REPORT ON INVESTIGATIONS INTO THE AFFAIRS OF

NATIONAL IRISH BANK LIMITED

AND

NATIONAL IRISH BANK FINANCIAL SERVICES LIMITED

BY HIGH COURT INSPECTORS

MR JUSTICE BLAYNEY AND TOM GRACE FCA

APPOINTED 30 MARCH 1998 AND 15 JUNE 1998

SUMMARY AND INSPECTORS' OBSERVATIONS

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Our work commenced on 30 March 1998, the date of our appointment to investigate the affairs of the Bank, and its scope was broadened on 15 June 1998 on our appointment to investigate also the affairs of National Irish Bank Financial Services Limited. In the initial stages of the investigations, we requested and received a large volume of documentation from the Bank. Preliminary review of this documentation, in particular the reports of Internal Audit, indicated that the Bank had a case to answer in each of the areas we were required to investigate.

We next initiated a programme of interviews, commencing with interviews of Bank staff; this had to be suspended, however, almost immediately, when Bank employees raised the issue of whether, when interviewed, they could refuse to answer our questions if there was a risk that their answers might incriminate them. This issue had to be determined in Court proceedings, which lasted until January 1999, and concluded with a Supreme Court judgement to the effect that interviewees could not refuse to answer our questions.

While these proceedings were pending we interviewed customers who had invested in Clerical Medical Insurance ("CMI") policies and further considered the documentation provided to us by the Bank.

Following resolution of the Court proceedings, we re-commenced interviews of Bank personnel, meeting initially with branch managers and thereafter with senior management, past and present, of the Bank.

Interviews with CMI policyholders and Bank personnel, together with review of reports prepared by the Bank relating to interest and fee amendments and to the sale of CMI policies, provided persuasive evidence of the existence of improper practices in each of the areas we were investigating. Extensive further work was however required to establish who was aware of, and responsible for, these practices.

Summary Conclusions – Improper Practices

Our conclusions on improper practices may be summarised as follows:

- Bogus non-resident accounts were opened and maintained in the branches, enabling customers to evade tax through concealment of funds from the Revenue Commissioners;
- Fictitiously named accounts were opened and maintained in the branches, enabling customers to evade tax through concealment of funds from the Revenue Commissioners;
- CMI policies were promoted as a secure investment for funds undisclosed to the Revenue Commissioners;
- Special Savings Accounts had DIRT deducted at the reduced rate, notwithstanding that the applicable statutory conditions were not observed;
- There was improper charging of interest to customers;
- There was improper charging of fees to customers.

At no time prior to our appointment did the Bank address the issue of a potential retrospective liability to the Revenue Commissioners for tax arising from the irregularities in the operation of DIRT.

Culture and Operational Environment

We consider it important to set the conclusions of our report in relation to tax evasion in the context of the culture of the period the subject of our investigation. This was highlighted in the report of the Committee of Public Accounts following their enquiry into DIRT, published in December 1999. The problem of DIRT evasion was an industry-wide phenomenon.

The operational environment in the Bank at the time has also to be taken into account and the behaviour of individual branch managers and staff must be viewed in this context. The branch network was target driven – there were, amongst others, targets for fee income and deposits, but limited support by way of systems or training to enable the achievement of these targets. Managers felt under pressure to meet these targets, in the setting of which they had negligible participation and which many considered unreasonable; they feared criticism and possible humiliation before their fellow managers if they did not meet the targets set.

While many branch managers operated, or played a part in, the improper practices, we have concluded that it would be inappropriate to find individual managers responsible, as we believe that responsibility for the practices lay at a higher level in the Bank. We must add also that we received no evidence that branch managers personally derived any direct financial benefit from the operation of any of the practices.

Summary Conclusions - Responsibility

We have concluded that responsibility for the improper practices which existed rests with senior management of the Bank during the period covered by the investigations.

It was their duty to ensure that the business of the Bank was so conducted that such practices did not occur and, if they did, that they were stopped immediately.

We have also concluded that the Head of the Bank's Financial Advice and Services Division, and a number of the financial services managers in that Division, were responsible for the promotion of the CMI policies as a secure investment for funds undisclosed to the Revenue.

We have also considered the discharge of their functions by the following:

- the Bank's internal audit;
- the external auditors to the Bank;
- the Audit Committee of the Board, and
- the Board of Directors.

We have concluded that, in respect of the matters under investigation, none of these were responsible for the improper practices which pertained. We are however of the opinion that both the external auditors and the Audit Committee were remiss in not requesting that management quantify the potential retrospective liability to the Revenue Commissioners arising from the high level of non-compliance by branch staff with DIRT statutory requirements reported by Internal Audit in December 1994.

The Attitude of the Bank

We wish to record that in the first year of our investigations we believed that we did not have the full co-operation of the Bank. The Bank's attitude during that period is illustrated by the Bank's reaction to our December 1998 interim report to the Court, in which we set out evidence received from investors in CMI policies, most of whom were at the time customers of the Bank. We made it clear in our interim report that we had reached no conclusion on this evidence, as we had not then heard any evidence from the Bank. Notwithstanding this, we were heavily criticised by the Bank, in correspondence conducted by the Bank's solicitors, for having prematurely made up our minds on the matters we were investigating. The Bank's criticism was described by Mr Justice Kelly, in a judgement delivered on 19 March 1999, as wholly unjustified.

Subsequently, the working relationship with the Bank improved. We had a number of helpful meetings with the Bank's Project Director, and with other members of the Bank's senior management.

At the Bank's request, in October 2000 we attended a presentation from senior executives of the Bank on changes in organisation, management and procedures since our appointment. We were informed that many of these changes would have taken place in any event as part of global developments in the National Australia Bank Group, but that there had been special emphasis on compliance issues in Ireland as a result of the news media reports of improper practices at NIB. The changes outlined at this presentation are summarised at Appendix 18. This summary was subsequently updated by the Bank as part of its response to our draft report – see below.

The Bank's Response to our Report

We delivered our draft report to the Bank on 1 August 2003. The Bank's response, dated 24 March 2004, is a brief Reaction Paper, supplemented by documents set out in seven schedules. This Paper is reproduced in full as Appendix 19.

In its Reaction Paper, the Bank does not take issue with anything in the report, apologises to all those who have been affected by the events which took place, and offers to discharge the Inspectors' reasonable taxed costs of the investigation.

The documents in the schedules set out the changes made by the Bank in the policies and controls relating to the matters the subject of our investigation, and indicate how customers deemed to have suffered loss as a result of the Bank's actions will be refunded or compensated.

The Paper also sets out details of costs amounting to Euro 64 million incurred by the Bank, or anticipated, in addressing the issues identified in the investigation. This total includes Euro 23.3 million in respect of customer refunds and compensation resulting from the investigation, and the Bank expects that there will be further payments on top of this figure.

Closing Observation

In order to form a balanced view of our findings, the report, together with the appendices, should be read in its entirety.

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PART 4: EVASION OF REVENUE OBLIGATIONS: SPECIAL SAVINGS ACCOUNTS

PART 6: THE PRACTICE OF IMPROPER CHARGING OF INTEREST

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APPENDICES

Appendix 12:	Copy model Investment Checklist to be prepared by FASD financial services managers in respect of single premium investment recommendations, with accompanying note from Patrick Cooney; copies, five completed Checklists.
Appendix 13:	Copy letter dated 30 July 1990 from Patrick Cooney to FASD financial services managers.
Appendix 14:	Copy report: "National Irish Bank: Unauthorised Interest & Fee Amendments", dated March 1999.
Appendix 15:	Copy Bank letter to the Inspectors dated 10 April 2001, outlining proposed further review of interest charges.
Appendix 16:	Copy memorandum from Dermott Boner dated 24 July 1992, with accompanying Form St 20 and guidelines for Management Time.
Appendix 17:	Copy Bank paper – Fees Review 2001.
Appendix 18:	Summary, Bank presentation on changes since Inspectors' appointment.
Appendix 19:	Copy Bank "Reaction Paper" dated 24 March 2004.

PART 1

INTRODUCTION

INTRODUCTION

APPOINTMENT OF INSPECTORS

On 30 March 1998, on the application of the Minister for Enterprise, Trade and Employment, the Inspectors were appointed by the High Court under Section 8 of the Companies Act, 1990 to investigate and report on the affairs of National Irish Bank Limited ("the Bank", "NIB") relating to:

(i) the improper charging of interest to accounts of customers of the Bank between 1988 and 30 March 1998;

(ii) the improper charging of fees to accounts of customers of the Bank between 1988 and 30 March 1998;

(iii) the improper removal of funds from accounts of customers of the Bank between 1988 and 30 March 1998;

(iv) all steps and action taken by the Bank, its directors and officers, servants or agents in relation to the charging of such fees or interest or the removal of any funds without the consent of the account holders and their actions arising from the issues when discovered;

(v) the manner in which the books, records and accounts of the Bank reflected the foregoing matters;

(vi) the identity of the person or persons responsible for or aware of any of the practices referred to above;

(vii) whether other unlawful or improper practices existed or exist in the Bank from 1988 to 30 March 1998 which served to encourage the evasion of any revenue or other obligations on the part of the Bank or Third Parties or otherwise.

On 15 June 1998, again on the application of the Minister for Enterprise, Trade and Employment, the Inspectors were similarly appointed to investigate and report on the affairs of National Irish Bank Financial Services Limited ("the Company", "NIBFSL") relating to:

(a) The effecting of insurance policies through NIBFSL with:

Clerical Medical Insurance Company Limited
Scottish Provident International Life Assurance Limited
Old Mutual International (Guernsey) Limited

(b) The role of NIBFSL, its officers, servants and employees in connection with the effecting of the said policies of insurance.

(c) The purposes behind the execution of the aforesaid policies of insurance.

(d) The knowledge of the management and board of directors of NIBFSL of the effecting of the said policies of insurance.

(e) The identity of the person or persons responsible for or aware of the effecting of or purposes behind the said policies of insurance.

Both Orders were amended on 31 July 2001. The effect of the amendments was to join the Bank in the Order of 15 June 1998 and make it, as well as the Company, the subject of that Order. The amendments also extended the list of insurance companies set out at (a) above to include CMI Insurance Company Limited, Clerical Medical and General Life Assurance Society and Clerical Medical Investment Group Limited.

Copies of the four Orders are set out at Appendices 1 to 4 to this report.

THE COMPANIES

National Irish Bank Limited was incorporated as Midland Montague Leasing (Ireland) Limited on 21 November 1978. It changed its name to Northern Bank (Ireland) Limited on 25 March 1986 and was licensed to carry on banking business by the Central Bank of Ireland on 28 April 1986, taking over the Republic of Ireland business of Northern Bank Limited on 1 July 1986.

On 31 October 1987 the share capital of the company was acquired by National Australia Finance (UK) Limited, now known as National Australia Group Europe Limited, a subsidiary of National Australia Bank Limited. On 15 April 1988 the company changed its name to National Irish Bank Limited.

National Irish Bank Financial Services Limited was incorporated as Northern Bank Trustee Company Limited on 12 January 1970. It changed its name to Northern Bank Trust Corporation Limited on 6 January 1976, to National Irish Bank Trust Company Limited on 15 April 1988, and finally to National Irish Bank Financial Services Limited on 3 November 1989.

National Irish Bank Financial Services Limited is a wholly owned subsidiary of National Irish Bank Limited.

MANAGEMENT STRUCTURE OF THE COMPANIES

The management structure of the Bank changed on a number of occasions during the period covered by the investigations. Organisational developments, insofar as they are relevant to areas the subject of the Inspectors' investigations and this report, are outlined below.

Summary

- The position of chief Dublin-based executive of the Bank was held by a number of individuals during the period, with differing titles.

- Reporting to the chief executive was a General Manager in charge of banking activities with responsibility for a number of areas including the retail branch network of the Bank; the title of this position also changed during the period.

- The executive in charge of the branch network had over the period a variable number of regional or area managers reporting to him; the titles and reporting lines of these individuals, to whom branch managers reported, changed on a number of occasions during the period 1988 to 1998.

- Separate from the branch network was the Financial Advice and Services Division of the Bank, set up in 1989 and headed by the same individual for the entire period covered by the investigation. He reported to the chief executive up to 1 January 1995, to the General Manager – Banking until 23 May 1997, and thereafter, up to the date of appointment of the Inspectors, to the Chief Operating Officer (see below).

- The Head of Audit reported to the chief executive up to 1 July 1991, then directly to the audit committee of the Board until April 1997, when responsibility for internal audit was transferred to National Australia Bank's European Audit function, based in Glasgow.

The Chief Executive

Jim Lacey was appointed Chief Executive of the Bank in February 1988, the appointment taking effect from 1 April of that year, and he held that position until 22 April 1994. Mr Lacey oversaw a number of changes in organisational structure during that period.

Barry Seymour was appointed Executive Director of the Bank on 22 April 1994 and held that position until 15 July 1996. He too introduced a number of organisational changes.

Philip Halpin became Chief Operating Officer of the Bank on 16 July 1996, holding this position at the date of the Inspectors' appointment. He reported to a Belfast-based Chief Executive – to John Wright from 16 July 1996 to 5 March 1997, and thereafter to Grahame Savage, Chief Executive at the date of the Inspectors' appointment.

Each of the above-named was on the circulation list for internal audit reports on branches while he held the position indicated.

The General Manager – Banking

Frank Brennan

Frank Brennan was appointed General Manager – Retail Banking in the management structure put in place in May 1988, shortly after Mr Lacey became Chief Executive. Mr Brennan had previously been General Manager (Operations). In both roles he had

charge of the branch network, reporting to the Chief Executive. Mr Brennan held this title until 1 July 1991, but on 1 October 1990, Dermott Boner (see below) was appointed Head of Retail, reporting directly to the Chief Executive in respect of the branch network, so from that date Mr Brennan was no longer directly responsible for the branches and from 30 September 1990 he ceased to be on the circulation list for internal audit reports on branches.

Mr Brennan subsequently held a number of other positions in the Bank:

- From 1 July 1991 Mr Brennan became General Manager – Corporate Services, retaining responsibility for Management Services (the Bank's information technology function); Internal Audit also reported to him in relation to administrative and operational matters in this role.

- Mr Brennan's title changed to General Manager – Administration on 3 May 1993, when he assumed responsibility for the Treasury and International Department (then headed by Philip Halpin) in addition to his existing duties. He retained this title and his duties remained largely unchanged in a reorganisation in December 1994.

- Mr Brennan's title changed to General Manager Risk Management and Administration in March 1996 "*to illustrate the emphasis we place on this element of his responsibilities*", according to Mr Seymour's memorandum to staff advising the setting up of a Risk Policy Committee.

- A reorganisation implemented by Mr Halpin in May 1997 saw Mr Brennan's duties unchanged, but his title amended to Head of Risk and Administration. Mr Brennan held this title at the date of the Inspectors' appointment.

Basil Noone

The late Basil Noone was General Manager – Banking from 1 July 1991 to 30 April 1993. A transferee from the parent bank, Mr Noone held no other positions in the Bank before or after his period as General Manager – Banking. During this time, Mr Noone was responsible for the branch network, with Mr Boner reporting to him in this regard. He was on the circulation list for internal audit reports on branches from August 1991 to February 1993.

At the time the Inspectors were interviewing present and former senior management of the Bank, they were informed by the Bank that Mr Noone, then retired and living in Australia, was extremely ill. He has since died. Accordingly, he was not interviewed by the Inspectors and because of this there is no finding in the report as to his knowledge of, or responsibility for, any of the practices under investigation.

Michael Keane

Michael Keane, formerly Head of Marketing (from 1 June 1988) became General Manager – Banking, with responsibility for Corporate and Retail Banking, on 3 May

1993 and held this position until 18 August 1996. There were several changes in the persons reporting to him in relation to retail banking during this period (see below). Mr Keane was on the circulation list for internal audit reports on branches from March 1993 to July 1996.

- Mr Keane became General Manager – Marketing and Distribution on 19 August 1996. He left the Bank on 23 May 1997.

Ken Windeyer

Ken Windeyer joined the Bank as General Manager – Banking on 19 August 1996 and held this position until 31 July 1997.

- Mr Windeyer became Head of Operations and Projects on 1 August 1997, his title subsequently being changed to Head of Operations and Programmes, a position he held at the date of the Inspectors' appointment.

Brian O'Driscoll

Brian O'Driscoll became Head of Personal Markets on 1 August 1997, in which position he became responsible for the branch network, the position of General Manager – Banking having been effectively abolished and replaced by separate executive positions in respect of personal and business markets. Mr O'Driscoll held this position at the date of the Inspectors' appointment.

The Regional Managers (including Head of Retail Banking, Head of Retail)

The management structure and the titles of the personnel to whom branch managers reported changed on a number of occasions during the period covered by the investigations.

- With effect from 1 June 1988, ***Dermott Boner*** and ***Kevin Curran*** were appointed Regional Managers, with responsibility for nineteen and twenty-two branches respectively; both reported to Mr Brennan, appointed General Manager – Retail Banking at the same time. Mr Brennan was assigned direct responsibility for five branches.

- On 1 October 1990 Mr Boner was appointed Head of Retail, reporting directly to the Chief Executive; to him reported Mr Curran and two newly appointed Regional Managers, ***Tom McMenamin*** and the late ***Michael O'Rourke***.

  By reason of the death of Mr O'Rourke, it has not been possible for him to be heard and accordingly the Inspectors make no finding in this report in relation to his knowledge and responsibility.

- From 1 July 1991, Mr Boner reported to Basil Noone, appointed General Manager, Banking at that time, while the three Regional Managers identified above continued to report to him.

- On 3 May 1993, Mr Boner became Chief Manager Retail. Mr McMenamin and ***Barry Grogan*** (a secondee from National Australia Bank) reported to him as Area Managers. Mr Curran retained his position as Regional Manager. Both Mr Boner and Mr Curran reported to the newly appointed General Manager – Banking, Michael Keane.

- A reorganisation effective from 1 January 1995 saw the retail business of the Bank once more divided into three regions, headed by Messrs Boner, Curran and McMenamin. They reported to Mr Keane.

- The retail business was again reorganised in February 1996, when following the retirement of Mr Boner, Mr Curran was appointed Head of Retail Banking, reporting to Mr Keane, and the retail business was divided into six areas, each the responsibility of an Area Manager. The Area Managers reported to Mr Curran up to the date of his retirement from the Bank on 4 July 1997, and thereafter to Mr O'Driscoll. This was the regional/area management structure in place at the time of the appointment of the Inspectors.

The Financial Advice and Services Division

Separate from the branch network was the Financial Advice and Services Division ("FASD") of the Bank, set up in 1989. This Division was responsible for the marketing of financial products, including those the subject of the investigation ordered on 15 June 1998. The executive in charge of this division, Nigel D'Arcy, reported to Mr Lacey as Chief Executive, and thereafter to Mr Seymour as Executive Director until 1 January 1995. From the latter date until 23 May 1997 he reported to the General Manager – Banking, and thereafter, up to the date of appointment of the Inspectors, to the Chief Operating Officer.

The FASD comprised a number of financial services managers, an investment manager and support staff, reporting to Mr D'Arcy.

While the financial results of the FASD were accounted for in NIBFSL, the FASD personnel were at all times during the period covered by the investigation employed by the Bank.

The Internal Audit Function

The position of Head of Audit was held by a number of individuals during the period covered by the investigations – Hilary Flood, Tim McCormick, Enda Carberry and Paul Harte.

The Head of Audit reported to the Chief Executive until 1 July 1991. From that date he reported directly to the Audit Committee of the Board, with reporting to the General Manager – Corporate Services in respect of operational and administrative matters. Responsibility for internal audit was transferred to National Australia Bank's European Audit function, based in Glasgow, in April 1997, at which time the audit approach and form of audit report were also significantly changed.

Review of branch audit reports prepared by the Bank's internal audit function was a significant element in the Inspectors' work; this is addressed in greater detail at page 17 below.

BACKGROUND TO APPOINTMENT OF INSPECTORS

Sale of CMI Insurance Policies

In January and February 1998 RTE television reported that NIB had been involved in the effecting of policies of life assurance on behalf of its customers with a number of companies in the Clerical Medical International Group ("CMI"), companies said not to be authorised under EU insurance legislation to carry on the business of life assurance in the State. It was later disclosed that in addition to CMI, policies were effected on behalf of its customers with Scottish Provident International Life Assurance Limited, with an address in the Isle of Man, and Old Mutual International (Guernsey) Limited, with an address in Guernsey in the Channel Islands, both similarly said to be unauthorised.

The key news media allegations were:

- Bank representatives gathered information on customers holding non-resident accounts, accounts in false names and customers with funds that had not been disclosed to the Revenue;

- The identified customers were invited to participate in an off-shore life assurance linked investment scheme with CMI;

- Most of the monies invested were redeposited with the Bank; for the account holders this had the effect that the nature of their original deposits, which in many cases was at the risk of discovery by the Revenue, was transformed;

- Senior managers in the Bank were aware that the off-shore investment scheme was being used to help customers evade tax, and

- Some senior managers of NIB encouraged customers to evade tax.

On 23 March 1998 the Minister for Enterprise, Trade and Employment, pursuant to the provisions of the Insurance Acts, appointed an authorised officer to examine the affairs of NIBFSL in light of these allegations.

Interest and Fee Charging Practices

On 25 March 1998 RTE television reported that employees of the Bank, under pressure to increase profits, had operated two distinct practices whereby improper charges were made to customer accounts.

The report claimed that interest charges had been increased, or "loaded", without

legitimate reason, and without customer knowledge, in four branches of the Bank – at Carndonagh, Carrick-on-Shannon, Cork and Walkinstown. The report added that although the Bank's internal auditors had identified the practice of interest loading at two of these branches, no refunds had been made to customers.

It was also alleged in the programme that customers' fees had been uplifted in the College Green branch of the Bank in November 1989 without customer knowledge or underlying justification.

Concern at these allegations prompted the Minister for Enterprise, Trade and Employment to apply for the appointment of inspectors to the Bank, under Section 8, Companies Act, 1990, and the appointment of the Inspectors was ordered by the High Court on 30 March 1998, as set out above.

Report of Authorised Officer

On 4 June 1998 the authorised officer appointed to investigate the affairs of NIBFSL reported to the Minister on an interim basis. From his examination of policy files of all persons who had purchased policies through NIBFSL in the period 1990 to 23 March 1998 from CMI, Scottish Provident International Life Assurance Limited, and Old Mutual International (Guernsey) Limited it appeared to him that:

- 282 policy holders might be in breach of Section 9, Insurance Act, 1936, and that the committal of these breaches appeared to have been assisted by persons employed by NIBFSL;

- The CMI product was promoted, to some limited extent, as a tax avoidance vehicle, and

- In the period prior to the removal of Exchange Controls in 1992, NIBFSL facilitated the movement of funds of Irish residents out of the country.

The authorised officer recommended to the Minister that his interim report be passed to the Director of Public Prosecutions for his consideration and that it be passed to the inspectors investigating the affairs of the Bank, so that they might consider whether they wished to broaden the scope of their investigations to encompass NIBFSL.

This did not become necessary as the Minister applied to the High Court on 15 June 1998 to have inspectors appointed to investigate the affairs of NIBFSL and, as set out above, the Inspectors were appointed to carry out such investigation.

ORGANISATION OF THE REPORT

From the time the Inspectors were appointed to investigate the affairs of NIBFSL in addition to investigating the affairs of NIB, both investigations were carried on in conjunction. While a separate interim report relating to the Bank was furnished to the High Court on 10 June 1998 and a similar report relating to the Company was

furnished to the High Court on 11 August 1998, all subsequent interim reports, dated respectively 17 December 1998, 29 July 1999, 27 July 2000, 3 December 2001, 17 July 2002 and 28 July 2003 related to both investigations. In addition, the matter was mentioned before Mr Justice Kelly on 4 November 2003 and on 4 February 2004, when the position in the two investigations at that stage was the subject of an affidavit presented to the Court. The matter was further mentioned before Mr Justice Kelly on 2 April 2004.

Following the established practice, this report also deals with both investigations.

The report deals separately with the improper practices investigated and the knowledge of, and responsibility for, these practices.

First addressed is the evasion of Revenue obligations, under three headings as follows:

Non-Resident Deposit Accounts	Part 2
Fictitious and Incorrectly Named Accounts	Part 3
Special Savings Accounts	Part 4

The sale of CMI and other policies is addressed in Part 5.

Improper practices relating to interest and fees are dealt with in the succeeding parts:

Improper Charging of Interest	Part 6
Improper Charging of Fees	Part 7

Each of these parts, insofar as is appropriate, deals with the Banks' systems and procedures, the development of the practice investigated, the evidence received by the Inspectors, and the Inspectors' conclusions on the existence of the practice.

The related issues of knowledge and responsibility of Bank personnel in respect of each of the practices are addressed in Part 8.

APPROACH TO RESPONSIBILITY

While the Inspectors are satisfied that many, but not all, branch managers engaged in the practices being investigated, they are nonetheless of the opinion that senior management in the Bank was responsible for the existence of those practices. Senior management had the duty to ensure that the practices did not exist and it was senior management that had the authority to put an end to them. The individual manager's authority was restricted to what happened in his or her branch. He or she cannot be held responsible for practices which existed across the branch network.

In the opinion of the Inspectors, the position of the financial services managers in the FASD was different from that of the branch managers. They were few in number, never exceeding six and mostly being only five, and they met regularly so that each

was aware of the practices and activities of the others. The Inspectors have found a number of these financial services managers, together with certain members of the senior management team, responsible for the promotion of the CMI policies as a secure investment for funds undisclosed to the Revenue.

LEGAL ADVICE AND COURT ACTIONS

The Inspectors engaged William Fry as their legal advisors. Assisted by Counsel, William Fry has advised on various issues arising in course of the Inspectors' work and has represented them in the Court actions referred to below.

Court Action – Concerns of Prospective Interviewees

At the commencement of their investigation of the affairs of the Bank the Inspectors wrote to all current or former employees of the Bank who had held positions at the level of manager or above within the Bank during the period covered by the investigation. The purpose of the letter was to request that they furnish to the Inspectors all information or documentation in their possession that might be relevant in any way to their enquiries.

Certain employees replied directly to the Inspectors. In addition the Inspectors received responses from solicitors acting for individual employees or former employees of the Bank who claimed that their clients, if interviewed by the Inspectors, would be entitled to certain rights, the most important of which were:

- the right to be legally represented,
- the right to advance notice of all questions to be put to them,
- the right to receive all documents concerning them, and
- the right to refuse to answer questions if the answers might incriminate them.

In view of the claims being made on behalf of the proposed interviewees, the Inspectors wrote to the solicitors who had made them setting out the procedures they intended to follow in conducting the investigation. The following is an extract from the letter sent by the Inspectors on 4 June 1998 to Mason Hayes & Curran, who represented 75 employees or former employees of the Bank:

1. ***Right to refuse to answer questions on the ground of self incrimination***

We have been advised that a person giving evidence to inspectors pursuant to Section 10 of the Companies Act, 1990 is not entitled to refuse to answer any question on the ground that the answer may tend to incriminate him or her. ...

2. ***Procedures to be followed***

We have explained that we consider that the first phase of interviews with witnesses will be an information gathering exercise. These interviews will be conducted in private. A transcript of the witness's evidence will be available

to the witness from the stenographers on payment of the cost of the additional copy. We have no objection to any witness being accompanied by a legal advisor at such interview but, with respect, we consider that it would be inappropriate, certainly premature and probably impossible to treat such interviews as approximating to a trial with an entitlement to attend and cross examine the evidence given by other witnesses.

There can be no question of our indemnifying your clients or any of them in relation to costs, whether legal or otherwise. Section 13 of the Companies Act, 1990 states that the expenses of and incidental to the investigation shall be defrayed by the Minister for Justice. We have no role to play in this regard and any question of costs which you may wish to pursue must be addressed to the Minister.

We do not propose to circulate lists of questions in advance of the taking of evidence from witnesses. Given the nature of our work, it will be impossible to predict with certainty what questions will or will not arise at any particular interview.

If, however, the outcome of the first phase of interviews indicates that it is possible that adverse conclusions may be drawn in relation to certain individuals dependent in whole or in part on the testimony of others, then it is our intention that a hearing will be held at which such issues can be addressed, and at which persons who may be at risk of an adverse finding will be entitled to attend to hear the evidence, cross examine the witnesses and give evidence themselves. In the light of these procedures, we consider it would be inappropriate and inconsistent with the statutory procedure to provide copies of the draft Report to witnesses and invite comments on it.

A letter in similar form was sent to the other solicitors who had written to the Inspectors. The Inspectors decided that the issues raised by the solicitors who had written to them should be determined as rapidly as possible since, if left uncertain, they would have resulted in continual delays. Accordingly, the Inspectors sought directions from the High Court pursuant to Section 7 (4) of the Companies Act, 1990 as to whether a right to refuse to answer questions on the grounds of possible self incrimination could be asserted by interviewees in the context of their investigations.

The Inspectors also sought a determination that the procedures which they proposed to adopt, as outlined in their letter of 4 June 1998 to Mason Hayes & Curran, were appropriate and proper for the purpose of the investigations.

The application for directions was heard on 10 July 1998 before Mr Justice Kelly who, by his Order of 11 June 1998, directed that the firms of solicitors representing employees and former employees be asked to agree amongst themselves on the nomination of one named individual to represent all of their clients and to nominate one firm of solicitors and one team of Counsel to appear on the hearing of the above-noted issues. A representative respondent was duly nominated and the matter came for hearing in the High Court before the late Mr Justice Shanley who, in his

judgement delivered on 13 July 1998, declared:

> *that persons (whether natural or legal) from whom information, documents or evidence are sought by the Inspectors in the course of their investigation under the Companies Act, 1990 are not entitled to refuse to answer questions put by the Inspectors or to refuse to provide documents to the Inspectors on the grounds that the answers or documents may tend to incriminate him, her or it.*

and

> *that the procedures outlined by the Inspectors in their letters dated the 4th June, 1998 [to Mason Hayes & Curran and others] are consistent with the requirements of natural and constitutional justice.*

A copy of the High Court Order is set out at Appendix 5.

The representative respondent lodged Notice of Appeal to the Supreme Court against the entire of the judgement dated 13 July 1998.

The Judgement of the Supreme Court was delivered on 21 January 1999 by Mr Justice Barrington, all of the other members of the Court concurring. The judgement upheld the decision of the late Mr Justice Shanley with the added proviso that "*a confession of a Bank official obtained by the Inspectors as a result of the exercise by them of their powers under Section 10 of the Companies Act, 1990 would not, in general, be admissible at a subsequent criminal trial of such official unless, in any particular case, the trial Judge was satisfied that the confession was voluntary*". The appeal against that part of the judgement of the late Mr Justice Shanley which approved the procedures which the Inspectors proposed to adopt was withdrawn, leaving standing his decision on this issue.

A copy of the Order of the Supreme Court is set out at Appendix 6.

Court Action – Scope of Enquiry into DIRT-related Matters

On 17 December 1998 the Dáil passed a resolution pursuant to the Comptroller and Auditor General and Committees of the Houses of the Oireachtas (Special Provisions) Act, 1998, which had been passed into law on 16 December 1998. This resolution provided *inter alia* that the Comptroller and Auditor General be requested to carry out an industry-wide investigation into the operation of Deposit Interest Retention Tax ("DIRT") by financial institutions and to furnish a report which would set out such facts and evidence as he deemed appropriate and would facilitate the efficient, effective and expeditious completion of the hearings by the Committee of Public Accounts into such matters.

One of the consequences of this resolution was that the Comptroller and Auditor General would be required to carry out an investigation into the operation of DIRT by NIB.

The Bank contended that, if the Inspectors were also to investigate compliance by the Bank with its DIRT obligations, this would result in a duplication of investigation and that it was "*unnecessary, wasteful and time consuming, both for the investigating*

authorities and for the Bank and the Company, because the same issue is being covered both by the Inspectors and by the Comptroller and Auditor General ... [when] both ... have all the necessary powers to conduct and complete a thorough investigation ...". The Bank accordingly sought an Order directing that the Inspectors should not engage in a DIRT compliance investigation of the Bank which extended beyond effecting such investigation as they considered necessary to report upon any issues of unlawful or improper practices that exist or existed in the Bank from 1988 to 30 March 1998 which served to encourage the evasion of any Revenue or other obligations on the part of the Bank or third parties or otherwise, and which related to the effecting or selling or marketing, in any capacity whatsoever, of insurance policies through the Bank and/or NIBFSL with the life assurance companies referred to in the Order of 15 June 1998.

The Bank's application was refused by Mr Justice Kelly on 19 March 1999.

A copy of the High Court Order is set out at Appendix 7.

Court Action – Access to Records of Isle of Man Branch

In September 1991 the Bank obtained a licence to operate a branch in the Isle of Man and this branch was available to receive deposits from 1 October 1991. On 1 December 1999, in the context of paragraph 2 (vii) of the Order dated 30 March 1998, the Inspectors wrote to the Bank requesting that they be provided with a listing of the deposit accounts at the Isle of Man branch of the Bank at 30 September 1992, such listing to include the name(s) on the account, the address(es) of the depositor(s) and the balance standing to the credit of each account at 30 September 1992.

The Bank responded that it had been advised by Isle of Man counsel that to supply the information sought without the protection of an Order of the Isle of Man Courts would expose the Bank to legal action in the Isle of Man Courts from account holders at its Isle of Man branch, on the basis that confidential information was being released by the Bank to a third party.

On 6 October 2000, the Inspectors brought a petition to the High Court of Justice of the Isle of Man pursuant to the Bankers' Books Evidence Act 1935 for an Order permitting inspection of the books of the Isle of Man branch of the Bank for the purpose of preparing a list of deposit accounts at that branch as at 30 September 1992, giving the details requested in the letter of 1 December 1999.

The Bank opposed the Inspectors' petition and on 27 April 2001 the petition was refused on the basis that the investigation by the Inspectors into the affairs of the Bank is not a legal proceeding for the purposes of the Bankers' Books Evidence Act 1935.

WORK DONE

Summary

The work in the investigations was carried out in two phases in accordance with the procedures which were approved in the High Court by the late Mr Justice Shanley in his judgement of 13 July 1998. The details of the procedures are set out above at pages 12 and 13. While the entire of Judge Shanley's judgement was appealed to the Supreme Court, the appeal against the part approving the Inspectors' procedures was withdrawn, so Judge Shanley's approval of their procedures remained unaltered.

The details of the two phases are set out below.

The First Phase

In the first phase, the Inspectors' work broadly comprised four principal elements:

- Examination of documents furnished to the Inspectors by the Bank on request and, to a lesser extent, documentation provided by other parties;

- Sworn oral evidence taken from present and former Bank staff and executives, customers of the Bank, and a number of other individuals considered by the Inspectors to be in possession of information concerning the affairs of the Bank or the Company;

- Discussions with officials of the Bank, both of a substantive and facilitative nature, and

- Evaluation of work which the Bank carried out in order to establish the factual position in relation to the allegations and to effect appropriate action.

The Inspectors also:

- Advertised their appointment in national daily newspapers summarising the terms of their appointment to investigate the Bank, seeking information relating to the practices being investigated.

- Corresponded and met with representatives of various State Agencies including the Revenue Commissioners, the Central Bank of Ireland and the Department of Enterprise, Trade and Employment.

The Inspectors did not investigate individual customer accounts, as:

- they were advised that the Bank had some 317,000 customer accounts as of 31 March 1998;
- such work would have been extremely time consuming and costly, and
- would have replicated work which the Bank had advised the Inspectors was to be undertaken by its staff, the results of which were shared with the Inspectors.

The findings set out in this report therefore do not include listings of improper interest or fee charges, bogus non-resident accounts, or branches ranked by reference to the incidence of improper practice. Detailed investigations carried out by the Bank, and the results thereof, are mentioned in the relevant sections of the report, but neither the Inspectors nor their agents participated in this work.

Review of Documentation

The Inspectors were assisted in their examination and interpretation of documentation by senior personnel from PricewaterhouseCoopers.

Particular emphasis was placed on review of internal audit reports on branch visits carried out during the period covered by the investigation, as they represent a contemporaneous record of the results of examination of branch procedures and records over that time. The Bank advised the Inspectors that a total of 202 branch audit reports had been prepared in the period 1988 to 1997, but that 38 of these were no longer available (20 in respect of 1988, 17 in respect of 1989 and 1 in respect of 1995). The Inspectors' review was perforce limited to the 164 reports furnished.

Interviews

All sworn interviews were carried out by the Inspectors; PricewaterhouseCoopers personnel assisted in preparing for interviews (particularly by way of identifying relevant documentation), and in following up matters arising from interviews.

A total of 235 sworn interviews was conducted in the first phase of the investigations, this total comprising 142 interviews with customers of the Bank (the majority of whom were investors in CMI policies), 87 interviews with present or former Bank staff, including senior executives and directors, 10 of whom were interviewed on more than one occasion, and 6 interviews with individuals falling into neither of these categories. A stenographer was present at each interview, and copy transcripts were made available on request to interviewees. Due to a Court action initiated by the Inspectors, required to clarify the position of interviewees and some ancillary matters (see above), with three exceptions, interviews with Bank personnel did not commence until February 1999.

Approximately 113 people held the position of branch manager during the period covered by the investigations. After interviewing 35 of these managers, the Inspectors were satisfied that they had received sufficient evidence to enable them to conclude that the practices being investigated existed.

The Inspectors have concluded that it would not be fair to name in their report the branch managers and Bank customers interviewed. Likewise, branch manager and customer interviewees quoted in the report have not been identified.

Numerous discussions were held with Bank executives in the course of the investigation. A number of these were of a formal nature, particularly in relation to reports prepared, and action taken, by the Bank. There were many other meetings on a less formal basis, directed at expediting progress in the Inspectors' work. In

addition to these direct contacts, there was extensive correspondence both with the Bank and its legal advisors.

Review of Actions Taken by the Bank

Fieldwork in review of actions taken by the Bank was carried out by PricewaterhouseCoopers personnel working to the Inspectors' direction. These reviews were followed by formal meetings with senior Bank personnel and by presentations from Bank executives in relation to actions taken by the Bank in the period following the Inspectors' appointment.

Authorised Officer - Acknowledgement

In conducting their investigation into the affairs of NIBFSL, the Inspectors had the benefit of sight of the report of the authorised officer Mr Cosgrove, and of discussions with Mr Cosgrove, whose assistance in expediting the initial phase of their investigation of the Company the Inspectors gratefully acknowledge.

The Second Phase

Individuals

After the conclusion of the first phase of the investigations, the Inspectors prepared their provisional findings and then wrote to every individual who could be adversely affected by them, setting out the provisional findings which affected the recipient and details of the evidence relevant to his or her knowledge and responsibility.

