DÁIL ÉIREANN

AN COMHCHOISTE UM AIRGEADAS, CAITEACHAS POIBLÍ AGUS ATHCHÓIRIÚ, AGUS AN TAOISEACH

JOINT COMMITTEE ON FINANCE, PUBLIC EXPENDITURE AND REFORM, AND TAOISEACH

Dé Máirt, 28 Bealtaine 2019

Tuesday, 28 May 2019

Tháinig an Comhchoiste le chéile ag 1.30 p.m.

The Joint Committee met at 1.30 p.m.

Comhaltaí a bhí i láthair / Members present:

Teachtaí Dála / Deputies	Seanadóirí / Senators
Peter Burke,	Rose Conway-Walsh,
Joan Burton,	Gerry Horkan.
Michael McGrath.	

I láthair / In attendance: Deputy John Brassil.

Teachta / Deputy John McGuinness sa Chathaoir / in the Chair.

Matters Relating to the Banking Sector (Resumed): Pensions and Investment Research Consultants Ltd

Chairman: We are dealing with matters relating to the banking sector. We are joined by Mr. Cormac Butler, who has been before us previously, and Mr. Tim Bush. They will give their opening statements, after which we will be in a position to raise various matters with both.

I advise the witnesses that, by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to the joint committee. If they are directed by the committee to cease giving evidence on a particular matter and continue to do so, they are entitled thereafter only to qualified privilege in respect of their evidence. They are directed that only evidence connected with the subject matter of these proceedings is to be given and asked to respect the parliamentary practice to the effect that, where possible, they should not criticise or make charges against any person, persons or entity by name or in such a way as to make him, her or it identifiable.

Members are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a person outside the Houses or an official either by name or in such a way as to make him or her identifiable.

I invite Mr. Butler to proceed with his opening statement.

Mr. Cormac Butler: I thank the committee for inviting us to speak about the banking sector, its impact on Ireland's housing crisis and the role of vulture funds. For 20 years, I have advised on financial institution risk in London and globally. I wrote books on risk measurement and financial instruments and trained more than 100 bank regulators globally. I gave evidence to two UK House of Commons inquiries.

I am joined by Mr. Tim Bush, a former member of the Urgent Issues Task Force, UITF, of the then UK and Ireland Accounting Standards Board. The UITF examined whether proposed accounting standards complied with company law. In 2010, Mr. Bush warned that the impairment accounting rule used by British and Irish banks was not in line with company law. This year, after nine years, the accounting profession and the Financial Reporting Council confirmed that the standards did not fit with the law. The law is concerned with accounts underpinning what is known as capital maintenance, which includes capital solvency.

At the 2015 Oireachtas bank inquiry, Irish bankers incorrectly claimed that, by law, they had to conceal losses and claimed that a new accounting standard would resolve this. It will not do so. Rather, it could lead to bigger problems. Among the problems created are subsidies to vulture funds. Some banks claim they profited from loan sales to vulture funds, but this is extremely unlikely. Thanks to flawed accounting standards, banks can bury loan write downs into reserves and thus record an artificial accounting profit. These transactions are potentially illegal if the true subsidy is concealed. The matter was addressed in an article headlined, "Questions raised over AIB €1.1 bn problem loans sale" published on 4 November last year by the *Financial Times*.

A further problem is insurance against past losses. Irish banks were not solvent on the night of the September 2008 guarantee. Unlike the Government, the ECB was aware of this, yet it insisted that the Government should pay for these hidden losses. Under EU law, the Government is not liable. Indeed, the cancellation of the promissory notes may be illegal.

Liquidity difficulties are another potential problem. If banks conceal their losses, it becomes impossible to borrow money. Today, banks continue to conceal losses which make borrowing difficult and expensive, a cost borne by current Irish mortgagors.

Asset stripping is another problem. One UK bank with operations in Ireland may have pushed small but healthy businesses into liquidation by calling in loans unnecessarily, a matter on which evidence was given to the committee by a group of small business owners. The actions of the bank were partly motivated by flawed bank bonuses and incentive schemes. Anthony Stansfeld, police commissioner for Thames Valley in the UK, expressed concern at similar practices in the UK and claimed that the problem is widespread, advising those affected to read the Project Turnbull report which was produced by a bank whistleblower.

