

**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

SUMMARY AND INSPECTORS' OBSERVATIONS

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.

CONTENTS

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 15 MARCH 1998 AND 30 JUNE 1998

	Page
PART 1: INTRODUCTION	
APPOINTMENT OF INSPECTORS	3
THE COMPANIES	4
National Irish Bank Limited	4
National Irish Bank Financial Services Limited	4
MANAGEMENT STRUCTURE OF THE COMPANIES	4
Summary	4
The Chief Executive	5
The General Manager – Banking	5
The Regional Managers	7
The Financial Advice and Services Division	8
The Internal Audit Function	8
BACKGROUND TO APPOINTMENT OF INSPECTORS	9
Sale of CMI Insurance Policies	9
Interest and Fee Charging Practices	9
Report of Authorised Officer	10
ORGANISATION OF THE REPORT	10
APPROACH TO RESPONSIBILITY	11
LEGAL ADVICE AND COURT ACTIONS	12
Court Action – Concerns of Prospective Interviewees	12
Court Action – Scope of Enquiry into DIRT-related Matters	14
Court Action – Access to Records of Isle of Man Branch	15
WORK DONE	16
Summary	16
The First Phase	16
The Second Phase	18
RECOMMENDATION ON COSTS	20

**PART 2: EVASION OF REVENUE OBLIGATIONS:
INCORRECTLY CLASSIFIED NON-RESIDENT DEPOSIT ACCOUNTS**

LEGISLATIVE REGIME	23
Position prior to the introduction of DIRT	23
Position after the introduction of DIRT	23
Non-Resident Declaration	24
Summary	25
NIB PROCEDURES	25
Inspectors' Criticism of the Special Circulars	27
BANK MANAGER EVIDENCE ON OPERATION OF PROCEDURES	28
ENQUIRIES OF BRANCH PERSONNEL BY SENIOR BANK MANAGEMENT	30
EXISTENCE OF BOGUS NON-RESIDENT ACCOUNTS IN THE BRANCH NETWORK	33
Bank Customer Interviews	33
Branch Manager Interviews	40
Interviews with Senior Bank Management	42
Interviews with former Heads of Internal Audit	42
Internal Bank Correspondence	43
INTERNAL AUDIT REPORTS	44
General	44
Use of Incorrect Forms	45
Use of Bank as Accommodation Address	45
Non-Resident Declarations at variance with other branch records	46
Non-Resident Deposits as Security for Resident Borrowings	47
Non-Resident Accounts in Fictitious Names	48
WHY DID BRANCH PERSONNEL OPERATE BOGUS NON-RESIDENT ACCOUNTS?	50
METHOD OF ACCOUNTING FOR DIRT	53
DIRT THEME AUDIT, DECEMBER 1994	54
Follow-up Meeting to DIRT Theme Audit	56
THEME AUDIT – TAXATION OF CREDIT INTEREST, JANUARY 1999	58
INSPECTORS' CONCLUSIONS	59

**PART 3: EVASION OF REVENUE OBLIGATIONS:
FICTITIOUS AND INCORRECTLY NAMED ACCOUNTS**

NIB PROCEDURES	63
Formal Guidance to Staff	63
EXISTENCE OF FICTITIOUS AND INCORRECTLY NAMED ACCOUNTS	64
Extracts from Letters from Bank Personnel	64
Bank Customer Interviews	65
SOURCE OF FUNDS FOR INVESTMENT IN CMI AND OTHER POLICIES	65
WHY WERE ACCOUNTS OPENED IN FICTITIOUS NAMES?	66
Branch Manager Interviews	66
EFFORTS TO ELIMINATE FICTITIOUS AND INCORRECTLY NAMED ACCOUNTS	67
Memorandum from General Manager – Banking, 1995	67
Memorandum from General Managers, 1996 and involvement of Head of Audit	67
Review of Declarations from Bank Managers	68
The Board Audit Committee	68
INSPECTORS' CONCLUSIONS	68