In this letter each person was invited to attend before the Inspectors for the purpose of making whatever submission or argument they might wish to present. In addition they were informed that they could give evidence themselves, call witnesses, and examine any witness if they so wished. They were requested to let the Inspectors know within fourteen days whether they wished to attend before the Inspectors or make a written submission.

Progress during this phase was very slow. It was not practical to impose strict time limits.

The Inspectors received numerous requests for documentation and for transcripts of the evidence of other persons interviewed by the Inspectors; consideration by the parties of material furnished on foot of these requests proved time consuming.

There were significant delays while individuals were making up their mind if they wished to cross-examine someone and, if they did, who it should be. Then, where cross-examination of a witness was sought, adequate notice had to be given to the witness, his or her availability confirmed, and a date fixed which suited all parties and, since there were altogether twenty four separate cross-examinations of witnesses, this part of the phase occupied a considerable amount of time. A number of individuals introduced expert witnesses; several also offered further direct evidence.

In addition, the Inspectors and their legal advisors had to deal with a substantial volume of correspondence from the lawyers of the persons involved.

Not all the parties to whom the Inspectors wrote in this phase of the investigations sought to cross-examine witnesses. With one exception however, all made written submissions, the majority supplementing these by oral submission through counsel.

As a result of the various matters referred to, this part of the second phase of the investigation took approximately eighteen months.

The Inspectors considered, at length and in detail, all matters arising during this phase – the points raised by the legal advisors of the individuals concerned, the testimony of witnesses cross examined, the evidence of expert witnesses, and the submissions, written and oral, made on behalf of the party. As a result, the provisional findings in respect of a number of persons were modified.

The submissions received on behalf of the different individuals were of such substance and variety that it would not be possible for the Inspectors to give their responses to each without inordinately increasing the volume of the report. The Inspectors have, however, taken fully into consideration the submissions of each individual before reaching a final conclusion as to their knowledge or responsibility.

In arriving at their conclusion in regard to any individual, the Inspectors relied solely on evidence notified to such individual and on any additional evidence adduced by the individual by way of examination or cross-examination of a witness or witnesses.

Where any conflict arose between the evidence of any individual and the evidence of a witness or witnesses which would support an adverse finding, the individual was given an opportunity to cross-examine such witness or witnesses, and the conflict was resolved by the Inspectors having regard to their view of the credibility of the individual and of the relevant witness or witnesses in the light of their cross-examination.

The Bank

Following the completion of their provisional findings in respect of individuals, the Inspectors, on 1 August 2003, furnished their draft report to the Bank. In their letter accompanying the draft, the Inspectors informed the Bank, as they had informed each individual to whom they had written at the commencement of the second phase, that in addition to making submissions either written or oral, or both, the Bank would be entitled to cross examine witnesses on whose evidence the Inspectors were relying, and to call further evidence if it wished. The Bank did not take up the option of calling or cross-examining any witnesses.

Following a number of preliminary meetings, on 24 March 2004, senior executives of the Bank, accompanied by the Bank's lawyers, delivered to the Inspectors the Bank's response to the draft report. The response is a document entitled "Reaction Paper" containing four and a half pages of text and seven schedules, which is reproduced in full at Appendix 19.

In this Reaction Paper the Bank does not take issue with anything contained in the draft report and does not seek any change in it.

The text of this report, therefore, is unaltered from that passed to the Bank on 1 August 2003, apart from this account of the second phase of the investigation as it relates to the Bank, the inclusion of the Reaction Paper as an additional Appendix and a number of references thereto in the text, some minor textual amendments, and a small number of deletions arising from the Inspectors' final review of the draft report.

In the Reaction Paper the Bank expresses its regret that during the period under investigation events took place which fell short of the standards customers and third parties dealing with the Bank were entitled to expect, and apologises to all those who have been affected by the events. The Bank describes the terms of the draft report as being of the utmost gravity and states that accordingly the Bank's view is that the taxpayer should not be liable for the Inspectors' costs and the Bank will therefore offer to discharge the Inspectors' reasonable taxed costs of the investigation, as recommended in the draft report furnished (see below).

The Reaction Paper also sets out how the Bank has responded, and is responding, to certain of the Inspectors' findings, and the changes the Bank has made to ensure that events of the type suggested in the original allegations could not recur.

At page 4 of the Reaction Paper, the Bank lists payments, incurred and anticipated, amounting to Euro 64 million, arising from the issues addressed in the investigations, of which Euro10.8 million relates to the Bank's ongoing "Offshore Investors' Settlement Programme" and Euro12.5 million represents refund and compensation payments to customers in respect of fees and interest. This latter amount includes anticipated additional refunds of Euro10.6 million arising from a programme of work and refunds devised in light of the Inspectors' views expressed in their draft report. This programme is described at Schedule V to the Reaction Paper.

RECOMMENDATION ON COSTS

Section 13 (3) of the Companies Act, 1990 provides that "*The report of an inspector may, if he thinks fit ..... include a recommendation as to the directions (if any) which he thinks appropriate in the light of his investigation, to be given under subsection (1)*" by the Court in regard to the payment of the expenses of and incidental to the investigation.

The Inspectors consider that their report should include a recommendation as to the directions to be given under subsection (1).

The Inspectors' recommendation, in the light of their investigation, is that the Bank should repay to the Minister for Justice, Equality and Law Reform the entire of the expenses of and incidental to the investigation.

PART 2

EVASION OF REVENUE OBLIGATIONS: INCORRECTLY CLASSIFIED NON-RESIDENT DEPOSIT ACCOUNTS

EVASION OF REVENUE OBLIGATIONS: INCORRECTLY CLASSIFIED NON-RESIDENT DEPOSIT ACCOUNTS

LEGISLATIVE REGIME

Position prior to the introduction of Deposit Interest Retention Tax

Deposit Interest Retention Tax ("DIRT") was introduced by the Finance Act, 1986.

Prior to the introduction of DIRT, under Section 175 of the Income Tax Act, 1967, a bank was obliged, if required to do so by notice from an Inspector of Taxes, to make and deliver to the Inspector a return of all interest paid or credited without deduction of tax, giving the names and addresses of the persons to whom the interest was paid or credited and stating in each case the amount of the interest. The statutory limit below which there was no reporting requirement for gross interest paid or credited on a deposit was IR£50.

However, if a person to whom any interest was paid or credited served a notice in Form F, on the bank:

(i) declaring that the person beneficially entitled to the interest was not then ordinarily resident in the State,

(ii) requesting that the interest not be included in any return under Section 175 of the Income Tax Act, 1967, and

(iii) undertaking to advise the bank without delay in the event of the person beneficially entitled for the time being to the interest becoming ordinarily resident in the State,

no return under Section 175 was necessary in respect of that interest.

Where the bank was not satisfied that the person who had served the notice in Form F was non-resident at the time the claim was made, it was obliged to request that that person provide the bank with an affidavit stating the name, address and country of residence of the depositor at the time the interest was paid or credited on the deposit account the subject of the notice in Form F served on the bank and, if the depositor was not the beneficial owner of the interest paid or credited on the account, giving like particulars in respect of the beneficial owner. The declarations in Form F were inspectable by the Inspector of Taxes on a named individual basis only.

Position after the introduction of DIRT

Following the introduction of DIRT, a bank, as a relevant deposit taker, is required under Section 32 of the 1986 Act to treat every deposit made with it as a relevant deposit and to deduct tax at the standard rate or, in the case of a relevant deposit held in a Special Savings Account, at the reduced rate in force at the time, from all interest paid or credited on the deposit, unless satisfied that the deposit is not a relevant deposit.

Excluded from the definition of a relevant deposit are, *inter alia*:

- A deposit in respect of which, up to 5 April 1995, no person "ordinarily resident" in the State is beneficially entitled to any interest (or after 5 April 1995 no person "resident" in the State) and a non-resident declaration in a form prescribed or authorised by the Revenue Commissioners has been made to the bank pursuant to Section 37 of the Act by the person or persons to whom any interest on the deposit is payable;

- A deposit by a charity the interest on which is exempt from income tax or, in the case of a company, Corporation Tax, and in respect of which a declaration pursuant to Section 38 of the Act has been made to the bank;

- A deposit made on or after 1 January 1993 by, and the interest on which is beneficially owned by, a company within the charge to Corporation Tax and in respect of which a declaration pursuant to Section 37B of the Act has been made to the bank, and

- A deposit made on or after 1 January 1993 by, and the interest on which is beneficially owned by, a pension scheme and in respect of which a declaration pursuant to Section 37B of the Act has been made to the bank.

During the period the subject of the investigation, banks were obliged to make a return to the Revenue Commissioners by 20 April each year detailing the interest paid in the year to the previous 5 April on which DIRT was exigible, and the DIRT in respect of that interest, and were obliged at the same time as the return was due to pay to the Revenue Commissioners the balance of the DIRT deductible for the relevant tax year, having taken account of any amount paid by way of interim payment on account of the DIRT deductible.

Non-Resident Declaration

The non-resident declaration made to the bank must be made by a person to whom interest is payable, must be signed by that person and must:

- Declare that the person or persons beneficially entitled to interest on the deposit up to 5 April 1995 is not or are not "ordinarily resident" in the State or thereafter is not or are not "resident" in the State;

- State the names, addresses of principal places of residence and the countries of ordinary residence or residence, as applicable, of the person or persons entitled to interest on the deposit at the time the declaration is made; and

- Contain an undertaking by the declarer that, if the non-residence conditions cease to be satisfied, the bank will be advised accordingly.

Before November 1993, when the Revenue gave a concession that a non-resident declaration would also serve to exempt interest on non-resident accounts from any

requirement to report it to the Revenue, it remained necessary for banks to hold a Form F for this purpose.

Summary

The relevant provisions of the Finance Act, 1986 in relation to non-resident deposit accounts held by individuals may be summarised as follows. If a non-resident Irish Pound denominated deposit account (or a foreign currency deposit on or after 1 January 1993) is to be excluded from the definition of a relevant deposit, and accordingly free from the obligation to have DIRT deducted, a bank must be satisfied that in respect of such deposit up to 5 April 1995 no person "ordinarily resident" in the State was beneficially entitled to any interest (and after 5 April 1995 that no person "resident" in the State was so entitled) and in addition the bank must hold a completed non-resident declaration form complying with the requirements indicated in the preceding paragraph (subject to certain transitional provisions in relation to foreign currency deposits).

NIB PROCEDURES

Prior to the introduction of DIRT, the Bank maintained accounts designated non-resident.

The procedures laid down by the Bank for the introduction and operation of DIRT were communicated to branch managers and other branch personnel in various ways, principally by way of Special Circulars. A summary of the relevant sections of the principal communications is set out below:

- Special Circular No. N13/86 was issued by Northern Bank Limited (to branches in the Republic of Ireland only) on 18 March 1986. This circular advised the introduction of DIRT with effect from 6 April 1986 and set out the manner in which non-resident deposit accounts were to be "flagged" at account level for DIRT purposes. It stated that the Bank's mainframe computer would examine all accounts on the system and would set the appropriate retention tax flags for each account category; retention flag "B" would be set on all accounts at that time designated as non-resident, with the implication that interest earned or credited on such accounts was to be paid without deduction of DIRT. Branch staff were required to ensure that the correct flags were set for any accounts opened after 4 April 1986.

- Special Circular No. S5/86 was issued by the Bank to all branches on 24 July 1986. This circular gave notice of the availability of declaration forms for non-resident deposit accounts to satisfy the declaration requirements of Section 37 of the Finance Act, 1986 and advised that such forms must be completed by 5 April 1987 for all non-resident accounts which existed at 5 April 1986, in default of which the account must revert to being liable to DIRT.

- Routine Circular No. R17/87 was issued to all branches on 1 April 1987, advising that all branches were to receive a report as at 6 April 1987 indicating the DIRT category of all deposit accounts. Branch staff were instructed to examine this report carefully and to ensure that the appropriate new declaration forms were in place for all accounts identified as not liable to DIRT, in default of which the account must revert to being liable to DIRT.

- Special Circular No. S9/93, issued to all branches on 11 March 1993, advised the branches of the introduction of branch Retention Tax Compliance Reports which, insofar as they related to non-resident accounts, required the branch to:

  - Examine all non-resident accounts flagged as exempt from DIRT to ensure that they were valid non-resident accounts and that non-resident declarations were held, and

  - Amend the DIRT flag so as to make liable to tax at standard rate all interest on any account where the requisite non-resident declaration was not held.

- In support of the implementation of the new LiveLink system (ie the Bank's main system for maintaining customer account details and transactions) on 3 May 1994, a LiveLink Reference Manual was issued to all branches. The introduction states "*It is imperative that all Branch staff read and familiarise themselves with the contents of this manual prior to the implementation of the new system.*"

  The reference manual introduced a new Non-Resident Monitoring Report to be produced on the working day after a static amendment had been made to any non-resident accounts at a branch. The purpose of the report was to highlight amendments on non-resident accounts which, *prima facie*, were inconsistent with the non-resident status afforded to the account and which therefore required further investigation by or under the control of a managerial official at the branch. This official was obliged to identify and record the reason for the amendment, to record his decision on the non-resident status of the customer and to attach both records to the relevant non-resident declaration form.

- Following consideration of the results of the DIRT Theme Audit described at pages 54 and 55 below, Special Circular No. S11/95 was prepared by the Bank's Finance and Planning Department and issued to all branches on 8 March 1995 under the signature of Frank Brennan, General Manager. The circular, which replaced all previous circulars in relation to DIRT, stated that "*DIRT must be deducted at the standard rate unless a valid declaration is held which has been signed, dated and in all other respects fully completed by the customer.*" The circular pointed to the responsibility of the staff member opening a non-resident deposit account to have a thorough understanding of the procedures for the opening of such accounts and to obtain fully and properly completed documentation on their opening.

  The circular also required that a person who wished to avail of DIRT-exempt non-resident status must produce documentation such as a driving licence, passport or

other identification with details of the person's address and signature as evidence of the entitlement to the non-resident status sought and that a photocopy of the identification documentation be retained on file by the branch.

- Special Circular No. S22/95, which was issued to all branches on 15 May 1995, introduced semi-annual DIRT compliance reports, to be completed by each branch manager and returned to the Bank's Finance and Planning Department. The standard-form report declared that the branch manager understood the contents of Special Circular No. S11/95 and either confirmed that the branch had proper statutory declarations on file for all accounts classified as DIRT-exempt non-resident accounts or, where a proper statutory declaration was not held, detailed the action which the manager proposed to take to rectify the situation.

  The circular also introduced a one page DIRT guide for use by cashiers and other branch staff which sought to summarise the contents of Special Circular No. S11/95 and included the following direction to branch staff:

  > *The official who opens the account must be fully satisfied that the customer is a non resident and I. D. must be produced before an account may be flagged non resident.*

- Special Circular No. S20/96 was issued to all branches on 24 April 1996. This circular, while emphasising that it was not the role of the Bank to give tax advice to prospective customers, set out the residency requirements for entitlement to non-resident status for DIRT and directed that:

  > *The bank should satisfy itself that the customer is a bona fide non-resident, documentary evidence should be produced e.g. foreign driving licence, passport, etc.*

- Special Circular No. S22/98 was issued to all branches on 7 December 1998, advising that a listing of all accounts at the branch designated as non-resident would shortly issue from Head Office. Each branch manager was required to examine all non-resident declarations, and, where the declaration was dated after 8 March 1995, the attached identification documents introduced by Special Circular No. S11/95, and certify by completing and signing a branch confirmation certificate that he/she was completely satisfied that all customers on the list issued from Head Office remained non-resident.

Inspectors' Criticism of the Special Circulars

The Circulars referred to above failed to inform branch staff expressly of the provisions of Section 32 (2) of the Finance Act, 1986, which require that a "*relevant deposit taker shall treat every deposit with it as a relevant deposit unless satisfied that it is not a relevant deposit*" – ie in the context of non-resident deposit accounts the Bank was obliged to treat every deposit account as an account in respect of which DIRT was to be deducted from interest paid or credited on the account, unless the Bank held a valid declaration from the depositor and was satisfied that the person

beneficially entitled to the interest was genuinely non-resident. It meant that the Bank was obliged to look at all non-resident deposit accounts on its books, since the provision applied both to existing and future accounts, and to deduct DIRT from the interest paid or credited on any accounts in respect of which it was not satisfied that the depositor was non-resident. This was never clearly explained to branch staff.

Because of this omission, managers seem to have believed, as appears from their evidence to the Inspectors, that, provided they had the declaration from the customer that he was non-resident, nothing further was required of them.

The first time that branch personnel were asked to concern themselves with the validity of non-resident deposit accounts was when they received Special Circular No. S9/93, which required them to examine such accounts "*to ensure that they are valid Non-Resident accounts and that non-resident forms are held.*" While this Circular required that non-resident accounts should be examined in order to ensure they were valid, the Circular did not specify how their validity should be tested. The Circular did not state, as it ought to have, that a non-resident account was not valid unless the Bank was satisfied that the person beneficially entitled to the interest on the account was non-resident. Furthermore, the only circumstance in which branch staff were directed to take action was if a non-resident form was not held. In such a case the non-resident flag was to be amended so that DIRT would be deducted.

Special Circular No. S11/95 introduced documentary requirements for the opening of new non-resident accounts. It required that before any new non-resident account could be opened, documentation had to be produced as evidence that the depositor was resident outside the State (e.g. a driving licence or passport or other identification with details of the person's address and signature). But there was still the same omission as before. Branch staff were not instructed that DIRT had to be deducted unless the Bank was satisfied that the depositor was non-resident. Because of this, an individual who was resident, but happened to have a foreign passport, or a foreign driving licence, would have been able to open a non-resident account. In regard to existing non-resident accounts, the circular was also deficient. The only direction given was that DIRT had to be deducted at the standard rate "*unless a valid declaration is held which has been signed, dated and in all other respects fully completed by the customer*".

Circular S22/95, issued on 15 May 1995, refers to a DIRT aide memoir prepared by Finance and Planning Department as a guide for use by cashiers and other branch staff. It is stated that it summarises the contents of Circular S11/95 but in fact it does more than that. It contains for the first time in any Bank document relating to non-resident accounts an instruction that "*The official who opens the account must be fully satisfied that the customer is a non-resident ...*" This instruction, however, concerns the opening of new accounts only. The Guide does not deal with existing accounts.

BRANCH MANAGER EVIDENCE ON OPERATION OF PROCEDURES

Present and former branch managers interviewed by the Inspectors have indicated that they did not believe there was any onus on them to check the veracity of the non-

resident declaration made by a customer when opening a non-resident account, and it was not their practice to do so. The procedure followed was to have the depositor sign the signature card, and complete and sign the form of declaration. The declaration was taken at its face value. The managers were under pressure to get deposits and did not question it. They considered the signature card and form of declaration was all that was required, and this remained the position until May 1995 when the Bank introduced account opening procedures to assist compliance with the money laundering provisions of the Criminal Justice Act, 1994.

Illustrative evidence from managers, which the Inspectors accept:

> *[Prior to the Money Laundering Act] if the customer came in and stated that he was from wherever he was from, ... we wouldn't have carried out checks to authenticate his address.*

oooOooo

Inspector: *When you were opening a non-resident account, what procedure did you adopt to satisfy yourself that the person was in fact a non-resident?*

Manager: *That they completed the form and signed it. I would say, being honest, nothing more than that.*

Prior to the Money Laundering Act there was no onus on the bank at that stage to produce [proof of identity] ... we took the word of the customer.

oooOooo

Inspector: *... did you feel that in regard to the form that you had to try and satisfy yourself that the declaration was reasonably accurate or, put in a more negative way, that you had no reason to believe that it wasn't accurate?*

Manager: *No ... They were signing the form, not you.*

oooOooo

Manager: *Just a signature card was all we required. Pre Criminal Justice Act 1994, all we needed at that time for a non-resident account was the declaration and signature card.*

Inspector: *Yes. And what was the position in regard to checking whether or not the person who was taking out the account was in fact a non-resident?*

Manager: *There was no obligation on me.*

oooOooo

We didn't open a non-resident account unless the person had a non-resident address and came in and said they were non-resident. Then, and this was before we had to have documentary evidence for opening accounts, you didn't query them to an extent because you were under pressure to get deposits.

oooOooo

If somebody came in to open an account and said they were non-resident and they signed the declaration, we accepted that. We didn't question them further.

oooOooo

The only time I saw pressure ... to do something with these accounts was in 1995 when Paul Harte in early 1995 [addressed the issue at an area meeting of branch managers.] That's when the pressure came on to close these accounts, up to that there wasn't [any pressure].

oooOooo

... if you had a customer that presented himself or herself to you as being a non-resident of the State, you were required to hold a non-resident declaration form, and in practice that's basically all that happened. If a person was completing a non-resident form, then generally speaking we didn't probe beyond that.

oooOooo

[Up until a couple of years ago] if a customer came in and signed a non-resident declaration generally that was sufficient.

oooOooo

As a manager I was delighted to see people coming in with over a hundred thousand pounds. I wouldn't be running around the streets to check if they were resident or otherwise but if he was a next door neighbour of yours or if he was lodging money every day of the week, there would be an onus on you then to do something about it.

ENQUIRIES OF BRANCH PERSONNEL BY SENIOR BANK MANAGEMENT

Just as the branch managers considered that what was required for the opening of a non-resident deposit account was the obtaining of the appropriate declaration, senior Bank management appear to have taken the view that the essential requirement for the validity of a non-resident deposit account was that the branch held the appropriate declaration in respect of it.

On a number of occasions between 1989 and 1993 Frank Brennan (the General Manager – Retail Banking to 30 June 1991, and thereafter General Manager – Corporate Services, and General Manager – Administration) wrote to branch managers about DIRT-free deposit accounts, and in the case of non-resident deposit accounts his request was always for confirmation that a non-resident declaration was held in respect of each non-resident account. This request was sometimes phrased slightly differently, being a request for confirmation that proper documentation was held for all non-resident accounts.

On 7 August 1991 Mr Brennan also wrote to the three Regional Managers – Kevin Curran, Regional Manager North West, Tom McMenamin, Regional Manager East, and Michael O'Rourke, Regional Manager South (with copies to Basil Noone, General Manager – Banking and Dermott Boner, Head of Retail) – on the subject of DIRT-exempt accounts, and in particular bogus non-resident accounts. He referred to the view of the Department of Finance that "a normal degree of care" is required of a bank in assessing whether a deposit is a relevant deposit or not, and stated "*It is vital therefore that all DIRT exempt accounts are supported by a properly completed declaration form.*"

On 11 November 1991, by way of follow-up to his letter of 7 August 1991, Mr Brennan again wrote to the Regional Managers requesting that they confirm to him "*that all D.I.R.T. exempt accounts are correctly documented*".

On 26 November 1993 Mr Brennan wrote to each branch manager reminding him of the procedures for opening non-resident accounts and advising him that he would shortly thereafter receive a computer printout listing all accounts classified as DIRT-exempt at his branch. Mr Brennan requested each manager to complete and return to him a certificate in the following form:

> *I confirm that proper documentation is held in respect of all non-resident accounts listed on print-out dated 2 December 1993.*

As noted above, Special Circular No. S22/95 introduced standard-form semi-annual DIRT compliance reports in which the branch manager declared he understood the contents of Special Circular No. S11/95 and either confirmed that his branch had proper statutory declarations on file for all accounts classified as DIRT-exempt non-resident accounts or, where a proper statutory declaration was not held, detailed the action which the manager proposed to take to rectify the situation.

From the approach adopted by senior Bank management, there appears to be no doubt that the emphasis was always on proper documentation being held in support of all non-resident accounts and this clearly influenced how branch managers understood their obligations in regard to these accounts. When branch managers were asked by Mr Brennan, or their Regional Manager, to confirm that non-resident deposit accounts were properly documented, or that they held the appropriate declaration in respect of all of them, they considered they were entitled to reply in the affirmative provided they held the relevant declarations, irrespective of the actual status of the account holder. In confirming that they held the relevant forms they were not vouching the validity of the information in those forms.

Evidence from branch managers to this effect, accepted by the Inspectors, includes:

Inspector: *... when you say "properly completed" does that ... mean that there was any effort made to authenticate the information on the form at that stage?*

Manager: *No, not as I understand it.*

Inspector: *So if, so effectively if you had a non-resident account form ... tick the box and move on to the next one?*

Manager: *I reckoned that was the end of my responsibility.*

oooOooo

My view on that is very simple: you put the question to me to confirm that all documentation was in order, that we held all documentation but was it that we held all documentation or that all documentation was in order? ... I can have every account in the place as a bogus non-resident account and so long as I have a non-resident form for each of them my documents are in order and held.

oooOooo

Inspector: *... what is it you believed that branch managers were being asked to confirm?*

Manager: *That they held completed non-resident forms in respect to every account.*

oooOooo

The use of the phase "all documentation" was to me a cop out. Your documentation might be right but that does not mean the account is right.

oooOooo

Manager: *The emphasis was on, have you a declaration for the account.*

Inspector: *... in relation to sending these back, once there was a declaration you sent it back, saying you had the declaration, it was not in anyway validating the authenticity of the declaration?*

Manager: *No, I don't think so.*

oooOooo

Inspector: *And the confirmations that you would send back, what was it that you were confirming? Was it that you held declaration forms or was it that you were confirming you held the forms and was* (sic) *vouching the validity of the information on those forms?*

Manager: *No, just that we were holding declaration forms.*

oooOooo

I would say it indicated we had a form for the actual account being there, the accuracy of it would not have been examined in detail. ... At all.

oooOooo

Inspector: *When you were signing that and saying that "proper documentation ..." does that mean you have a form for each non-resident account or that you have researched the facts as to whether the account holder is actually non-resident?*

Manager: *To me it would have implied that the form was held.*

oooOooo

My memory is that the focus at the time was purely on whether if you had X number of non-resident accounts, did you have X number of non-resident declarations to match those accounts.

... the bank's audit team and senior management focus purely on whether a declaration existed for a particular account or not ...

oooOooo

EXISTENCE OF BOGUS NON-RESIDENT ACCOUNTS IN THE BRANCH NETWORK

The Inspectors received evidence of the existence of bogus non-resident accounts in the branch network through interviews with Bank customers, interviews with Bank personnel at both branch manager and senior management levels, and from review of internal Bank correspondence and branch audit reports.

Bank Customer Interviews

In the course of interviews with persons who invested in the Clerical Medical Insurance ("CMI") Personal Portfolio policy (see Part 5), the Inspectors received a substantial body of evidence in regard to the existence of bogus non-resident accounts in the branch network. Most of the investors had been customers of the Bank and had had such accounts before making their investment. In some cases they stated they had opened the accounts on the advice of the branch manager, in others it had

been at their own request with a view to evading tax. In the case of most of the investors, they stated that the manager was well aware that they were not non-resident.

The Inspectors are satisfied that on this issue there is substantial agreement between the evidence of the customers and that of the branch managers. Illustrative evidence from customer interviews, accepted by the Inspectors, includes:

Inspector: *Was the deposit account with a Northern Ireland address held in [branch]?*

Customer: *It was in [different branch] first where [manager name] was but subsequently when he moved to [branch] I moved the account to there.*

Inspector: *So when [manager name] was in [different branch] you had the deposit account with a Northern Ireland address and when he transferred to [branch] you went with him?*

Customer: *Yes.*

Inspector: *When you had the deposit account in [branch] with a Northern Ireland address who suggested that you should invest in CMI?*

Customer: *[manager name] was the first person to suggest that there were advantages in meeting this financial advisor, Mr [name].*

Inspector: *Was it the position that the deposit account with the Northern Ireland address would be closed and the account opened with CMI?*

Customer: *Yes. I was anxious to get my money back. As a policeman I was getting worried about it, I was not happy about it and they were aware of that.*

oooOooo

Inspector: *What made you decide to put the money into [branch] and in a non-resident account?*

Customer: *To avoid paying tax on it. In addition there was the fact that it was money that was taken from the business which would be hard to explain to the Revenue at the time ...*

Inspector: *Where were you living at the time you had the account?*

Customer: *In [town in Republic of Ireland, distant from branch].*

oooOooo

Inspector: *And what was the address on the account?*

Customer: *It was an address in England. When I opened the account I was advised that this was the best way to put in the money and I would not have to pay tax on it. I had a daughter living in England and it was her address I used.*

Inspector: *When had you opened the account?*

Customer: *I had it for years.*

oooOooo

Inspector: *What address was on the account when you opened it, was it your new address in [town in Republic of Ireland] or your Australian address?*

Customer: *[named street], that is in Melbourne.*

Inspector: *Was that because people in the bank thought you were living in Australia?*

Customer: *No, they were very aware of where I was.*

Inspector: *They were fully aware of where you were?*

Customer: *Yes.*

Inspector: *Effectively, at the time you opened the savings account which was to earn interest you had a bogus non-resident account?*

Customer: *Yes.*

oooOooo

Inspector: *So in June '92 you came back home to the house that you bought the previous year, so you took up residence here in Ireland and you had an account in the National Irish Bank in [town], OK, with "care of the branch" on it?*

Customer: *Yes.*

Inspector: *OK, but you didn't have your own address on it?*

Customer: *No.*

Inspector: *But he [ie named manager] would have been aware you were now living in Ireland?*

Customer: *Oh, yes.*

Inspector: *Why would that be, why would he just have "care of branch"?*

Customer: *To avoid the tax.*

oooOooo

Inspector: *And whose name was that deposit account in?*

Customer: *The deposit account was in my wife and my young son and myself, ...*

Inspector: *And what address would have been on that account?*

Customer: *It was an English address.*

Inspector: *And so from a tax point of view, would you have been, at that stage, an Irish resident?*

Customer: *Oh yes, very much so, very much so.*

And later

Inspector: *So at that stage then [in January 1987], what discussion took place with the bank ... vis-à-vis opening a non-resident account?*

Customer: *Yeah, well I am going to say this out straight. The manager, he said, "why don't you open an English account, a non-residential* (sic) *account".*

Inspector: *What benefit would he have put forward in relation to that?*

Customer: *Well, he says you don't have to reveal it to the tax people.*

Inspector: *And who was that manager?*

Customer: *[manager name] was his name.*

oooOooo

Inspector: *And then he [ie named Bank official] opened an account for you in the [name] branch?*

Customer: *Yes.*

Inspector: *And he opened it as a non-resident account?*

Customer: *Yes.*

Inspector: *What was the address for that account?*

Customer: *It was [spouse's aunt]'s address when she was in America.*

Inspector: *How did he know that address?*

Customer: *We gave it to him, he asked us for the American address.*

Inspector: *Who did he think this money belonged to?*

Customer: *We told him the story, I would say he thought it was our money.*

Inspector: *So he knew it was your money?*

Customer: *Yes.*

Inspector: *What was the reason for his opening a non-resident account for you?*

Customer: *The way you wouldn't have to pay tax on it ...*

Inspector: *In whose name was the account in [branch]?*

Customer: *It was in [spouse]'s parents' name with [spouse's aunt]'s address in America.*

oooOooo

Inspector: *Would the bank have been aware you had accounts in different names?*

Customer: *They would have set that up for me at the start for the simple reason that I would say to the bank I could get better interest in different places and they would say, we'll sign a form – I think it was an F17 where you declare you are non-resident – we will get you that you will not be paying DIRT, you are not supposed to be in the country. So that they set up that for me, it wasn't a matter of me going in and asking for it. I would just say that I could get 1% interest rate better in some other bank and they would say, no, hold on, sign this form.*

Inspector: *Who would have introduced that concept to you, who would have said you could have a non-resident account?*

Customer: *[name], the bank manager.*

oooOooo

Inspector: *Now, Miss [customer name], do you know the particulars of this account in the National Irish Bank in [named town]? Your brother said it was a non-resident account.*

Customer: *Yes, and it was in both our names.*

Inspector: *In both your names?*

Customer: *Yes.*

Inspector: *And what address was given?*

Customer: *I think it was [named street]. Wait until I see.*

Inspector: *Where was it? Was it in England or the States or ...*

Customer: *Australia I think it was.*

Inspector: *And how was it that the address in Australia was given? Was that on your suggestion or on someone else's suggestion?*

Customer: *It was their suggestion.*

Inspector: *When you say "their suggestion", who?*

Customer: *In the bank.*

Inspector: *In the bank?*

Customer: *Yes.*

Inspector: *And can you remember who it was that, who was it? Was it the manager's suggestion or another official?*

Customer: *The Manager.*

Inspector: *Can you remember the name of the Manager?*

Customer: *[mispronounced, but identifiable, manager name].*

Inspector: *Was he there at the time?*

Customer: *I think it was [mispronounced, but identifiable, manager name].*

oooOooo

Inspector: *Whose address is that UK address?*

Customer: *It was the address of an uncle of mine who is now dead.*

Inspector: *So it is an address you would have supplied to the bank yourself?*

Customer: *That is correct.*

Inspector: *I take it you did not live there?*

Customer: *No, apart from going there on holidays.*

Inspector: *At the time you supplied that address you would have been resident in the Republic of Ireland?*

Customer: *Correct.*

Inspector: *Would you know, in relation to that account, if DIRT was deducted, that is, the deposit account with a foreign address?*

Customer: *I couldn't honestly say that.*

Inspector: *Can you tell me why there was a foreign address on the account?*

Customer: *I suppose it was avoiding paying tax on it.*

oooOooo

Inspector: *Was the money you used to invest in the CMI in an account in the names of yourself and your sister?*

Customer: *Yes, but it was my money.*

Inspector: *And what was the address for the account?*

Customer: *It was an American address. I was in America and I had money there a few years before I came back. I came back in '84 so they had my American address, they just kept it under that address.*

Inspector: *Was this money you had brought back with you from America?*

Customer: *Most of it.*

Inspector: *Had it been in that account then in the names of yourself and your sister from 1984?*

Customer: *Yes.*

Inspector: *And with the American address?*

Customer: *Yes.*

Branch Manager Interviews

Branch managers indicated at interview that the practice of having bogus non-resident deposit accounts existed throughout the Bank.

Illustrative evidence, accepted by the Inspectors:

> *... I would say around '92, '93, the first rumblings were probably starting that there had to be something done about the non-resident situation in the banks, ...*

oooOooo

Inspector: *In relation to bogus non-resident accounts, you have said clearly that there was an industry-wide problem and it existed on a reasonably extensive scale within NIB. Is that not right?*

Manager: *Yes.*

Inspector: *... is that something that was just in the awareness of the branch manager network or would everyone have known about it?*

Manager: *I would say everybody had to know.*

oooOooo

Inspector: *In your view did the practice of what could loosely be described as bogus non-resident accounts exist within the bank?*

Manager: *Yes.*

Inspector: *Did it exist within those branches where you were manager?*

Manager: *Yes.*

Inspector: *... have you reason to believe that practice was widespread within the network?*

Manager: *Without question.*

Inspector: *Would people at a senior level within the bank, people at a level above branch manager, have been aware of the existence of that practice?*

Manager: *They would because most of these people, certainly under the Northern Bank regime, worked their way up from postage clerk to senior position ...*

oooOooo

Manager: *... I think when you went in [ie on transfer to a different branch] you inherited and you stayed with them.*

Inspector: *The first time that you felt there would have been any significant pressure in relation to this was when Mr Harte tackled the matter in 1995?*

Manager: *Correct.*

oooOooo

Inspector: *Was it something that was available at the branches where you were manager, were they within the branch, regardless of whether you opened some or whether you inherited some?*

Manager: *I would have thought there would have been a certain few in each branch.*

oooOooo

Inspector: *At that stage what would have happened once you discovered they were not genuine non-resident?*

Manager: *In a lot of cases nothing. We would have tried to tidy them up and tell them that is not non-resident, we want them to become resident and attract DIRT. If they disagreed we would eventually say to them that we would get the financial services to talk to them.*

oooOooo

Inspector: *Did they exist, from your knowledge, right across the branch network?*

Manager: *Yes, I would have to say it would be widescale.*

oooOooo

Interviews with Senior Bank Management

Senior Bank management were questioned on their knowledge of the existence of the practice. Responses included:

Dermott Boner

Inspector: *... would that have given rise to suspicion on your behalf that there may have been in existence in the branch network bogus non-resident accounts?*

Mr Boner: *Yes.*

And at a later interview:

> *I'm saying we had suspicions that a lot of managers hadn't shown their hand.*
>
> *There was no test to ensure that there were no bogus non-resident accounts. What the branches were told was that the bank did not want [bogus] non-resident accounts ...*

Kevin Curran

> *There were some mavericks [in the branches] there is no question or doubt about it.*
>
> *[Revenue evasion] was a national sport in the eighties and early nineties.*

Frank Brennan

> *I was blue in the face writing to branches about the requirements under the Finance Act, 1986 ... I do not think I could put my hand on my heart and say we were perfect at any stage.*
>
> *I recall writing on a number of occasions giving instructions to close down such accounts and saying that we were not in the business of bogus non-resident accounts.*

Interviews with former Heads of Internal Audit

Former heads of the Bank's internal audit function made observations as follows:

Enda Carberry

> *As far as I recall it came up in a number of audits ... which in itself would tend to support the view that there was a culture.*

Paul Harte

> *I believed it was a practice that had been there for quite a while, both in National Irish Bank and in the industry.*

And at a later interview:

Inspector: *Do you believe that certain of the managers within the branch network deliberately tried to conceal the maintenance of these accounts from the internal auditors by use of fictitiously named accounts, or whatever?*

Mr Harte: *Yes, Yes.*

Internal Bank Correspondence

Gerry Hunt, Head of Financial Control, in November 1993 addressed a memorandum titled "Non Resident Accounts" to Mr Brennan, Mr Keane and Mr Boner, with a copy to Mr Lacey, noting concerns expressed to him by senior officials in the Department of Finance and in the Office of the Revenue Commissioners regarding "*the alleged actions of a number of bank officials*". He expressed the view that a Revenue audit focussing on non-resident documentation was likely and noted a difficulty in explaining the significant increase in the level of non-resident deposits held at branches of the Bank in the year ended 30 September 1993. He stated that he had spoken with the Group Tax Manager and the Head of Audit and reported that both shared his concerns that the Bank's documentation might be "weak" in the following areas:

1. *c/o branch addresses.*
2. *Non resident declaration forms missing, incomplete or inaccurate.*
3. *Unusual addresses that clearly warrant closer scrutiny eg Main St., Swansey,* (sic) *Wales.*
4. *Obvious errors eg non res. deposit and resident loan in same name.*

Mr Hunt was interviewed by the Inspectors:

Inspector: *Can you recall whether you would have had a genuine concern at the time?*

Mr Hunt: *I would not have written that note [of 18 November 1993] if I did not have some concerns.*

The full text of Mr Hunt's memorandum is reproduced at Appendix 8.

