	€1,347	€25,904,051

The number of directors at credit institutions at each year-end for the period covered ranged from 56 to 71⁵. In all years, less than half of directors held loans at their credit institutions. The data in this table is not directly comparable to the data in Appendix 1 as the Appendix is based on the financial year-end of the institution (which is 31 March in the case of Bank of Ireland) and the fact that some of the published financial statements contained inaccuracies.

Table 2: Analysis by Loan Type

Loan Type	Number of Directors' Loans (31 December 2005 – 31 December 2008)
<i>Residential Mortgage</i>	40
<i>Commercial Loan</i>	53
<i>Investment Loan (Shares, Funds etc)</i>	16
<i>Investment Loan (Property)</i>	11
<i>Credit Cards</i>	32
<i>Overdrafts</i>	13
<i>Residential Investment Property</i>	6
<i>Car Loan</i>	5
<i>Term Loans</i>	10

¹ Source: responses received to the Financial Regulator's request of 24 December 2008.

² The largest quarter-end balance for the year in question.

³ The smallest quarter-end balance for the year in question.

⁴ Total balance at year-end (31 December)

⁵ Postbank was authorised in 2007.

Table 2 sets out details of the number of loans per loan type held by the directors. The figures include loans drawn down but exclude undrawn facilities. The most common types of loan were residential mortgages and loans to businesses connected to a director.

4.2 Approval of Directors' Loans

In all institutions visited, the approval process for directors' loans does not differ from the normal loan approval process or the normal staff loan approval process if a staff home loan scheme exists.

The Review found some instances where approval procedures were not followed for directors' loans. These instances in the main involved the failure to seek a valuation for the underlying security.

4.3 Disclosure in the Financial Statements

The on-site investigation found inaccuracies in disclosures in financial statements.

These inaccuracies included:

- Loans to directors that had not been identified and therefore were not disclosed;
- Loans to connected parties that had not been identified and therefore were not disclosed;
- Incorrect balances on disclosed loans; and
- Loans included in disclosures that were not required to be disclosed.

The largest non-disclosure of a loan to a director amounted to €148,214 while the largest non-disclosed loan to a connected party amounted to €1.3 million⁶. Errors were discovered in 10% of the declarations of exposures signed by directors.

These errors are attributable to governance and control issues surrounding the preparation of the disclosures. In most credit institutions, preparation of the disclosures involves a search of loan databases to identify directors' loans. In some instances not all relevant loans databases were searched, or there were deficiencies in the search parameters that were used.

Table 3 provides additional data in respect of the loans to directors and loans to connected parties that had not been identified for disclosure in the financial statements and therefore were not disclosed.

Table 3: Loans not Disclosed in the Financial Statements during the review period

Loans not Disclosed	Number of Instances	Aggregate Value of those Loans	Largest Loan Balance	Smallest Loan Balance
Loans to Directors	6	€29,813	€148,214	€1,415
Loans to Connected Parties	10	€18,538,903	€1,300,000	€70,520

⁶ This was a loan to a business connected to a director.

Table 4 provides additional data in respect of the balances incorrectly quoted on disclosed loans.

Table 4: Incorrectly Quoted Balances in the Financial Statements

No of Instances	Largest Understatement	Largest Overstatement
5	€100,000	€75,289

4.4 Failure to Disclose

In one credit institution, the Review found two small loans of less than €6,000 each that were omitted from the data submitted to the Financial Regulator in response to its letter of 24 December 2008.

4.5 Regulatory Reporting

The Review examined differences between information provided to the Financial Regulator in quarterly returns of directors loans and the information published in the financial statements. However the information was not directly comparable due to differences in the definition of connected parties. Appendix 2 provides additional detail on the differences between the various requirements.

All of the loans reviewed were in compliance with the Financial Regulator's limit of 2% of own funds.

Two of the covered institutions had an arrangement whereby they submitted a return of directors' loans on an annual basis only. All credit institutions are now required to complete the quarterly return.