A new accounting standard could also lead to abuses of company law. Some years ago, a well-known company was able to split its assets into two separate companies. Investors could recognise substantial profits from the property of the company while staff and creditors were shunted into another company and were unpaid, contrary to the spirit of company law.

On pension and reputation, the recent collapses of London Capital & Finance, Patisserie Valerie and Carillion caused havoc for those in private sector pensions in the UK. Kevin Hollinrake, MP, called for an inquiry into compensating investors.

On rights issue problems, it is difficult to see how banks can approach shareholders and investors for additional funds if they are not disclosing all of their losses. Company law prevents innocent shareholders from being burdened with losses that were concealed when they made the investment.

On subsidised loans, the accounting profession may have exploited accounting standards to conceal subsidies given to developers, a matter which Deputy Catherine Murphy attempted to investigate. There is a risk that IBRC exploited the accounting standards when measuring these subsidies.

As regards a solution, a House of Commons report published in April, entitled "The Future of Audit", concluded that banks concealing losses are potentially breaking the law and that advice by the various accounting bodies, including a legal opinion they commissioned, is incorrect. Under the capital maintenance rules, banks are not allowed to pay dividends out of capital, as confirmed by the AssetCo *v*. Grant Thornton LLP 2019 case law. Mr. Bush presented this at a House of Lords inquiry in 2010 and, on behalf of the UK Local Authority Pension Fund Forum, obtained a legal opinion from George Bompas QC which set out the law in a way which indicates that some witness statements given to the Irish banking inquiry were incorrect. The aforementioned AssetCo High Court case confirmed this interpretation of the law.

We strongly suggest that bankers who appear before the committee should be asked to restate their published accounts to comply with the law. If they do so, banks will have to reveal that they were insolvent at the time of the guarantee and, as a result, the ECB loans will have to be reclassified as capital. This would automatically resolve the legality surrounding the repayment of promissory notes and, more important, reveal the huge subsidies given to various vulture funds. It would also reveal the extent of asset stripping that forced many Irish businesses into failure. If the banks fail to do so, they will have to provide a legal opinion stating that the report of the House of Commons report is wrong and so is the recent admission by the Institute of Chartered Accountants in England and Wales, ICAEW, that it gave flawed advice on the concealment of losses. Under Irish company law, it remains a criminal offence to misreport the financial position.

Mr. Tim Bush: Mr. Butler explained the defective accounting standard known as IAS 39 very well. Essentially, the problem started because the standard was drafted to be compatible with EU law, but the detailed guidance notes which everybody follows and which are explicit on points of detail were drafted with the position in the United States in mind. Obviously, that creates scope for confusion and, as a result, banks recorded artificial profits and paid flawed bonuses even on loss-making transactions because their profits and assets were overstated for a considerable period from approximately the beginning of 2005 in the UK and Ireland when the standards were introduced.

I have submitted a PwC document published in 2004, entitled "Joining the Dots", to the committee. It correctly identified that the banking regulation known as the Basel accord relied on banks recognising all losses to comply with company law in the way described by Mr. Butler. These are known as the EU capital maintenance rules, which apply to all companies and ensure that banks and other companies only pay dividends out of genuine profits. Basically, it is a solvency test that applies to every company.

The Basel rules were intended to give an additional layer of protection, beyond what is required of normal companies, to banks. The purpose was to protect the interbank market, in which banks borrow from and lend to each other. If the interbank market is enabled to operate effectively, banks can borrow and lend cheaply with each other. Company law is supposed to protect creditors and shareholders and the Basel system is supposed to protect the interbank market and make it safer than would be the case under company law. That is why, before the crisis, banks could borrow at cheaper rates than companies.

The PwC document refers to the problem with these revised standards, but draws the incorrect conclusion that the Basel accord compensated for it; it did not. At best, it took one year's losses, rather than lifetime losses, and for some strange reason divided that by two, assuming that half the loss could go to creditors and half to subordinated debt. The technical reason for doing so was a concern over allowing banks to go into run off. Ultimately, banks failed to be going concerns when investors would not touch them as a result of their suspicions eventually that there was no capital there.