On 7 November 1994, prior to the commencement of the DIRT Theme Audit discussed at pages 54 and 55 below, Paul Harte, Head of Audit, sent a memorandum

to Mr Brennan, Mr Keane and Nigel D'Arcy, Head of the Bank's Financial Advice and Services Division, stating, *inter alia*:

> *Non-Residents*
>
> *(a) Branches again need to be reminded of the requirements in relation to non-residents. It is not sufficient to simply have a non-resident form – where branches are aware that customers are resident DIRT must be deducted.*
>
> *(b) the whole area of DIRT needs to be reviewed. Audit Department will soon carry out a theme audit of the area and this will cover all areas including instructions issued to branches, forms, staff knowledge, withdrawal notice requirements etc.*

On 9 February 1995, on the completion of the DIRT Theme Audit, Mr Brennan addressed a memorandum to the Executive Director of the Bank, Barry Seymour, which included the following:

> *Having wrestled with DIRT for a number of years, I do believe that we must introduce a change of attitude by our management staff to the legal requirements. It is an Irish failing that there is considered little harm in closing ones eyes to tax evasion and to confusing evasion with avoidance.*

INTERNAL AUDIT REPORTS

General

Branch audit reports are consistently critical of the standard of compliance with the legislative provisions and Bank procedures pertaining to the operation of non-resident deposit accounts. With regard to the Bank's obligation to hold a non-resident declaration in a form prescribed or authorised by the Revenue Commissioners pursuant to Section 37 of the Finance Act, 1986 for each account designated by the Bank as a non-resident account, the deficiencies most commonly reported were:

- Failure to produce non-resident declaration form at time of audit;
- Holding a "Charities" declaration form instead of a non-resident declaration form;
- Relying on "obsolete" non-resident declaration forms in use prior to the Finance Act, 1986;
- Non-resident declaration forms not dated, (eg Dungloe, July 1995: 39% of sample undated);
- Non-resident declaration forms not fully completed, and
- Incorrect account number on non-resident declaration form.

Use of Incorrect Forms

As a transitional measure, the Finance Act, 1986 provided that existing non-resident declarations given to a bank under Section 175 (4) of the Income Tax Act, 1967 would continue to have effect up to 5 April 1987 as if they were declarations made under Section 37 of the 1986 Act. After that date declarations under the 1967 Act ceased to have effect and thereafter declarations in the new format are necessary for all non-resident accounts. Special Circular No. S5/86 and Routine Circular No. R17/87 issued by the Bank to all branches on 24 July 1986 and 1 April 1987 respectively advised branches of this requirement.

Notwithstanding what was advised in these circulars, it was noted in internal audit reports on 27 branches between 1988 and 1996 that obsolete non-resident declaration forms were still in use. In addition, audit reports on 18 branches between 1991 and 1996 noted that "Charities" declaration forms were being used instead of non-resident declaration forms.

Use of Bank as Accommodation Address

Internal audit reports for branches in May 1992 and November 1992 noted the use of branch as an accommodation address and stated that such use was not to occur in the future. In his letter of 26 November 1993, Mr Brennan advised each branch manager that use of the branch as an accommodation address was strictly forbidden when opening non-resident accounts.

As noted at page 26 above, the new LiveLink system became operational in all branches on 3 May 1994. This system required input of a customer address for each deposit account. Internal Audit subsequently reported that notwithstanding the clear instruction in Mr Brennan's letter, "care of branch" addresses and Irish addresses were being input to LiveLink for non-resident deposit accounts. Between September 1995 and October 1996 one or other or both of these irregularities were noted by Internal Audit as having occurred in 17 branches.

In course of interview with Mr Boner, the Inspectors referred to a memorandum dated 23 November 1993 sent by him as Head of Retail to all branch managers.

Inspector: *In particular I refer to the following:*

1. Care-of-branch addresses. What's the problem with care-of-branch addresses?

Mr Boner: *Well, care-of-branch addresses would obviously lead to conclude* (sic), *rightly or wrongly, that there's some reason why the person can't give a proper address; and, therefore, that they may not be a legitimate non-resident. I mean, if they were a legitimate non-resident, why wouldn't they give a non-resident address?*

Non-Resident Declarations at variance with other branch records

Internal audit reports at the dates listed below noted instances where non-resident declarations were at variance with other branch records. Examples include:

August 1991 (circulated to J Lacey, B Noone, D Boner, K Curran)

A number of completed forms were at variance with other branch records.

March 1992 (circulated to J Lacey, B Noone, D Boner, T McMenamin)

It would appear that some accounts designated 'Non-Resident' are connected to other resident accounts at Branch.

May 1992 (circulated to J Lacey, B Noone, D Boner, M O'Rourke)

A few instances were noted where the residential status quoted on the non-resident declaration forms were at variance with other Branch records.

July 1992 (circulated to J Lacey, B Noone, D Boner, K Curran)

Instances were noted where the residential status quoted on the declaration was at variance with other Branch records.

Recommended Action

The Manager must be satisfied that all Non-Resident accounts are bona fide and comply fully with the requirements of the Finance Act 1986.

September 1992 (circulated to J Lacey, B Noone, D Boner, K Curran)

Instances were noted where the residential status on Non-Resident Declaration forms was at variance with other Branch records.

April 1993 (circulated to J Lacey, M Keane)

One instance was noted where the residential status quoted on a Non-Resident declaration form was at variance with other Branch records. (The account has since been correctly designated Resident).

May 1993 (circulated to J Lacey, M Keane, D Boner)

Instances were noted where the residential status on Non-Resident deposit accounts was at variance with other Branch records.

July 1993 (circulated to J Lacey, M Keane, D Boner)

Three instances were noted where the residential status on a Non-Resident savings account was at variance with other branch records.

October 1993 (circulated to J Lacey, M Keane, K Curran)

Eleven instances were noted where the address on the non-resident savings account was at variance with other branch records.

August 1994 (circulated to B Seymour, M Keane, D Boner)

Three instances were noted where the address on Non-Resident accounts was at variance with other branch records.

Recommended action

The Manager/Assistant Manager is asked to ensure that all non-resident accounts at Branch are bona fide.

September 1995 (circulated to B Seymour, M Keane, K Curran)

During the course of the Audit, Management gave written confirmation that all Non-Resident accounts were genuine. Despite this confirmation, it was noted on five occasions (3%) that Non-Resident addresses were at variance with other branch records.

Non-Resident Deposits as Security for Resident Borrowings

Internal Audit also identified instances where non-resident deposits were held as security for resident borrowings, among which were:

March 1992 (circulated to J Lacey, B Noone, D Boner, K Curran)

It was noted that two Bonus Saver accounts were classified non-resident where Letters of Lien were held supporting lending on resident accounts in the same names.

November 1992 (circulated to J Lacey, B Noone, D Boner, K Curran)

Advances made to Branch customers [name] are partly secured by a letter of lien over deposits held in the same name. These deposits are designated non-resident (exempted from Retention Tax) on the basis that correspondence for administrative purposes is to a United Kingdom address. The account should immediately be redesignated to collect Deposit Interest Retention Tax.

February 1993 (circulated to J Lacey, B Noone, D Boner, M O'Rourke)

One instance was noted where a Bonus Saver account was exempt from Deposit Interest Retention Tax and the beneficial owners were Irish residents. It was further noted that these deposits were held in support of a letter of guarantee for lending at Branch. The funds have now been transferred in to an account which is subject to DIRT in future.

July 1993 (circulated to J Lacey, M Keane, D Boner)

Three instances were noted where lending to resident customers was secured by Letters of Set-Off over Non-Resident deposits at Branch.

Branch Response

A full review of all L.O.L. security will now take place and above incidences (long standing) will be addressed.

August 1995 (circulated to B Seymour, M Keane, T McMenamin)

Two instances were noted where lending to resident customers was secured by Letters of Set Off over deposits with Non Resident status. The deposits in both cases related to the principals of the companies in question.

Recommended Action

Management are asked to ensure that this practice ceases immediately. Non Resident accounts must not be opened in future unless they are genuine.

April 1996 (circulated to B Seymour, M Keane, K Curran)

A non-resident savings account with a present balance of £10,780 in the name of [two names] was opened in September 1994. These deposits belong to [two different names] (IR residents). It is further noted that a letter of set-off is held over these deposits.

Non-Resident Accounts in Fictitious Names

Internal Audit also reported instances where non-resident savings accounts were maintained at branches in fictitious or incorrect names, including:

October 1993 (circulated to J Lacey, M Keane, K Curran)

Seven instances were noted where there was a mismatch between the name on the account and the exact name of the customer.

A deposit receipt account is held in a fictitious name.

April 1994 (circulated to B Seymour, M Keane, D Boner)

1. *A Non Resident Super Saver account is held in the name of [two names] and the account details are at variance with other Branch records.*
2. *It was also noted that the customer details on Livelink relating to [two names as above] are in the name of [two different names, incorporating the same first names but different surname].*

Further examination of transactions which passed over the account revealed

that [second surname as above] & [first surname as above] are one and the same persons. Retention Tax is not collected on this Super Saver account.

June 1995 (circulated to B Seymour, M Keane, T McMenamin)

Four other instances were recorded where Non-Resident savings accounts were opened in fictitious or incorrect customer names.

September 1995 (circulated to B Seymour, M Keane, K Curran)

1. *A non-resident savings account with a balance of £210,000 is held in the name of [two names]. These deposits belong to Branch customers [two different names] (IR residents). This particular account was highlighted in the October 1993 audit when at that time the funds were held on Deposit Receipt.*

2. *A non-resident savings account with a balance of £27,900 is held in the name of [name] (IR resident). These deposits belong to Branch customer [different name].*

Branch Response

These accounts have had a long association with NIB. In the case of item one, every effort has been made to have the account regularised. If it is the Bank's desire to instruct Branch to have these accounts closed, then proper procedures will be implemented in future. ... These accounts have been in existence prior to my arrival in June 1993.

January 1996 (circulated to B Seymour, M Keane, K Curran)

Both the Manager and the Assistant Manager signed a declaration confirming that fictitious/incorrectly named accounts do not exist and that all non-resident accounts are genuine. Despite this confirmation the following irregularities were found:

1. *A non resident savings account, which currently has a balance of £230k, in the name of [two names] was opened in November 1992. These deposits belong to [two different names, comprising the same first names but different surname] T/A [name] (IR residents).*

2. *A non-resident savings account with the present balance of £100k in the name of [two names] was opened in August 1995. These deposits belong to [two different names] (IR residents).*

3. *A non-resident savings account with a present balance of £205k in the name of [name] was opened in May 1994. These deposits were*

previously in the name of [different name]. These deposits belong to [name differing from both noted above] (IR resident).

The irregularity noted at *1.* above had been noted on the previous Internal Audit visit to this branch (see April 1994 extract above).

February 1996 (circulated to B Seymour, M Keane, K Curran)

Audit were made aware of the following irregularities:

1. *A non resident savings account, which currently has a balance of £78000 in the name of [two names] was opened in January 1993. These deposits belong to [different name] (IR resident).*

2. *A non-resident savings account in the name of [two names/initials, single surname] was opened in June 1995. Present balance £58000. These deposits belong to [two different names/initials, with the same surname as above]. (IR residents).*

3. *A non-resident savings account in the name of [two names/initials] was opened in December 1992. Present balance £32000. These deposits belong to [two similar names, incorporating one different initial]. (IR residents).*

4. *Deposit accounts in the names of [name] & [name] (Total balances £148000) are incorrectly designated as Non Residents.*

It should be noted that present management did not open these accounts and they are presently endeavouring to make contact with the relevant customers to have the irregularities rectified.

WHY DID BRANCH PERSONNEL OPERATE BOGUS NON-RESIDENT DEPOSIT ACCOUNTS?

Branch managers have indicated that they opened and maintained bogus non-resident deposit accounts for the following reasons:

- To gain or retain deposits – the branches were under pressure to increase deposits, and were struggling to do so. Because of competition from other banks, frequently the only way to gain or keep a deposit was to agree it should be DIRT free.

- To preserve a business relationship – if a valuable customer threatened to withdraw his business, unless facilitated, the account might have been lost.

- In the culture of the time, closing an account because it was bogus would not have been accepted as a good reason for losing the deposit.

Illustrative evidence received from branch managers and accepted by the Inspectors includes:

I am aware that I did facilitate a couple of customers with non-resident status, which, in hindsight, I was not totally comfortable with but it was to protect a deposit that I felt would have been lost to one of my competitors ...

I was regularly faced with the challenge that if I did not do it, it would be done by [named other banks] or whoever.

There may well have been a wider business connection that would have been valuable to me.

oooOooo

Manager: *... you didn't query them to an extent because you were under pressure to get deposits.*

And later

Inspector: *If you had said that the reason for losing the account was because you would not facilitate the operation of a [bogus] non-resident account – would you not have regarded that as a justifiable reason?*

Manager: *No, because of the pressure you were under, either directly or indirectly, to get business.*

oooOooo

Inspector: *... why at that stage would you just not tell them you were going to close the account?*

Manager: *First, we would be losing the money out of the deposits for the branch and we were struggling to reach the deposits. Certainly if it was a big amount there would be a lot of gathering to make it up and make our target for that year ...*

oooOooo

On the one hand they're telling me to get it sorted out, on the other hand they're telling me to get the resources up.

oooOooo

Under the pressure to increase the business I was happy to do it.

oooOooo

... going back to the pressure element, or the threat of losing business to [named bank], I mean, I think we were scared, I would say, of losing business.

I think possibly the overriding ambition to increase your deposit base may have taken precedence over the strict interpretation of the non-resident rule. I suppose if you reclassified those accounts, the chances are you would lose the business and the deposits, as you can see, would plummet.

It would be a very brave man in the regime that was in the bank at that time that would have stood up and be (sic) *counted, and say the deposits are actually going down by 20 percent overnight, the reason being, X, Y, Z. I don't think anyone was brave enough to stand up and do that.*

oooOooo

Inspector: *[Why] would you have facilitated the maintenance of bogus non-resident accounts within the branch?*

Manager: *Possibly from the fear of losing the business.*

oooOooo

As a branch manager you tried to protect your base as best you could and I would reckon that most people, if they saw someone approaching and saying, "I am closing that account, I can get a better rate down the street, I won't have to pay any tax on it," it was possibly done to retain the business.

oooOooo

... they were big customers in [branch] that had successful operations, they had bank accounts elsewhere ... and I was trying to get my foot in the door.

And as well as that, I was heavily targeted for deposits on the other side. ... and the best way I could get my foot in the door at the time as I felt at the time was to facilitate them in whatever way I could.

It was pressure that I needed these accounts to achieve my targets and if I rock the boat anyway that the accounts would leave me.

I was a bit more than flexible regarding the rules and maybe I bent the rules or turned a blind eye on occasions to achieve my targets ... the deposits would have been lost to the opposition. And deposits at that time were very hard to replace.

oooOooo

In the course of interview, evidence, which they accept, was given to the Inspectors by the Head of Audit to the effect that the failure to address the issue of bogus non-

resident deposit accounts in the Bank resulted from management inaction due to the potential effect on the Bank's deposit base of addressing this issue.

Paul Harte

Inspector: *Can you tell me why it took time to sort out the accounts?*

Mr Harte: *In my view it was because of management inaction. ... I think there was a reluctance on management's behalf to lose that sort of money from the network.*

Inspector: *Because it was quite significant?*

Mr Harte: *Yes.*

METHOD OF ACCOUNTING FOR DIRT

Where the Bank affords non-resident status to a deposit account, the deposit account is flagged as being exempt from DIRT – ie interest on the account is to be paid gross of DIRT. The onus is placed on branches to ensure that the correct DIRT flags are set at account level. Thereafter the amount of DIRT deducted on the payment or crediting of interest on deposit accounts is processed automatically by the computerised accounting systems of the Bank.

Accordingly, if the DIRT flags set at account level by branch personnel are incorrect, an incorrect return of DIRT to the Revenue Commissioners will result.

Extract from interview with John O'Brien of the Bank's Finance Department:

Inspector: *And if they had told you [the conclusions of the DIRT Theme Audit report] ... or made the report available to you, would it in any way have influenced the way you would have gone about preparing and submitting the return?*

Mr O'Brien: *Not really because it was very much a mechanical exercise completing the return. You really took the figures that were provided ... for you from the financial reports. The only analysis that went into it was really kind of checking that what was the reason for maybe a large increase in the amount of DIRT paid or whatever because we wanted to kind of make sure we weren't paying too much to the Government. And we would have been looking at say the balances of deposits and whether they had increased significantly or whether interest rates had increased or whatever.*

Extract from interview with Gerry Hunt, former Head of Finance:

Inspector: *I am puzzled by the fact that insofar as your returns are concerned you were acting separately from what was going on in the bank. In other words, you were accepting the information you were given and there was no way your department could check the accuracy of that information.*

Mr Hunt: *By and large that is true. There was very little way, we inherited systems and those systems were tried and tested over the years. They accumulated information and there were literally millions and millions of transactions going on.*

Inspector: *At what stage, when the tax return was put in front of you and you were signing on behalf of the bank, would you say, better check these out?*

Mr Hunt: *We would have checked the authenticity of the numbers. There were procedures there to be gone through ... if a procedure did not happen properly at a branch, there was no realistic way we could find out. There were internal controls and checks and others would have had the responsibility to ensure that those things were done properly ...*

Inspector: *And you are clear from your perspective nobody ever raised any issue in relation to taxation matters with you coming from the internal audit of the branches?*

Mr Hunt: *I can't recall anyone raising such issues.*

DIRT THEME AUDIT, DECEMBER 1994

On the initiative of Paul Harte, Head of Audit, the Bank selected the area of DIRT compliance for its first Theme Audit, a concept whereby a particular theme or area is selected for review on a Bank-wide basis. The Bank's stated reason for the selection of DIRT for the first Theme Audit was:

> *DIRT compliance issues (principally missing and incomplete documentation) continue to be reported in branch and other audits on a regular basis. For this reason, it was decided to select DIRT for our first theme audit to gain an understanding of the extent of DIRT compliance problems.*

The results of the DIRT Theme Audit, carried out in December 1994, were rated as unsatisfactory with the following overall conclusion recorded:

> *Results of this audit are very disappointing and management must take immediate steps to improve the situation. The structure of the whole area can be improved but the level of non-compliance is too high. It appears that there*

> *needs to be an organisation-wide change in attitude to the whole area. This is a risk area and the penalties for non-compliance at the level shown in this report would be very significant.*

In the course of the audit, internal audit staff visited twelve branches in total. Each branch sample included 30 non-resident accounts and the report states that testing in that category "*concentrated for the most part on the following areas*":

> *Ensure that properly completed non resident declaration forms were held for the 30 non-resident accounts. Briefly check that address on declaration form is not at variance with other branch records.*

The report's major findings on the main issues affecting all aspects of DIRT compliance were:

1. *Lack of clear and concise guidelines. Procedures do not clearly differentiate between the different types of DIRT.*

2. *Lack of understanding regarding documentation required for each account category e.g. we identified instances where charity form was used for a non-resident account.*

3. *There has been no co-ordinated review of all DIRT documentation on a regular basis. In late 1993, Administration Department conducted a review of non resident and DIRT exempt accounts whereby all branches were required to sign off on DIRT documentation held. This type of sign off does not guarantee that all DIRT documentation is in order as branch audits have continued to reveal problems in this area.*

Major findings in relation to non-resident accounts included:

- *Approximately 40% of declarations selected contain some errors/omissions.*

- *Our examination of non-resident accounts showed:*

    1. *Non-resident declaration forms were not sighted for 12% of accounts.*

    2. *21% of the declarations had an incorrect account number.*

    3. *13% of the declarations were not dated.*

- *Details at variance with other branch records*

    Instances have been reported in branch audits where non resident details were at variance with other branch records. Some branches appear to be of the opinion that once a non resident declaration form is held there is no obligation on the branch to confirm the residency of the account holder.

The DIRT Theme Audit report is reproduced in full at Appendix 9.

Follow-up Meeting to DIRT Theme Audit

On 20 January 1995, following completion of the DIRT Theme Audit report, Michael Keane, General Manager – Banking, sent a memorandum to Barry Seymour, Executive Director, noting that the "*recent theme Audit gives serious cause for concern*" and suggesting that a meeting take place "*to define the extent of the problem and to produce an action plan (including definition of responsibilities).*" This meeting, chaired by Mr Keane, took place on 9 February 1995 and was attended by Mr Seymour, Mr Brennan, General Manager – Administration, Mr Boner and Mr McMenamin, Regional Managers, Mr Harte, Head of Audit, Patrick Byrne, Head of Finance, and others. The minutes of the meeting record that the following action steps were agreed:

- Issue of a circular to contain clarification of the rules in relation to DIRT and simple instructions to be followed at branch level. The responsibility for drafting this circular was assigned to the Finance Department.

- Ongoing control and enforcement to be effected by issuing to branches on a quarterly basis lists of accounts designated as non-resident, and requesting compliance checking at branches.

- Audit staff to examine these lists as part of audit of compliance testing in future to ensure that DIRT documentation checking is complete.

- Branch Business Meetings to be devoted for a period of time to DIRT issues, in relation to compliance with the procedures laid out in the circular for DIRT-free/SSA accounts to be issued to branches, noting that non-compliance would result in immediate reversion to standard rate DIRT deduction status on the account.

The minutes note that, for future reference, responsibility for monitoring and enforcement of DIRT/tax compliance in relation to savings and deposit accounts rested with Retail and Administration. The summary timetable of agreed actions resulting from the meeting however records no action points for Administration.

The minutes do not evidence any consideration of the question of a potential retrospective liability to the Revenue Commissioners for DIRT resulting from the findings of the Theme Audit. This was confirmed to the Inspectors by a number of those who attended the meeting:

Barry Seymour

Inspector: *... did anybody attempt at the time to quantify the amount of money that may have been due to the Revenue?*

Mr Seymour: *Not to my recollection, Tom, no. I can't say that. But whether*

or not Patrick Byrne did it in Finance, I don't know. But not to my recollection.

Inspector: *But it isn't something that was discussed?*

Mr Seymour: *Not to my recollection, no.*

Patrick Byrne

Inspector: *Would you be aware ... if there was any effort to retrospectively quantify the tax that would have been due?*

Mr Byrne: *... my recollection is ... there was no talk when it came to tax or financial statements as of September, at putting a figure in for a liability. So the only deduction I have from that is there wasn't a figure calculated.*

Michael Keane

Inspector: *One thing that puzzles me, but after the date, the DIRT issue, ... [whether there] was liability for DIRT in arrears, was that ever raised or discussed within the bank?*

Mr Keane: *No, insofar as I can recall it was looking forward to fixing it is what my recollection was as separate* (sic) *to look back and to see was there any liability.*

Frank Brennan

Inspector: *... who would you have regarded had the responsibility in the bank to quantify any liability that may have existed to the Revenue?*

Mr Brennan: *I don't remember that specific question being asked of anybody but the Finance Department were the people responsible for returning the tax deducted to the Revenue and I would see it as their responsibility ...*

The Bank's external auditors, KPMG, received a copy of the DIRT Theme Audit report and it was considered by them when conducting their audit of the Bank's financial statements for the year ending 30 September 1995. When conducting their audit KPMG were, accordingly, aware of the conclusion in the DIRT Theme Audit report that "*this is a risk area and the penalties for non-compliance at the level shown in this report would be very significant*" and this put them on notice of a potentially material liability. This should have led to KPMG asking management to quantify the potential retrospective liability to the Revenue Commissioners for DIRT resulting from the findings of the Theme Audit. KPMG did not seek to have this done. The Inspectors are of the opinion that, if KPMG had requested that the potentially material

liability be quantified, this would have emphasised its importance to senior management and it is unlikely that they could have ignored it, as they did.

The Bank has confirmed to the Inspectors that it has found no evidence that, on discovering irregularities in the operation of non-resident accounts either as a result of the DIRT Theme Audit of December 1994 or otherwise, the Bank calculated the DIRT liability resulting from the deficiencies noted or, prior to the Inspectors' appointment, remitted any payment to the Revenue Commissioners in discharge of such liability.

THEME AUDIT – TAXATION OF CREDIT INTEREST, JANUARY 1999

During August and September 1998 the European Audit Division of National Australia Bank conducted an audit of compliance with tax legislation and internal procedures of the Bank. Ten non-resident deposit accounts were selected for review in each of ten randomly selected branches; no stratification by value took place.

The overall conclusion of the report on this Theme Audit, issued January 1999, includes the following:

- *We have assessed the standard of compliance in National Irish Bank as UNSATISFACTORY. A high level of errors has been identified in ... Overseas Resident Accounts (NOR) ...*

- *18% of sampled NOR accounts have been found to be erroneous when tested against current legislative requirements. These errors do not in themselves suggest that the customers were ineligible for the payment of interest without deduction of tax but do indicate a need for immediate remedial action.*

- *Controls at branch level have not been effective despite confirmations to the contrary from branch management through the Bank's six-monthly declaration process. Increased centralisation of the overview and control processes should be considered as the key element of any future control framework.*

"Significant Audit Issues" identified relating to non-resident accounts included:

- *It was evident that in some cases blank declarations had been signed by customers and branch staff had not subsequently ensured that the declarations were fully completed.*

- *Procedures for ensuring that customer's identity was verified did not provide evidence that this, in fact, had occurred.*

- *The six-monthly branch declaration process, to confirm that D.I.R.T. requirements were being met on an ongoing basis, was not robust and gave a false picture of compliance in the Bank.*

The 18% error rate noted above was analysed as follows:

7% *no declaration held*

5% *not signed by all parties*

3% *address missing or incorrect for at least one party to the account*

3% *account records suggested that advice had been received indicating the customer was now resident in the Republic of Ireland. However, the account status had not been changed and it therefore remained in operation as a non resident account.*

Referring to the six-monthly declaration confirming compliance with DIRT regulations, the report noted:

- *9 of the 10 branches sampled had erroneously certified full compliance or had failed to identify accounts which were invalid;*
- *there is no process in Finance Department to ensure all declarations are held or to follow up those branches where full compliance has not been achieved;*
- *the wording of the existing declaration form is ambiguous and does not support the objective of ensuring full compliance with DIRT regulations.*

INSPECTORS' CONCLUSIONS

The Inspectors find:

1. Bogus non-resident deposit accounts were opened and maintained by the Bank and were widespread in the branch network during the period the subject of the investigation.

2. The opening and maintenance of such accounts by the Bank constituted an unlawful and improper practice which served to encourage the evasion of Revenue obligations by third parties, both on the funds deposited and on interest earned.

3. Up until May 1995 senior Bank management failed to inform branch staff in clear terms of the relevant provisions of the Finance Act, 1986 – that non-resident deposits had to be treated as deposits in respect of which DIRT had to be deducted from the interest unless the Bank was satisfied that the person beneficially entitled to the deposit was non-resident. In addition, senior Bank management failed to have a review conducted at that time to ensure that all existing non-resident accounts were genuine.

4. At branch level the Bank failed to deduct DIRT from bogus non-resident accounts and from non-resident accounts where a properly completed declaration in a form prescribed or authorised by the Revenue Commissioners was not held by the branch.

5. Although senior management was aware of the existence of bogus non-resident accounts, the Bank failed to account to the Revenue Commissioners for the DIRT properly payable on the interest paid or credited on such accounts.

6. The Bank failed to account to the Revenue Commissioners for DIRT payable on the interest paid or credited on non-resident accounts where the Bank did not hold a properly completed declaration in a form prescribed or authorised by the Revenue Commissioners.

PART 3

EVASION OF REVENUE OBLIGATIONS: FICTITIOUS AND INCORRECTLY NAMED ACCOUNTS

EVASION OF REVENUE OBLIGATIONS: FICTITIOUS AND INCORRECTLY NAMED ACCOUNTS

NIB PROCEDURES

Formal Guidance to Staff

The position at 1 January 1988 was governed by the account opening procedures set out in the Branch Procedures Manual of 1976. These provided that as regards current accounts the manager had "*to satisfy himself as to the identity, respectability and suitability of the proposed customer*" but as regards deposit accounts all that was required was that "*a specimen signature*" be obtained on a special signature card.

Subsequent guidance to staff is summarised below:

- The provisions of the 1976 Manual relating to current accounts were repeated in the Branch Procedures Manual of 1992 and were for the first time also applied to deposit accounts.

- The first mention of accounts in fictitious names in any Bank document occurs in the Code of Conduct/Policy and Staff Guidelines of February 1993. Section 3 of this document, at paragraph 3.2 under the heading "Prevention of Fraud", provides as follows:

  > *The Bank can at any time be a target for fraud. The sophistication of criminals is such, that fraud can sometimes be difficult to detect. Staff should be continually alert where unusual activities or requests are made by customers, non-customers and colleagues, irrespective of that colleague's rank or position. Procedures are in force to protect both the Bank and staff and should be adhered to at all times. These procedures are detailed in the various procedural manuals, circulars and management instructions.*
  >
  > *Accounts must not be opened or operated in fictitious names. Where any doubt exists, consult your immediate superior.*

- On 21 April 1995 Special Circular No. S19/95 on money laundering was issued to all staff members prior to the coming into effect on 2 May 1995 of the money laundering provisions of the Criminal Justice Act, 1994 affecting the Bank. This circular states:

  > *This Act now adds the full rigour of criminal law to the prohibition on opening/conduct of accounts in fictitious names referred to at Para. 3.2 in the Bank's Booklet "Code of Conduct/Policy and Staff Guidelines" of February 1993.*

- In September 1996 the Bank issued a Human Resources Policy & Procedures Manual. Section 3 set out the Code of Conduct for Bank employees and at

paragraph 3.6 under the heading "Prevention of Fraud" states:

> *Our bank can at any time be the target of fraud. Your actions and decisions can help prevent these attempts being successful. Staff should be continually alert where unusual activities or requests are made by customers, non-customers and colleagues, irrespective of that colleague's rank or position. Accounts must not be opened or operated in fictitious names. This can be avoided by ensuring that the correct procedures for identifying customers are adhered to at all times. In particular the Money Laundering Provisions of the Criminal Justice Act must be adhered to at all times.*
>
> *Poor adherence to procedures which permit fraud to occur will result in disciplinary action, which may include dismissal, against any employee.*

- The prohibition on opening accounts in fictitious names is again reiterated in Part B of the 1996 Branch Procedures Manual (the relevant section was issued in January 1997). At paragraph 2.2, captioned "Outline of Requirements re Money Laundering", it states:

> *Officials must always be alert to the possibility of accounts being used for Money Laundering purposes. Do not permit accounts to be opened in fictitious names or where any associated business cannot be seen to conform with ethical and legal standards.*

EXISTENCE OF FICTITIOUS AND INCORRECTLY NAMED ACCOUNTS

In the light of the evidence received from Bank personnel and from customers of the Bank, the Inspectors are satisfied that fictitious and incorrectly named accounts existed in the Bank during the period the subject of the investigation, up until the end of 1996.

Illustrative evidence, which the Inspectors accept, is set out hereunder.

Extracts from Letters from Bank Personnel

At the outset of the investigation the Inspectors wrote to present and former employees of the Bank who, in the period from 1 January 1988 to 30 March 1998, held positions at the rank of manager or above, reciting the terms of the Order under which they were appointed, and requesting they furnish all information or documentation that might be relevant to the investigation. The following extracts from replies are relevant to the opening and maintenance of fictitious or incorrectly named accounts:

> *During my period as Deputy Manager, [named] Branch (1993 - to date) a small number of accounts (three or four) were brought to my attention by*

cashiers etc as being in incorrect names. At my request they have all since been closed. All attracted DIRT tax at the normal rate prior to closure.

oooOooo

There were a few irregular non-resident accounts and fictitious accounts at this office ([named]) when I arrived here and these have either been closed or regularised to the proper name/status.

oooOooo

Prior to the requirement to seek proper identification, under the Money Laundering Act 1995 (sic), *it may have been that accounts were opened on the basis of incorrect information from customers.*

Bank Customer Interviews

Inspector: *And who would have known about the existence of that account [in incorrect name]?*

Customer: *Myself and the manager.*

oooOooo

Inspector: *There was money used [for investment in CMI] from an account in [correct names], the [branch name] account?*

Customer: *Yeah.*

Inspector: *And there was one in [incorrect names] in [different branch]?*

Customer: *Yeah.*

Inspector: *Who actually owned the account in the [different] branch?*

Customer: *We owned it, yeah.*

SOURCE OF FUNDS FOR INVESTMENT IN CMI, SCOTTISH PROVIDENT INTERNATIONAL AND OLD MUTUAL INTERNATIONAL POLICIES

Data provided by the Bank disclosed that many investments in CMI, Scottish Provident International and Old Mutual International policies were funded, in whole or in part, from funds in fictitious or incorrectly named deposit accounts in the Bank's branch network, certain of which had DIRT deducted from interest earned.

WHY WERE ACCOUNTS OPENED IN FICTITIOUS NAMES?

In the light of the evidence received, the Inspectors are satisfied that the main reason customers had accounts in fictitious names was to keep undeclared funds hidden from the Revenue and that branch managers were aware of this.

Illustrative evidence, which the Inspectors accept, is set out hereunder.

Branch Manager Interviews

Inspector: *... where people had accounts in the incorrect name what would you have thought the reason for that was?*

Manager: *I can surmise ... that there was probably a Revenue background.*

oooOooo

Inspector: *What would your view be as to why somebody would have a fictitious account?*

Manager: *Well, my view would be to conceal money from ... maybe even from a family member or it could be from the Revenue Commissioners.*

oooOooo

Inspector: *What would you have thought yourself as to why people chose to have the accounts in a second, in their second initial; would that relate to sensitivity?*

Manager: *We would have to take that as being a reason.*

oooOooo

Inspector: *I would like to know whether or not you were aware of a practice in the bank of facilitating the opening up of fictitiously named accounts or bogus non-resident accounts?*

Manager: *Well, in my limited experience as a manager, I would say I have come across the issues.*

Inspector: *And in relation to people like Mr [incorrect customer name], or who had bogus non-resident accounts, would it be reasonable to assume that the Revenue didn't know about that money?*

Manager: *I would imagine in some of the cases it would be reasonable.*

oooOooo

Inspector: *What would have been the purpose of these [fictitious or incorrectly named] accounts?*

Manager: *Obviously they didn't want the Revenue to know about it.*

EFFORTS TO ELIMINATE FICTITIOUS AND INCORRECTLY NAMED ACCOUNTS

Memorandum from General Manager - Banking, 1995

On 7 December 1995 Michael Keane, General Manager – Banking, issued to all branch management a memorandum titled "Account Names/Descriptions". The essence of the memorandum was that it informed branches that:

- *Opening or operating accounts in fictitious names is expressly forbidden in our Code of Conduct.*
- *Operating accounts in this manner does not fulfil our "Professionalism in our actions and ethics" value.*

and managers were asked to *"fulfil [their] personal responsibility"* in regard to such accounts

Memorandum from General Managers, 1996 and involvement of Head of Audit

The next step towards eliminating fictitious and incorrectly named accounts was initiated by Paul Harte, Head of Audit. This was a meeting held to discuss such accounts on 15 May 1996, attended by Frank Brennan, General Manager Administration, Michael Keane, General Manager Banking and Kevin Curran, Head of Retail Banking

Following this meeting, on 30 May 1996, Mr Keane and Mr Brennan issued a memorandum to all branch management titled "Fictitious/Incorrectly Named Accounts". This memorandum informed the branches that *"all fictitious or incorrectly named accounts must be regularised and/or closed, even where there is a possibility that the business will be lost."*

Mr Harte's involvement with the issue continued as the memorandum required branch management to complete and return to the Audit Department by 15 June 1996 a declaration to the effect that:

- there were no fictitious or incorrectly named accounts at the branch,
- the branch manager had not instructed or authorised any other member of staff to open fictitious or incorrectly named accounts, and
- no fictitious or incorrectly named accounts had been closed in the previous three months.

In the event that any fictitious or incorrectly named accounts existed in the branch or had been closed in the previous three months, the memorandum required that these accounts be listed on the declaration, noting the account name, the customer's name and "Comments/Action Plan".

Review of Declarations from Branch Managers

On 22 July 1996 Mr Harte furnished to Mr Keane and Mr Brennan, with a copy to Mr Curran, a summary of the declarations returned and his recommendations arising therefrom. Mr Harte's report noted that 24 branches had disclosed fictitious accounts, and that the highest number of fictitious accounts in any one branch was 13.

Following receipt of the declarations, Mr Harte received from branch managers progress reports on their efforts to regularise these accounts. These reports indicate that included in the steps taken by the managers to resolve the problem of fictitious and incorrectly named accounts were:

- The funds in the account were transferred to CMI.

- The account was relocated in another branch of the Bank in the customer's correct name.

In the opinion of the Inspectors these proposed solutions were improper as they served to encourage the continued evasion of tax by the Bank's customers.

The Board Audit Committee

The Board Audit Committee of the Bank, meeting on 24 February 1997, "*noted that all falsely designated accounts have now been cleared*".

INSPECTORS' CONCLUSIONS

The Inspectors find:

1. Fictitious and incorrectly named accounts were opened and maintained by the Bank and existed throughout the branch network during the period of the investigation up until the end of 1996.

2. The opening and maintenance of such accounts by the Bank served to encourage the evasion of tax as it concealed the true ownership of the funds in the accounts.

3. Bank personnel were aware or ought to have been aware of the reason for the opening of such accounts.

4. In 1995 and 1996, when branch managers were directed that all fictitious and incorrectly named accounts must be regularised and/or closed, even where

there was a possibility that the business might be lost, managers sought to retain for the Bank the funds on deposit in such accounts by proposing to the customers that they invest in CMI, or by suggesting that they deposit the funds in another branch of the Bank in their correct names.

In the opinion of the Inspectors these "solutions" were improper because they served to encourage customers to continue to evade tax.

PART 4

EVASION OF REVENUE OBLIGATIONS: SPECIAL SAVINGS ACCOUNTS

EVASION OF REVENUE OBLIGATIONS: SPECIAL SAVINGS ACCOUNTS

LEGISLATIVE REGIME

On or after 1 January 1993, Section 37A of the Finance Act, 1986 as introduced by Section 22 of the Finance Act, 1992 permitted the opening by individuals of bank accounts designated as Special Savings Accounts ("SSA's"), the interest on which benefited from a reduced rate of Deposit Interest Retention Tax ("DIRT"), being 10% up to 5 April 1995 and 15% from 6 April 1995 to 5 April 1998, provided certain conditions were met and a declaration confirming compliance with those conditions, in a form prescribed or authorised by the Revenue Commissioners, was made by the deposit holder to the bank.