**PART 4: EVASION OF REVENUE OBLIGATIONS:
SPECIAL SAVINGS ACCOUNTS**

LEGISLATIVE REGIME	73
RETURNS TO REVENUE COMMISSIONERS	74
NIB PROCEDURES	75
DIRT THEME AUDIT, DECEMBER 1994	76
Conclusion	76
Scope of Audit Testing	76
Findings	76
Interview with Head of Audit	77
BRANCH INTERNAL AUDIT REPORTS	77
THEME AUDIT – TAXATION OF CREDIT INTEREST, JANUARY 1999	79

RETROSPECTIVE DIRT LIABILITY TO THE REVENUE COMMISSIONERS	80
INSPECTORS' CONCLUSIONS	80
 PART 5: THE SALE OF CMI, SCOTTISH PROVIDENT INTERNATIONAL AND OLD MUTUAL INTERNATIONAL POLICIES	
THE BANK, THE COMPANY AND THE LIFE ASSURANCE COMPANIES	83
The Financial Advice and Services Division ("FASD")	83
Management and Personnel of the FASD	83
Role of National Irish Bank Financial Services Limited	84
Relationship of the Bank and the Company with CMI	85
Relationship of the Bank and the Company with Scottish Provident International	86
Relationship of the Bank and the Company with Old Mutual International	86
Authorisation of Insurers to carry on business in the State	87
THE LIFE ASSURANCE PRODUCTS	87
General	87
Nature of CMI Products sold by FASD	87
Investor Targeting and Assurances of Confidentiality	90
Obligation to make Returns to the Revenue Commissioners	94
THE PURPOSES FOR WHICH THE CMI PERSONAL PORTFOLIO WAS BEING USED	95
Evidence of Mr D'Arcy, Head of FASD	95
"Finding a safe haven for Revenue-sensitive funds"	95
"Regularising of bogus non-resident deposits"	100
"Retention of deposits"	104
"Securing new deposits for the Bank"	108
"Earning commission for the Bank"	109
THE ROLE OF THE BANK	110
General	110
Identifying Customers with Undeclared Funds	110
Promoting the Sale of CMI Policies	111
REASON FOR SUCCESS OF PRODUCT	114
Summary	114
Typical Investment	114
INSPECTORS' CONCLUSIONS	115

PART 6: THE PRACTICE OF IMPROPER CHARGING OF INTEREST

OUTLINE OF SYSTEM	119
General	119
Changes in Interest Rates	119
MANUAL INTEREST ADJUSTMENTS	120
The Charging Regime	120
Operation of the System	121
Branch Staff Evidence	126
ACTION TAKEN BY THE BANK ON FIRST DISCOVERY OF IMPROPER PRACTICE	130
The Chief Executive	130
The General Manager – Retail Banking	131
The Regional Managers	132
Impact on Customers	132
ACTION TAKEN BY THE BANK FOLLOWING NEWS MEDIA REPORTS	132
Interviews with Bank Staff	132
Bank Investigation Work: The Unauthorised Interest & Fee Amendments Report	133
Customer Queries	136
Inspectors' Observations on Work Done by the Bank	137
Further Work proposed by the Bank	137
INSPECTORS' CONCLUSIONS	137

PART 7: THE PRACTICE OF IMPROPER CHARGING OF FEES

REGULATORY REGIME	141
Introduction	141
The Central Bank Act, 1971	141
The Central Bank Act, 1989	141
The Consumer Credit Act, 1995	142
Subsequent Changes in the Regulatory Regime	142
THE FEE CHARGING SYSTEM AND ITS DEVELOPMENT	143
Introduction and Overview	143
Fee Categories	143
The Fee Charging Process	144
Development of System	145
Summary	146