4.6 External Auditors

The general approach by external auditors when reviewing the disclosures in the financial statements in respect of directors' loans involves:

- Inquiries of management as to whether any transactions had taken place that required disclosure in the financial statements and management representations that this information was disclosed to the auditors;
- Review of relevant records;
- Review of the register of loans to directors;
- Declarations from each of the directors confirming their respective loan balances maintained on the register of loans to directors. In some cases a specific form is used for this purpose; and
- Agreeing the detail provided by the directors and the information provided by management to the disclosures contained in the financial statements.

This approach is complemented by audit procedures in other areas, which can provide further assurance over the completeness and accuracy of information provided by management.

No concerns about the accuracy of directors' loan disclosures were brought to the attention of the respective boards over the period of the Review. However, as our

investigation has identified a number of errors in disclosures across the institutions reviewed, we will discuss with IAASA how the audit procedures can be improved to provide greater assurance of the accuracy of the information disclosed, without having to rely to such an extent on management representations and directors' own confirmations.

5. ADDITIONAL CONTEXT

The issues that came to light in the case of Anglo Irish Bank have focused attention on an area that has traditionally been viewed as a low-risk area in credit institutions. This view would have been informed by the fact that institutions were required to disclose on an annual basis the aggregate amount of loans to directors and that such disclosures were subject to review by each institution's external auditors.

In addition, banks are required by company law to maintain a register of loans to directors and to make this register available to shareholders for a period in advance of the annual general meeting. Similar provisions apply to building societies under the Building Societies Acts.

The Financial Regulator has stipulated limits for credit institutions' loans to their directors. A credit institution's exposure to any one of its directors, including any exposures to any business in which the director has a major interest,⁷ may not exceed 2 percent of the institution's own funds,⁸ and the aggregate of all such exposures may not exceed 10 percent of own funds.

⁷ A major interest is defined as a holding by a person, either on his own or in concert with another person, of 10 per cent. or more of the shares or voting rights in an undertaking.

⁸ The regulatory capital of an institution.

The Financial Regulator's ability to report publicly on the outcome of the Review is constrained by the obligations imposed by (inter-alia) Section 33AK of the Central Bank Act, 1942 (as amended) and the EU directive 2006/48/EC (the banking directive). Therefore, this report can only provide information in summary and collective form.

6. CONCLUSION

The Review has found no evidence of the removal or reduction of loans at the year-end to avoid disclosure in the financial statements. However, the Review found inaccuracies in disclosures in financial statements in some of the institutions examined attributable to governance and control issues surrounding the preparation of the disclosures. The Financial Regulator views these omissions and inaccuracies very seriously and will be following up on these matters with the institutions concerned.

7. FUTURE DISCLOSURE REQUIREMENTS

In order to deal with the findings of this Review and the issues that gave rise to it the Financial Regulator has introduced new disclosure requirements with immediate effect, to be made in the audited annual financial statements, regarding directors' loans and loans to connected persons of a director:

- the amount owed by the person to whom the loan or agreement was made in respect of principal and interest at the beginning and end of the period covered by the financial statements
- the maximum amount of the liability during the period
- the amount of any unpaid interest, and

- the amount of any provision that has been made in respect of any failure, or anticipated failure, to repay all or part of the loan.

These institutions will also be required to maintain a register of all such loans at their registered offices for review by shareholders.

7.1 Additional Actions

In addition, the Financial Regulator will:

- Require all credit institutions to improve their processes and systems in relation to the preparation of the disclosures of directors' loans.
- Inform other relevant authorities of the issues arising from the Review that are of relevance to them.
- Consider the appropriate action to be taken in the case of one credit institution that failed to disclose loans in the data submitted to the Financial Regulator in response to its letter of 24 December 2008.
- Require all credit institutions to perform an annual reconciliation between the regulatory returns for directors' loans and the disclosures in financial statements.
- Review the limit on directors' loans of 2% of own funds with a view to reducing it.
- Require that all directors' loans should be approved by the group credit committee. Application for the loan should be made via the company secretary's office and the company secretary shall be kept apprised of all stages of the application and shall maintain comprehensive files in this regard. In addition any loan granted to a director that constitutes an exception to the credit policy shall require sign-off by the group chief executive. If the exception relates to the Chief

Executive, it should be signed off by the Chairman. A copy of all exceptions must be forwarded to the Chairman of the audit committee.