The conditions attaching to such accounts in the period from 1 January 1993 to 30 March 1998 are detailed in Section 37A of the Finance Act, 1986, now Section 264 of the Taxes Consolidation Act, 1997. These conditions, in addition to the requirement that the completed declaration referred to above was held by the bank, were:

- The account shall be opened and held in the name of the individual beneficially entitled to the interest;
- The account shall not be opened or held in the name of an individual who is not at least 18 years of age or married;
- The balance in the account shall not at any time exceed IR£50,000 including relevant interest;
- Except in the case of a couple married to each other, the account shall not be a joint account;
- An individual may have only one SSA at any time except that a couple married to each other may have two joint accounts with a maximum balance of IR£50,000, each opened and held jointly by them;
- No withdrawal of money shall be made from the account within the period of three months commencing with the date on which it is opened, and
- The terms on which the account is opened shall require the individual to give a minimum of 30 days' notice to the relevant deposit taker in relation to the withdrawal of any money from the account.

Interest on SSA's is not returnable by the account holder as income for the purposes of the Income Tax Acts and accordingly the reduced rate of DIRT deducted from interest payable on SSA's is regarded as satisfying the individual's full liability to tax in respect of that interest and furthermore the interest payable is ignored for the purposes of PRSI, Health Contribution and Employment Levy.

An account ceases to be an SSA if any of the conditions attaching to such accounts cease to be satisfied with the effect that:

- The bank must deduct tax at the standard rate then in force from all interest paid or credited on the deposit on or after the date the account ceases to be an SSA, and

- The individual is liable for PRSI, Health Contribution and Employment Levy on such interest.

If a withdrawal is effected in the period of three months from the date of opening of the account then the account has never satisfied the conditions for its operation as an SSA and the bank is therefore required to deduct DIRT at standard rate from all interest paid or credited from the date of opening of the account.

RETURNS TO REVENUE COMMISSIONERS

In the annual returns which a bank is required to make to the Revenue Commissioners (see page 24 above) are included details of the DIRT appropriate to the interest paid or credited on SSA's in the year of assessment. Set out below is a summary of information based on the annual returns of NIB to the Revenue Commissioners pursuant to Section 33 (2) of the Finance Act, 1986:

Year of Assessment	Interest on SSA's IR£	DIRT Rate on SSA's	DIRT on SSA's IR£
1992/1993	2,685,229	10%	268,523
1993/1994	6,602,412	10%	660,241
1994/1995	8,612,682	10%	861,268
1995/1996	5,912,505	15%	886,876
1996/1997	6,291,738	15%	943,761
1997/1998	11,498,842	15%	1,724,826
			5,345,495

This table shows the amount of the reduced DIRT paid by the Bank on the total of the SSA's in each of the six years between 1992 and 1998 As it is clear from the findings of the DIRT Theme Audit of December 1994, summarised at pages 76 and 77 below, that the samples of SSA's tested in the branches showed that 20% of the declarations were missing or incomplete, and that there was a high rate of failure in observing the requirement to give a minimum of thirty days' notice for every withdrawal, it follows that a significant proportion of the SSA's were not entitled to benefit from DIRT at the reduced rate.

NIB PROCEDURES

The procedures laid down by the Bank for the opening and operation of SSA's were communicated to Bank personnel principally by the issue of Special Circulars. The undernoted Special Circulars deal with the qualifying criteria for the operation of deposit accounts as SSA's and each of them clearly refers to the prohibition on withdrawals from SSA's within the first three months following their opening and to the requirement for a minimum of 30 days' notice of withdrawals:

- Special Circular No. S26/92 dated 15 December 1992, addressed to branch managers and heads of departments.

- Special Circular No. S1/93 dated 6 January 1993, addressed to branch managers and heads of departments.

- Special Circular No. S4/93 dated 22 February 1993, addressed to all staff.

- Special Circular No. S27/93 dated 9 June 1993, addressed to branch managers and heads of departments.

Special Circular No. S9/93, issued to all branches on 11 March 1993, introduced a Retention Tax Compliance Report which, *inter alia*, required branch staff to examine all accounts designated as SSA's to ensure that they met the qualifying criteria and that an appropriate declaration was held for each such account, in default of which interest paid or credited was to be subject to DIRT at the standard rate.

As noted in Part 2, Special Circular No. S11/95, which was issued to all branches on 8 March 1995 following the DIRT Theme Audit of December 1994, replaced all previous circulars in relation to DIRT. It clearly sets out the rules applicable to the operation of deposit accounts as SSA's and a DIRT guide summarising the contents of this Circular was issued for use by cashiers and other branch staff on 15 May 1995. The Circular also advised branch personnel of the availability of Notice of Withdrawal of Funds forms which were to be attached to the withdrawal slip when the withdrawal had been effected. This was the first time such forms were made available to the branches.

As also noted in Part 2, Special Circular No. S22/95, which was issued to all branches on 15 May 1995, introduced semi-annual DIRT compliance reports, to be completed by each branch manager and returned to the Bank's Finance and Planning Department. The standard-form report declared that the branch manager understood the contents of Special Circular No. S11/95 and either confirmed that the branch had proper statutory declarations on file for all accounts classified as SSA's or, where a proper statutory declaration was not held, detailed the action which the branch manager proposed to take to rectify the situation.

DIRT THEME AUDIT, DECEMBER 1994

Conclusion

The results of the DIRT Theme Audit of December 1994 were rated as unsatisfactory. As noted in Part 2 the following overall conclusion was recorded:

> *Results of this audit are very disappointing and management must take immediate steps to improve the situation. The structure of the whole area can be improved but the level of non-compliance is too high. It appears that there needs to be an organisation-wide change in attitude to the whole area. This is a risk area and the penalties for non-compliance at the level shown in this report would be very significant.*

Scope of Audit Testing

Twelve branches were selected for the Theme Audit. In the area of SSA's, internal audit staff were directed to carry out the following work at each branch:

- *Ensure that properly completed SSA declaration forms were held for [each of a sample of] 30 SSA's.*
- *Briefly review the listing of branch SSA's for apparent inconsistencies (e.g. sole and joint accounts held by same person, joint account held by persons not married to each other).*
- *Discuss understanding of SSA notice requirements with two members of branch staff.*
- *Review withdrawal notices for selected SSA withdrawals (e.g. notice period, amount of withdrawal and signature of account holder(s)).*

Findings

The major findings of the Theme Audit on the main issues affecting all aspects of DIRT compliance are set out in Part 2 at page 55. In relation to the operation of SSA's the report's major findings were:

- *... an unacceptably high proportion of declarations were* (sic) *missing or incomplete – approximately 20% of SSAs.*

- *SSA notice requirements are not being properly imposed – 91% of withdrawals reviewed breached the notice requirements. The profile of this issue needs to be raised again; a number of initiatives should be undertaken including use of standard documentation.*

- *Our review of 136 SSA withdrawal notices showed:*

  1. *Notices were not sighted for 79% of withdrawals.*

  2. *55% of notices found were invalid e.g. no notice date, notice < 30 days.*

3. *None of the accounts in breach of the notice requirements had been subject to 27% DIRT from the date the requirements were breached.*

- *Many branches are finding it difficult to impose SSA notice requirements due to:*

  (a) Fear of losing deposits.

  (b) No standard procedure/documentation for implementing notice requirements.

  (c) Lack of understanding of notice requirements.

- *Approximately 20% of SSA declarations selected contained some errors/omissions.*

- *Our review of 372 SSA declarations showed:*

  1. *SSA declaration forms were not sighted for 7% of accounts.*

  2. *9% of the declarations were not dated.*

  3. *5% of the declarations were not properly completed (e.g. no address, no account name).*

- *A high level review of SSAs in the selected branches showed that 29 SSAs did not comply with SSA qualifying conditions (e.g. sole and joint accounts held by same person, joint account held by persons not married to each other). It should be noted that this was a high level review which would only highlight very obvious inconsistencies.*

The DIRT Theme Audit report is reproduced in full at Appendix 9.

Interview with Head of Audit

Asked whether any consideration was given to expanding the scope of the DIRT Theme Audit to encompass all branches, Paul Harte, Head of Audit at the time the Theme Audit was carried out, stated:

> *If the business needed more assurance and needed more work on that, then they should have done it themselves; as far as I was concerned I had done a proper sample, I had identified these issues and nobody questioned the veracity of those issues.*

BRANCH INTERNAL AUDIT REPORTS

Branch audit reports, both in the period prior to the DIRT Theme Audit and thereafter, were consistently critical of the level of branches' compliance with the requirement to

hold a properly completed declaration form for each account designated as an SSA. Deficiencies noted included:

- Forms not sighted for a number of accounts;
- Forms not fully completed;
- Incorrect forms used;
- Forms not dated;
- Amended or incorrect account numbers noted on declaration;
- In the case of joint accounts, declarations signed by one party only.

In addition, audit reports noted instances where account holders were not entitled to avail of Special Savings Account status.

In the period after the DIRT Theme Audit and after the issue of Special Circular No. S11/95 to all branches on 8 March 1995, branch audit reports at the dates listed below noted breaches of notice requirement provisions:

January 1996 (circulated to Barry Seymour, Michael Keane, Kevin Curran)

1. *Several instances were noted where withdrawals were permitted within the initial ninety day period and the tax deduction status code on the relevant accounts was not amended to "C" i.e. standard 27% DIRT.*

2. *A few instances were noted where withdrawals were processed and the required written thirty day notice of withdrawal was not obtained.*

January 1996 (circulated to Barry Seymour, Michael Keane, Kevin Curran)

1. *From an examination of the Tax Deduction Compliance section of the Managers Morning report since 4th January 1996, eleven instances were noted where withdrawals were permitted on "SP" accounts within the initial ninety day period and the tax deduction status code on the relevant accounts was not amended to "C" i.e. standard 27% DIRT.*

2. *A number of instances were noted where withdrawals were processed and the required written thirty day notice of withdrawal was not obtained.*

May 1996 (circulated to Barry Seymour, Michael Keane, Kevin Curran)

From an examination of the Tax Deduction Compliance section of the Managers Morning report, a small number of instances were noted where withdrawals were permitted on SSA accounts within the initial ninety day period and the tax deduction status code on the relevant accounts was not amended to "C" i.e. standard 27% DIRT.

July 1996 (circulated to Philip Halpin, Michael Keane, Kevin Curran)

By enquiry, it was established that on a small number of occasions, withdrawals were permitted on SSA accounts within the initial ninety day

period and the tax deduction status code on the relevant accounts were (sic) *not amended to "C" i.e. standard 27% DIRT.*

In each of the four above-noted reports, branches were reminded of the statutory provisions relating to the withdrawal of funds from SSA's.

THEME AUDIT – TAXATION OF CREDIT INTEREST, JANUARY 1999

As noted in Part 2, during August and September 1998 the European Audit Division of National Australia Bank undertook an audit of compliance with tax legislation and internal procedures at the Bank. Testing was carried out on a sample of ten SSA's in each of ten randomly selected branches; no stratification by value took place.

The overall conclusion of the audit was that the standard of compliance in the Bank was rated as unsatisfactory. In relation to SSA's it was noted that:

- *21% of sampled SSA accounts were in error against legislative requirements and in this instance there is the possibility that up to 4% of the customers may be ineligible for these accounts.*

- *The major weaknesses identified were lack of understanding by branch staff of the eligibility requirement for joint accounts; failure to evidence that the identification of customers had been verified and in 79% [39 of the 49 withdrawals made in 1998 from the accounts reviewed during the audit] of the sample tested withdrawals from accounts being allowed without the required notice period being given.*

- *The branch declaration process [to confirm that DIRT requirements were being met on an ongoing basis] was ... inaccurately reporting the level of compliance with D.I.R.T. regulations across the sample of declarations tested.*

The 21% error rate noted above was analysed as follows:

5% *no declaration held*

3% *joint account for unmarried customers*

1% *2 accounts for the same customer*

2% *declaration unsigned*

10% *full customer name not on declaration*

RETROSPECTIVE DIRT LIABILITY TO THE REVENUE COMMISSIONERS

The Bank has confirmed to the Inspectors that it has found no evidence that, on discovering breaches of the conditions applicable to the operation of deposit accounts as SSA's, either as a result of the DIRT Theme Audit of December 1994 or otherwise, the Bank calculated the DIRT liability resulting from the deficiencies noted or, prior to the Inspectors' appointment, remitted any payment to the Revenue Commissioners in discharge of such liability.

INSPECTORS' CONCLUSIONS

The Inspectors find:

1. The Bank failed to deduct Deposit Interest Retention Tax ("DIRT") at the standard rate from interest paid or credited on accounts designated as Special Savings Accounts where the branch did not hold a properly completed declaration in a form prescribed or authorised by the Revenue Commissioners or where there had been a breach of the statutory requirements relating to withdrawals.

2. Although senior management was aware of the breaches of the relevant statutory requirements, the Bank took no steps to calculate and remit to the Revenue Commissioners arrears of DIRT due, being the difference between tax at the standard rate, which ought to have been deducted, and tax at the reduced rate actually applied.

PART 5

EVASION OF REVENUE OBLIGATIONS: THE SALE OF CMI, SCOTTISH PROVIDENT INTERNATIONAL AND OLD MUTUAL INTERNATIONAL POLICIES

THE SALE OF CMI, SCOTTISH PROVIDENT INTERNATIONAL AND OLD MUTUAL INTERNATIONAL POLICIES

THE BANK, THE COMPANY AND THE LIFE ASSURANCE COMPANIES

The Financial Advice and Services Division

On 1 May 1989, Nigel D'Arcy commenced employment with the Bank, having been recruited by the then Chief Executive, Jim Lacey, to establish the Financial Advice and Services Division ("FASD") of the Bank to provide a range of independent financial services, primarily in the insurance and investment-related sector, to Bank customers and others. Prior to the establishment of the FASD, such products were sold to Bank customers through managers' insurance agencies. The Bank acquired the interest in the managers' insurance agencies with effect from 1 January 1990.

The role of the FASD was to generate income for the Bank from:

- The sale of high value insurance products used for tax planning, business planning and personal financial planning.

- The development through the Bank's branch network of sales of high volume insurance products such as endowment policies, regular premium savings and protection plans.

Management and Personnel of the FASD

Throughout the period from 1 May 1989 Mr D'Arcy held the position of Head of FASD.

The Bank employed financial services managers whose responsibilities were to obtain referrals for high value insurance products from the Bank's retail branches and to deal with direct enquiries from the public with respect to such products. The financial services managers reported directly to Mr D'Arcy.

Each financial services manager dealt with a specified group of branches and had a specific sales target of initial commission entitlements on insurance products sold. The remuneration of the financial services managers was by way of basic salary and a performance-related bonus based on the initial commission entitlements earned for the Division by each of them. The financial services managers therefore had a direct and individual potential financial benefit from sales effected by them or attributed to them.

The first three financial services managers commenced employment with the Bank on 1 September 1989 and a further six persons held positions as financial services

managers in the period covered by the investigation. The names of the financial services managers and the periods throughout which they filled that role are:

Beverley Cooper-Flynn	1 September 1989 to 5 June 1997
Michael Fitzgerald	1 September 1989 to 31 July 1997
Alistair Stewart	1 September 1989 to 25 June 1994
Charlie McCarthy	4 December 1989 to 15 June 1998*
Patricia Roche	1 October 1991 to 19 September 1994
Bob Wynne	15 August 1994 to 15 June 1998*
Frank Lynch	15 March 1995 to 15 June 1998*
Gerry Stewart	20 June 1997 to 15 June 1998*
John Bailey	25 August 1997 to 15 June 1998*

*Employed as financial services manager at the date of the Inspectors' appointment.

Both Ms Cooper-Flynn and Ms Roche were granted leave of absence from the dates noted above and were still employed by the Bank at 15 June 1998.

Patrick Cooney was recruited as investment analyst on 4 December 1989 and was appointed investment manager on 1 January 1991, a position he held until 12 July 1996.

Role of National Irish Bank Financial Services Limited

In addition to establishing the FASD, the Bank used National Irish Bank Financial Services Limited ("the Company", "NIBFSL"), a wholly owned subsidiary of the Bank, to account for the income and expenses of the FASD relating to the sale of life assurance and investment type products. The Company, but not the Bank, was authorised as an insurance intermediary under the Insurance Act, 1989, in its capacity as a broker.

The board of the Company, from November 1989 and throughout the remainder of the period the subject of the investigation, comprised senior executives of the Bank and the secretary for the time being of the Bank was the secretary of the Company. However the directors of the Company, *qua* directors, did not consider the affairs of the Company other than in the context of formal approval of the annual financial statements of the Company. None of those engaged in the business of the FASD were employees of the Company.

Relationship of the Bank and the Company with CMI

On 6 March 1990 Mr Cooney and Alistair Stewart of the FASD attended a presentation made in Dublin to a number of banks and investment houses by representatives of CMI Insurance Company Limited and other companies within the CMI Group of Companies ("CMI"). On 16 March 1990 CMI wrote to Mr D'Arcy outlining possible developments between CMI and the Bank "*with a view to providing offshore contracts for your Irish clients*".

The FASD commenced to do business with CMI shortly after receipt of this letter. The nature of the relationship of the Bank and the Company with CMI is evidenced by copy documentation provided to us by the Bank and by CMI which indicates the following:

- On 28 June 1990 Mr D'Arcy, purporting to act on behalf of NIBFSL, applied for the appointment of the Company by CMI Financial Management Services Limited as an intermediary. Mr D'Arcy was not at that time either an employee or a director of the Company.

- On 24 July 1990 Linda Hughes, an administrative assistant in the FASD, as sole signatory, made application for indemnity terms to CMI Insurance Company Limited on behalf of "National Irish Bank Financial Advice & Service Division". The application form stated that, in the case of a limited company, the application must be signed by two directors.

- On 19 May 1993, Mr D'Arcy as Head of Financial Services signed a Terms of Business and Scales of Commission Agreement for a Master Distributor with the CMI Group of Companies and purported to do so on behalf of NIB.

- On 10 September 1993 Mr D'Arcy as Head of Financial Services signed a Terms of Business and Scales of Commission Agreement for an Introducer with the CMI Group of Companies and purported to do so on behalf of NIB.

- On 9 June 1994 Mr D'Arcy as Head of Financial Services completed an application for indemnity terms with the CMI Group of Companies, purporting to do so on behalf of the Company. In this instance the application for indemnity terms was also signed by Bank executives Frank Brennan and Michael Keane, then General Manager – Administration and General Manager – Banking respectively.

- On 26 January 1995, CMI Financial Management Services Limited wrote to Mr D'Arcy referring to the Terms of Business Agreement signed by him on behalf of NIB on 10 September 1993:

  > *Following your recent clarification of name, the Terms of Business Agreement is hereby amended to show the correct name of National Irish Bank Financial Services Limited.*

The agreements of 19 May 1993 and 10 September 1993 each stated the role of the Bank in the following terms:

> *For the avoidance of doubt the introduction of Business in accordance with these Terms of Business does not constitute the Master Distributor* (agreement dated 19 May 1993)/*Introducer* (agreement dated 10 September 1993) *a partner employee or agent of the Companies and the Master Distributor/ Introducer remains at all times the agent of his client in respect of the Business.*

It is evident from the above that while there was confusion as to the identity of the party contracting with CMI, the role of the Bank or of the Company as applicable was that of an introducer of business to CMI.

Relationship of the Bank and the Company with Scottish Provident International

In early 1994, Mr Lacey instructed that, for prudential reasons, the monies deposited by CMI with the Bank (discussed further below) should not exceed a ceiling of IR£20 million. Discussions took place with Scottish Provident International Life Assurance Limited, ("Scottish Provident International"), a company mentioned by Mr Lacey as a possible alternative to CMI, which company had a Personal Investment Portfolio product similar to the CMI Personal Portfolio policy. These discussions led to the Bank entering into an arrangement with Scottish Provident International similar to the arrangement it had with CMI.

Extract from Nigel D'Arcy memorandum to Kevin Curran, Regional Manager North West, dated 25 March 1994:

> *Our business with CMI is substantial and, as a matter of prudence, we have set up an arrangement (virtually identical to the CMI arrangement, vis-à-vis deposits etc) with Scottish Provident International to split new business. The CMI and SPI arrangements will run in tandem (one does not replace the other).*

An agreement dated 31 March 1994 between Scottish Provident International and the Company was signed on behalf of Scottish Provident International on 5 April 1994 and was signed on behalf of the Company by Mr D'Arcy on 22 April 1994. Mr D'Arcy was not at the time either an employee or director of the Company.

Relationship of the Bank and the Company with Old Mutual International

Mr D'Arcy, purporting to act for and on behalf of the Company signed a Terms of Business Agreement with Old Mutual International (Guernsey) Limited ("Old Mutual International") on 25 September 1996.

Only one policy was effected with Old Mutual International through NIB.

Authorisation of CMI, Scottish Provident International and Old Mutual International to carry on business in the State

No insurance undertaking may carry on business in the State unless it is the holder of an authorisation from the Minister for Enterprise, Trade and Employment. In the case of life assurance business, this regulation has been in force since at least 1984 (see Article 4 of the European Communities (Life Assurance) Regulations, 1984 (S.I. No. 57 of 1984)). This obligation is now imposed by Article 6 of the European Communities (Life Assurance) Framework Regulations, 1994 (S.I. No. 360 of 1994). Neither CMI Insurance Company Limited, Scottish Provident International nor Old Mutual International was authorised to carry on life assurance business in the State at any time in the period up to 15 June 1998.

THE LIFE ASSURANCE PRODUCTS

General

The Scottish Provident International policy shared the key features of, and was promoted in the same manner as, the CMI Personal Portfolio product. Therefore, while the focus hereunder is on CMI products, references to the marketing and sale of CMI products are to be taken as references to the Scottish Provident International product also, and the references to CMI in the Inspectors' conclusions at pages 115 and 116 are likewise to be taken as referring to Scottish Provident International also.

Nature of CMI Products sold by FASD

The FASD introduced life insurance business to CMI on behalf of its clients in the period from March 1990 to 29 January 1998, the date from which the Bank withdrew the CMI policies from sale.

The principal life insurance policies for which introductions were made to CMI by the FASD were as follows:

- Emerald International Portfolio
- CMI Premier Bond
- CMI Personal Portfolio
- CMI Passport – Wealthbuilder Plan

Emerald International Portfolio

The Bank formally launched the Emerald International Portfolio, a broker bond based on the CMI International Portfolio Bond underwritten by CMI, in July 1990, a number of policies having been "sold" by the FASD prior to that time. The Emerald International Portfolio was a fund of funds geared to medium to long term capital growth and was dependent upon the performance of world equity markets.

From the outset, publicity for the product noted the advantages, so far as concerned probate on the death of the policyholder, of having the policy assigned to a trust. The principal advantages of the trust were that the policyholder could during his lifetime enjoy the benefits of the policy and effect partial or complete surrenders of the policy. The trust allowed the policyholder(s) as settlor(s) of the trust to retain the beneficial ownership of the policy while vesting the legal ownership of the policy in the trustees of the trust. Accordingly, on the death of the policyholder (or in the case of joint life policies, on the death of the last policyholder to die), there is no transfer of legal ownership and the trustees can therefore hold the trust fund on trust for the beneficiaries nominated by the settlor without the need for probate.

Illustrative evidence includes:

Extract from sales brochure issued by FASD:

> *TRUST DEED ADVANTAGES*
>
> *Investing in the Emerald International Portfolio has the added advantage that through a trust deed mechanism we can ensure that your beneficiaries will receive the proceeds of your investment immediately on death with no probate requirement.*

Extract from Nigel D'Arcy memorandum to senior management of the Bank, dated 11 July 1990, attaching copy of note sent to all branch managers on 4 July 1990:

> *TRUST DEED ADVANTAGES – **EXTREMELY IMPORTANT***
>
> *Investing in the Emerald International Portfolio has the added advantage that through a trust deed mechanism, intended beneficiaries will receive the proceeds of the investment **immediately on death** with no foreign probate requirement. This is vitally important since many overseas deposit accounts cause untold probate delays and problems.*

Extracts from a report prepared by Alistair Stewart for customers at the time of their investment in the Emerald International Portfolio:

> *[Customers have a] sum of money currently on sterling deposit to be invested for long term growth and security. Confidentiality and the continuation of the investment in the event of the death of [the customers] is of vital importance.*
> ...
>
> *It would be our intention to assume that, in making these investments that confidentiality and the continuance of the investment are assured i.e. that whatever circumstances happen in the future, this portfolio will carry on and not have to go through any probate process. This I believe together with the investment strategy as outlined, will insure the growth and security of [the customers'] investment.*

It is suggested in Mr D'Arcy's memorandum of 11 July 1990 that the advantage of creating a trust was that it prevented the delay that could occur if probate had to be obtained before the beneficiaries could access the funds. There is no doubt this was one of the advantages but in the opinion of the Inspectors an equally if not the more important one from the investor's point of view, and this would have been known to Mr D'Arcy, was that the absence of the need for probate meant that the funds could be kept concealed from the Revenue Commissioners. This is the clear inference to be drawn from the following statement in a number of letters sent by Ms Cooper-Flynn to customers in 1991 in regard to the Emerald Prosperity Fund. In referring to the fact that the money could be paid out to the beneficiaries without going through probate, she states:

> *This facility removes any risk involved in distributing [the customer's] money on death.*

With the downturn of world equity markets in early 1992, many of the Bank's clients were concerned at the volatility of the Emerald International Portfolio and wished to have their monies otherwise invested. As the funds invested in the Emerald International Portfolio had failed to attain what was regarded by the Bank as "critical mass", the fund was exposed to sudden unit price fluctuations upon any large encashment of units in the fund. Accordingly, the FASD decided to close the Emerald International Portfolio funds and to recommend to holders of units in these funds that they switch their investments to other CMI managed funds.

CMI Personal Portfolio

The CMI Personal Portfolio is a whole of life assurance policy underwritten by CMI in the Isle of Man. Although the contract provides the minimum life cover so as to be considered a contract of life assurance, its primary purpose is as an investment vehicle. The choice of investment content within the CMI Personal Portfolio is under the control of the policyholder or that of his appointed advisor. A distinct and identifiable portfolio is created for each policyholder. The FASD was invariably appointed investment advisor to the policyholder and CMI acted upon the instructions of FASD personnel in relation to the initial investment of CMI Personal Portfolio funds and in relation to any change in the manner in which the funds were to be subsequently invested.

The CMI Personal Portfolio was part of the normal product range offered by CMI and was made available for sale through the FASD in 1991, with the first policy being effected in the first half of that year.

There was no formal launch by the FASD of the CMI Personal Portfolio, or of any CMI single premium product other than the Emerald International Portfolio. The CMI Personal Portfolio was introduced to branch managers of the Bank in 1992 through presentations made by FASD financial services managers, often accompanied by Richard Marshall, CMI area manager for Ireland.

When the CMI Personal Portfolio policies were first sold by the FASD, the funds were typically invested outside the Bank, in CMI managed funds and in other

investments. From 1992, the majority of funds invested in CMI Personal Portfolio policies were reinvested on deposit with the Bank and this was known to senior management of the Bank.

A significant portion of the income of the Company in the year ended 30 September 1992 consisted of commissions earned on business introduced to CMI. The greater part of the income of the Company in the years ended 30 September 1993 and 30 September 1994 consisted of such commissions.

Investor Targeting and Assurances of Confidentiality

The Inspectors are satisfied that at least from the second half of 1992 the CMI Personal Portfolio policy was mainly targeted at persons who had funds undisclosed to the Revenue Commissioners and was promoted in a manner that made it attractive to such persons.

The Product Features Sheet used by some of the FASD financial services managers was in the following form:

CMI PERSONAL PORTFOLIO

Advantages

1. *Confideniality* (sic)*/Security*

   Deposit is transferred out of existing account and re-invested in the names (sic) *of a holding company. Therefore clients names does* (sic) *not appear on any account.*

2. *No Probate requirements*

   Investment is written in trust i.e. client can decide on day one who the beneficiaries will be in the event of his death. All the beneficiaries need to supply is a death certificate and the investment will be released.

3. *Cautious Investment*

   The client can have the funds invested in the exact same deposit account as he is in presently and at the same rate or he can choose any other sterling deposit account anywhere in the world.

4. *Tax Free*

   All returns are paid gross.

5. *Accessibility*

   Client can draw an income if he wishes.

6. *Quarterly Valuations provided*

7. *The portfolio can also invest in shares, unit funds, bonds and deposit accounts.*

The advantages at the top of those listed – "Confidentiality/Security" and "No Probate requirements", would clearly have been of particular interest to persons with undisclosed funds and they were reiterated regularly in reports prepared for prospective customers by some of the FASD financial services managers.

The full text of the Product Features Sheet is reproduced at Appendix 10.

The advantage of "no probate requirements" is spelled out as follows in one of Alistair Stewart's reports dealing with the Personal Portfolio product:

> *... thus avoiding the possibility of such monies being included in any Inheritance Tax calculations.*

It could hardly have been stated more clearly that the advantage was the possibility of evading tax.

The advantage of "no probate requirements" is also stressed in the following extracts from a report prepared for a prospective investor by Patricia Roche:

> *BANK DEPOSIT ACCOUNT*
>
> *(C). In the event of the death of any of the named person* (sic) *to an account a "Grant of Probate" would be required. This automatically notifies the Capital Taxes Office of the existence of certain assets. ...*
>
> *As confidentiality and continuity of your capital is of paramount importance to you, I would suggest that you consider changing your existing approach to your deposit account. Instead of holding the deposit account directly in your own names you should transfer the monies into a Trust, which you own and of which you would be beneficiaries. ...*
>
> ***An important feature of the portfolio is the trust facility, which ensures that a "Grant of Probate" is not required in the event of death. ...***

The full text of this report is set out at Appendix 11.

In an earlier letter from Ms Roche to a customer, written in May 1992, comparing a Scottish Provident Investment Bond with an investment in Post Office Savings Certificates, the advantage to be gained from avoiding probate is again shown to be that complete confidentiality is assured. It is stated in the letter that in the case of investment in Post Office Savings Certificates "*confidentiality is not complete*" because "*in the event of the death of the Bond holder where Bonds to the total value of £5,000 or more are held, either a Certificate of Clearance from the Capital Taxes Office or letters of administration or a Grant of Probate are required*".

Apart from what is to be found in the Bank's documentation, the Inspectors are satisfied from the evidence of investors and some of the FASD financial services managers that, as part of the promotion of the CMI Personal Portfolio, a guarantee was given that the investment was confidential and that the Revenue Commissioners would never get to hear of it. The latter part of the guarantee may not always have been stated expressly, but that it was implied was quite clear.

The Investment Checklist

Even before the CMI Personal Portfolio began to be promoted as a means of tax evasion, whether or not funds for investment in single premium policies had been declared to the Revenue Commissioners was a matter of interest to the FASD.

At the time of the introduction by the FASD of the Emerald International Portfolio there was in existence an investment checklist introduced by Patrick Cooney on 28 February 1990. Mr Cooney requested that this checklist be completed by the FASD financial services managers in respect of all single premium investment recommendations and returned to Mr Cooney. The completion of the investment checklist, *inter alia*, required the financial services managers to reply to the following question:

Is the money declared? *Yes/No.*

Copies of investment checklists for four parties who invested in the Emerald International Portfolio each record "*no*" as answer to the question "*Is the money declared?*" One of the investment checklists includes the notation "*very hot*", and another investment checklist notes that the person is "*Ripe for the New Fund*".

Questioned as to the significance of this question, Mr Cooney at interview with the Inspectors stated:

> *Is the money declared and that would have meant money declared, is it declared in their tax returns. That could be an investment like post office, unit linked funds, such investment did not have to be declared in a person's tax returns. That would be what that is there.*

Mr Cooney was questioned as follows on the recorded response referred to above:

Inspector: *What does "very hot" mean?*

Mr Cooney: *That would mean a very hot prospect. It would mean that this is a client who is ready to go.*

Inspector: *It wouldn't mean "very hot" from a revenue perspective?*

Mr Cooney: *No, it is very easy in hindsight to look at these things when we looked back at our division.*

Coincident with the launch of the Emerald International Portfolio, Mr Cooney in a letter dated 30 July 1990 which accompanied the monthly investment bulletin to the FASD financial services managers stated:

> *Finally, we have the people who have money invested offshore already or whose money is "Hot". In this scenario, we should in almost all cases, direct the monies into our New Bond, "The Emerald International Portfolio"...*

Mr Cooney was asked to explain the term "hot" in the context of this letter:

Inspector: *Could I just ask then in relation to the second last paragraph where you say "finally, we have the people who have money invested off-shore already but whose money is hot". What would you have meant by that?*

Mr Cooney: *Hot prospects.*

The model Investment Checklist with accompanying note from Mr Cooney, together with five completed examples of the Checklist, are reproduced at Appendix 12.

Mr Cooney's letter of 30 July 1990 is reproduced at Appendix 13.

Scottish Provident International and Confidentiality

In discussions with representatives of Scottish Provident International the issue of confidentiality was also raised.

Illustrative evidence:

Extract from minutes of meeting between Nigel D'Arcy and representatives of Scottish Provident International on 1 March 1994:

> *ND'A confirmed the following points regarding the bank deposit business:*
>
> - *Confidentiality is a key selling point along with flexibility.*

Extract from note dated 27 January 1995 from a representative of Scottish Provident International to the FASD:

> *Following my meeting with Charlie [McCarthy] and Michael [Fitzgerald], they have both raised concerns over the use of Telegraphic Transfers. As you know there is some question mark over the visibility of TT's.*
>
> *If you receive two pieces of business from the branches, both accompanied by drafts, but one case is grey money and the other is clean declared money. The drafts are both written out to NIB and have to be cleared in Dublin. You will then raise TT's to go to the Isle of Man.*

> *The question both Charlie and Michael have is: Which account will the drafts go in to and from which accounts will the TT's come from? The point they are making is that if both clean and grey money are mixed together and there was an investigation by the Revenue, the clean money could actually expose the grey money.*

Extract from letter dated 23 October 2000 from the same representative of Scottish Provident International to the Inspectors:

> *Grey money in the context of my discussions would have referred to funds or investments not entering or having entered a tax system. This would not imply that the funds or investment would not enter the tax system, although there may be occasions when this was not necessary at that stage, for example a foreign national temporarily residence* (sic) *in Ireland in receipt of foreign emoluments etc. We would not have received information regarding clients, or potential clients, funds* (sic) *as this would have been between the advisor (NIBFS) and the client.*

Obligation to make Returns to the Revenue Commissioners

The assurances of confidentiality given with respect to the CMI Personal Portfolio policies effected on or after 20 May 1993 did not take account of the obligation of the Bank or the Company to make a return of such sales to the Inspector of Taxes. It appears that none of the FASD financial services managers had been instructed by FASD management of those provisions of the Finance Act, 1993 which oblige any Irish resident person acting as an intermediary in connection with the issuing of a foreign life assurance policy on or after 20 May 1993 to deliver a return specifying the following details of each resident in respect of whom it has acted:

- The full name and permanent address of the resident.
- The resident's tax reference number.
- The full name and address of the relevant person with whom the foreign policy was entered into.
- The date on which the policy was entered into and the amount of the premium payments made under the policy.

These provisions were originally introduced by Section 24 of the Finance Act, 1993, which inserted Section 20A in the Capital Gains Tax Act, 1975. This latter Section subsequently became Section 594 of the Taxes Consolidation Act, 1997 which applies the provisions of Section 895 of the Taxes Consolidation Act, 1997 with relevant amendments.

The return must be submitted by the intermediary company in respect of each chargeable period in which it has acted as an intermediary, within nine months after the end of the relevant accounting period of the company.

The Bank did not include details of the sale of CMI, Scottish Provident International or Old Mutual International life assurance policies in any such return made at any time prior to the news media allegations in January 1998.

THE PURPOSES FOR WHICH THE CMI PERSONAL PORTFOLIO WAS BEING USED

Mr D'Arcy's Evidence

Mr D'Arcy, in evidence which the Inspectors accept, confirmed to them that he was aware that the CMI Personal Portfolio was being used for a purpose for which it was not intended:

Inspector: *Now, in the course of our investigation we have received evidence that the purposes behind the sale of the CMI policy included benefits for the bank as follows; "(a) The retention of deposits, the regularising of bogus non-resident deposits, the earning of commission for the bank, the securing of new deposits for the bank, finding a safe haven for Revenue-sensitive funds."*

Now, would you say that that is a fair summary of how CMI was seen by branch managers, senior management within the bank and by people in the FASD division?

Mr D'Arcy: *... yes, that would be fair, if you are not time-specific.*

Mr D'Arcy's response, acknowledging the different purposes behind the sale of the CMI policies, was confirmed by evidence from other sources.

Each of the purposes, together with evidence relevant to each, will be dealt with separately.

"Finding a safe haven for Revenue-sensitive funds"

Evidence of FASD Personnel

FASD personnel have told Inspectors that they did not consider it was incumbent on them to refuse to do business with persons whose monies had not been declared to the Revenue Commissioners, and they considered CMI was a suitable investment for people with such monies.

Illustrative interview evidence, which the Inspectors accept:

Patricia Roche

Ms Roche: *Generally speaking, at the sales meetings – I use the phrase "Revenue sensitive" when I am talking to you – but most of the time we would just have discussed hot money and that was a*

term that was freely used at sales meetings. That would not have been unique to me.

Inspector: *If the expression, "hot money" had been used at the sales meetings, why would you have related that to the Revenue?*

Why would you not have regarded it as a hot prospect?