Ireland, the UK and the US were the worst-affected regimes. It was not a global crisis. Those three jurisdictions had the worst ordinary lending banks, as opposed to investment banks. Interestingly, some countries, such as Australia, introduced safeguards to counteract the problem. Australia created an additional standard in 2006 - I have provided it to the committee - which would have solved all of the problems we face today and which were present before and during the crisis. There was also a natural correction in much of continental Europe as countries there did not permit the faulty standard in the accounts of banks themselves and it was only compulsory in the consolidated accounts of listed groups. As such, a French bank such as Société Générale would have proper numbers in the accounts of what it considered banking companies, as well as proper public accounts - only consolidated accounts would be slightly wrong.

However, because the UK and Ireland have similar accounting regimes due to the accounting standards board setting the standard for both states, they did not adjust for the defect in IAS 39 and permitted the option of IAS 39 operating in banking companies, rather than using UK and Ireland generally accepted accounting principles, GAAP. Of particular significance is that in a further step it was also permitted to be used for management accounts for the banks.

Although the Ireland and the UK merely permitted the use of IAS 39 in banking companies, rather than its use being required, using UK or Irish GAAP was an option which could have corrected it. Unfortunately, the accounting standards board also copied IAS 39 into the UK and Irish GAAP, such that even if one prepared accounts under UK or Irish GAAP rather than international standards, one would have the same error. That is why there was a near systemic banking crisis in ordinary Irish and UK high street banks and building societies. I say it was near systemic because four of the main London-based clearing banks, namely, HSBC, Lloyds, Barclays and NatWest, which is part of the RBS group, had counteracting controls that seemed to make some proper adjustment in spite of the standards. None of those banks collapsed. The problems with Lloyds when it acquired HBOS - a bank that had collapsed - and the problems with NatWest were not just NatWest itself but with the wider RBS Group. All of the big ones that collapsed were the Alliance and Leicester, Allied Irish Bank, Anglo Irish Bank, Bank of Ireland, Ulster Bank, the Co-operative Bank, HBOS and the parts of RBS that were not based in London. At the time we produced an analysis for the local authority pension funds entitled Banks Post Mortem, which was released in 2012. Interestingly, at the time we produced the report we could not understand why the Co-operative Bank had not collapsed. A year later it did collapse because the Bank of England went in and discovered that its loan books were as bad as all the others but because the Co-operative Bank did not have a quoted share price the market did not pick it up.

My simple conclusion is that accounting standard setting cannot be left to the accountants. It should have legislative standards of scrutiny. Part of the reason we are still talking about this ten years after the crisis is that people who have produced faulty accounts for banks have a vested interest in pretending there was nothing wrong. For basic strict liability reasons the penalties on directors and auditors for producing faulty accounts are quite severe in civil law. Effectively they owe all the losses back. My overall conclusion is that one has to have legislative standards of scrutiny of the standards when they are being set, not after they have caused the problem. I say legislative standards of scrutiny because all of these issues link with other areas of law around misrepresentation on the purchase of shares, misrepresentation when people put new capital into banks and misrepresentation at annual general meetings when directors want to get elected on the numbers. The simplest answer would be to look at what the Australians did in 2006.

Chairman: I thank Mr. Bush.

Senator Rose Conway-Walsh: Go raibh maith agat and I thank the witnesses for their presentations. Has anything been learned or has anything changed? This paints a really bad picture of where things are at. I am concerned that the banks are in to this committee time and time again, including the Central Bank. Do the witnesses know why the Central Bank is not addressing these matters? They have said that there are liquidity problems, losses are being hidden and we are not being given the true picture. There are the different layers of the standards bodies and the Central Bank, which is the regulator. There are also the big four audit companies. Similar to the situation in Britain we have asked for those audit companies to be examined and to come before the Competition and Consumer Protection Commission, an issue I feel strongly about. It is almost like there is collusion there. Will the witnesses speak to that in the context of what has changed?