- Require institutions to ensure that each director is fully informed and regularly reminded of their obligations with regard to disclosure of their loans and loans to connected parties and their responsibility to ensure that no inaccurate declaration is made when signing the annual disclosure forms.

Appendix 1: Directors Loans as per Credit Institutions Annual Financial Statements

Loan Balance €m	2005	2006	2007
Allied Irish Banks plc	2.6	3.7	14.4
Bank of Ireland	28.5	74.0	9.7
EBS Building Society	0.3	0.8	4.4
Irish Life & Permanent plc	0.8	0.7	0.7
Irish Nationwide Building Society	0.9	2.0	1.4

Number of Directors with Loans	2005	2006	2007
Allied Irish Banks plc	6	7	8
Bank of Ireland	12	13	12
EBS Building Society	N/A	N/A	3
Irish Life & Permanent plc	2	2	2
Irish Nationwide Building Society	4	3	3

With the exception of Bank of Ireland, the annual accounts year-end date is 31 December. Bank of Ireland has a reporting date of 31 March which, for the purpose of this table, is shown for the prior year-end. (i.e. 31 March 2006 is included in 2005 data.)

In the case of EBS Building Society, their Annual Financial Statements do not disclose the number of directors having loans prior to 2007.

Allied Irish Banks p.l.c. reports separate details for quasi-loans (credit card facilities) in its financial statements. These details are not included in the tables and were as follows:

- 31 December 2005 €0.04 million (8 persons)
- 31 December 2006 €0.05 million (11 persons)
- 31 December 2007 €0.07 million (13 persons)

Appendix 2: Connected Party\Related Party definitions

Type of Person	Building Society Act	Companies Act	IAS 24	Regulator's risk exposure return
Director - Personally	X	X	X	X
Spouse	X	X		
Sister /Brother	X ⁹	X		
Daughter/Son	X ⁹	X		
Mother/Father	X ⁹	X		
Associated Body Corporate	X ¹⁰			
Controlled Body Corporate		X ¹¹		
Trustee of trust	X ¹²	X		
Close Family ¹³			X	
Key Management Personnel ¹⁴			X	
Controlled entities ¹⁵			X	
Significant Influence entities			X	
Jointly Controlled entities			X	
Companies in which the Director has a major Interest ¹⁶				X
Shareholders having control, joint control or significant influence			X	

⁹ The definition of mother, father, sister, brother, son and daughter includes step-mother, step-father and so on.

¹⁰ A Body Corporate is associated with a Director if he and his spouse, parent, brother, sister, child or trustee of a trust own between them at least one fifth of the equity share capital or are entitled to exercise more than one fifth of the voting rights at a general meeting

¹¹ A Body Corporate is deemed to be controlled by a director if he and his spouse, parent, brother, sister, child or trustee of a trust own between them more than half of the equity share capital or are entitled to exercise more than half of the voting rights at a general meeting

¹² A Trustee of a trust, acting in his capacity as the trustee, of which the beneficiaries include the director, his spouse or any of his children or a body corporate with which he is associated

¹³ Close family members of related parties has been defined in IAS 24 as family members who may be expected to influence, or be influenced by, the individual in their dealings with the entity

¹⁴ Key Management Personnel are defined in IAS 24 as are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

¹⁵ Subject to control, joint control or significant influence by Key Management Personnel or any close family member

¹⁶ The Financial Regulator defined a major interest as a holding by a person, either on his own or in concert with another person, of 10 per cent or more of the shares or voting rights in an undertaking.