Ms Roche: *It might have been a hot prospect as well, but I would have understood, and I don't think I am being presumptuous when I say that we would all have understood, that hot money was in respect of moneys that people had not declared or that they were concerned about the Revenue becoming aware of.*

And later

Ms Roche: *The way we might have talked about this product is that the beauty of it is that an individual can still have his deposit and it is now confidential, they don't have to worry about the Revenue discovering it, they are avoiding the DIRT on it and in the event of death there is no probate. We were all talking about people living here, it was not a case that these were all non-residents.*

Inspector: *... the advantage effectively, that would have been explained to you before you went out on the road to sell the product would be, effectively, that once the investment was made, the Revenue would never get to hear about it?*

Ms Roche: *Yes. It may not have been articulated in exactly those terms but that it was the perfect home for hot money, that type of term would have been used.*

And later

Ms Roche: *My own peace of conscience of the whole thing, because I recognised from the beginning that it wasn't kosher, was that it wasn't really a matter for me to concern myself with the tax affairs of individuals, that it was a legitimate investment product in itself and it was up to the individuals to act as their own moral conscience and return it or not return it.*

Patrick Cooney

Inspector: *... would you have become aware of the fact that some of the moneys invested in CMI was money that hadn't been declared to the Revenue?*

Mr Cooney: *No, that wasn't my job.*

Inspector: *And did you regard it as anybody else's job?*

Mr Cooney: *No. No, it wasn't anybody else's job.*

Beverley Cooper-Flynn

Inspector: *In relation to CMI Personal Portfolio policies ... were you aware of the source of funds?*

Ms Cooper-Flynn: *Not generally but, at times, it did become apparent. But not generally. Source of funds really wasn't an issue for me. I was an investment advisor.*

Nigel D'Arcy

Inspector: *So in other words when you speak about the culture of that time by that you mean accepting undeclared funds for investment?*

Mr D'Arcy: *I would think that whether they were going into deposits or anything else, I would say, I would say yes.*

Inspector: *Where as a result of your making enquiry or otherwise you became aware that funds for investment in CMI Personal Portfolio policies or other single premium policies were undeclared to the Revenue Commissioners did this knowledge have any effect on your decision to allow FASD sales consultants to sell or not to sell a policy to the particular person or did it have any effect on the type of policy that they would recommend to the customer?*

Nigel D'Arcy: *It generally would not have had an effect.*

Charlie McCarthy

Inspector: *The selling point was that this was totally confidential ... and at the end of the day there were no probate requirements ... Now if you put the two of those together, right, would you think that that product would be of interest to somebody who had money that was undeclared to the Revenue?*

Mr McCarthy: *Probably.*

And later

Inspector: *... is it right, Charlie, to say that you didn't regard it as your business ... to find out what the source of funds were* (sic) *as to whether it was resident, non-resident, fictitious, bogus or hot ...*

Mr McCarthy: *Yes.*

Alistair Stewart

Inspector: *If, say, I have the money on deposit with the Northern Bank in Belfast, would you ask me why it was in Belfast?*

Mr Stewart: *No, that wasn't part of my brief. We were there to extend investment advice. If you were to start asking clients those questions I don't suppose they would hang around.*

And later

Inspector: *[Would you say] something like: "if the money is not declared to Revenue, CMI would be a good haven for it". Is that correct?*

Mr Stewart: *Yes ... It was an option but not the only one.*

Bob Wynne

Inspector: *[Did you] concern yourself in relation to what the source of funds were* (sic)*?*

Mr Wynne: *... no I didn't.*

Evidence of Bank Managers

Some branch managers also were of the view that CMI was a suitable investment for people with undeclared funds. Illustrative evidence from branch managers, which the Inspectors accept, includes:

Inspector: *So at the time, at the meeting then, Mr [manager name], ... did you come away with a view that this product, CMI, may have been attractive to people who had not declared their income to the Revenue Commissioners?*

Branch Manager: *Yes.*

oooOooo

Inspector: *Did you target people who had money in Northern Ireland or elsewhere, outside the jurisdiction, as potential customers?*

Branch Manager: *I understood that they would be suitable for CMI.*

oooOooo

It [the CMI product] was marketed at people who had sensitive money ...

oooOooo

Inspector: *So the big benefit, the real big benefit of CMI?*

Branch Manager: *No name.*

Inspector: *The Revenue never get to hear about it?*

Branch Manager: *Yes, of course.*

oooOooo

Inspector: *After this briefing with the people from CMI and the FASD the understanding was that if people invested in CMI the Revenue would not get to hear about it?*

Branch Manager: *I would have to say that that is what I understood.*

oooOooo

While the CMI Personal Portfolio policy was targeted principally at customers of the Bank, many of whom held bogus non-resident accounts or fictitious or incorrectly named accounts in the Bank, certain persons who were not customers of the Bank but were known to have funds which were not disclosed to the Revenue Commissioners were also approached with a view to investment in CMI Personal Portfolio policies.

Customers – Revenue-related matters

The Inspectors interviewed 135 persons who had invested in CMI policies and 4 who had invested in Scottish Provident International policies. Many interviewees indicated that the funds invested had not been declared to the Revenue Commissioners and were on deposit with the Bank in a bogus non-resident account, a fictitiously named account from which DIRT was being deducted, or a fictitiously named bogus non-resident account. Their evidence was to the effect that the CMI policies were promoted by the Bank as an investment which was wholly confidential and would never become known to the Revenue Commissioners, and also that, if the policy was assigned to trustees, the beneficiaries named by the investor would, on the latter's death, be able to have the funds released to them on the production of a death certificate, thereby avoiding the necessity of probate having to be obtained.

Reports of the Revenue Commissioners

That a substantial proportion of the monies invested in the Personal Portfolio had not been declared to the Revenue Commissioners is made clear by the annual reports of the Revenue Commissioners, the most recent of which covers the year ended 31

December 2003. The Report sets out the position in its "*Clerical Medical Insurance – National Irish Bank Scheme*" investigation as follows:

Cases originally targeted for investigation	*452*
Investigations concluded by end 2003	*395*
Cases settled	*285*
Total collected (tax, interest and penalties)	*€42.5 million*
Cases finalised with no additional liability arising	*110*

The remaining 57 cases are the subject of ongoing investigations, in respect of which €4.78 million has been paid on account.

"Regularising of bogus non-resident deposits"

Illustrative documentary evidence includes:

Extracts from an attachment to a memorandum of 17 August 1994 from Geoff Bell, Head of Management Services, to Frank Brennan, General Manager, copied to Michael Keane, Paul Harte, Patrick Byrne and Nigel D'Arcy:

Background

Scheme launched several years ago by Financial Advice and Services Division (FASD) whereby funds are invested for Irish residents by insurance company based in the Isle of Man (Clerical Medical International – CMI) in deposits, securities or stocks and shares in accordance with individual customer's requirements. Funds are introduced by FASD and client confidentiality is of the utmost importance. As part of the scheme CMI reinvest the Irish pound investments in the originating NIB branch. ...

OPERATION OF CMI DEPOSITS AT PRESENT

BRANCH

Customer decides to invest in CMI following advice from FASD. Funds may be an existing branch deposit or other but are usually of sensitive nature. Confidentiality a prerequisite in investment.

Extracts from a report produced by NAB Group Audit entitled "Development, Launch, Marketing and Selling of the CMI Personal Portfolio Product" dated 22 April 1998 ("the Washusen Report"):

There is evidence to suggest that certain senior managers at the time were aware of NIB accounts containing funds which were 'sensitive' ... and that the CMIPP product was being used by some branch managers to disguise the ownership or status of the money contained therein.

An attachment to the Washusen Report addresses the term "*sensitive*" as follows:

> *The term 'sensitive' has been frequently used in interviews and appears in some documentation. Those interviewed have expanded on this term with phrases such as 'being of doubtful provenance, probably for tax related reasons'.*

Illustrative evidence, which the Inspectors accept, received at interviews of senior Bank personnel, includes:

Frank Brennan

Inspector: *... doesn't that indicate that as far back as ... 17 of August 1994, that you must have been aware that sensitive funds were being channelled into CMI?*

Mr Brennan: *... yes, I would have read that at the time, presumably, yes.*

Nigel D'Arcy

Mr D'Arcy: *It [CMI Personal Portfolio] was just another product on a panel but it was seized upon, it was seized upon. I think it was probably, I did discover quite, as I say, in 1992, that it was being used perhaps in a way which wasn't intended and ...*

Inspector: *- and what way was that?*

Mr D'Arcy: *Well, I mean I think it's quite clear, it's being used for, you know, with sensitive funds or deposit accounts ... which were not accurately classified.*

And later

Mr D'Arcy: *... it was quite obvious that, that there were a lot of non-resident accounts that were not genuine non-resident accounts and shouldn't have been classified as such in the first place and obviously there is a linkage between that and CMI product.*

Similar evidence, which the Inspectors accept, was received from branch managers:

> *It [the CMI product] was marketed at people who had sensitive money to put it nicely, ... People with hot money to put it bluntly.*

oooOooo

> *There was an understanding, as I had it anyway and I think it was widespread, that any accounts ... that you couldn't stand over from the point of view of names or residential status to have them regularised [by introducing them to the FASD for investment in CMI].*

oooOooo

I would have told [financial services manager] the status of it [the account] at the time ... And that we were endeavouring to have it changed.

oooOooo

Inspector: *Did you have in your branch ... a number of accounts that you would have regarded as sensitive, being defined as monies that were not declared to the Revenue?*

Branch Manager: *I would have suspected, yes.*

Inspector: *And did you then target those accounts as possible candidates or customers of CMI?*

Branch Manager: *Yes.*

oooOooo

Well I may have asked him to regularise the account, he may not have been happy to do that and then I may have asked him to speak with our Financial Services Division to see was there anything else that could be done for him.

oooOooo

It was one way of regularising these accounts that needed to be regularised ...

oooOooo

It was implied that it was something which might facilitate people who had non-resident money.

oooOooo

Inspector: *What would happen if you became aware of the fact that there was ... a bogus non-resident account ...?*

Branch Manager: *... they would be the people that I would be considering for CMI.*

Inspector: *And why would you have regarded CMI as regularising the position? Is that something you conceived of yourself or is that something that somebody else told you?*

Branch Manager: *Well, that's how the product was introduced to us.*

oooOooo

I cannot remember it being targeted specifically at non-resident deposits but it looks very much to me as if it was geared towards that type of thing.

oooOooo

There was no question now about him [customer] being resident. We had his money, we had to do something about it and I would have referred him to FASD.

Inspector: *Finally, what was the reason you introduced all of these customers to FASD?*

Branch Manager: *They were non-resident accounts that we wanted out of the branch.*

oooOooo

The beauty ... was this product was available to people who had always [had] ... sensitive funds or funds that may not have been declared to the Revenue. This was the last chance of tidying up any such accounts, it would take the customer's name out of the equation.

oooOooo

Inspector: *Why were these accounts swept into CMI?*

Branch Manager: *To tidy them up ... This was a way of removing them from the normal deposits that were held at the branch.*

oooOooo

Inspector: *And can you recollect what the FASD people said to you about the product?*

Branch Manager: *My recollection is that it was a Bond, an investment portfolio that was offshore and on my understanding was that essentially it legitimised any so-called bogus non-resident accounts that may exist.*

oooOooo

... there is no doubt in my mind ... it [the CMI product] was there to tidy up the bogus non-resident accounts

oooOooo

The use of CMI policies to regularise bogus non-resident accounts was also discussed with FASD financial services managers; interview evidence included the following, which the Inspectors accept:

Charlie McCarthy

Inspector: *If the bank had a bogus non-resident account and senior management was insisting that the bank manager get rid of it. In those circumstances, wouldn't the bank have been at risk of losing the deposit?*

Mr McCarthy: *Yes*

Inspector: *... wouldn't that be one of the circumstances in which CMI would enable the bank to keep the deposit?*

Mr McCarthy: *Maybe so, yes.*

Patricia Roche

Inspector: *Were you aware that some branch managers were trying to disguise the ownership of money by using the CMI personal portfolio product?*

Ms Roche: *... it would have been my understanding, because of conversations leading up to the investment taking place, perhaps, that that was essentially the purpose of the investment.*

"Retention of deposits"

Illustrative documentary evidence:

Extract from Nigel D'Arcy memorandum to Kevin Curran, Regional Manager North West, dated 25 March 1994:

> *As you are aware, our relationship with CMI has been extremely successful on two counts:*
>
> *Protecting deposits which would otherwise be lost to NIB (as well as attracting new deposits into the network)*
>
> ... ...

Extract from Nigel D'Arcy letter to Inspectors, received 10 July 1998:

> *The Bank's original rationale for the Financial Services Division was to provide a range of independent financial services as opposed to own manufactured products, primarily in the insurance and investment related*

sector, and also to keep monies within NIB control where they were in danger of being lost, particularly deposits.

Branch responses relating to fictitiously named accounts:

The declarations to Paul Harte from branch personnel referred to at page 68 in Part 3 of the report, dealing with fictitious and incorrectly named accounts, contain notations such as "*To call and arrange transfer to CMI*". It is a reasonable inference that this was a way to retain deposits within the Bank.

Illustrative interview evidence from senior Bank personnel and FASD financial services managers, which the Inspectors accept:

Kevin Curran

It had been indicated by Head Office that CMI had agreed with the bank to replace any funds lodged with them on foot of insurance policies or bonds with the bank and that the bank would allocate those funds to the branches where the relationship existed.

... only when funds were likely to leave the bank, would the manager refer the person to an FASD person.

Patricia Roche

... it goes so far as to say that were it (sic) *to offer other investments, I would have been in the seriously bad books of all the branch managers because they would have lost the deposit. The only thing there was to do was to put moneys on deposit.*

What would generally happen is I would know that what is to happen is that this money is to come back on deposit.

Branch managers were also questioned on the retention of deposits; their evidence, which the Inspectors accept, included the following:

... if a deposit was under threat because of the poor return or the range of products that we had in-house, we were definitely -- to my knowledge, to my recollection, we were instructed as a last resort; in other words, don't lose that deposit without at least letting the FASD people see what they can do.

oooOooo

... the other part of the CMI would be, as we were told, was that the deposit, while it might change to a number on the account, would remain in the bank.

Inspector: *Did it surprise you that when an individual was investing his money in CMI the form the investment would take would always be a deposit in the branch of NIB out of which the money came?*

Branch Manager: *We were told at the time that this was the arrangement that had been set up with CMI.*

oooOooo

... we didn't want to lose the resources.

oooOooo

... I never thought deeply about the issue other than that it allowed us to retain our deposits.

Other documentary evidence, retention of deposits and related issues

Other evidence of the importance of the retention of deposits, and issues related thereto, is provided by Bank documents, including the following:

Extract from memorandum of 4 March 1993 from Nigel D'Arcy to all Financial Services Managers, Patrick Cooney, Grace Gaskin and J Lacey (for information):

The outlook for the Division is now extremely positive, despite the severe operating climate. This is (or will be) due to the following initiatives:

1. *The "CMI" campaign. The results coming in from this initiative are exceptional and also very desirable in terms of being extremely high value. The Master Agency initiative will also bear excellent results over the next few months. The addition of an offshore Irish Pound asset class to the CMI currency portfolio is also a very significant development. An excellent feature of the CMI initiative is that most of the underlying assets are placed back on deposit with us.*

Extract from memorandum titled "Procedures for CMI Personal Portfolio Deposits returning to NIB Branches" from Eithne Martin of FASD to all branch managers on 19 November 1993:

The rate applied to this deposit is usually at the sole discretion of the Branch Manager and is applied when the money is returned to Branch from CMI.

In certain cases a special rate has been agreed between Branch Managers and clients.

Extract from facsimile transmission dated 17 February 1994 from Rick May of CMI to Nigel D'Arcy, copied to J Lacey, M Keane and D Boner:

... I am writing, as requested, to confirm CMI's position as to the money currently held through Personal Portfolio Bonds originally introduced by National Irish Bank that are invested in deposit accounts with the National Irish Bank.

Whilst the contract is between CMI and the policyholder, National Irish Bank is the Introducer of the business and is involved in the original recommendation to invest the policy monies into National Irish Bank deposit accounts. CMI is not involved with these contracts in any active fund management of the policy monies and therefore CMI would not actually change the investment decision without the agreement of the National Irish Bank except at the expressed instructions of the individual policyholder or, of course, in exceptional circumstances where CMI believed that the policyholders assets were at risk.

Extract from memorandum dated 3 August 1994 from JF Brennan – General Manager to Geoff Bell, Head of Management Services:

In fairness to Nigel [D'Arcy], he was under pressure from Retail not to strip the individual branches of deposits and this led to a situation where funds destined for CMI came back, in part, to the remitting branch but instead of being in a customer's name they were now held under CMI with a reference number for identification. As I understand it also, there was, at times, negotiation on the term and rate given on the CMI deposit. The branch manager had a role in this negotiation which led me to the conclusion that they clearly identified the deposit with a particular customer even though the account title was CMI with a unique number.

Extract from inter office memorandum dated 7 November 1994 from P Harte to JF Brennan, MJ Keane and N D'Arcy:

FASD needs to actively manage investments in CMI. FASD are formally appointed Investment Managers and they must not allow undue influence from branches. FASD must make the investment decisions; if this does not happen there is a possibility that the tax structures will be interfered with and that FASD could be sued for any investment losses which might occur.

Extract from memorandum dated 11 November 1994 from Nigel D'Arcy to JF Brennan, MJ Keane and P Harte, in response to inter office memo of 7 November 1994:

As stated correctly in the memo FASD are (sic) *formally appointed Investment Managers/Advisors on the CMI Personal Portfolio product. The important point to note is that FASD instruct* (sic) *CMI to carry out certain investment instructions, invest in deposits, individual equities or unit trusts. CMI then make contact with the relevant Financial Institution or Investment House and invest the funds accordingly.*

As indicated ... above, our role is Investment Adviser and CMI's role is to carry out and execute investment instructions.

Extract from memorandum dated 16 April 1996 from Nigel D'Arcy to Michael Keane following takeover by Halifax Building Society of CMI:

> *I will be meeting CM next week and will ask for a **letter** from them confirming that there will be no "funny games" with the CM deposits in NIB. I already have an older letter on this and basically there is no question of there ever being a problem on this front: as advisors, we (FASD) decide where deposits within the CM Personal Portfolio are to be placed.*
>
> *We are prudential in terms of the level of CM deposits with NIB – these are always within the region of £20m. to £21.5m.*

Other evidence

Bank documents and the report of the authorised officer appointed by the Minister for Enterprise, Trade and Employment highlight the proportion of funds re-deposited with the Bank:

- The Washusen Report (a Report produced by NAB Group Audit in April 1998) discloses that 216 Personal Portfolios were sold by the FASD and the report of the authorised officer records that in the case of 194 Personal Portfolios the monies were placed back on deposit with the Bank. The explanation for this is that the investors, contemporaneously with making their investment, and frequently without being aware of it, appointed the FASD as their investment advisor, and the FASD then instructed CMI to place the funds back on deposit with the Bank.

- A letter from the Bank to the office of the Chief Inspector of Taxes dated 12 February 1998 states:

> *Of the £34M originally invested in the CMI Personal Portfolio, approximately £29M was received by National Irish Bank as deposits from CMI. ... Currently the funds deposited by CMI stand at circa. £ Irish 22.6M and £ sterling 2.5M.*

"Securing new deposits for the Bank"

Illustrative interview evidence, which the Inspectors accept:

Branch managers spoke of gaining deposits through promotion of CMI policies:

> *So from the branch manager's point of view, you either gained a deposit on your deposit base or you retained the deposit on your deposit base.*

oooOooo

Inspector: *So why was it ... that you decided to introduce him to the Financial Services Division?*

Branch Manager: *... in the context of the twofold gain which the branch would enjoy, both in terms of achieving an objective on referral*

commission and, notional as it might be, and growing the branch deposit book.

Financial services manager Patricia Roche stated:

... certainly in a small number of cases the branch manager may have had somebody who was [a person who did not have money on deposit at the branch] or was not necessarily a customer of the bank.

Illustrative documentary evidence:

Extract from Nigel D'Arcy memorandum to Kevin Curran, Regional Manager North West, dated 25 March 1994:

As you are aware, our relationship with CMI has been extremely successful on two counts:

... ...

Protecting deposits which would otherwise be lost to NIB (as well as attracting new deposits into the network) ...

"Earning commission for the Bank"

Bank personnel at interview indicated to the Inspectors how the sale of CMI products assisted them meet their commission targets.

Illustrative interview evidence, which the Inspectors accept, includes:

Inspector: *So why was it ... that you decided to introduce him to the Financial Services Division?*

Branch Manager: *... in the context of the twofold gain which the branch would enjoy, both in terms of achieving an objective on referral commission and, notional as it might be, and growing the branch deposit book.*

oooOooo

Charlie McCarthy

Inspector: *... when you say targets, was that targets for the branch in relation to referrals?*

Mr McCarthy: *No. It was commission target.*

Inspector: *For the branch?*

Mr McCarthy: *Yeah.*

Inspector: *For the branch, and one way to get that target would be to refer work because effectively then you'd get the credit and the branch would get the credit?*

Mr McCarthy: *Precisely.*

Inspector: *Then would it be fair to say that the deposit was protected and commission was earned?*

Mr McCarthy: *Yeah, you could say that.*

Other illustrative evidence includes:

Extract from Nigel D'Arcy memorandum to Kevin Curran, Regional Manager North West, dated 25 March 1994:

> *As you are aware, our relationship with CMI has been extremely successful on two counts:*
>
> ... ...
>
> *Providing substantial "other income", which is a priority for all of us.*

THE ROLE OF THE BANK

General

The Bank's role may be summarised as identification of customers and others with undeclared funds, funds in bogus non-resident accounts, or funds offshore, and then promoting the sale of the CMI policies to these persons.

Identifying customers with undeclared funds, funds in bogus non-resident accounts, or funds offshore.

Illustrative interview evidence, which the Inspectors accept, includes:

Nigel D'Arcy

Inspector: *Did you know that potentially people within the bank were targeting Revenue-sensitive monies for investment in CMI?*

Mr D'Arcy: *Yes.*

Patricia Roche

> *What would have more than likely happened is I would have been told [by the branch manager] Mr [customer name] has a deposit, it's revenue sensitive, or a term of that nature may have been used to suggest he had a deposit which*

suggests he wanted it moved from its existing place into something else and still keep as a deposit.

Branch manager interview

... and he [Kevin Curran] suggested to me that perhaps we should have FASD look at the case [of a fictitiously-named bogus non-resident savings account with a balance of £210,000]. At that point I contacted the rep concerned and subsequent to that a meeting took place. That's how it ended up at CMI ... That's generally what used to happen.

Promoting the sale of the CMI policies – *by Guaranteeing Confidentiality from the Revenue Commissioners*

Illustrative interview evidence from FASD personnel, which the Inspectors accept, includes:

Nigel D'Arcy

Inspector: *Now, we have also received evidence that the bank and personnel within the FASD Division of the bank ... promoted the sale of the CMI policies by guaranteeing confidentiality with the Revenue ... . Do you believe that the bank, including people within the FASD Division, was targeting hot money in this fashion?*

Mr D'Arcy: *... at the outset I, I don't know but it certainly became the case.*

Charlie McCarthy

The unique selling point I suppose would be the confidentiality ... They could be concerned about the Revenue ...

Patricia Roche

If I were asked the question, then yes, I probably would have said that it was completely confidential and that it was now in a numbered account at the branch.

Bob Wynne

Inspector: *So if somebody asked you would the Revenue get to hear about this investment, what would your answer have been?*

Mr Wynne: *They will if you disclose it to them but the onus is on you, that the product itself is confidential.*

Mr Wynne commenced employment with the FASD on 15 August 1994, after the enactment of Section 24 of the Finance Act, 1993 which required that details of all

sales of foreign life assurance policies be notified to the Revenue Commissioners by the Bank as intermediary. Because of this the statement that the CMI Personal Portfolio was confidential was incorrect and it appears that Mr Wynne had not been instructed by FASD management on the provisions of the Act.

Evidence on confidentiality from branch managers, which the Inspectors accept, includes:

Branch Manager: *... it's a similar type of confidentiality as to any other bank product. I suppose that he could have kept it [the CMI product] separate any other* (sic), *from his family or whatever as well.*

Inspector: *Or from the Revenue?*

Branch Manager: *Or from the Revenue, yes.*

oooOooo

Confidentiality was a big issue.

oooOooo

Inspector: *So why was it these customers would be interested in CMI?*

Branch Manager: *Total confidentiality ... No one would know about it.*

oooOooo

Inspector: *It was to facilitate the concealment of client funds from the Revenue, that was the attraction of CMI?*

Branch Manager: *That was my understanding from day one.*

Promoting the sale of the CMI policies – *by representing that, where a trust was created, the funds, on the death of the investor, would be passed to the beneficiaries on the production of a death certificate, thus obviating the need for probate.*

Illustrative evidence, which the Inspectors accept – FASD Personnel:

<u>*Nigel D'Arcy*</u>

Inspector: *Now, we have also received evidence that the bank and personnel within the FASD Division of the bank ... promoted the sale of the CMI policies ... by representing that where a trust was created the funds on the death of the investor would be passed to the beneficiaries on the production of a death certificate thus obviating the need for probate and by representing that the investment was free from tax. Do you*

believe that the bank, including people within the FASD Division, was targeting hot money in this fashion?

Mr D'Arcy: *... at the outset I, I don't know but it certainly became the case.*

Extract from internal memorandum dated 28 September 1994 prepared by the legal department of CMI concerning the Personal Portfolio policy of a deceased customer of the Bank, which memorandum was copied to Nigel D'Arcy:

> *Perhaps the most important point that needs to be remembered here and which I would ask you to consider very carefully is the fact that CMI has been put on notice by both the Bank and the family that the policy proceeds represent undeclared funds. As I understand it, this means that this is money that has not been and is not intended to be declared to the Irish Revenue. One of the objections to the Personal Representatives dealing with this policy is that the value of the policy (or the proceeds) will form part of the estate and that of course will be valued for Inland Revenue purposes. I assume that this will cause a tax liability. The intention in asking CMI to pay the money to the "nominated beneficiaries" and to take this somewhat unorthodox route is to ensure that the policy proceeds remain undeclared monies and that the Irish Revenue are not informed. It seems to me that this may amount to an attempt to defraud the Irish Revenue. Therefore, in CMI agreeing to pay the "nominated beneficiaries" in the manner suggested and in taking the indemnity from the Bank, CMI facilitates this process.*

Mr D'Arcy executed a Deed of Indemnity on behalf of NIB wherein he represented and warranted that the Bank had acted and continued to act as trustee in relation to the deceased customer's CMI Personal Portfolio policy and was entitled to receive the proceeds of the policy as trustee for the benefit of the beneficiaries. Mr D'Arcy was not empowered by the Bank to execute such a Deed of Indemnity.

Charlie McCarthy

> *The advantage was the trust document and the letter of wishes that in the event of a death, that the monies wouldn't go into the estate, they'd be payable to the beneficiaries on the production of a death certificate*

Illustrative evidence, which the Inspectors accept - branch managers

Branch Manager: *I suppose the selling factor in the CMI was the trust element, if a person died it was not necessary to effect probate.*

Inspector: *And what was the effect of that?*

Branch Manager: *The Revenue wouldn't know about it.*

oooOooo

Inspector: *Is it your understanding that in the event of the demise of the husband or wife the money would pass and Revenue would not become aware of it?*

Branch Manager: *That is what we were told.*

oooOooo

Inspector: *So is it fair to say that ... you would have told customers in relation to CMI, it was totally confidential both in life and in death?*

Branch Manager: *That's right, yes.*

oooOooo

Well in hindsight the advantage was that the money could pass on to the next generation outside of the person's estate.

oooOooo

Obviously if the money was not declared to the Revenue or anyone else and it was not included in the Will it was an advantage to be able to keep it undeclared in the event of death.

REASONS FOR SUCCESS OF PRODUCT

Summary

In the opinion of the Inspectors, the reason for the success of the CMI campaign was that it suited all the parties involved with it:

- The branch managers got rid of their bogus non-resident and fictitiously named accounts, but retained the deposits.
- Promotion of the policy offered the prospect of gaining additional deposits of "sensitive" funds.
- The Bank earned commission.
- The FASD financial services managers earned substantial bonuses.
- The customers believed they were getting an investment which would be confidential from the Revenue Commissioners.

Typical Investment

The manner in which funds in the CMI Personal Portfolios were invested indicates very strongly that most of the investors were not concerned with the return on their

investment but were interested in ensuring that it would be concealed from the Revenue Commissioners. The following transaction was typical:

- A customer has a deposit of IR£100,000 in a branch of the Bank in a bogus non-resident account.
- He is persuaded that it will be safer to have his money in CMI – confidentiality from the Revenue Commissioners is absolutely guaranteed, and also no probate requirements arise if a trust is created.
- On taking out the policy, the investor pays an immediate charge of 1% of the capital invested and over the first five years a further 8% at a rate of 1.6% annually.
- IR£97,000 of his investment is returned to the Bank on deposit at the same rate of interest as before, the balance of IR£3,000 being retained in a separate account and applied to meet initial charges.
- In addition to the 8% charge, the investor is charged Stg£300 per annum (later, Stg£480 per annum) for being furnished with a quarterly account and, if he has created a trust, a further annual fee of Stg£125 (later Stg£175), plus VAT, for the maintenance of the trust.

While the above investment was typical, the Inspectors think it right that they should state that not all the monies invested in the CMI Personal Portfolio product were necessarily funds undisclosed to the Revenue Commissioners.

INSPECTORS' CONCLUSIONS

The Inspectors find:

1. Monies which were undisclosed to the Revenue Commissioners, including funds held in bogus non-resident accounts and fictitious and incorrectly named accounts, were targeted by Bank personnel for investment in CMI policies.

2. Bank personnel promoted CMI policies as a secure investment for funds which had not been declared to the Revenue Commissioners, thereby engaging in a practice which served to facilitate the evasion of Revenue obligations by third parties.

3. Prospective investors were given an assurance by Bank personnel that their investment would be confidential from the Revenue Commissioners and, if made the subject of a trust, would pass to their beneficiaries without probate having to be obtained, thus making it possible for the funds invested to be kept hidden from the Revenue Commissioners even after the investor's death.

4. The role of the branch personnel of the Bank was to identify likely investors, and the role of the FASD personnel was to introduce customers to CMI and induce them to take out policies with CMI.

5. The purposes for the Bank behind the execution of such policies were:

(i) The earning of commission.
(ii) The retention of deposits.
(iii) The gaining of new deposits.

PART 6

THE IMPROPER CHARGING OF INTEREST

THE PRACTICE OF IMPROPER CHARGING OF INTEREST

OUTLINE OF SYSTEM

General

The system for charging interest on customer current accounts in branches remained unchanged for the period covered by the investigation.

Interest rates for individual customers are set at branch level following agreement with the customer on the provision of borrowing facilities. (For accounts with no agreed borrowing facility a standard default rate applies if the account becomes overdrawn). Data on the appropriate interest rate – base rate, DIBOR, etc, together with any additional margin – is input to the Bank's central computer system at the branch, and thereafter the calculation process is automated. The central system applies the appropriate interest rate to the cleared balance daily and accrues the interest charge until the quarterly charging date.

At quarter end the system applies the accrued interest amount to each account and an Interest Applied Report is produced for each branch, detailing interest charged to each account. This report does not require action by branch staff, but is produced for record purposes only.

Changes in interest rates

When the reference rate – base rate, etc – changes, details are entered centrally.

Changes in margin can be made at branch level at any time, and become effective, through the central system, from the following day.

Manual intervention in the interest charging process is provided for in the system:

- When an account is closed at other than a normal interest charging date, the branch is obliged to charge manually the interest due to date of closure. In addition to the amount accrued due on the system since the last charging date (which branch personnel can ascertain by on-line enquiry), it may be necessary to effect adjustments recorded in the Fee and Interest Amendment Book (see below), and there may be interest due in respect of lodgement items uncleared as at closure date. This latter necessitates a separate calculation by branch staff. The combined amount is charged to the customer's account by journal entry at branch level.

- The system also allows branch-originated journal adjustments to the interest charge in respect of amounts recorded in the Fee and Interest Amendment Book. This Book records errors requiring amendment of fee and interest charges to customers, and also additional interest charges arising from the suspension of cheques – ie where a customer cheque is "held over" rather than returned unpaid, allowing the customer time to put his account in funds to meet the cheque.

Branch Procedures Manuals made available to the Inspectors state that the Fee and Interest Amendment Book was to be used to provide branch staff with a day-to-day record of fee and interest adjustments to be made at the end of the charging period, or when the account was closed or transferred, whichever came first.

The Inspectors have received no evidence of improper charging of interest applied by the central system; the balance of this section of the report therefore addresses manual interest adjustments only.

MANUAL INTEREST ADJUSTMENTS

The Charging Regime

Introduction

As stated above, the system for charging interest is largely automated, but manual intervention is possible:

- to facilitate closure of accounts at dates other than the normal interest charge dates,
- to allow for the correction of errors, and
- to enable the charging of additional interest when cheques are suspended at a branch.

In a report entitled "National Irish Bank – Unauthorised Interest & Fee Amendments", dated March 1999, passed to the Inspectors on 26 March 1999 (the "Unauthorised Interest & Fee Amendments Report" – see page 133 below), the Bank referred to the process in the following terms:

> *... the systems catered for manual adjustments to be made to correct genuine errors and to apply interest resulting from the practice of 'suspending' customers' cheques to allow them time to introduce sufficient funds into their account to allow these cheques to be presented and paid.*

Guidance Material Issued

The Inspectors have been informed by the Bank that the 1992 Branch Procedures Manual represented a consolidation of instructions and procedures then in force, and that this Manual therefore, for practical purposes, sets out the system as it operated in 1988. This manual sets out detailed procedures for calculating interest adjustments arising on closure of accounts and addresses the manner in which the Fee and Interest Amendment Book should be maintained.

This Manual states that the Fee and Interest Amendment Book was to be used to provide branch staff with a day-to-day record of fee and interest adjustments (eg correction of errors) to be made at the end of the charging period, or when the account was closed or transferred, whichever came first.

The Manual required that full details of the prospective adjustment, together with the reason therefor, be entered in this Book and initialled by the branch manager. The Manual specified that the Fee and Interest Amendment Book, in so far as interest amendments were concerned, should not include adjustments which branch staff might wish to make as a result of examining the interest applied report received at the end of the charging period.

The 1996 Branch Procedures Manual contains very similar provisions, the initialling process being re-assigned to a Signing Official.

Queried by the Inspectors as to why there existed a facility to further adjust interest charges after adjustments noted in the Fee and Interest Amendment Book had been incorporated in such charges, the Bank by letter dated 24 April 2001 advised:

> *This examination of the amounts of interest applied to customers' accounts allowed the management of the branch a final opportunity to overview an automated process for errors and to ensure that inappropriate interest charges were not levied. Any errors apparent to the reviewer could be rectified before customer statements were produced.*

The Bank advised that it did not have an exhaustive list of reasons which would justify the amendment of an interest posting; examples given are waivers of an interest charge for various reasons.

Both Manuals provided that where an adjustment was made to the interest appearing on the interest applied report, the customer statement should be retyped to show only one interest amount – ie the original system-generated amount amalgamated with the adjustment effected at branch level. Accordingly, the customer would not have been aware from the bank statement that an adjustment had been made.

The 1996 Manual specified a routine designed to minimise the work involved in retyping statements.

Operation of the System

Internal Audit Reports – General Themes

Contemporaneous evidence of the operation of the system for interest amendment is furnished by the internal audit process. A number of themes emerge from review of branch audit reports for the period covered by the investigation:

- Interest amendment book not used, resulting in customer not being charged;
- Interest amendment book not used, while adjustment effected in customer's account;
- Interest adjustments recorded in the interest amendment book not adequately annotated or not appropriately initialled/authorised;
- Interest discrepancies highlighted on Account Closure Reports not signed, not explained;

- Interest adjustments not recorded, not annotated/explained on the Interest Applied Report;
- Manual interest calculations not appropriately checked;
- Failure to charge interest in respect of suspended cheques;
- Failure to obtain appropriate authorisation for interest refunds.

While the frequent inclusion of comments of this nature in internal audit reports indicates shortcomings in the operation of mechanisms for recording and controlling interest adjustments, in the audit reports made available to the Inspectors no note of improper charging is recorded until April 1990, notwithstanding evidence that fees had been charged as interest prior to that time, as indicated at page 130 below.

Internal Audit Reports – Unjustified Interest Amendments

In a number of instances in the period 1990 to 1993, internal audit reports make explicit reference to manual interest amendments which were inappropriate, in that they were effected without legitimate reason or cause, or were adjustments in respect of amounts said to be due to the Bank in respect of legitimate (non-interest) charges.

Several of these instances were treated as "Report Points" in the relevant audit report, and a full extract of the particular passage in each case is reproduced below.

The April 1990 audit report on ***Carrick-on-Shannon branch*** recorded:

WEAKNESS/POTENTIAL ADVERSE CONSEQUENCE

It was noted that Interest Charges were increased without legitimate reason or customers' knowledge on twenty accounts in November 1989 and thirty-three accounts in February 1990.

The above practice could lead to loss to the Bank through customer dispute, litigation or adverse publicity.

REMEDIAL ACTION REQUIRED

Interest amendments may only be made to correct Branch errors. The practice of "loading" interest in this manner must be discontinued.

RESPONSE BY BRANCH MANAGEMENT

We note that as and from now only branch errors can be corrected using interest amendment sheets.

While we only loaded interest rates for customers who were very demanding, we were certain that we were safe in applying the additional interest charges. No queries ever came back from customers who (sic) *interest was loaded.*

We note and confirm that this practice will be discontinued.

The audit report of August 1990 on ***Carndonagh branch*** recorded:

WEAKNESS/POTENTIAL ADVERSE CONSEQUENCE

It was noted that interest charges were increased without legitimate reason or customer knowledge, on twelve occasions in May 1990 and thirteen occasions in February 1990. This practice also applied in 1989. The Debit Interest Applied Reports were not amended in respect of these alterations.

This could lead to loss to the Bank through customer dispute, litigation or adverse publicity, due to the issuance of an Interest Certificate for the correct amount, or a customer's accountant querying why an amended statement was issued at interest charging periods.

REMEDIAL ACTION REQUIRED

Interest amendments may only be made to correct branch errors. The practice of "loading" interest must be discontinued.

RESPONSE BY BRANCH MANAGEMENT

The practice of loading was initiated for accounts that were either constantly in excess of their agreed limits (as evidenced by appearance in the Morning Report), or were the subject of frequent urgent S/L reports. Through discussions at branch the implications of loading were highlighted, but for obvious reasons immediate cessation was not feasible. The practice has been gradually scaled down and will be totally eliminated before the next charging period.

The following was reported in respect of ***Sligo branch*** in October 1990:

WEAKNESS

Interest amendments were effected on twenty-two accounts in November 1989 and thirteen accounts in March 1990, without legitimate cause or customer authority. The Debit Interest Reports were not amended.

POTENTIAL ADVERSE CONSEQUENCE

Increasing interest charges could lead to queries from the customer or his accountant in respect of the non-computer produced statements at the interest charging periods. Interest Certificates could also be issued for amounts different to the statement figure. If a copy statement is requested by a customer the interest amendment could be highlighted in error.

RECOMMENDED ACTION

Interest amendments should only be effected for legitimate reasons.

BRANCH RESPONSE: The practice has been discontinued.

The May 1993 audit report on ***Blanchardstown branch*** recorded:

WEAKNESSES

The following weaknesses were noted:
1. *Interest charges were increased without legitimate cause on eight accounts in November 1992 and on six accounts in November 1991.*
2. *One instance was noted where a customer's interest was increased by £300 to offset bad debts of employees for* (sic) *that customer.*
3. *Many instance was* (sic) *noted where interest was increased on closure of accounts to cover Management time charges.*

POTENTIAL ADVERSE CONSEQUENCE

Increasing interest charges without legitimate cause could lead to queries from customers or their accountants and result in loss to the Bank due to dispute or adverse publicity.

RECOMMENDED ACTION

In future interest should only be amended where there are legitimate reasons. Where Branch wish to apply additional charges these should be collected by way of a Fee.

BRANCH RESPONSE

We will ensure in future that interest is only amended when there is a legitimate reason.