Mr. Tim Bush: I thank the Senator. It is a very good question. When we identified the problem back in 2009 and 2010 it struck me early on that one of the first people to openly speak out, not only to describe the problem but to describe it very clearly, was the Governor of the

Central Bank, Professor Patrick Honohan. He put it beautifully and so clearly. The Bank of England was not saying the same thing. The Bank of France was kind of saying it because it was in a position where it could. The then outgoing Governor of the Bank of England, Mervyn King, started talking about it but I believe that the problems the central banks have is that in law it is illegal for them to prop up a bank that is insolvent. They either lend to a solvent bank or they have to transparently put in new capital. If they are lending money to an insolvent bank they are effectively putting capital into an insolvent bank, and by that they should not be able to whip it out again. Huge conflict of interest arises when a central bank lends to a bank that is, essentially, bust and it then goes into a limbo state. I believe it is best to let such a bank fail. One does not have the ongoing zombie state of the living dead where the central bank is conflicted because it has lent money it, the auditors are conflicted because they have followed particular accounting standards that have not delivered company law and the directors are conflicted because they have run the bank badly and have given numbers that do not show the true position. The conflicts of interest are enormous. Interestingly, Mr. Butler refers to the case that settled in the High Court in London in February this year, called AssetCo plc *v* Grant Thornton UK. AssetCo is a company that sold vehicles to the United Arab Emirates. The AssetCo case was interesting because it was the first major case against an auditor to settle in a UK court since 1968. The law was so clear in the 1968 case that it was enough to refer to and the respondents - the big four firms - preferred to settle out of court rather than having the 1968 case given a second lease of life. AssetCo decided to take its case right to the High Court, which was decided there. The case describes exactly not only the 1968 position but also the 1890s law because these are the same issues. The law is quite shocking and is quite clear that in the AssetCo case the auditors owed back to the company all the dividends that had been paid from false numbers. Not only that, the auditors owed all the funds that had been put into the company but which were then mis-invested. Effectively, it is consequential loss, which is the consequences of making business decisions based on the wrong numbers. When they see this case most people are quite shocked that it is the legal basis of settling on cases where the accounts were faulty. The position is so harsh that one can see why people do not want to go around the street with a loud hailer telling everybody that that is their liability position. Potentially, any company where there has been misinvestment due to the wrong numbers could follow the AssetCo case.

Senator Rose Conway-Walsh: Mr. Butler referred to Carillion and the impact of the audit company ruling Carillion was in a good state of health and the small and medium businesses have really suffered as a result of that. There has been no corrective action whatsoever. At the time I asked to have the audit companies examined by the Competition and Consumer Protection Commission.

Mr. Cormac Butler: If the audit companies come before the committee the members should ask them if, as a result of the AssetCo *v* Grant Thornton UK, it is time for banks to restate their accounts. If the banks did restate their accounts they would have to reveal all losses. I believe that what would come to light is that between 2005 and 2008 Irish banks were moving into insolvency. It was a reckless period and they were giving out loans to everyone left, right and centre. They were accumulating huge amounts of losses but were not disclosing it. The Central Bank was aware that the banks were doing this, but the Irish Government - at least officially - was not aware-----

Senator Rose Conway-Walsh: Is the witness sure that the Central Bank was aware?

Mr. Cormac Butler: We have documents going back to 2001. They were aware of the problems with IAS 39 and they raised concerns about it. They were certainly aware of it. Between 2005 and 2008 we had a situation where the European Central Bank would have been aware that banks were measuring insolvency and measuring their losses incorrectly, but the Irish Government was not so aware. In 2008 the Irish Government effectively either gave a guarantee or injected funds into the banks, but at that point the banks had already suffered losses. This has caused a problem, which probably explains why people are slow to correct this issue. The problem is that once one lends money to an insolvent bank one cannot take that money back out again. The bank must declare that it is insolvent and the money is then distributed to all the creditors evenly so no creditor is affected worse than other creditors. In 2008 many of the banks, if not all of them, were insolvent. The ECB had injected funds. The ECB had made a loss at that point. I shall outline what should have happened. The banks should have declared their insolvency and should have looked for an equity injection. The central banks really should have said: "We do not want the commercial banks to fail and therefore we need to put in an equity injection." They, however, did it the wrong way around. They lent money to the banks and the banks delayed telling us about their insolvent situations. The ECB lent money to the banks and the Irish banks then approached the Irish Government for support and funds, admitting they were in difficulty. It is the wrong way to do it.

Senator Rose Conway-Walsh: How can we identify now which banks are solvent and which are not?