CHARGES FOR ADMINISTRATION AND MANAGEMENT TIME	146
The Charging Regime prior to 1996	146
Operation of the System prior to 1996	149
Pre-notification of Fees	155
Delay in Implementing new Time Recording System	157
ACTION TAKEN BY THE BANK ON FIRST DISCOVERY OF IMPROPER PRACTICE	159
No Action Taken prior to 1996	159
ACTION TAKEN BY THE BANK FOLLOWING NEWS MEDIA REPORTS	159
Interviews with Bank Staff	159
Bank Investigation Work: The Unauthorised Interest & Fee Amendments Report	160
Customer Queries	163
Further Work proposed by the Bank	163
INSPECTORS' CONCLUSIONS	164
PART 8: KNOWLEDGE AND RESPONSIBILITY	
INTRODUCTION	167
CONCLUSIONS CONCERNING ENTITIES OTHER THAN INDIVIDUALS	167
Internal Audit	167
The External Auditors	168
The Audit Committee of the Board	168
The Board of Directors	169
EVASION OF REVENUE OBLIGATIONS: INCORRECTLY CLASSIFIED NON-RESIDENT DEPOSIT ACCOUNTS	169
Bogus Non-Resident Accounts	169
The Branch Managers	170
The Regional Managers	170
Area Managers Appointed February 1996	171
General Manager – Banking	171
Head of Finance	173
Chief Executive	175
Executive Director	175
Chief Operating Officer	176

EVASION OF REVENUE OBLIGATIONS:	
FICTITIOUS AND INCORRECTLY NAMED ACCOUNTS	177
The Branch Managers	177
General Manager – Risk Management and Administration, General Manager – Banking	177
Head of Audit	177
Chief Executive, Executive Director	178
EVASION OF REVENUE OBLIGATIONS:	
SPECIAL SAVINGS ACCOUNTS	178
The Branch Managers	178
The Regional Managers	179
General Manager – Banking	179
Head of Finance	180
Chief Executive, Executive Director	180
THE SALE OF CMI, SCOTTISH PROVIDENT INTERNATIONAL AND OLD MUTUAL INTERNATIONAL POLICIES	181
The Financial Advice and Services Division (“FASD”)	181
Nigel D’Arcy, Head of FASD	181
The FASD Financial Services Managers, Investment Manager	182
The Branch Managers	185
Head of Retail/Regional Managers	185
General Manager – Administration	186
General Manager – Banking	186
Head of Audit	186
Chief Executive, Executive Director, Chief Operating Officer	186
THE PRACTICE OF IMPROPER CHARGING OF INTEREST	187
The Branch Managers	187
The Regional Managers	187
General Manager – Banking	188
Chief Executive	188
THE PRACTICE OF IMPROPER CHARGING OF FEES	189
The Branch Managers	189
The Regional and Area Managers	189
General Manager – Banking	190
Chief Executive, Executive Director	191

APPENDICES

- Appendix 1: Order of the High Court dated 30 March 1998, appointing the Inspectors to investigate the affairs of National Irish Bank Limited.
- Appendix 2: Order of the High Court dated 15 June 1998, appointing the Inspectors to investigate the affairs of National Irish Bank Financial Services Limited.
- Appendix 3: Order of the High Court dated 31 July 2001, amending the Order of 30 March 1998.
- Appendix 4: Order of the High Court dated 31 July 2001, amending the Order of 15 June 1998.
- Appendix 5: Order of the High Court dated 13 July 1998 declaring that persons called before the Inspectors were not entitled to refuse to answer questions put by the Inspectors, nor to refuse to produce documents, and that the procedures proposed by the Inspectors for the conduct of their investigation were consistent with the requirements of natural and constitutional justice.
- Appendix 6: Order of the Supreme Court dated 21 January 1999 upholding the 13 July 1998 Order of the High Court, with the proviso that confessions obtained by the Inspectors would not in general be admissible at a subsequent criminal trial, unless the confessions were voluntary.
- Appendix 7: Order of the High Court dated 19 March 1999 refusing an application by NIB that the Inspectors' DIRT compliance investigation of the Bank should be limited.
- Appendix 8: Copy memorandum dated 18 November 1993 from Gerry Hunt, Head of Financial Control, to Frank Brennan, Michael Keane and Dermott Boner titled "Non Resident Accounts".
- Appendix 9: Copy Report on DIRT Theme Audit, December 1994.
- Appendix 10: Copy Product Features Sheet used by some of the FASD financial services managers in the promotion of the CMI Personal Portfolio policy.
- Appendix 11: Copy report dated 20 April 1993, prepared by Ms Patricia Roche of the FASD for a prospective investor in the CMI Personal Portfolio policy.

- 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.