Critical comments considered less serious were classified in audit reports as "Discussion Points" or as "Weaknesses of Lesser Significance". Matters reported in relation to interest amendments included:

Discussion Point, **College Green, Dublin branch**, February 1992:

> *Interest should only be amended when properly authorised by the Manager or Regional Office. Amendments relating to charges should NOT be included on interest amend* (sic) *sheets.*

Weakness of Lesser Significance, **Walkinstown branch**, March 1992:

> *It was noted that on a few occasions interest adjustments were effected which did not relate to interest errors.*

Weakness of Lesser Significance, **Fermoy branch**, May 1992:

> *It was noted that the fee for suspending cheques was incorporated in the quarterly interest charge. Interest should only be amended in respect of interest adjustments and all other charges should be incorporated in the fee.*

Weakness of Lesser Significance, **Strokestown branch**, May 1992:

> *It was noted that amendments were effected to interest relating to charges for suspending cheques and telephone calls. Interest should only be amended in respect of interest errors. All other amendments should be incorporated in the fee charged.*

Weakness of Lesser Significance, **Bray branch**, December 1992:

> *A significant number of the interest discrepancies resulted from the Branches* (sic) *practice of amending the interest calculated by Livelink by:*
> *a) in the case of debit interest increasing the amount charged and*
> *b) reducing the amount paid in the respect* (sic) *of credit interest.*
>
> *Branch should cease this practice immediately and where deemed appropriate a fee is to be levied.*

Weakness of Lesser Significance, **O'Connell Street, Dublin branch**, January 1993:

> *A number of instances were* (sic) *noted where interest adjustments were effected and the interest charged was increased for amounts between £10 and £50 without legitimate cause. One instance was noted where interest was increased by £150 in respect of Management time. In future interest should only be increased for legitimate reasons. All other charges should be collected by way of a fee.*

Weakness of Lesser Significance, **Letterkenny branch**, May 1993:

> *It was noted that the £5 fee for each cheque suspended has been charged to customers* (sic) *accounts as interest. Please note that this charge should be applied as a fee in future.*

In summary, the internal audit reports received by the Inspectors record the misuse on eleven occasions (four of which were considered at the time to merit a "Report Point" grading) of the facility to manually amend interest charges to customers.

Bank Investigation 1998/99

Investigations carried out by the Bank subsequent to news media reports on "interest loading", reported upon in March 1999 (discussed in more detail below) resulted in interest refunds totalling some IR£132,000 (before indexation) being made to customers of twelve branches in all:

Branch	*Period in respect of which refund made*
Baggot Street, Dublin	May 1990 to November 1991
Blanchardstown	February 1991 to May 1993
Carndonagh	November 1987 to November 1990

Branch	*Period in respect of which refund made*
Carrick-on-Shannon	November 1987 to November 1990
Cork	May 1988 to November 1990
Letterkenny	November 1987 to May 1993
Limerick	May 1988
O'Connell Street, Dublin	November 1988 to November 1994
Sligo	May 1988 to February 1990
Strokestown	November 1995 to February 1998
Walkinstown	May 1989 to November 1990
Waterford	May 1988 to August 1990

No refunds were made by the Bank (nor was the amount involved quantified) in respect of charges for suspending cheques which, though not interest, were included in interest amounts debited to customers' accounts, on the basis that such charges were "*clearly substantiated as being due to the Bank*" (see pages 20 and 21of the Unauthorised Interest & Fee Amendments Report at Appendix 14). This Report makes clear that the practice of classifying as interest charges for suspending cheques was not limited to the twelve branches listed above.

The Inspectors regard as improper the charging as interest to customers' accounts of any non-interest charges, and therefore consider such charges should have been refunded.

Branch Staff Evidence

The Inspectors interviewed 37 current and former Bank branch managers and staff.

A number of those interviewed were at the relevant times managers of branches identified in news media reports as locations where "interest loading" was reported to have taken place – ie where interest charges had been increased without proper cause. In other instances, the Inspectors were aware at the time of interview that the Bank personnel had held positions of responsibility at the relevant times in branches where the Bank had made refunds of interest charged.

A significant proportion of interviewees stated that they had not participated in the practice of loading interest in the manner described, and that they were unaware of its occurrence at other locations.

It is evident from the manager responses to the "Report Points" in the 1990 branch audit reports cited above that the managers concerned did not regard themselves as charging customers other than for amounts due, albeit that these were not interest amounts. The majority of managers and others interviewed who worked at the branches where "loading" had taken place did not deny knowledge of its occurrence, but sought to justify the loading by reference to features of the account or the customer, and their understanding of Bank practice as observed at other locations.

Justifications offered by interviewees included:

At the time I considered it quite a legitimate charge. On reflection and with the benefit of hindsight, I certainly should not have charged it as interest, I should have charged it as fees.

oooOooo

I had simply done what I had seen done in my previous office which was Cork.

... loadings were made ... for a variety of reasons, the most common one being that the account was troublesome in some shape or form, not necessarily a bad account, but where a good deal of additional time was taken up in respect of the account for various reasons.

oooOooo

... you were not doing the interest on the basis of boosting revenue to the bank, you were doing it on the basis that the customer you picked was entitled, by virtue of the amount of additional work he had caused you, to pay this amount.

oooOooo

... I condoned the fact that interest was increased by a smaller amount to cover the activity associated with the suspension of the cheque.

oooOooo

Extract from note from manager interviewee passed to the Inspectors at interview:

At the interest charging periods the interest was amended by small amounts on the listed accounts which had been very troublesome during the year. Because we had no Control Clerk I felt that proper interest was not being collected on those accounts where many cheques were being suspended, returned, unpaid, recalled, received for collection and value given prior to lodgement, or paid against uncleared effects.

Extract from interview with the above-noted manager:

Inspector: *They [interest adjustments] didn't relate to management time at all?*

Manager *No.*

oooOooo

And I would have decided -- the unpaid book was the record, and if Mr Brown's appearing in the unpaid book very, very regularly, we would have

made a crude estimate of saying we possibly should be charging this guy £20, £50 or £100 interest adjustment to recoup our loss. That was how it was done.

It would have been just a guess in relation to the number of cheques that were suspended.

The determining factor possibly was to basically recoup the lost interest for the bank and the extra work involved in doing what we did, which I honestly would have considered was a benefit to the customer rather than return his cheque for whatever reason, and letting the customer worry about it. We would have contacted the customer, said we have a cheque here, would you mind holding it, yeah, no problem. Possibly where we fell down was certainly we will hold the cheque, Mr [customer name], but it is going to cost you £5 or £10 or whatever. That is where we fell down.

oooOooo

When questioned by the Inspectors on why charges were levied in this fashion, and whether customers would have been aware that the interest charge included an element of fee, interviewee responses included such observations as:

It was probably a sneaky way of making a charge that was seen to be properly due. I suppose it was easier than fighting with someone because of a fee. It was probably cowardly.

oooOooo

You couldn't collect it by way of fee because it would have been noticed so it was applied by way of interest, and applied inappropriately.

Inspector: *At the time it was done would the customers of the bank have been aware of the practice?*

Manager: *No.*

oooOooo

Inspector: *Would the customers have known at that stage that their interest figure was being adjusted because they were being troublesome?*

Manager: *The interest charge was posted on the statement and sent out to them so it was left to them to query the interest charge if they wished.*

Inspector: *No, but would they have known?*

Manager: *They wouldn't have been advised in writing.*

oooOooo

Inspector: *The customer sees interest on his bank statement, would it have been normal that he would have assumed that that related to interest, and not to charges?*

Manager: *I would assume -- he had every right to assume that, yes. ...*

Inspector: *Why would it [charge related to work in suspending cheques] not be put through as a charge?*

Manager: *I don't honestly know at this stage. It possibly should have been put through -- split and put through as a charge on it, and an interest amendment.*

oooOooo

Questioned on the extent of the practice throughout the branch network, interviewees who admitted participation in, or direct knowledge of, the practice gave as their understanding that the practice was to a greater or lesser extent widespread:

Inspector: *Was this something you invented yourself?*

Manager: *Not at all. That is one of the points I made to our internal auditors. I told them that whatever was in the report ... I had not invented the wheel.*

oooOooo

Inspector: *Have I understood you correctly to say that interest adjustment was a widespread practice within the bank?*

Manager: *I would have felt it was.*

Inspector: *There has been a suggestion that the practice existed in only the five branches that were named.*

Manager: *That is totally incorrect.*

oooOooo

At the time it [ie inclusion in interest charged of a fee element related to suspension of a cheque] was something that was not peculiar just to O'Connell Street branch, it happened in a number of branches, ...

oooOooo

I was aware that it was fairly widespread.

A number of Bank personnel interviewed by the Inspectors have spoken of a practice, prior to the period covered by this investigation, and indeed prior to the introduction of the Bank's computerised accounting system, of "adjusting the decimal", a practice whereby interest charges to customers were increased to compensate the Bank for the time and trouble involved in servicing their needs. It was represented to the Inspectors that this practice was accepted by senior management of the day, and the practice reported in audit reports in the 1990/93 period represented no more than the continuation of this procedure into the computerised era. These managers believed that the inclusion of amounts for "time and trouble" in interest charges was accepted, if not overtly approved, by senior management in the Bank.

Dermott Boner stated in the course of his evidence that the practice of charging specifically for management time originated in a request in 1985 or 1986 from the Chief Executive of the day that management time should be recovered, and that interest charges were increased to reflect management time during his period as manager of the Cork branch. Since the purported request to charge for management time pre-dated the period being investigated by the Inspectors, they have not sought to verify it, nor to ascertain how it was intended that the charge should be made.

A number of managers who admitted that interest had been loaded by them or at their direction stressed that the practice was transparent as regards the internal records of the Bank, but had not been the subject of comment in branch audit reports prior to 1990. The manager of the Carrick-on-Shannon branch also placed some emphasis on the fact that the 1990 audit of his branch was the first branch audit carried out by the person who led the audit team on that occasion.

In summary, the majority of bank managers interviewed by the Inspectors denied participation in, or knowledge of, a practice of loading interest. Managers who admitted they had loaded interest indicated a belief that the practice was widespread and predated the period covered by the investigation; they believed senior management in the Bank would not at the time have disapproved of the practice.

ACTION TAKEN BY THE BANK ON FIRST DISCOVERY OF IMPROPER PRACTICE

The Chief Executive (Jim Lacey)

As noted at page 122 above, the practice of increasing interest "without legitimate reason" appears to have been first reported by Internal Audit to senior management in the April 1990 report on Carrick-on-Shannon branch. This report was circulated to the Chief Executive, Mr Lacey, the General Manager – Retail Banking, Frank Brennan, and the Regional Manager responsible, Kevin Curran.

On 21 May 1990, Mr Lacey issued a memorandum to Mr Brennan, with a copy to Mr Curran, stating, *inter alia*:

> *From the Branch Manager's response it would seem to me to indicate that he was somewhat surprised at this matter having been picked up by Audit and I would be obliged if you could let me have a bit more detail as to how this*

practice came into being and also your view as to how widespread such a practice might be. It is a practice that we must cease immediately for obvious reasons. We have in place a variety of means of putting on additional charges to accounts where they are troublesome and cost a lot more to run, etc. This can be through additional fees and also, if necessary, we can charge higher interest rates but if we are they must be clearly communicated to the customer.

The General Manager – Retail Banking (Frank Brennan)

Mr Brennan's review of the Carrick-on-Shannon branch audit report, addressed to Mr Curran, also dated 21 May 1990, included the following:

> *The remarks under Report Point 1, Core 2* (ie the text reproduced at page 122 above) *we discussed briefly in the recent past. The branch management response would seem to suggest that interest was loaded to compensate for a short fall in fee income from demanding customers. Given that the auditors found 33 cases of loading it would appear that branch have used the "soft option" principle widely and this is unacceptable. Report Point 4 indicates some refunds were made and no doubt you will see if there is a link between the two.*

Mr Brennan wrote to both Regional Managers (Kevin Curran and Dermott Boner) on 5 June 1990 as follows:

> *In the recent audit of Carrick-on-Shannon branch it was discovered that there was an interest loading made on customer accounts without any prior agreement or notice to the customer. Some indication was given that this loading was in lieu of irrecoverable fees or simply a penalty for nuisance caused by the customer during the charging period.*
>
> *I was not aware of such a practice in the branches and would wish to*
>
> *(a) know of all incidences where this practice has taken place and*
> *(b) confirmation that it ceases immediately.*
>
> *I am sure you do not need me to tell you that it is quite wrong to surcharge a customer without proper notice. Should there be occasion to penalise an account holder for any reason, be it breaking an arrangement or causing a considerable amount of labour to service their* (sic) *needs, then there is a mechanism in place to make additional charges. What I do not want to see from any manager is use of the soft option of "hidden" costs and this must be stopped immediately.*

Mr Brennan's review of the August 1990 Carndonagh branch audit report, addressed to Mr Boner, included the following:

> *I don't understand the management reply to Report Point 1, Core 2* (ie the text reproduced at page 123 above). *If an account is in excess of the agreed limit*

> *then the 6% loading should automatically apply. Was it a case of the loading being omitted at the static input stage and applied manually later or was it that interest over and above the 6% loading being* (sic) *charged? The frequency of the S/L report has nothing to do with interest rates but suggests that the limits are insufficient for customer needs or that customer is taking unauthorised credit which we would not support from Regional Office? In either case the matter should be addressed with the customer and if penalty interest is used to bring discipline notice should be given in advance to customer.*

Mr Brennan has advised the Inspectors that the 1990 audit reports on Carrick-on-Shannon and Carndonagh branches and the memoranda referred to above are the only references he can find on the subject of improper charging of interest to accounts in the investigation period.

The Regional Managers (Dermott Boner and Kevin Curran)

While there is evidence that the Regional Managers addressed the issue with the branch managers concerned, and sought assurance from all branches within their respective regions that if such a practice existed it should cease immediately, the extent to which they received such assurance is unclear.

Mr Brennan has advised the Inspectors that he received no formal response from either Regional Manager to his memorandum of 5 June 1990.

Impact on Customers

Neither Mr Lacey's memorandum nor Mr Brennan's directed that refunds be made where interest had been improperly charged.

The Regional Managers did not instruct the branch managers to make refunds.

The Bank has confirmed to the Inspectors that it has found no evidence that refunds of such interest were made prior to the Inspectors' appointment.

ACTION TAKEN BY THE BANK FOLLOWING NEWS MEDIA REPORTS

Interviews with Bank Staff

Bank internal audit staff interviewed 210 staff following the news media allegations of interest and fee loading. The Inspectors, with a view to minimising the number and extent of interviews they themselves would be obliged to carry out, sought from the Bank copies of the notes taken at these interviews. The Bank claimed privilege over this material, and declined to make it available to the Inspectors. The Bank has however formally advised the Inspectors that all material otherwise requested by the Inspectors has been furnished to them, including all documentary material referred to at the staff interviews.

The Inspectors considered a Court challenge to the Bank's claim to privilege over the interview notes, but decided against it on the grounds that it was preferable to conduct a comprehensive interview programme themselves rather than become involved in what might turn out to be lengthy and costly litigation.

Bank Investigation Work: The Unauthorised Interest & Fee Amendments Report

General

The Bank's investigation of the allegations of interest and fee loading broadcast on RTE is the subject of a report dated March 1999 entitled "National Irish Bank: Unauthorised Interest & Fee Amendments", prepared by National Australia Group's European Audit function, hereafter termed the "Unauthorised Interest & Fee Amendments Report". A copy of this report was furnished to the Inspectors on 26 March 1999 and is reproduced at Appendix 14. Brief extracts from this report have been cited at pages 120 and 126 above.

Work Done

The work described in the Unauthorised Interest & Fee Amendments Report includes initial work carried out by the Bank's internal audit staff, work carried out by Arthur Andersen at the Bank's request, and work carried out thereafter by Bank staff.

The objectives of the investigation included the quantification of the impact on customers of any unacceptable activities which had taken place.

The scope of the review was restricted to current account adjustments. The Bank concluded that a "*targeted approach rather than a fully substantive one*" was appropriate and therefore directed its work at "*locations where the risk of occurrence was assessed as being high*".

The investigation team did not seek to verify the working of the system in either the interest or fee areas, but sought to consider the result of the amendment process.

Arthur Andersen work

In the interest area, the Bank's initial scoping exercise identified five branches where interest loading might have occurred, and the accounting firm Arthur Andersen ("AA") was engaged to establish "*whether additional interest charges have been debited to customer current accounts at quarter end without any contractual, statutory or other valid basis for doing so and, if so, the extent thereof at the following branches of the Bank for the following periods*":

- Blanchardstown February 1991 - May 1993
- Carndonagh October 1987 - December 1990
- Carrick-on-Shannon October 1987 - December 1990

- Cork January 1988 - December 1990
- Walkinstown January 1989 - December 1990

The timespan for review was later extended to encompass manual bulk postings of interest amendments within 5 business days of the quarter end posting date.

Following their review, AA classified the adjustments by reference to the explanations contained in the available documentation, and these findings are summarised in the Unauthorised Interest & Fee Amendments Report as follows:

	Number	Value IR£
Supporting evidence for interest adjustment found	332	128,201
Additional charge relates to management time	200	42,255
Unresolved	574	58,257
Total	1,106	228,713

Bank staff carried out further review work on all interest adjustments identified by AA, other than those found to be justified interest amendments or charges in respect of management time. Incorporation of the results of this additional work in the summary resulted in final summary figures as follows:

	Number	Value IR£
Supporting evidence for interest adjustment found	359	132,364
Additional charge relates to management time	382	55,112
No basis for justification	365	41,237
Total	1,106	228,713

The Report notes that the 365 adjustments for which no justification could be found relate to 171 customers across the five branches the subject of review.

Inspectors' Observation on Analysis of Adjustments

The title of the third class of adjustments in the review work carried out by Bank staff – "No basis for justification" implies that the inclusion as interest of charges relating to management time (the second class) was justified, which clearly it was not. In fact it was the practice which had been highlighted by Internal Audit as being improper. There could clearly be no justification for including a charge for management time as interest. The number of adjustments for which there was no justification should accordingly have been 747, and not 365.

Work carried out by Bank investigation team

Bank staff carried out additional work on manual interest amendments under a number of headings:

- Supplementary work on the five branches reviewed by AA, extending the time periods of review;
- Review of adjustments at branches where staff who had worked in branches where loading had been identified subsequently worked;
- Review of branch audit reports;
- Review of General Ledger postings, all branches, for round-sum adjustments in the quarters ended 31 May 1989 and 30 November 1990;
- Limited review of Interest Amendment Sheets;
- Investigation of customer enquiries;
- Review of all manual interest adjustments over IR£500, and all round-sum adjustments below that amount, effected during the period 31 March 1996 to 31 March 1998.

Only adjustments made at or about the quarter end date were reviewed, and with few exceptions, investigation was limited to "round-sum" adjustments.

Conclusions

The conclusions of the Unauthorised Interest & Fee Amendments Report in the interest area are as follows:

> *Some incidence of interest amendments, which could not be fully justified as interest, was found in all of the five named branches. In total this amounted to £100,513. Additional work carried out identified that of this total an amount of £59,275 could have been justified if it had been charged as a management time fee. This leaves £41,238 with no evidence of a justifiable charge being due.*
>
> *The review of the wider network identified incidences of interest adjustments which could not be justified, as interest, in a further 8 branches totaling* (sic) *£34,816.*
>
> *The relatively small incidence discovered in the remainder of the network, supported by the absence of repetitive interest loading findings in Internal Audit reports, indicates that the practice was not widespread and given the absolute amounts involved that the motivation was not to enhance Bank*

profitability. No branches were identified through the review of external audit management letters.

The review of Internal Audit reports highlighted instances where branches were charging a management time fee for suspending cheques as interest. Although non compliant with procedures, on the basis that these charges could be fully substantiated they were not included within amounts to be refunded.

The system for interest charging was unchanged throughout the period investigated and, due to interest calculations being made on cleared balances, remains largely invisible to the customer. The requirement for interest amendments still remains although this process could be reviewed to give greater visibility to the customer which in turn would act as a control over the processing of unjustified amounts.

The review of the last two years showed that only one 'spoke' branch, Strokestown, was not adhering to the laid down procedures for interest amendments by recovering management charges through amending the interest charge. This amounted to less than £800 in total.

The Bank made refunds both of amounts where no justification could be established and of amounts representing management time, excepting time and other charges in respect of suspending cheques. As already stated at page 126 above, the Inspectors consider these latter charges should also have been refunded.

Inspectors' Observations, Unauthorised Interest & Fee Amendments Report: Findings on Interest Amendments

The Inspectors do not accept that the Bank, on the basis of the work done, was entitled, because of the scope limitations on that work, to reach the conclusion that the practice of interest loading was not widespread within the Bank.

The Inspectors do not disagree with the other conclusions of the Report as far as they go, but do not accept that the work done excludes the possibility that there were other incidences of improper interest charges in the branches reviewed or elsewhere in the branch network.

Customer Queries

The Bank set up and advertised a telephone helpline, which customers could contact with queries relating to interest or fee charges on their accounts.

The Bank has advised the Inspectors that on receipt of a customer query, it sought to review the customer's account for the entire period covered by the query, relying on the presence or absence of a request for a customer statement (to facilitate re-typing, as described at page 121 above) at or about the charge period end as conclusive evidence of whether a manual adjustment was made, requiring review. A prescribed review procedure was followed to establish whether a refund was warranted, to

prepare an inflation-adjusted refund if required, and advise the customer of the position.

Inspectors' Observations on Work done by the Bank

In course of their consideration of the work done and the conclusions reached in the Unauthorised Interest & Fee Amendments Report, the Inspectors indicated to the Bank their reservations regarding the scope of work undertaken, and their view that the work carried out did not adequately support the conclusion reached.

Further Work proposed by the Bank

By letter dated 10 April 2001, the Bank advised the Inspectors that it "*has embarked on a programme to review interest postings across the branch network for the period 1/10/1987 – 5/4/1998*" – see Appendix 15. The Bank subsequently advised the Inspectors that the details of the additional work carried out, the conclusions reached and the consequent action undertaken or proposed, would be included in its submissions in response to the Inspectors' provisional findings.

Following receipt of the Inspectors' draft report on 1 August 2003, the Bank devised a new programme, "Fees and Interest Refund Programme" which is set out in Schedule V of the Bank's Reaction Paper, reproduced in full at Appendix 19. How the Bank came to take this step is described as follows on page 4 of Schedule V:

> *In light of the views expressed by the Inspectors, and on reconsidering the decisions underlying its previous approach, the Bank has devised a further programme of work and refunds on which it has sought independent verification.*

It is anticipated by the Bank, at page 4 of the Reaction Paper, that this programme will result in additional fees and interest refund payments to customers of Euro10.6 million.

INSPECTORS' CONCLUSIONS

The Inspectors find:

1. During the period the subject of the Inspectors' investigation, the interest charged by the Bank to some customers in their quarterly account included sums which were not in fact interest.

2. The inclusion of such sums in the charge for interest was improper.

3. The sums which were improperly charged as interest should, on discovery by Internal Audit, have been immediately refunded by the Bank.

4. While the Inspectors note that since the commencement of their investigation, the Bank has refunded to customers an inflation-adjusted total of approximately IR£570,000 in respect of charges which could not be justified as interest on 564 accounts in twelve branches, they do not accept that the Bank, on the basis of its investigative work done, is entitled to conclude that all incidences of improper interest charges have been identified.

5. Refunds of sums improperly charged as interest made following the Bank's investigation should not have excluded sums charged for the suspension of cheques.

PART 7

THE IMPROPER CHARGING OF FEES

THE PRACTICE OF IMPROPER CHARGING OF FEES

REGULATORY REGIME

Introduction

All financial institutions which provide banking services to customers in Ireland are required to hold a banking licence issued by the Central Bank. The Central Bank is accordingly the principal public authority assigned to regulate and supervise the operations of the domestic banks. The powers and functions of the Central Bank in this regard are derived from the Central Bank Acts, 1942-1997.

On 13 May 1996 certain regulatory functions were transferred to the Director of Consumer Affairs, under the provisions of the Consumer Credit Act, 1995. Under Part XII of this Act, the Director of Consumer Affairs is responsible for the regulation of all charges imposed by credit institutions "*in relation to the provision of any service to a customer or group of customers.*"

The Central Bank Act, 1971

The Central Bank Act, 1971 provided the Central Bank with two main powers with which it might regulate the fees charged to customers by banks:

- Under Section 10, the Central Bank was given a discretion to attach to any licence granted, conditions which they believed would promote the orderly and proper regulation of banking, and

- Section 18 obliged licence holders to furnish to the Central Bank any information the Central Bank specified as necessary for the due performance of its statutory functions.

Prior to 1989 the Central Bank had no specific powers in relation to charges, but they were the subject of an informal agreement between the licensed banks and the Central Bank. Pursuant to its ongoing task of monitoring the business carried on by licence holders, the Central Bank would regulate the fees charged by banks to the accounts of customers, while the banks would keep the Central Bank informed of same. This agreement was strictly between the Central Bank and the banks.

The Central Bank Act, 1971 placed no specific obligations on banks to disclose to the Central Bank the level of (or changes to) fees charged to customers unless, of course, they were requested to make such disclosure.

The Central Bank Act, 1989

Section 28, Central Bank Act, 1989 required that, within two months of the commencement date for this Section (1 September 1989), banking licence holders should keep the Central Bank informed as to the charges (and the terms and conditions of such) that were being levied for services provided.

Section 28 (1) required all licensed banks to notify the Central Bank of:

- All charges imposed by such licence holder in relation to the provision of any service to the public or to any class of the public, and
- Any term or condition upon or subject to which such service was provided.

Section 28 (2) stated the Central Bank must be notified of every proposal:

- To change any charge, term or condition previously notified to the Central Bank for the purposes of the Section, or
- To impose any charge, term or condition applying to the provision of a service to the public or to any class of the public not previously notified to the Central Bank for the purposes of the Section.

Section 28 (3) empowered the Central Bank to direct a licensed bank:

- To refrain from imposing or changing a charge, term or condition applying to the provision of a service to the public or to any class of the public, without the prior approval of the Central Bank, and
- To publish, in such manner as might be specified by the Central Bank from time to time, information on any charge, term or condition applying to the provision of a service for the public or to any class of the public.

Section 28, Central Bank Act, 1989 was repealed by Section 19 of the Consumer Credit Act, 1995 which came into force on 13 May 1996. Thus, the provisions summarised above were applicable between 1 November 1989 and 13 May 1996.

The Consumer Credit Act, 1995

The repealed Section 28 of the Central Bank Act, 1989 was replaced by Section 149 (1) of the Consumer Credit Act, 1995. The functions and powers formerly vested in the Central Bank under Section 28 of the 1989 Act were vested by Section 149 of the 1995 Act in the Director of Consumer Affairs and the obligations of banks (together with all other credit institutions) in regard to notifying charges, and alterations in charges, remained broadly similar to what they had been, save that the party to be notified became the Director of Consumer Affairs.

Subsequent Changes in the Regulatory Regime

Pursuant to the Orders of the High Court dated 30 March 1998 and 15 June 1998, the investigations cover the period from 1988 to 30 March 1998. Consequently, the regulatory regime summarised above is that which prevailed during the period of the investigations and does not take into account the further changes which were introduced subsequently.

THE BANK'S FEE CHARGING SYSTEM, AND ITS DEVELOPMENT OVER THE PERIOD COVERED BY THE INVESTIGATION

Introduction and Overview

At the outset of the period covered by the investigation, the system in NIB for the calculation of bank fees provided that a proportion of the charge was automatically recorded by the Bank's computerised accounting system, while the balance required manual adjustment by Bank staff. Since 1988, the system has evolved, with the progressive introduction of formalised charges for a wide range of account activity and an increase in the proportion of those charges automatically captured by the computerised system. There remains a facility for manual amendment of charges, but, since the introduction of pre-notification of fees in 1996 (see page 155 below), the only amendments which ought to be made are those necessary for the correction of errors.

Fee Categories

Personal Accounts

The Inspectors have been advised by the Bank that at the outset of the period under review, in January 1988, fees calculated and charged to personal customers' accounts fell under three headings:

- Transaction charges
- Administration and management time charges
- Ancillary charges.

Transaction Charges

Transaction charges relate to the number of debit transactions (eg cheques) processed through a customer's account for the quarterly charging period. The Bank's computer system calculated this fee by applying the standard tariff for each type of transaction to the number of transactions processed in the period.

There was a minimum charge of IR£3.25 per quarter for all active current accounts. This charge applied for any level of activity up to twenty-five debit transactions in the quarter. Where a greater number of debit transactions had been processed, the normal tariff based calculation applied.

If an account remained in credit during the entire quarter, it was exempt from fees.

Administration and Management Time Charges

Administration and Management time charges arise from the provision of services "*outside the normal course of business*", which do not fall within the transactional or ancillary charge categories. The charges were based on a time measurement priced in 1988 at a rate of IR£10 per hour or part thereof.

Ancillary Charges

Ancillary charges relate to specific services rendered; these were charged as they arose, by effecting manual accounting entries to the customer account. Services and events giving rise to ancillary charges included the following:

- Accepting direct debit mandates
- Bank drafts/gift cheques
- Cheque cards
- Standing Orders
- Unpaid cheques.

Business Accounts

Business accounts were subject to charges on principles similar to those applicable to personal accounts, with two exceptions:

- For business accounts with more than 1,500 transactions per year, it was Bank policy that a costing be carried out, which monitored all account activities; based on this data a fee was agreed with the customer, subject to periodic review. This agreed fee could be a set amount per quarter, or expressed as a percentage of account turnover, resulting in the charge moving in line with the level of activity on the account.

- For business accounts which maintained cleared credit balances, an allowance was made against the charges at an agreed rate, based on the average balance maintained. (This abatement rate formed part of the published tariff information).

The Fee Charging Process

The computed charges for each account in each branch were listed quarterly on a "Fees to be Applied Report", which was despatched to the branch some days prior to the end of the quarterly charging period. At that time a routine circular was issued to all branches reminding staff of the review to be carried out, and the deadline for its completion.

Upon receipt of the Fees to be Applied Report, the branch was required to adjust the charge recorded therein both in respect of adjustments arising during the quarter as recorded in a "Fee and Interest Amendment Book", and in respect of administration or management time.

As outlined in Part 6 at pages 120 and 121, the 1992 Branch Procedures Manual, represented to the Inspectors as reflecting the instructions applicable to branch staff at 1 January 1988, states that the Fee and Interest Amendment Book was to be used to provide branch staff with a day-to-day record of fee and interest adjustments (eg correction of errors) to be made at the end of the charging period, or when the account was closed or transferred, whichever came first. The Manual required that full details of the prospective adjustment, together with the reason therefor, be entered in this

Book and initialled by the branch manager. The Manual specified that the Fee and Interest Amendment Book should not include adjustments which branch staff might wish to make as a result of examining the fee and interest reports received at the end of the charging period.

At the end of the charging period the net fee adjustment was to be transferred to the Fees to be Applied Report, "*together with any other adjustments which you may wish to make as a result of examining these reports* ". Senior Bank management have advised the Inspectors that the principal adjustment to be made in exercise of this discretionary authority was in respect of fees for administration and management time.

The 1992 Branch Procedures Manual also required that a branch official

> *Annotate, on the [Fees to be Applied] report, any changes which you wish to make, by replacing the Mainframe calculated fee with the fee which you wish to charge. Initial all changes and, where the fee is reduced, state the reason for reduction.*

Amendments effected in the Fees to be Applied Report were entered to the Bank's central computer system through branch terminals and a listing of amendments, termed the "Static Mark-off Report – Amended Fees Input Details" then issued to branches for checking purposes.

After the amended fees had been charged to customer accounts a Fees Applied Report was issued to each branch for record purposes, detailing all fees charged to customer accounts for the quarter.

Fees charged to customers at quarter end thus potentially comprised three elements:

- a combined amount for transactions charges (or, in the case of business accounts, a negotiated fee) and ancillary charges, as set out on the Fees to be Applied Report;
- adjustments recorded during the quarter in the Fee and Interest Amendment Book, and
- charges in respect of administration and management time,

the latter two being incorporated in the fee charged initially by way of manual amendment on the Fees to be Applied Report.

Development of System

The "three report" system described above remained in place throughout the period covered by the investigation. Developments during the period included:

- Adjustments to the standard tariffs.

- Increase in the hourly rate of charge in respect of administration and management time from IR£10 per hour to IR£25 per hour in 1992.

- Introduction of an account maintenance fee of IR£3 per quarter in September 1990, when the minimum charge was abolished. This maintenance fee was increased in November 1992 to IR£3.75 per quarter. Transaction charges were levied in addition to this charge.

Form St.20 – Customer Action Pad

On 24 July 1992 guidelines for charging management time were issued, together with a "Customer Action Pad" for recording, on a daily basis, details of services provided to customers outside the normal course of business.

Time Recording Procedures to Facilitate Pre-notification of Charges

In March 1996, prior to the introduction of pre-notification of charges, a detailed circular was issued to Bank staff setting out procedures for recording account administration time (formerly referred to as administration and management time), including a listing of standard times for many services and tasks. Time sheets for input on a daily, weekly or monthly basis to the Bank's central computer system were also introduced. A second circular, issued in April 1996, described systems changes arising from the introduction of pre-notification of charges.

Ancillary Charges

Ancillary charge development over the period arose through both the introduction of new charges – eg fees in respect of amendments to standing orders or direct debits, and the standardisation of charges, such as referral fees, previously accounted for by way of charge for administration and management time.

Summary

The Inspectors have not received any evidence of improper charging of fees in respect of transaction charges, ancillary charges or adjustments recorded in the Fee and Interest Amendment Book. It is not necessary, accordingly, to refer further to any of these charges or adjustments, and the balance of this Part of the report is therefore concerned solely with the purported charging of fees for administration and management time.

CHARGES FOR ADMINISTRATION AND MANAGEMENT TIME

The Charging Regime prior to 1996

Introduction and Overview

As stated above, in the period covered by the investigation, one of the categories of fee for which the branches were instructed to charge was administration and

management time. Such charges are described as follows in a document entitled "Fee and Interest Procedures 1988 – 1998", furnished to the Inspectors by the Bank on 15 December 2000:

> *These charges accrue for the provision of services outside the normal course of business to customers and is* (sic) *not covered by either transactional or ancillary charges. The charges are based on a time measurement that is converted at a prescribed hourly rate.*

In a later paragraph in the same document, it is stated that:

> *Upon receipt of the Fees to be Applied Report the branch has the discretion to adjust the charge to reflect the appropriate level of administration or management time.*

In a document entitled "Evolution of Current Policy and Controls in National Irish Bank Limited" dated 28 May 1998, and furnished to the Inspectors on 21 October 1999, the fee amendment process was described as follows:

> *At each charging date, branch management review all current accounts, amending the actual printout to the required amount.*

At the end of each quarterly charging period, branch staff were obliged to go through the Fees to be Applied Report and decide which accounts should be charged for administration and management time and how much the charge should be.

Prior to July 1992, the Bank did not provide branches with any procedural guidance setting out how administration and management time should be charged, nor with any system prescribing how such time spent on customers' accounts should be recorded. As stated in the document quoted above, this was left to the discretion of the branch.

In the Unauthorised Interest & Fee Amendments Report referred to in Part 6 at page 133, the Bank described the fee amendment process in the following terms:

> *The fee system required a significant amount of manual adjustments to be made which, particularly in the earlier periods when there was little automation, was heavily reliant on the accuracy, judgment and integrity of the individuals processing and reviewing them.*

Guidance Material in use at 1 January 1988

The Bank has confirmed to the Inspectors that at 1 January 1988 there was no written instruction to staff on the maintenance of records of chargeable time.

Guidance in relation to charges as of 1 January 1988 was provided by a paper entitled "Guide to Costings, Northern Bank (Ireland) Limited, November 1987". This Guide set out details of fees chargeable on personal and business accounts, much of the Guide addressing costing methodologies. An appendix to the Guide provided a list of ancillary charges, specifying that they "*should be levied on an "on the spot basis"* ",

and not, except in exceptional circumstances, be allowed to accrue and thus require adjustment at the end of the quarterly charge period. The Guide did not address the area of administration or management time in any respect.

The 1992 Branch Procedures Manual, represented to the Inspectors as reflecting the instructions applicable to branch staff at 1 January 1988, does not contain any guidance on the nature of work or service to customers which should give rise to an administration or management time charge, nor does it give any guidance on the form of record to be maintained by branch staff responsible for delivery of the service. As noted at page 145 above, the Manual refers only to "*any changes which you wish to make*" on the Fees to be Applied Report.

Every branch was however set an annual target for fees, and the charges for administration and management time were part of the fees which contributed to meeting this target.

Routine circulars advising the timetable for issue and review of the Fees to be Applied Reports in the period covered by the investigation contained no guidance on the form of amendment required or how it should be determined.

The fee charged by the Bank in the customer's quarterly account was a global amount, none of its constituents being separately identified, so customers were unaware of the level of charges for administration and management time.

The Customer Action Pad, Form St.20, introduced July 1992

As noted above, on 24 July 1992 Dermott Boner, then Head of Retail, issued a memorandum to all branch managers and staff in relation to fees and management time. Attached were guidelines for charging management time with the instruction that such a charge be "*applied to all accounts that are troublesome and time consuming*". It instructed managers that accounts "*should be monitored daily with details of services provided recorded*" on a new "***Customer Action Pad***". The memorandum stated that increasing fee income was "*one of our key targets for the present financial year*" and the branch managers were instructed to set "*a target for Management time for the quarter ending September '92*". A copy of this memorandum, with attachments, is reproduced at Appendix 16.

A similar memorandum prepared by Mr Boner was issued on 24 August 1995, under a covering note from Michael Keane, General Manager – Banking.

The introduction of the Customer Action Pad did not bring about any improvement in how management time was recorded and charged. Managers found the system cumbersome and unworkable. So, notwithstanding the availability of the Customer Action Pad, the situation in regard to charging management time remained basically the same as it had been prior to its introduction.

The introduction of the Pad does however confirm that there had previously been no system in place for recording management time.

Branch managers, in evidence which the Inspectors accept, stated that the Customer Action Pad was rarely used; illustrative extracts include:

> *There was a time when they brought in what they call 'action pads' ... I would have to say that the completion of those was haphazard ...*
>
> oooOooo
>
> *... around 1992/'93, there was a system brought in of action pads ... it would be only fair to say that it was a guesstimate again of the action [pads] that you didn't complete.*
>
> oooOooo
>
> *The customer action pad was ... an unworkable system.*
>
> oooOooo
>
> *I would say 90% of the time they weren't used.*
>
> oooOooo
>
> *... they were not used widely. They were not used at all.*
>
> oooOooo

Bank management have suggested to the Inspectors that the memorandum covering the issue of the Customer Action Pad did not constitute an addition to the Branch Procedures Manual, and may not therefore have been regarded by Branch staff as a mandatory direction.

In thirty-one branch audit reports in the period October 1993 to July 1995 it was noted that the Customer Action Pad St.20 was not used to record management time.

Operation of the System prior to 1996

The Inspectors interviewed 37 current and former branch managers and staff.

There was general agreement amongst these interviewees that between January 1988 and March 1996 there was no prescribed system for charging administration and management time, and no system for recording such time, apart from the attempt to introduce a "Customer Action Pad" in July 1992 referred to above (and a similar communication in August 1995). One branch manager did devise a system of his own, which appeared to work satisfactorily, but this was an exception to the general practice.

Descriptions of how the charging of management time operated in practice were very similar. Generally the bank manager, in some cases with assistance from senior officials within the branch, decided what charges to make. They went through the

Fees to be Applied Report and picked out the customers who, from memory, they considered should be charged, and set about determining what the charge should be. Their view of the procedure was that it was a guesstimate, unscientific, arbitrary, crude and clumsy. As regards matters which were taken into account in deciding which customers to charge, and the amount of the charge, the following is a summary of the evidence, which the Inspectors accept, of the managers interviewed:

- Business customers bore the brunt of the charges, particularly those who were regarded as "troublesome".

- "Troublesome" personal customers were also charged.

- The charge for the previous quarter was the guideline. The current quarter's charge would either be the same or slightly more.

- The charges were target driven. There was pressure to increase fee income.

- The branches were required to recover 125% of customer cost. (Interpretations of this requirement varied, and its application was limited in practice).

- Consideration was given to the level of charge the account could bear without the customer querying it.

Bank manager interviewees indicated that while the IR£10 per hour (later, IR£25 per hour) charge was applicable to the time spent in servicing customer accounts, no detailed workings were prepared to support the application of this composite rate to time spent.

As evidence of the subjective and random nature of amendments made, managers confirmed that if for any reason the amended Fees to be Applied Report were destroyed, and it was necessary to repeat the adjustment exercise, the revised charges to individual customers would probably differ from those determined in the first instance, though the total uplift would in all likelihood be the same or very similar to the original total.

Bank branch staff evidence

Illustrative extracts of evidence from present and former branch managers and staff on how the system operated at branch level, which the Inspectors accept, include:

> *Well, there was no rule of thumb, it was kind of a guess figure, you know.*

oooOooo

> *It was a guesstimate.*

oooOooo

It would have been relative to the last quarter. ....

Well, it [the hourly rate of £25] would have been at the back of our head ... I didn't apply, I didn't have a scientific rate. As I say, there was just a guesstimate that £100 would cover my time. ...

A guesstimate, yes. It was my best, I wasn't being dishonest, I wasn't trying to load people or anything. It was my best guesstimate on what time I had spent or [my assistant] had spent or how troublesome this account was. It was a best guesstimate.

oooOooo

Well, I would have sort of thought what sort of nuisance has he been over the previous period and come up with a figure.

oooOooo

It was, at best, a decent guess as to the level of how the fee should be increased. ...

Inspector: *... would you have been conscious of the target that had been set for the branch in relation to charges?*

Manager: *Honestly, yes.*

oooOooo

Well, fees there was no sort of organised – well structured way of collecting what we now call administration time in dealing with customers. So fees would have been added on if it was a troublesome account at each quarter.

oooOooo

... the bank never really had a system where management time was to be charged other than the fact that we were told to obtain 125% cost covered. ...

There was no basis really. It was really just how much trouble you had with that account during the previous charging period, and it could have been as simple as just adding £10 or £5. There was no real basis, it was just depending on what happened.

oooOooo

Truthfully, I would say there was a lot of guesswork done on troublesome accounts, put on a bit here and there. ...

There were a lot of things omitted from it that the system wouldn't pick up but there was no proper system in place to record things that should have been

recorded. I would say there were people overcharged and people undercharged, if one were to go through the nitty gritty.

oooOooo

Up until the fairly recent past, the Bank had no way of recording Management time and [it] had to be guessed.

oooOooo

... the guideline was the previous fee and there would have been a certain amount of fees to be got in that quarter so it would really have to be the same fee as the last time plus a little bit more.

oooOooo

There wasn't a system, what was there was archaic. You were relying on memory for a good number of years.

oooOooo

There were no guidelines as to how to price, something which always annoyed me somewhat. All one really had to go on was the view of the previous manager in relation to the customer. In consultation with the Deputy manager, the Assistant Managers, the Accounts Department and perhaps the Foreign Box (sic), *you would come to a decision as to whether the customer merited a similar loading. It was really a very unsatisfactory exercise.*

oooOooo

I suppose the best way of putting it is that you would not reduce the fees to less than they were in the previous period. That is taking a bald point. You would leave the fees as they were in the previous year or quarter as the case might be. You would know the people who should be charged a little more than indicated in the report and that would be based on the level of correspondence you had to do in relation to them or the fact that they were in and out to you all the time.

oooOooo

On the fee, it was target driven. There is no doubt in my mind on that ...

oooOooo

Inspector: *Was it a guesstimate based on documentation on what you thought the time may have been or was it a guesstimate of what the account might bear without raising a query?*

Manager: *It was a guesstimate, it's probably a combination of those.*

oooOooo

I would say that in some instances people were possibly overcharged and in other instances undercharged.

Internal Audit Reports

Findings noted in branch audit reports between 1992 and 1996, at the dates set out below, are consistent with the evidence set out above:

March 1992: It was noted that where fees were increased that an explanation was not annotated and confirmed by the Manager/Deputy Manager as required.

May 1992: Where increases to fees are made an explanation should be recorded beside the entry on the fees to be applied report. Branch should ensure that increases can be justified if queried by customers.

June 1992: When fees were increased/decreased there was (sic) *often inadequate explanations annotated to the fees to be applied report.*

September 1992: It was noted that a reason was not annotated on the fees to be applied report when fees were decreased or increased.

February 1993: From examination of the fees to be applied reports many instances were noted where customers (sic) *fees were increased by substantial amounts and there was often inadequate explanations annotated on the report.*

April 1993: It was noted that the reason why fees were increased was not noted on the fees to be applied report.

May 1993: It was noted that the reason why fees were increased or reduced was not annotated on the fees to be applied report as required.

June 1993: A number of instances were (sic) *noted where fees calculated by the computer system were amended but no explanation was given.*

July 1993: When fees are increased/reduced the fees to be applied report was not annotated with a suitable explanation.

July 1993: Many instances were noted where the fee as calculated by Livelink was increased/reduced but the report was not annotated with a suitable explanation.

August 1993: Many instances were noted where fees were increased or reduced below the figure calculated by Livelink and a suitable explanation was not annotated on the fees to be applied report.

September 1993: The fees to be applied report is not annotated as required when fees are increased/reduced below the figure calculated by Livelink.

October 1993: It was noted that the fees to be applied report was not annotated with a meaningful explanation or signed by an authorised official beside the relevant entry, when fees were adjusted.

October 1993:

- *Numerous instances were noted where customers* (sic) *fees were substantially increased without legitimate cause or reason.*
- *The fees to be applied report is not annotated with a meaningful explanation and signed by an authorised official beside the relevant entry when fees are increased or reduced below the figure calculated by Livelink.*

November 1993: It was noted that the Fees to be Applied Report was not annotated with a meaningful explanation beside the relevant entry when fees were increased or decreased below the figure calculated by Livelink.

December 1993; January 1994; May 1994: Numerous instances were noted where customers (sic) *fees were substantially increased and a meaningful explanation was not annotated beside the relevant entry.*

January 1994; February 1994; March 1994; November 1994; February 1995: Numerous instances were noted where fees were increased or decreased and a meaningful explanation was not annotated beside the relevant entry.

April 1994: Numerous instances were noted where fees were increased and a meaningful explanation was not annotated beside the relevant entry.

July 1995: Many instances were noted where fees were increased and a meaningful explanation was not annotated beside the relevant entry.

July 1994; December 1994; January 1995; February 1995; May 1995; June 1995; July 1995: Instances were noted where fees were increased or decreased and a meaningful explanation was not annotated beside the relevant entry.

July 1994: A few instances were noted where fees were increased or decreased and a meaningful explanation was not annotated beside the relevant entry.

September 1994: Many instances were noted where customers (sic) *fees were substantially increased and a legitimate reason was not recorded on the Fees to be Applied Report.*

November 1994: On a number of occasions fees as calculated by Livelink were increased and a suitable explanation was not recorded on the fees to be applied report.

February 1995: A number of instances were noted where fees were increased or decreased and a meaningful explanation was not annotated beside the relevant entry.

June 1995; March 1996: Instances were noted where fees were increased and a meaningful explanation was not annotated beside the relevant entry.

Findings noted in internal audit reports referred to below are consistent with the oral evidence received to the effect that there was no system in the branches for recording management time:

August 1995: Following an examination of the Fees to be Applied reports and Costing reports produced this year to date, it is noted that approximately £20k is charged to customers each quarter in respect of management time (this is in addition to normal fees). There is no system at Branch to record details of management time.

September 1995: It is noted that administration charges represents (sic) *approximately 25% of total fees charged each quarter. There is presently no system at Branch to record details of administration charges.*

November 1995: It is noted that there is no system at Branch to record details of administration charges.

February 1996: Administration charges represent approximately 5% of total fees charged each quarter. There is presently no system at Branch to record details of administration charges.

March 1996: Account administration charges represent approximately 20% of total fees charged each quarter. There is presently no structured system at Branch to record details of administration time.

April 1996: From an examination of two recent Fees to be Applied Reports, it is noted that account administration time charges represents (sic) *only approximately 8% of total fees charged each quarter. Furthermore, there is no system at Branch to record details of account administration time.*

April 1996: From an examination of two most recent Fees to be Applied reports, it is noted that account administration charges represents (sic) *only approximately 4% of total fees charged each quarter. Furthermore, there is currently no system at Branch to record details of account administration time.*

May 1996: From an examination of two recent Fees to be Applied reports, it is noted that account administration time charges represents 1% to 2% of total fees charged each quarter. There is currently no structured system at Branch to record details of account administration time.

Pre-notification of Fees

In 1996, as a result of an initiative taken by the Director of Consumer Affairs, a system of pre-notification of fees was introduced by the five main banks, including National Irish Bank. Special Circular S10/96 dated 1 March 1996, the title of which was "Recording of Account Administration Time" summarised the background as follows:

> *Currently, it is still the practise* (sic) *of some Banks, including National Irish Bank, to apply fees to a customer's account and leave it up to the customer to*

discover the extent of the bank's deductions on receipt of their statement. Information on the makeup of this charge is not provided to the customer unless it is subsequently requested. Whilst it has been normal practice for Banks to act in this way, lately there has been growing pressure on Banks, particularly from the Director of Consumer Affairs, to provide customers with an itemised breakdown of their charges before they are applied to the account.

In a press release on 'Bank Charges' made during 1995, the Director of Consumer Affairs referred to the provisions of the pending Consumer Credit Bill and declared:

"All of the five main Banks will have introduced a system of pre-notification of their main transaction charges before the end of 1996 ..... The effect of pre-notification will be to give customers details of charges two weeks before they are debited to accounts. Customers will then have an opportunity of querying these charges before they are actually debited."

It should be noted that the requirements of pre-notification will not be included in formal legislation provided that the Banks' "voluntary" actions are approved by the Director of Consumer Affairs.

Within National Irish Bank, software is currently being developed which will allow the Bank to meet these requirements. It is expected that this software will be implemented at the beginning of May with the first pre-notification Fee Advices being produced at the end of the charging period in August.

The circular went on to state that the charge which was previously referred to as a management time or administration charge had now been replaced with the designation "account administration".

The requirement for the pre notification of fees necessitated keeping a record of account administration and a key feature of the revised system provided for the input at branch level on an ongoing basis of time spent on account administration, so that such charges would henceforth be automatically included in the calculation of the fee at the end of the charging period. New forms, which required that details of time taken and the nature of the work done be recorded and input daily, weekly or monthly to the computer system, were introduced in the circular, to take effect from the May/August charging period of 1996.

The content of the Fees to be Applied Report was amended to include all activity items, including details of all account administration time inputs – date, time spent and work category.

It was explicitly stated that the only amendments which ought to be necessary on review of the Fees to be Applied Report would be those resulting from current period input errors which had not already been corrected. Fee amendment procedures were set down, and a fee amendment form, requiring that the basis of the alteration be recorded, was prescribed.

Managers interviewed were comfortable with the post-1996 system, albeit that there appeared to have been some "teething troubles" attending its introduction. Their comments included:

> *It's a proper system now.*
>
> oooOooo
>
> *Well, I am not sure of the date [of introduction of the new system in 1996], but even in the early stage of that system it is difficult to, you know, people weren't familiar with the system, they weren't documented. We are documenting it 90% correctly now, but in the early stage at the introduction of the system, again you would have had an element of the crude mechanism.*
>
> oooOooo
>
> *Since '98* (sic) *- I can't remember exactly what time in '98 but during '98, that system was discontinued and everything was, we had to do administration sheets ...*
>
> oooOooo

Inspector: *The situation now is there would be no manual intervention at the quarter end?*

Manager: *No, except ... if there was a blatant error.*

Delay in Implementing new Time Recording System

Fee Income Theme Audit

This audit was carried out in October 1996, and was the subject of a report to Bank management in November 1996. The audit represented the first formal review of the fee income area following introduction of the revised system for recording account administration time on a contemporaneous basis. The stated principal objective was to ensure that fee income was being properly collected.

The majority of findings relate to areas where the Bank may have been failing to record, and therefore to recover, charges, but the report also records deficiencies in completion, coding, input and checking of account administration forms in the branches visited. It would appear that at the outset of the pre-notification period, the newly introduced system for recording account administration time was not fully operational and that to an extent the practice of unsupported amendment of the Fees to be Applied Report persisted.

As is indicated in the second interview extract quoted above, managers interviewed acknowledged that the new system took some time to become fully operational.

Internal Audit Reports

Internal audit reports from branch visits about this time also indicate some delay in adoption of the revised procedures:

August 1996:

> *By enquiry, it was established that the completion and input of account administration input forms in respect of quarter end August did not commence until early July. This has necessitated the manual input of a considerable amount of account administration time at quarter end for which details are not fully documented.*

October 1996:

> *By enquiry, it was established that account administration input forms were not completed and input on all occasions in respect of the first half of the quarter ended August 1996. This necessitated the input of a considerable amount of account administration time (65 hours approximately) at August quarter end under category 99 (general) for which details are not fully documented. It was further noted that category 99 (general) represents almost 40% of total administration time charges for this quarter.*

December 1996:

- *An examination of the most recent Fees to be Applied reports indicates that account administration input forms are not being completed on all occasions by staff dealing with customer queries, lending, counter activity etc. An examination of the reports revealed the following:*
  (a) Over 95% of the account administration time charges for the quarter ending August 1996 were input in bulk at the end of the quarter for which details were not fully documented.
  (b) Only two hours of account administration time were input for the full quarter ending November 1996 (some charges are levied at time of transaction/task).

- *By enquiry, it was established that in some cases account administration time charges and in one case activity charges are applied to accounts at the time of the transaction/task and are therefore not pre-notified.*

Review of November 1997 Fees to be Applied Reports

Review on behalf of the Inspectors of a sample of Fees to be Applied Reports for the quarter ended November 1997 revealed that at that date, extensive manual adjustments were still being effected at quarter end in a number of branches.

ACTION TAKEN BY THE BANK ON FIRST DISCOVERY OF IMPROPER PRACTICE

No Action Taken prior to 1996

While Internal Audit had regularly reported that "*customer fees were substantially increased and a meaningful explanation was not annotated beside the relevant entry*", as appears from the branch audit reports referred to above, the Inspectors have not found any evidence that these reports resulted in any move by the Bank to examine how fees were being charged.

In fact, prior to the introduction of the Customer Action Pad in July 1992, there appears to have been no appreciation at any level within the Bank that it was improper or inappropriate that customers be charged for services on a time-related basis while there was no system in operation for recording such time. Indeed, as is clear from the memorandum which accompanied it, the Customer Action Pad was not introduced with the intention of remedying a deficiency in control systems, but in an effort to ensure that a greater proportion of manager and staff time was charged to customers. As already stated, the introduction of the Pad did not bring about any improvement in how management time was charged. Managers found the system cumbersome and unworkable.

No effective action was taken until an upgrade of the computerised system for customer charges was introduced in April 1996 in anticipation of the requirement of the Director of Consumer Affairs (referred to at pages 155 and 156) to prenotify customer charges.

ACTION TAKEN BY THE BANK FOLLOWING NEWS MEDIA REPORTS

Interviews with Bank Staff

As already indicated in Part 6, the initial action taken by the Bank was to have internal audit staff interview 210 Bank personnel. The Inspectors, with a view to minimising the number and extent of interviews they themselves would be obliged to carry out, sought from the Bank copies of the notes taken at these interviews. The Bank claimed privilege over this material, and declined to make it available to the Inspectors. The Bank has however formally advised the Inspectors that all material otherwise requested by the Inspectors has been furnished to them, including all documentary material referred to at the staff interviews.

As already noted, the Inspectors considered a Court challenge to the Bank's claim to privilege over the interview notes, but decided against it on the grounds that it was preferable to conduct a comprehensive interview programme themselves rather than become involved in what might turn out to be lengthy and costly litigation.

Bank Investigation Work: The Unauthorised Interest & Fee Amendments Report

General

As described in Part 6, the Bank's investigation of the allegations of interest and fee loading broadcast on RTE is the subject of a report dated March 1999 entitled "National Irish Bank: Unauthorised Interest & Fee Amendments", prepared by National Australia Group's European Audit function, hereafter termed "the Unauthorised Interest & Fee Amendments Report". A copy of this report was furnished to the Inspectors on 26 March 1999 and is reproduced at Appendix 14.

Work Done

As already outlined in Part 6, the work described in the Unauthorised Interest & Fee Amendments report includes initial work carried out by the Bank's internal audit staff, work carried out by Arthur Andersen at the Bank's request, and work carried out thereafter by Bank staff.

The objectives of the investigation included the quantification of the impact on customers of any unacceptable activities which had taken place.

The scope of the review was restricted to current account adjustments. The Bank concluded that a "*targeted approach rather than a fully substantive one*" was appropriate and therefore directed its work at "*locations where the risk of occurrence was assessed as being high*".

The investigation team did not seek to verify the working of the system in either the interest or fee areas, but sought to consider the result of the amendment process.

Arthur Andersen work

In the fee area, following review of available branch audit reports, the Bank decided to concentrate on the branch referred to in the RTE report, that at College Green, Dublin. The Fees to be Applied Report was not available for the November 1989 charge period, the subject of the allegations of unjustified fee increase, and so the next charge period was chosen. Arthur Andersen ("AA") was therefore engaged to investigate "*whether fees have been debited to customer current accounts at the College Green branch of the Bank without any contractual, statutory or other valid basis and, if so, the extent thereof for the February 1990 quarter end posting date.*"

Following classification of a total of 896 manual amendments to the Fees to be Applied Report in the quarter, AA reviewed Fee Amendment Sheets, Costing Sheets and Customer files; the documentation provided unambiguous support for a specific amendment in two instances only.

Work carried out by Bank investigation team – College Green branch

Bank staff carried out an account by account review for each College Green, Dublin, branch customer identified by AA as having a fee amendment greater than IR£3.00 in the quarter – 549 in all. By applying standard times for management activities identifiable from examination of the account to a cost per hour, a calculation of management time cost was compared to the fee uplift.

The outcome of this exercise is summarised in the Unauthorised Interest & Fee Amendments report as follows:

	No.	IR£
Fee amendments	885	11,294
Examined	549	10,651
Justified	439	9,958

The Report notes, and Bank management have emphasised the point to the Inspectors, that the list of activities warranting a management charge indicates that only a small proportion would be identifiable from a review of transactions on the account.

The Bank concluded that the results of this work represented a "*high level of satisfaction with ... fee charging practices at the time of the allegations*". The Bank further decided to use a matrix based on the level of fee uplift identified at this branch as a key indicator in evaluating the level of fee adjustment effected at other branches during the period investigated.

Work carried out by Bank investigation team – other branches

Bank staff carried out additional work on fee amendments using the same approach as that adopted for the College Green, Dublin, branch, under a number of headings:

- A sample of twelve branches was selected for detailed review of some 50 amendments for one quarter. The Report states that the sample was biased towards branches and time periods which had been found to include unjustified interest amendments. The Bank concluded that the results of this examination were satisfactory for all branches except Cork and Carndonagh branches.

- Review of other branches where the managers of these two branches had worked resulted in a similar "unsatisfactory" conclusion being reached in respect of Waterford branch.

- A matrix of "reasonable" fee uplifts, by account type and account activity level, was developed based on the results of the review at College Green, Dublin branch. This matrix was then applied across all customer fee enquiries for one quarter. Enquiries failing this test were subjected to a detailed account review for the

quarter in question to establish whether adequate justification for the fee uplift existed. The Bank concluded from this work that fee refunds were not warranted at branches other than those identified above – Cork, Carndonagh and Waterford.

- A minimum of ten amendments over two quarters was examined at all other branches; no further instances of unjustified fee charging were identified from this work.

Conclusions

The conclusions of the Unauthorised Interest & Fee Amendments Report in the fees area are as follows:

> *The fee charging process in place at the time of the allegation involved a series of three reports and required manual intervention for the application of management time charges. The approach taken in College Green branch, namely making manual amendments to the Fees to be Applied Report, was typical across the network.*
>
> *While many of the activities which would warrant management time charges are invisible to a retrospective account review, the results of the work carried out in College Green gave a high level of satisfaction with their fee charging practices at the time of the allegations.*
>
> *Work carried out across the remainder of the network confirms that there was no widespread abuse of fee charging practices. However Cork, Carndonagh and Waterford branches have been identified as having low justification levels for fee uplifts applied during certain time periods. Whilst the full quantification of the position in Waterford has not yet been completed, it is anticipated that the total amount of fees that will be refunded will be approximately £200k before indexation.*
>
> *System developments in the periods since the allegations were made have resulted in improvements in the capture of administration and management time and, as a follow on, in enhanced transparency to the customer.*
>
> *The introduction of detailed pre-notification of fees in August 1996 gives a high level of comfort with the integrity of current fee charging practice.*

Arising from the work described above, fee refunds were made to customers of the three above-named branches only.

The Bank has advised the Inspectors that it has now made inflation-adjusted refunds totalling approximately IR£960,000 in respect of unjustified fee adjustments. (This total includes refunds in respect of some charges made in 1987).

Inspectors' Observations, Unauthorised Interest & Fee Amendments Report: Findings on Fee Amendments

As there was no system in operation in the Bank for recording administration and management time between 1988 and April 1996, and in light of the internal audit reports and the consistency of the evidence the Inspectors have received from branch managers, the Inspectors reject the conclusions of the Unauthorised Interest & Fee Amendments Report that there was no widespread abuse of fee charging practices and that fee refunds to customers should be confined to three branches only.

Customer Queries

The Bank set up and advertised a telephone helpline, which customers could contact with queries relating to interest or fee charges on their accounts.

The Bank has informed the Inspectors that approximately 1,481 fee-related queries were received, through the helpline and otherwise.

The Bank's approach to the resolution of these queries and to responses to customers placed considerable reliance on the work described in the Unauthorised Interest & Fee Amendments Report and the conclusions reached from that work, as summarised at pages 160 to 162 above. This resulted in many replies to customers being based on work done at branch level rather than on review of their accounts. Customers whose individual accounts did not reach an acceptable threshold in course of the work underlying the Unauthorised Interest & Fee Amendments Report, or whose accounts contained unresolved issues, were given assurances based on the view taken of the relevant branch, notwithstanding the results of work on their accounts.

Further Work proposed by the Bank

Following, *inter alia*, discussions with the Inspectors, the Bank informed the Inspectors that it would undertake a fee review which would examine in detail the areas described in a paper entitled "Fees Review 2001" which was furnished to the Inspectors on 8 August 2001. This paper is reproduced as Appendix 17.

The Bank subsequently advised the Inspectors that the details of the additional work carried out, the conclusions reached and the consequent action undertaken or proposed, would be included in its submissions on the Inspectors' provisional findings when received.

Following receipt of the Inspectors' draft report on 1 August 2003, the Bank devised a new programme, "Fees and Interest Refund Programme" which is set out in Schedule V of the Bank's Reaction Paper, reproduced in full at Appendix 19. How the Bank came to take this step is described as follows on page 4 of Schedule V:

> *In light of the views expressed by the Inspectors, and on reconsidering the decisions underlying its previous approach, the Bank has devised a further programme of work and refunds on which it has sought independent verification.*

As already stated (see page 137) the Bank anticipates that this programme will result in additional fees and interest refund payments to customers of Euro10.6 million.

INSPECTORS' CONCLUSIONS

The Inspectors find:

1. Between 1988 and April 1996 there was no system in operation at the branches for the contemporaneous recording of administration and management time.

2. The manner in which branch managers purported to charge fees for administration and management time during this period was in the opinion of the Inspectors improper, resulting in some customers being overcharged, across the branch network.

3. While the new system for recording and charging account administration time introduced in March 1996 was to take effect from the May/August charging period of 1996, this system did not become fully operational in the branches on schedule, and extensive manual adjustments were still being effected in a number of branches in November 1997.

4. Customers at branches other than those at Carndonagh, Cork and Waterford were overcharged and have not been refunded.

PART 8

IMPROPER PRACTICES: KNOWLEDGE AND RESPONSIBILITY

IMPROPER PRACTICES: KNOWLEDGE AND RESPONSIBILITY

INTRODUCTION

The Order appointing the Inspectors to investigate the affairs of the Bank requires that they, *inter alia*, investigate and report on the identity of those responsible for or aware of the practices being investigated.

In carrying out this aspect of the investigation, the Inspectors have not considered it relevant to comment on the knowledge of employees of the Bank holding positions subordinate to that of manager, as, while junior officials may have been aware of the existence of practices which were improper, they were not in a position to effect change, and so could not be held to have any responsibility for their existence.

Subject to that limitation the issue of the responsibility of individuals or their knowledge is dealt with hereunder, separately, in respect of each of the improper practices identified in Parts 2 to 7 of the report.

The responsibility or knowledge of other entities falls to be dealt with in respect of the totality of the improper practices, and the Inspectors' conclusions in regard to these form the first section of this Part.

CONCLUSIONS CONCERNING ENTITIES OTHER THAN INDIVIDUALS

The relevant entities are:

- The Bank's internal audit function
- The external auditors to the Bank
- The Audit Committee of the Board
- The Board of Directors.

Internal Audit

The Inspectors reviewed with particular attention internal audit reports on branch visits carried out during the period covered by the investigation, as they represent a contemporaneous record of the results of examination of branch procedures and records over that time. (The Bank advised the Inspectors that a total of 202 branch audit reports had been prepared in the period 1988 to 1997, but that only 164 of these reports could be located, the missing reports largely relating to the early years of the period being investigated).

The Inspectors also reviewed internal audit reports on other areas within the scope of the investigation, including reports on the FASD and theme audits on DIRT, interest, and fee income.

Review of these reports and interviews with internal audit personnel, past and present, have led the Inspectors to conclude that the Bank's internal audit personnel performed

their function in a satisfactory manner. As noted above, in each of the areas the subject of the investigation, with the exception of the manner of promotion of the CMI policies, internal audit staff identified, and reported to senior management in the Bank, instances of improper practices. The Inspectors are of the view that the manner of promotion of the CMI policies was not within the remit of Internal Audit.

The Inspectors accept that it is not the function of internal auditors to correct improper practices or deficiencies in procedures discovered by them.

The External Auditors

The Inspectors have considered the position of KPMG, who were the external auditors from 1990, in relation to the matters being investigated.

In carrying out their audits KPMG were aware of, and placed reliance on, the work of Internal Audit, as they concluded that Internal Audit was competent. In so far as Internal Audit identified the matters being investigated by the Inspectors, KPMG were satisfied that the issues were being reported to management and the Audit Committee and accordingly did not consider it necessary to modify their audit plans to specifically examine the areas reviewed by Internal Audit. In the opinion of the Inspectors, these judgements, with one exception, which is dealt with above at pages 57 and 58, were appropriate.

The Audit Committee of the Board

General

The Inspectors have considered the operation of the Board Audit Committee and have concluded that the Committee:

- afforded to Internal Audit access to Board level in the Bank, independent of senior management;
- ensured that no limitation was placed on the scope of operation of the internal audit function;
- met regularly and received presentations from Internal Audit,

and dealt satisfactorily with matters the subject of the Inspectors' investigation which were raised by Internal Audit, save in relation to DIRT.

DIRT

The management summary in the quarterly audit report to the Audit Committee in respect of the quarter ended February 1995 stated that, in the quarter under review, Internal Audit had completed its first theme audit, which was concerned with DIRT. The audit was rated "unsatisfactory".

The report noted three major audit findings in relation to DIRT, each with a 4 star significance rating (ie the second most serious rating on a scale of 1 to 5). It was clear from the findings that both in regard to non-resident accounts and Special Savings Accounts there had been a significant failure on the part of the Bank to observe the relevant statutory requirements.

The corrective action proposed by Internal Audit and accepted by management did not include any proposal to deal with the issue of the Bank's liability for such arrears of DIRT as might be due in the circumstances. Because of this, the Audit Committee ought not to have accepted the corrective action proposed as being adequate, but should have sought further information as to how management intended to deal with the issue of a potential retrospective liability for DIRT.

The Board of Directors

The Inspectors have considered the duties of a Board of Directors in relation to the matters under investigation, in particular the general duty of care imposed on directors.

The Inspectors note that:

- the Board of NIB appointed a committee of the Board with suitable terms of reference to deal with audit matters, appointed suitably qualified directors to this Committee, and received regular reports from it;
- there was an internal audit function in place, with independent access to Board level in the Bank;
- the Audit Committee met regularly and received reports from the Head of Internal Audit.

The Inspectors have received no evidence that any of the improper practices being investigated were brought to the attention of the Board.

In the circumstances, the Inspectors are of the opinion that the Board of the Bank cannot be held responsible for the existence of these practices.

EVASION OF REVENUE OBLIGATIONS: INCORRECTLY CLASSIFIED NON-RESIDENT DEPOSIT ACCOUNTS

Bogus Non-Resident Accounts

As stated in Part 2 at page 59, the Inspectors have concluded that the opening and maintenance of bogus non-resident accounts by the Bank constituted an unlawful and improper practice which served to encourage the evasion of Revenue obligations by third parties, both on the funds deposited and the interest earned thereon.

The Branch Managers

Managers at those branches where bogus non-resident accounts existed were aware or ought to have been aware of the existence of such accounts. They failed in their duty to deduct the relevant Deposit Interest Retention Tax ("DIRT").

Branch managers also had a duty to ensure that if properly completed declarations were not held for all accounts classified as DIRT-exempt non-resident accounts, DIRT should be deducted. They were aware of this obligation and failed to observe it.

The Inspectors do not consider it appropriate to find individual managers responsible for the practice of non-compliance with the legislative provisions relating to DIRT, as they believe that responsibility for this practice lay at a higher level in the Bank.

The Regional Managers (Dermott Boner, Kevin Curran and Tom McMenamin)

The titles and roles of Messrs Boner, Curran and McMenamin, and the periods for which the positions were held are set out in Part 1 at pages 7 and 8.

Throughout the periods they held Regional Manager (or superior) positions – ie 1 June 1988 to 19 January 1996 in the case of Mr Boner, 1 June 1988 to 4 July 1997 in the case of Mr Curran, and 1 October 1990 to 18 January 1996 (including a period as Area Manager) in the case of Mr McMenamin – each was made aware, through internal audit reports circulated to him (see Part 2, pages 44 to 50), of the deficiencies or "irregularities" which existed in the operation of DIRT-exempt non-resident accounts at branches. The majority of such reports referred to the failure of branches to hold properly completed declarations for all accounts classified as DIRT-exempt non-resident accounts.

Certain audit reports copied to the three above-named referred to instances where lending to resident customers was secured by letters of lien over deposit accounts with non-resident status. Reports copied to Mr Boner and Mr Curran also referred to instances where the residential status stated on non-resident declarations was at variance with other branch records. A report circulated to Mr McMenamin noted that some accounts designated "non-resident" were connected to resident accounts at the branch; another referred to four instances where non-resident savings accounts were opened in fictitious or incorrect customer names. In the opinion of the Inspectors, these audit reports pointed to the likelihood that the non-resident accounts referred to therein were in fact bogus. In addition, reported documentary non-compliance was on such a scale as to constitute, in the opinion of the Inspectors, a further indication that a substantial proportion of the non-resident accounts could be bogus.

Additionally, while none of these three executives were on the circulation list for the DIRT Theme Audit report of December 1994, Mr Boner and Mr McMenamin attended the meeting of senior management held on 9 February 1995 to discuss the results of the audit and the DIRT compliance issues arising therefrom, and Mr Curran, although not present at the meeting, is noted as having been circulated with a copy of the minutes.

In evidence given when interviewed by the Inspectors, Mr Boner and Mr Curran acknowledged that they had suspicions that bogus non-resident accounts existed in the branch network.

The Inspectors believe the inevitable inference from the above is that Mr Boner, Mr Curran and Mr McMenamin were not only aware of the failure of branches to hold properly completed non-resident account declarations but ought also to have been aware of the widespread existence of bogus non-resident accounts in the branch network.

Mr Boner, Mr Curran and Mr McMenamin had each a responsibility in respect of the branches in his region to ensure that all accounts classified as DIRT-exempt non-resident accounts were correctly classified as such and, in this regard, particularly in light of the deficiencies disclosed in the audit reports circulated to him, had each a responsibility to make reasonable enquiries of the branches for which he was responsible to satisfy himself that all such account holders were genuinely non-resident and that properly completed declarations were in place for all accounts so classified.

Mr Boner, Mr Curran and Mr McMenamin had each a responsibility to ensure that DIRT at the standard rate was deducted from interest paid or credited where the conditions for the operation of accounts as DIRT-exempt non-resident accounts were breached.

Mr Boner, Mr Curran and Mr McMenamin each failed to discharge these responsibilities.

Area Managers Appointed February 1996

As noted in Part 1 at page 8, six Area Managers were appointed with effect from 1 February 1996. Each had previously been a branch manager; the majority received branch audit reports in respect of the branches for which they were responsible which contained adverse comment in respect of compliance with the DIRT regime.

In February 1996, DIRT compliance issues were being addressed at a higher level in the Bank (as a result of the Bank's review of the 1994 DIRT Theme Audit). The Inspectors have therefore concluded that these Area Managers do not bear responsibility for the failures at branch level to deduct DIRT where it ought to have been deducted.

General Manager – Retail Banking/General Manager – Banking (Frank Brennan and Michael Keane)

The titles and roles of Messrs Brennan and Keane, and the periods for which these positions were held are set out in Part 1 at pages 5 to 7.

As General Manager – Retail Banking between May 1988 and July 1991, one of Mr Brennan's responsibilities was to ensure that the branches had full and accurate

instructions in regard to deducting DIRT from deposit interest, and to ensure that appropriate procedures were in place to implement the instructions.

Between July 1991 and March 1998, while Mr Brennan's title and functions changed from time to time, he continued to be responsible for procedures in the branches and accordingly he continued to be responsible for ensuring that there was an appropriate system in place for compliance with the DIRT regime.

The evidence discloses that prior to May 1995 no circular or other communication was issued to the branches, after the coming into force of the Finance Act, 1986, which informed branch staff of the effect of Section 32 (2) of the Act which provides that "*a relevant deposit taker should treat every deposit as a relevant deposit unless satisfied that it is not a relevant deposit.*" The effect of this Section was that the Bank was required to deduct DIRT from every account designated non-resident unless it held a valid declaration and was satisfied that the person beneficially entitled to the interest on the account was genuinely non-resident. By failing to inform the branches prior to May 1995 of the requirements of this Section, Mr Brennan, during the period preceding May 1995, failed to discharge his responsibility of ensuring that proper procedures were in place in the branches to secure compliance with the statutory provisions for the operation of DIRT-exempt non-resident accounts.

In the capacity of General Manager – Retail Banking or General Manager – Banking, Mr Brennan and Mr Keane were each made aware, through internal audit reports circulated to them, of the deficiencies or "irregularities" which existed in the operation of DIRT-exempt non-resident accounts at branches. The majority of such reports referred to the failure of branches to hold properly completed declarations for all accounts classified as DIRT-exempt non-resident accounts.

Certain audit reports copied to Mr Keane referred to instances where the residential status stated on non-resident declarations was at variance with other branch records; others referred to instances where lending to resident customers was secured by letters of lien over deposit accounts with non-resident status. In the opinion of the Inspectors, these audit reports pointed to the likelihood that the non-resident accounts referred to therein were in fact bogus.

None of the branch audit reports received by the Inspectors where Mr Brennan was on the circulation list referred to non-resident accounts connected to other resident accounts at the branch, to lending to resident customers being secured by liens over deposits with non-resident status or to other matters which, in the opinion of the Inspectors, pointed to the likelihood that certain non-resident accounts were in fact bogus. However, he attended the meeting of senior management held on 9 February 1995 to discuss the results of the DIRT Theme Audit and the issues arising therefrom. In the minutes of this meeting, Mr Brennan is noted as having stated that he felt that there was a need to change attitudes at branch level so that possible tax evasion could be eliminated to the greatest degree possible.

On the same day, 9 February 1995, Mr Brennan sent a memorandum, quoted in Part 2 at page 44, to the Executive Director, which noted Mr Brennan's concerns over a

number of years in the area of compliance with the legal requirements for the operation of DIRT-exempt non-resident accounts.

Mr Keane was on the circulation list for the DIRT Theme Audit report and chaired the 9 February 1995 meeting.

The Inspectors believe in the light of the above that Mr Brennan and Mr Keane were not only aware of the failure of branches to hold properly completed non-resident account declarations but ought also to have been aware that bogus non-resident accounts existed throughout the branch network.

It was the responsibility of Mr Brennan and Mr Keane, while General Manager – Retail Banking or General Manager – Banking, to ensure that accounts classified as DIRT-exempt non-resident accounts were correctly classified as such and to see that Regional Managers secured full compliance with the statutory provisions relating to DIRT. They failed to discharge this responsibility.

As noted at pages 54 and 55 above, the conclusion in the DIRT Theme Audit report was as follows:

> *Results of this audit are very disappointing and management must take immediate steps to improve the situation. The structure of the whole area can be improved but the level of non-compliance is too high. It appears that there needs to be an organisation-wide change in attitude to the whole area. This is a risk area and the penalty for non-compliance at the level shown in this report would be very significant.*

No one at the meeting of 9 February 1995, Mr Brennan and Mr Keane included, raised the question of a potential retrospective liability to the Revenue Commissioners for DIRT resulting from the findings of the Theme Audit. In his evidence to the Inspectors Mr Brennan claimed that this would have been the responsibility of the Finance Department. Even if the primary responsibility rested elsewhere, both Mr Brennan and Mr Keane, by reason of being part of senior management, had a responsibility to raise the issue at the meeting, and this they failed to do.

Head of Finance (Gerry Hunt and Patrick Byrne)

Mr Hunt was Chief Accountant at 1 January 1988. His title subsequently changed to Head of Financial Control, then to Head of Finance and thereafter to Head of Finance and Strategy. He ceased to hold the latter position on 31 December 1993.

Mr Byrne was appointed Head of Finance on 11 April 1994; his title subsequently became Head of Finance and Planning.

The Head of Finance had responsibility for ensuring that the Bank made returns of DIRT to the Revenue Commissioners within prescribed time limits. The accuracy of these returns was critically dependent on the proper categorisation of deposit accounts at branch level between those exempt from DIRT, those liable to DIRT at the standard rate of tax, and those liable at a reduced rate.

In the respective periods throughout which Mr Hunt and Mr Byrne were responsible for returns of DIRT to the Revenue Commissioners, neither was on the circulation list for branch internal audit reports. Accordingly neither was aware through this medium of the extent of the deficiencies or "irregularities" in the declarations held by branches in support of claims for DIRT-exempt non-resident status.

On 18 November 1993, Mr Hunt, as a result of concerns expressed to him by senior officials in the Department of Finance and in the Office of the Revenue Commissioners sent a memorandum to Mr Brennan, Mr Keane and Mr Boner, with a copy to Mr Lacey (see Part 2, page 43, and Appendix 8) to alert them to the probability of a Revenue audit of banks' non-resident accounts.

As stated above, Mr Hunt ceased to be Head of Finance on 31 December 1993. While the concerns which caused him to send the memorandum referred to could have put him on notice that the DIRT figures received from the branches might not be accurate, since no DIRT returns were submitted to the Revenue Commissioners by the Finance Department in the interval before he left, he did not have to consider the implications for future returns.

Mr Byrne was on the circulation list for the DIRT Theme Audit report of December 1994 and attended the meeting on 9 February 1995 to discuss the results of the audit and the issues arising therefrom. He was thus aware of the extent of non-compliance in the operation of DIRT-exempt non-resident accounts and ought to have known the consequences of such non-compliance for the accuracy of the returns of DIRT being made by him, or persons under his control, to the Revenue Commissioners.

At the meeting on 9 February 1995, Finance and Planning Department was charged with responsibility for drafting revised instructions to staff in relation to the operation of DIRT. These instructions were issued on 8 March 1995, as Special Circular No. S11/95. As already stated, this Circular introduced documentary requirements in relation to the opening of new non-resident accounts, but did not address the position in regard to accounts which had been opened previously apart from indicating that a valid declaration must be held *"which has been signed, dated and in all respects fully completed by the customer"*, nor did it inform the branches of the provisions of Section 32 (2) of the Finance Act, 1986 (see page 27 above). As Head of Finance and Planning, Mr Byrne shares responsibility for the defects in this Circular.

Mr Byrne, in common with Mr Seymour, Mr Keane and Mr Brennan, has given evidence to the Inspectors that the issue of a potential retrospective liability to the Revenue Commissioners for DIRT arising from the findings of the Theme Audit was not considered at the meeting of 9 February 1995. The Bank has confirmed to the Inspectors that no payment of retrospective DIRT was made to the Revenue Commissioners prior to their appointment.

Mr Byrne, as Head of Finance at the time of the DIRT Theme Audit, had a responsibility to raise the issue of potential retrospective liability for DIRT due in respect of interest on accounts wrongly classified as DIRT-exempt, and failed to do so.

Chief Executive (Jim Lacey)

Jim Lacey was the Chief Executive of the Bank from 1 April 1988 to 22 April 1994.

During this time he was copied with internal audit reports and accordingly had notice of the deficiencies or "irregularities" which existed in the operation of DIRT-exempt non-resident accounts at branches. The majority of such reports referred to the failure of branches to hold properly completed declarations for all accounts classified as DIRT-exempt non-resident accounts, but certain of the reports referred to instances where the residential status stated on non-resident declarations was at variance with other branch records, while others referred to instances where lending to resident customers was secured by letters of lien over deposit accounts with non-resident status. In the opinion of the Inspectors these audit reports pointed to the likelihood that the non-resident accounts referred to therein were in fact bogus. In addition, the extent of reported documentary non-compliance was on such a scale that, in the opinion of the Inspectors, it constituted a further indication that a substantial proportion of the non-resident accounts could be bogus.

The Inspectors believe the inevitable inference from the above is that Mr Lacey should not only have been aware of the failure of the branches to hold properly completed non-resident account declarations but should also have been aware that bogus non-resident accounts existed throughout the branch network.

As Chief Executive, Mr Lacey held ultimate responsibility to ensure that DIRT was deducted from interest paid or credited on all accounts subject to DIRT under the Finance Act, 1986. He failed to discharge this responsibility.

Executive Director (Barry Seymour)

Barry Seymour was appointed Executive Director of the Bank on 22 April 1994 in succession to Mr Lacey. Mr Seymour's appointment was on an interim basis but was in fact continued until 15 July 1996.

During his term of office, Mr Seymour was copied with internal audit reports, as Mr Lacey had been, and accordingly had notice of the deficiencies or "irregularities" which existed in the operation of DIRT-exempt non-resident accounts at branches.

The majority of such reports referred to the failure of branches to hold properly completed declarations for all accounts classified as DIRT-exempt non-resident accounts. Certain of these reports referred to instances where the residential status stated on non-resident declarations was at variance with other branch records, while others referred to instances where lending to resident customers was secured by letters of lien over deposit accounts with non-resident status. In the opinion of the Inspectors, these audit reports pointed to the likelihood that the non-resident accounts referred to therein were in fact bogus. In addition, the extent of reported documentary non-compliance was on such a scale that, in the opinion of the Inspectors, it constituted a further indication that a substantial proportion of the non-resident accounts could be bogus.

The DIRT Theme Audit of December 1994 highlighted the extent of the irregularities. Mr Seymour was made aware of significant issues of documentary non-compliance, the lack of understanding at branches of the Bank's duty to satisfy itself on non-resident status, and the resultant failure to deduct DIRT at the standard rate from interest paid or credited where the conditions for the operation of accounts as DIRT-exempt non-resident accounts were breached.

Through his receipt of the branch audit reports referred to above, and the DIRT Theme Audit report, Mr Seymour should not only have been aware of the failure of the branches to hold properly completed non-resident account declarations, but should also have been aware of the fact that bogus non-resident accounts existed throughout the branch network.

Mr Seymour attended the meeting of senior management of the Bank on 9 February 1995 convened to consider what corrective action was needed to remedy the situation disclosed by the DIRT Theme Audit, but he failed at that meeting, as did everyone else who attended it, to address, or even to raise, the question of the potential liability of the Bank to the Revenue Commissioners resulting from the irregularities.

In spite of the corrective action taken by the Bank following the DIRT Theme Audit, there continued to be non-compliance in the branches with the requirements for DIRT-exempt status during the remainder of Mr Seymour's term of office.

Whilst the Inspectors accept Mr Seymour's submission that DIRT compliance procedures improved during his term of office, nonetheless, as Executive Director, Mr Seymour held ultimate responsibility to ensure that DIRT was deducted from interest paid or credited on all accounts subject to DIRT under the Finance Act, 1986. He failed to discharge this responsibility.

Chief Operating Officer (Philip Halpin)

Philip Halpin was appointed Chief Operating Officer from 15 July 1996 and held that position on the appointment of the Inspectors on 30 March 1998. In that role, Mr Halpin was circulated with seven branch internal audit reports which referred to DIRT compliance issues in the area of DIRT-exempt non-resident accounts. None of these reports referred to issues other than documentary compliance. Mr Halpin, in his previous role as Head of Treasury & International, was circulated with a copy of the DIRT Theme Audit report of December 1994 but did not attend the meeting on 9 February 1995 held to discuss the results of the audit and the issues arising therefrom.

Mr Halpin's evidence to the Inspectors was that, as Head of Treasury at that time, he was not concerned with the main findings of the DIRT Theme Audit but only with the audit's favourable conclusion in regard to Treasury.

Mr Halpin inherited the problem of bogus non-resident accounts. He considered that he was entitled to assume that the issues concerning DIRT compliance raised by the DIRT Theme Audit had been addressed by those who were directly responsible.

While Mr Halpin may not have received such a volume of internal audit reports of documentary non-compliance as to make inevitable the inference that a substantial proportion of the non-resident accounts could be bogus, he had sufficient information to be aware that there were continuing problems in relation to DIRT. As Chief Operating Officer part of his responsibility was to ensure that DIRT was deducted from interest paid or credited on all accounts subject to DIRT under the Finance Act, 1986 and he failed in this regard.

EVASION OF REVENUE OBLIGATIONS: FICTITIOUS AND INCORRECTLY NAMED ACCOUNTS

The Branch Managers

Between 1988 and 1996 fictitious and incorrectly named accounts existed in the branch network. In the opinion of the Inspectors, branch managers were aware that the principal reason for the opening of these accounts was the evasion of tax by the Bank's customers.

In response to the instruction dated 30 May 1996 from the General Manager – Banking and the General Manager – Risk Management and Administration to remove such accounts from the books (see Part 3, page 67), certain managers suggested to customers that they close the accounts and either invest the money in CMI or place it in their correct names at another branch of the Bank. These "solutions" were improper as they served to encourage the account holder to continue to evade tax, but were not objected to by the Head of Audit, who was aware of them.

While the opening and maintenance of such accounts and the "solutions" proposed for regularising them were improper, the Inspectors have nonetheless concluded that it is not appropriate to find individual managers responsible for this practice as they believe that responsibility in this regard lay at a higher level in the Bank.

General Manager Risk Management and Administration, General Manager – Banking (Frank Brennan and Michael Keane)

The Inspectors have received no evidence that the General Manager – Risk Management and Administration or the General Manager – Banking were aware of the existence of fictitious and incorrectly named accounts across the branch network prior to the issue by Mr Keane of the memorandum dated 7 December 1995 referred to at page 67. The Inspectors believe the action taken by Mr Brennan and Mr Keane to eliminate such accounts was appropriate.

Head of Audit (Paul Harte)

Paul Harte, Head of Audit, had a major role in having fictitious and incorrectly named accounts removed from the branches (see Part 3, pages 67 and 68). The declaration which the branches were required to make by the memorandum of 30 May 1996 from the General Managers was directed to be sent to the internal audit department. This declaration was to include details of all the fictitious accounts still remaining in the

branches, and Mr Harte was informed by the managers what they proposed to do in order to eliminate these accounts. What was being recommended to some customers was that the account be closed and the funds either invested in CMI or placed in correct names at another branch of the Bank.

In the opinion of the Inspectors, Mr Harte ought to have known that these "solutions" were improper, as they served to encourage the continued evasion of tax by the Bank's customers, and he should have refused to allow them to be adopted.

Chief Executive, Executive Director

Jim Lacey, as Chief Executive of the Bank in the period 1 April 1988 to 22 April 1994 may not have had knowledge of the existence of fictitious or incorrectly named accounts at the branches. Barry Seymour, Executive Director of the Bank from 22 April 1994 to 15 July 1996, may not have had knowledge of the existence of such accounts until late 1995.

Nonetheless, as Chief Executive and Executive Director respectively, both Mr Lacey and Mr Seymour must bear ultimate responsibility for the practice of opening and maintaining fictitious or incorrectly named accounts during the periods they held their respective positions.

During the period Mr Seymour held the position of Executive Director, the General Managers took action to eliminate such accounts.

EVASION OF REVENUE OBLIGATIONS: SPECIAL SAVINGS ACCOUNTS

The Branch Managers

Branch managers knew or ought to have known that properly completed declarations were not held by them for all accounts classified as Special Savings Accounts ("SSA's").

Branch managers also knew or ought to have known that withdrawals from SSA's were being permitted within three months of the opening of the account or without the requisite notice period being given.

It was the branch managers' duty to ensure that Deposit Interest Retention Tax ("DIRT") at the standard rate was deducted from interest paid or credited where a properly completed declaration was not held for an account classified as an SSA, where there was a withdrawal within three months of the account being opened, or the statutory period of notice for a withdrawal was not given, and they failed to discharge that duty.

While the breaches of statutory requirements relating to declarations and withdrawals occurred at branch level, the Inspectors do not consider it appropriate to find

individual managers responsible, as they believe that responsibility for ensuring adherence to statutory provisions lay at a higher level in the Bank.

The Regional Managers (Dermott Boner, Kevin Curran and Tom McMenamin)

The titles and roles of Messrs Boner, Curran and McMenamin, and the periods for which they held their positions are set out in Part 1 at pages 7 and 8.

Each of these three was made aware, through circulation of branch internal audit reports, of widespread documentary non-compliance in the area of SSA's. Furthermore, Mr Boner and Mr McMenamin attended the meeting of senior management held on 9 February 1995 to discuss the results of the DIRT Theme Audit and the issues arising therefrom, while Mr Curran was circulated with a copy of the minutes of the meeting.

In the light of this evidence, the Inspectors believe that Mr Boner, Mr Curran and Mr McMenamin were aware that DIRT at the standard rate was not being deducted as it ought to have been from interest paid or credited where the conditions for the operation of accounts as SSA's were being breached.

Mr Boner, Mr Curran and Mr McMenamin had each a responsibility to ensure that all accounts classified as SSA's were correctly classified as such and, in this regard, particularly in light of the deficiencies disclosed in the internal audit reports circulated to them, each had a responsibility to make reasonable enquiries of the branches for which he was responsible to satisfy himself that properly completed declarations were in place for all accounts classified as SSA's.

Mr Boner, Mr Curran and Mr McMenamin had each a responsibility to ensure that DIRT at the standard rate was deducted from interest paid or credited where the conditions for the operation of accounts as SSA's were breached.

Mr Boner, Mr Curran and Mr McMenamin each failed to discharge these responsibilities.

General Manager – Banking (Michael Keane)

Michael Keane was appointed General Manager – Banking on 3 May 1993 and held that position up to 18 August 1996. Throughout this period, Mr Keane was made aware, through audit reports circulated to him, of the deficiencies which existed in the operation of SSA's at branches, the failure of branches to hold properly completed declarations for all accounts classified as SSA's and instances of failure to comply with the relevant withdrawal notice requirements. The Inspectors believe that through these reports he was aware that DIRT at the standard rate was not being deducted as it ought to have been from interest paid or credited where the conditions for the operation of the accounts as SSA's were being breached.

Furthermore, Mr Keane was on the circulation list for the DIRT Theme Audit report of December 1994 and chaired the meeting of senior management held on 9 February 1995 at which the results of the audit and the issues arising therefrom were discussed.

Mr Keane had a responsibility to ensure that all accounts classified as SSA's were correctly classified as such and to ensure that DIRT at the standard rate was deducted from interest paid or credited where the conditions for the operation of accounts as SSA's were breached. Mr Keane failed to discharge these responsibilities.

Head of Finance (Gerry Hunt and Patrick Byrne)

As noted at page 173 above, the Head of Finance had responsibility for ensuring that returns of DIRT were made to the Revenue Commissioners within prescribed time limits. As stated, the accuracy of these returns was critically dependent on the proper categorisation of deposit accounts at branch level between those exempt from DIRT, those liable to DIRT at the standard rate of tax, and those liable at a reduced rate.

In the respective periods throughout which Mr Hunt and Mr Byrne were responsible for returns of DIRT to the Revenue Commissioners, neither was on the circulation list for branch internal audit reports. Accordingly neither was aware through this medium of the extent of the deficiencies in the operation of SSA's at the branches.

The Inspectors have no evidence that anything was brought to the notice of Mr Hunt which ought to have apprised him of these deficiencies.

Mr Byrne, however, was on the circulation list for the DIRT Theme Audit report of December 1994 and attended the meeting on 9 February 1995 to discuss the results of the audit and the issues arising therefrom. He was thus aware of the extent of non-compliance in the operation of SSA's and ought to have known the consequences of such non-compliance for the accuracy of the returns of DIRT being made by him, or persons under his control, to the Revenue Commissioners.

As already noted, Mr Byrne, in common with Mr Seymour, Mr Keane and Mr Brennan, has given evidence to the Inspectors that the issue of a potential retrospective liability to the Revenue Commissioners for DIRT arising from the findings of the Theme Audit was not considered at the meeting of 9 February 1995. The Bank has confirmed to the Inspectors that no payment of retrospective DIRT was made to the Revenue Commissioners prior to their appointment.

Mr Byrne, as Head of Finance at the time of the DIRT Theme Audit, also had a responsibility to raise the issue of potential retrospective DIRT due on accounts wrongly classified as SSA's, and failed to do so.

Chief Executive, Executive Director

Jim Lacey, as Chief Executive of the Bank in the period 1 January 1993 to 22 April 1994 may not have had knowledge of the deficiencies in the operation of SSA's at the branches. As Chief Executive Mr Lacey must nonetheless bear ultimate responsibility for the shortcomings which existed in this area during that period.

Barry Seymour held the position of Executive Director of the Bank from 22 April 1994 to 15 July 1996 and during that period was made aware, through audit reports circulated to him, of the deficiencies which existed in the operation of SSA's at

branches, both in relation to documentary non-compliance and breaches of the withdrawal notice requirements.

Mr Seymour was also circulated with the DIRT Theme Audit report of December 1994 and attended the meeting on 9 February 1995 to discuss the results of the audit and the issues arising therefrom. He was thus aware of significant issues of documentary non-compliance in relation to SSA's, the widespread failure to ensure adherence to the notice requirements for withdrawals from such accounts, and the resultant failure to deduct DIRT at the standard rate from interest paid or credited where the conditions for the operation of such accounts as SSA's were breached.

As Executive Director, Mr Seymour bears ultimate responsibility for the failure of the Bank to deduct DIRT at the standard rate from interest paid or credited on all accounts classified as Special Savings Accounts where the conditions to which such accounts were subject were not observed.

THE SALE OF CMI, SCOTTISH PROVIDENT INTERNATIONAL AND OLD MUTUAL INTERNATIONAL POLICIES

The Financial Advice and Services Division

As described at pages 83 and 84 above, on 1 May 1989 Nigel D'Arcy was recruited by the then Chief Executive of National Irish Bank, Jim Lacey, to establish the Financial Advice and Services Division ("FASD") of the Bank to provide a range of independent financial services, primarily in the insurance and investment-related sector, to Bank customers and others.

The Bank employed financial services managers whose responsibilities were to obtain referrals for high value insurance products from the Bank's retail branches and to deal with direct enquiries from the public with respect to such products.

Nigel D'Arcy

Mr D'Arcy was head of the FASD during the entire of the period from 1 May 1989 to the date of the appointment of the Inspectors on 15 June 1998 to investigate the affairs of National Irish Bank Financial Services Limited. All the financial services managers reported directly to him.

Mr D'Arcy's evidence to the Inspectors, at his interview on 7 September 2000, can be summarised as follows:

- As head of the FASD, Mr D'Arcy became aware in 1992 that funds undisclosed to the Revenue Commissioners were being targeted by Bank personnel for investment in CMI.

- Prospective investors were being assured by the FASD managers that their investment would be confidential from the Revenue Commissioners.

- They were also being assured that if their investment was made the subject of a trust, the beneficiaries could obtain the funds invested, after the death of the investor, on production of a death certificate, thus avoiding the necessity of probate having to be taken out.

- He also became aware that CMI was being used by the Bank to regularise bogus non-resident accounts and fictitious and incorrectly named accounts.

- The manner in which the CMI policies were being promoted served to facilitate the evasion of tax by the persons investing in the policies.

The Inspectors' findings concerning Mr D'Arcy's knowledge and responsibility are:

- Mr D'Arcy was aware that monies which were undisclosed to the Revenue Commissioners, including funds held in bogus non-resident accounts and fictitious and incorrectly named accounts, were being targeted by Bank personnel for investment in CMI policies, and he failed to stop the practice.

- Mr D'Arcy was aware that the FASD financial services managers were promoting CMI policies as a secure investment for funds which had not been declared to the Revenue and failed to stop the said practice, which served to facilitate the evasion of Revenue obligations by third parties.

- Mr D'Arcy was aware that prospective investors were being given an assurance by the FASD financial services managers that their investment would be confidential from the Revenue Commissioners and, if made the subject of a trust, would pass to their beneficiaries without probate having to be obtained, thus making it possible for the funds invested to be kept hidden from the Revenue Commissioners even after the investor's death.

In his evidence to the Inspectors Mr D'Arcy stated that from 1992 he was fully aware of the manner in which the CMI policies were being promoted by the financial services managers, and since as head of the FASD he could have stopped the practice, he was, in the opinion of the Inspectors, primarily responsible for the continuation of the practice. The responsibility of the financial services managers has to be judged against this background. They were operating with Mr D'Arcy's tacit approval.

The FASD Financial Services Managers; Patrick Cooney, Investment Manager

The names of the nine individuals who were employed at different times as financial service managers in the FASD are set out at page 84 above. The Inspectors make no findings in regard to three of the persons named, Michael Fitzgerald, Gerry Stewart and John Bailey.

Michael Fitzgerald was interviewed by the Inspectors on 25 March 1999 and a copy of the transcript of this interview was mailed to his solicitors on 18 May 1999. The Inspectors sought to interview Mr Fitzgerald a second time in late 1999, but were advised by Mr Fitzgerald's solicitors that he was not medically fit. The Inspectors

arranged that Mr Fitzgerald be examined by an independent medical practitioner, who confirmed Mr Fitzgerald's incapacity to attend for interview.

In January 2002 the Inspectors sent to Mr Fitzgerald their provisional findings relating to him. In reply, the Inspectors received a letter from his solicitor enclosing a medical certificate from a doctor stating that Mr Fitzgerald was not fit to respond to the Inspectors' provisional findings.

In these circumstances, the Inspectors are precluded from making any findings with regard to Mr Fitzgerald.

Messrs Stewart and Bailey are omitted because they did not join the FASD until June and August 1997 respectively, and were involved in the sale of very few CMI policies.

The Inspectors' findings in regard to the remaining six financial services managers and Patrick Cooney will be structured as follows:

- ***Beverley Cooper-Flynn, Charlie McCarthy, Patricia Roche and Alistair Stewart***
- ***Frank Lynch and Bob Wynne***
- ***Patrick Cooney***

Beverley Cooper-Flynn joined the FASD as a financial services manager on 1 September 1989 and continued working in the FASD until 5 January 1997 when she was given leave of absence by the Bank.

Charlie McCarthy joined the FASD as a financial services manager on 4 December 1989 and was still working in the FASD on 15 June 1998, the date on which the Inspectors were appointed to investigate the affairs of the company.

Patricia Roche joined the FASD as a financial services manager on 1 October 1991. She took leave of absence from the Bank on 19 September 1994 for personal reasons.

Alistair Stewart joined the FASD as a financial services manager on 1 September 1989 and he continued working in the FASD until 25 June 1994.

Beverley Cooper-Flynn, Patricia Roche and Alistair Stewart sold a substantial number of CMI policies. Charlie McCarthy also sold a number of CMI policies, but not as many as the other three.

All four were aware that monies being invested in CMI were undeclared to the Revenue. All four assured their customers that their investment was completely confidential from everyone, including the Revenue. They also informed their customers that if their investment was made the subject of a trust their beneficiaries could obtain the funds after their death without having to take out probate.

The Inspectors' findings in regard to the knowledge and responsibility of Beverley Cooper-Flynn, Charlie McCarthy, Patricia Roche and Alistair Stewart are:

- They sold CMI policies as a secure investment for funds which had not been declared to the Revenue.

- They gave an assurance to prospective investors that their investment would be confidential, that the Revenue Commissioners would not become aware of it.

- They told prospective investors that if their investment was made the subject of a trust it would pass to the beneficiaries on the production of a death certificate, thereby avoiding the necessity of probate being obtained, and making it possible for the funds invested to be kept hidden from the Revenue Commissioners even after the investor's death.

Bob Wynne joined the FASD as a financial services manager on 15 August 1994, and ***Frank Lynch*** joined as a financial services manager on 15 March 1995.

At the respective times they joined, the culture in regard to the sale of CMI policies was well established. After they took up their positions, the CMI policies continued to be sold in the same way as previously. Branch managers continued to refer customers to the financial services managers with a view to investment in CMI only, particularly when they thought that they were at risk of losing a deposit. However, the level of CMI sales had declined from its peak.

The Inspectors are satisfied that on joining the FASD, Mr Wynne and Mr Lynch carried on the practice that existed in regard to the promotion of CMI policies before they joined, and accordingly find:

- They sold CMI policies as a secure investment for funds which had not been declared to the Revenue.

- They gave an assurance to prospective investors that their investment would be confidential, that the Revenue Commissioners would not become aware of it.

- They told prospective investors that if their investment was made the subject of a trust it would pass to the beneficiaries on the production of a death certificate, thereby avoiding the necessity of probate being obtained, and making it possible for the funds invested to be kept hidden from the Revenue Commissioners even after the investor's death.

Patrick Cooney joined the FASD as Investment Analyst on 4 December 1989 and he was appointed Investment Manager on 1 January 1991, a position he held until he ceased working for the Bank on 12 July 1996.

Mr Cooney worked closely with the financial services managers and the Inspectors are satisfied that he was fully aware that they were promoting the CMI policies as a secure investment for funds which had not been declared to the Revenue.

While Mr Cooney's principal function was to assist the financial services managers with advice in regard to investments, he was also involved in the sale of CMI policies to a small number of customers, either assisting the financial services managers, or occasionally replacing a financial services manager who was not available.

The Branch Managers

Branch managers introduced customers to CMI or referred customers to the FASD for introduction to CMI, in many cases in the knowledge that such introduction was to enable the customers to continue to conceal funds from the Revenue.

The Inspectors have concluded that it is not appropriate to find individual managers responsible for the manner in which the CMI policies were promoted. They take the view that responsibility in this regard lay with the FASD and at a higher level in the Bank.

Head of Retail/Regional Managers (Dermott Boner, Kevin Curran)

Dermott Boner was Head of Retail between 1 October 1990 and 1 January 1995 and after that a Regional Manager until his retirement in February 1996. During his period as Head of Retail he was aware that funds coming from deposits in the branches, when invested in CMI through FASD, were reinvested by CMI on deposit with the Bank. He was also aware, from his knowledge of the retail section of the Bank, and in particular from his knowledge of an investment made in CMI in 1993 by a customer of the Bank who invested approximately £600,000 which had not been declared to the Revenue Commissioners, that FASD were promoting CMI polices as a secure investment for funds which had not been declared to the Revenue Commissioners.

Mr Boner shares responsibility for this practice and for the Bank's failure to take steps to ensure that the promotion of CMI policies in this manner was stopped.

Kevin Curran was one of the Regional Managers in the Bank between 1988 and February 1996 and after that was Head of Retail Banking until his retirement from the Bank. He was aware that "sensitive" funds, and funds in bogus non-resident accounts and fictitious and incorrectly named accounts were being invested in CMI through the FASD.

He was also aware that the CMI product was very successful and resulted in CMI having substantial deposits with the Bank.

He knew that the FASD was promoting CMI policies as a secure investment for funds which had not been disclosed to the Revenue Commissioners.

Mr Curran shares responsibility for this practice and for the Bank's failure to take steps to ensure that the promotion of CMI policies in this manner was stopped.

General Manager – Administration (Frank Brennan)

Frank Brennan, while General Manager – Administration, as the addressee of the memorandum dated 17 August 1994 from Geoff Bell, Head of Management Services quoted in Part 5 at page 100, knew that the CMI policy was being promoted to persons with "*sensitive*" funds with "*confidentiality a prerequisite in investment*" and also knew the extent of the funds deposited by CMI with the Bank resulting from the sale of CMI Personal Portfolio policies.

Mr Brennan shares responsibility for the Bank's failure to take steps to ensure that the promotion of CMI policies in this manner was stopped.

General Manager – Banking (Michael Keane)

Michael Keane, while General Manager – Banking, was copied with Mr Bell's memorandum of 17 August 1994. He thus knew that the CMI policy was being promoted to persons with "*sensitive*" funds and also knew the extent of the funds deposited by CMI with the Bank resulting from the sale of CMI Personal Portfolio policies.

Mr D'Arcy reported directly to Mr Keane from 1 January 1995 to the date of Mr Keane's ceasing to act as General Manager – Banking.

Mr Keane shares responsibility for the Bank's failure to take steps to ensure that the promotion of CMI policies in the manner stated above was stopped.

Head of Audit (Paul Harte)

Paul Harte, Head of Audit, became aware in 1996 that CMI was being used by branch managers as a means of continuing to conceal from the Revenue Commissioners undeclared funds which had been on deposit in fictitious or incorrectly named accounts. He ought to have taken steps to ensure that this practice was stopped.

Chief Executive, Executive Director, Chief Operating Officer (Jim Lacey, Barry Seymour, Philip Halpin)

Jim Lacey as Chief Executive recruited Mr D'Arcy to establish the FASD; Mr D'Arcy reported directly to him. Mr Lacey was aware of the level of deposits made by CMI with the Bank. He knew or ought to have known how the product was being promoted.

Whether or not Mr Lacey was aware that the CMI product was being promoted to persons wishing to conceal, or continue to conceal, funds from the Revenue Commissioners, as Chief Executive of the Bank he has to bear responsibility for the existence of this practice, which served to facilitate customers of the Bank and others in evading tax.

Barry Seymour held the position of Executive Director of the Bank from 22 April 1994 to 15 July 1996. On his appointment, he inherited the practice whereby customers of the Bank, and others, were being facilitated in evading tax through investment in the CMI product. As Executive Director of the Bank he has to bear responsibility for the continuation of the practice.

Philip Halpin was appointed Chief Operating Officer of the Bank on 15 July 1996 and held that position on the appointment of the Inspectors on 30 March 1998. On his appointment, he inherited the practice whereby customers of the Bank, and others, were being facilitated in evading tax through investment in the CMI product. As Chief Operating Officer of the Bank he has to bear responsibility for the continuation of the practice.

THE PRACTICE OF IMPROPER CHARGING OF INTEREST

The Branch Managers

The branch managers who effected, or who directed there be effected, adjustments to interest charged to customers otherwise than in respect of legitimate interest amounts were clearly aware of the practice of "loading" interest.

These branch managers undoubtedly engaged in the practice, but the Inspectors have nonetheless concluded that it is not appropriate to find individual managers responsible, as they accept the evidence of managers that they loaded interest in the belief that they were charging customers for amounts legitimately due to the Bank (albeit misdescribed), and under the impression that their superiors would not at the time have disapproved of such practice.

No instruction to make refunds was received by the branch managers and accordingly the Inspectors are of the opinion that the managers were not responsible for the Bank's failure in this regard.

The Regional Managers (Dermott Boner and Kevin Curran)

As noted in Part 1 at page 7, the Regional Managers in 1990, the time of first reporting of interest loading, were Dermott Boner and Kevin Curran.

Mr Curran was made aware of the existence of the practice of loading interest through receipt of the May 1990 internal audit report on Carrick-on-Shannon branch. This knowledge was reinforced by memoranda from Frank Brennan, then General Manager – Retail Banking, dated 21 May 1990 (addressed to Mr Curran) and 5 June 1990 (addressed to both Mr Curran and Mr Boner), quoted in Part 6 at page 131.

As noted, Mr Boner was an addressee of Mr Brennan's memorandum of 5 June 1990 and he also received a copy of the August 1990 internal audit report on Carndonagh branch.

Mr Boner's knowledge of the practice antedated the 5 June 1990 memorandum and the audit report on Carndonagh branch; he had, for some six years prior to being appointed Regional Manager, been manager of the Bank's Cork branch, where he had overseen interest loading on customers' accounts (to remunerate the Bank for management time, according to Mr Boner). In common with other managers interviewed, he at the time considered the practice acceptable.

The actions of the Regional Managers in response to Mr Brennan's memorandum of 5 June 1990 were appropriate in that they gave instructions that the practice of loading interest cease.

They however did not revert to Mr Brennan as requested by him to report on how widespread the practice was, and it remains unclear whether they took sufficient steps to establish this. While it must remain a matter of speculation what might have ensued if they had furnished a comprehensive report to Mr Brennan, no supplementary guidance to the branches was issued.

The Regional Managers share with Mr Brennan responsibility for the failure to refund customers whose interest charges had been loaded – no instruction issued to the branches, and the focus of attention was on the future only.

General Manager – Retail Banking (Frank Brennan)

The General Manager – Retail Banking in 1990 was Frank Brennan. He was made aware of the practice of loading interest through receipt of the audit reports on the Carrick-on-Shannon and Carndonagh branches. (Mr Brennan ceased to be on the circulation list for branch audit reports from September 1990).

Mr Brennan's response to the audit report on Carrick-on-Shannon branch, and to the related memorandum dated 21 May 1990 from Mr Lacey, was appropriate in so far as he requested that he be advised of the extent of the practice and he instructed that the practice cease. He however omitted to give any instruction that refunds be made to customers.

Mr Brennan also failed to ensure that he was advised of the extent of the practice, and by reason of his failure in this regard he was unable to take any decision on whether further action was required.

Mr Brennan shares responsibility for the Bank's failure to make appropriate refunds to customers at the time, notwithstanding his evidence to the Inspectors that the primary responsibility to refund customers lay with the branch manager, and thereafter with the relevant Regional Manager.

Chief Executive (Jim Lacey)

Jim Lacey was Chief Executive of the Bank for the period during which the adverse internal audit reports on interest loading were issued, and with which he was copied.

Mr Lacey's reaction to receipt of the April 1990 report on Carrick-on-Shannon branch was appropriate in that he directed that the practice cease, but incomplete in that it failed to address the issue of refunds to customers.

THE PRACTICE OF IMPROPER CHARGING OF FEES

The Branch Managers

During the period 1988 to mid 1996, the vast majority of branch managers included, in amounts charged to customers, fees for which there was no supporting documentation.

Managers interviewed have indicated to the Inspectors that these fees purportedly related to management time.

The Inspectors are satisfied that the branch managers were required by senior management in the Bank to charge for management and administration time, but that senior management had failed up to 1996 to put in place a proper system for recording and charging such time.

In these circumstances the Inspectors have concluded that it is not appropriate to find the branch managers responsible, as they believe that responsibility for the failure to introduce an appropriate time recording system lay at a higher level in the Bank.

The Regional and Area Managers

As set out in Part 1 at pages 7 and 8, the management structure and the titles of the personnel to whom branch managers reported changed on a number of occasions between 1988 and 1996. The executives holding the positions of Regional and Area Manager during the period were Dermott Boner, Kevin Curran, Tom McMenamin and Barry Grogan.

The late Michael O'Rourke also held the position of Regional Manager. By reason of the death of Mr O'Rourke, it has not been possible for him to be heard and accordingly the Inspectors make no finding in this report in relation to his knowledge and responsibility. Any references to Regional Managers in this section are not to be taken as including him.

All those holding the position of Regional or Area Manager during the period 1988 to 1996 knew or ought to have known that the Bank Procedures Manual did not contain any guidance on the nature of the work or services to customers which should give rise to an administration or management time charge, nor did it give any guidance on the form of record to be maintained by branch staff responsible for delivery of the service.

They were aware that there was not at that time any system in operation for recording branch management and administration time which was charged to customers.

In addition, they were all on the circulation list for internal audit reports on branches under their supervision; as indicated in Part 7 at pages 153 to 155, there was a constant theme therein of dissatisfaction with the lack of explanation for fee increases recorded on the Fees to be Applied Report. They were also aware from internal audit reports of the failure of the introduction of the Customer Action Pad by Mr Boner in 1992 to bring about an improvement in the situation.

The Regional Managers, Head of Retail, and Area Managers holding the latter title in the 1993/94 period – ie Dermott Boner, Kevin Curran, Tom McMenamin, and Barry Grogan must bear some of the responsibility for the failure to put in place an appropriate system for recording management and administration time to be charged to customers.

Following a reorganisation in February 1996, six Area Managers were appointed. The Inspectors are unaware of any initiative taken by these Area Managers to rectify the position; their date of appointment as Area Managers however postdates commencement of work on the systems improvements which included the time recording facility referred to in Part 7 at pages 155 and 156 and therefore the Inspectors have concluded that they should not be held responsible for failing to act to bring about a change in the system.

General Manager – Retail Banking/General Manager – Banking (Frank Brennan and Michael Keane)

As outlined in Part 1 at pages 5 to 7, Frank Brennan held the position of General Manager – Retail Banking from 1988 to 30 June 1991 and Michael Keane held the position of General Manager – Banking from 3 May 1993 to 18 August 1996.

During the periods they respectively held the position, Mr Brennan and Mr Keane knew or ought to have known that the Bank Procedures Manual did not contain any guidance on the nature of the work or services to customers which should give rise to an administration or management time charge, nor did it give any guidance on the form of record to be maintained by branch staff responsible for delivery of the service.

As General Manager – Banking, Mr Keane was made aware, through receipt of branch audit reports, of the consistently reported shortcomings concerning the lack of explanation supporting adjustments on the Fees to be Applied Reports, and, from September 1993, of the failure of the 1992 introduction of the Customer Action Pad to bring about an improvement in the situation.

Mr Brennan and Mr Keane bear the principal responsibility for the Bank's failure, during the periods they occupied the respective positions of General Manager – Retail Banking or General Manager – Banking, to put in place an appropriate system for recording management and administration time which was chargeable to customers. Between July 1991 and March 1996, while Mr Brennan's title and functions changed from time to time, he continued to be responsible for procedures in the branches and accordingly he continued to share responsibility for the Bank's failure in this regard.

Chief Executive, Executive Director (Jim Lacey and Barry Seymour)

Jim Lacey was Chief Executive of the Bank from 1 April 1988 to 22 April 1994.

Barry Seymour became Executive Director of the Bank on 22 April 1994 and held that position until 15 July 1996.

Through receipt of branch audit reports, both Mr Lacey and Mr Seymour were made aware of consistently reported shortcomings concerning the lack of explanation supporting fee increases recorded on the Fees to be Applied Reports. They were also made aware, through receipt of branch audit reports, that the Customer Action Pad introduced in July 1992 was not being used. It was their responsibility to ensure that there was a system in place in the branches for the contemporaneous recording of management and administration time. Such a system was introduced in March 1996 following pressure on banks from the Director of Consumer Affairs to provide customers with an itemised breakdown of their charges before being applied to the account.

Mr Lacey, during the period he was Chief Executive, and Mr Seymour, during the period he was Executive Director, each bear ultimate responsibility for the failure of the Bank, prior to March 1996, to put in place in the branches an appropriate system for recording management and administration time which was chargeable to customers.

John Blayney 

Tom Grace 

Joint Inspectors

9 July 2004