Mr. Cormac Butler: One rule of thumb method is to look at the assets that were sold to the National Asset Management Agency, NAMA. Banks would not have suffered a discount of 30%, 40%, 50%, or 60% if they could have held onto and serviced the loans themselves. If a bank has assets on its balance sheet which are overvalued by 30%, 40% or 50%, one can rest assured that bank is not solvent.

There are other tests. For instance, there was an issue surrounding burning the bondholders and some of the Irish banks took American hedge funds to court. The banks told the hedge funds that they had huge losses for which the hedge funds should bear some of the burden. The hedge funds told the banks, more or less, that once the banks started declaring themselves insolvent, the hedge funds would start accepting the losses. Of course, the banks were unwilling to state they were insolvent but the fact that they attempted to burn the bondholders meant that they felt the bondholders had suffered loses. Bondholders suffering losses in a bank means that the value of the assets is below that of the liabilities and the bank is insolvent.

Senator Rose Conway-Walsh: Is Mr. Butler saying that some or all of the Irish banks are now insolvent? Profits are declared all of the time and dividends are given out. Representatives of Ulster Bank were before the committee a couple of weeks ago and it has given something like €1.5 billion to the Royal Bank of Scotland, RBS.

Mr. Cormac Butler: In order to answer if the banks insolvent at the moment, the question that must be asked of them is if they are valuing loans at their recoverable amount. They will not be able to answer "Yes" to that question because, under accounting standard IAS 39, and its replacement accounting standard, banks are not required to value loans at recoverable amounts. They are allowed to used historical values. If I lend the Senator €1 million and she can only afford to repay €400,000, according to current accounting rules, I show the loan at €1 million and not €400,000. That is against the law because the judgment in AssetCo Plc *v.* Grant Thornton UK LLP means that an entity must identify how much it has genuinely lost before it can pay a dividend. When the banks come before the committee, committee members should ask for an assurance that all loans are never valued above the amount the banks expect to recover. The banks are solvent if they genuinely give the committee that assurance but, if they do not give that assurance, they are not measuring their solvency correctly and, as was the case in 2008, there could be a huge mountain of hidden losses.

Senator Rose Conway-Walsh: What specific legislation do we need to put in place?

Mr. Cormac Butler: The legislation is already there, it is a question of whether the banks are complying with it. I can direct the Senator to the AssetCo case to which Mr. Bush referred. There was also a UK report which came out in February named "The Future of Audit". That report made clear that the advice given by some accounting professionals is incorrect and those accounting professionals also stated it is incorrect. The legislation is already there, it is only a matter of getting the banks to comply with it.

Senator Rose Conway-Walsh: Does Mr. Butler believe we need to do a report similar to the "The Future of Audit" here?

Mr. Tim Bush: I will comment on that. We definitely need to do that. The select committee of the UK Parliament that was looking at this area took evidence from the accounting firms on the Wednesday of that week and were given a view of the law by the accountants. The AssetCo case settled on the Thursday and, by the time the committee came back the following Tuesday, its members realised there was the court's version of the law and what they had been told the day previously by the accountants.

Interestingly, on that Tuesday, the French firm Mazars appeared before that committee. Mazars is a professional firm and its representatives told the committee the truth, the whole truth and nothing but the truth and it was good to watch. For historical reasons and due to EU directives, UK and Irish company law is identical. People who are chartered accountants of an Irish institute take exams based on the same questions as their UK counterparts, only one paper contains reference to the UK Companies Act and the other to the Irish Companies Act. I know that people try to pull the wool over one's eyes and read the UK Companies Act wrongly by misinterpreting words. From talking to Mr. Butler and looking at the two Acts over the years, whoever drafted the Irish legislation has made it clearer. It is easier to understand the UK Companies Act by reading the Irish legislation because, somewhere along the line, the drafting of the Irish legislation was better and it is impossible to make the same mistakes made by people who have misinterpreted the UK Act, because the Irish Act is so clearly set out. All that is needed, as Mr. Butler said, is for institutions to follow the law.

Mr. Cormac Butler: Banks will be unable to use a defence that English law is different to Irish law on this issue. If one was to examine "The Future of Audit" report and present the findings to the bankers, they would not be able to challenge it on the grounds that it is British law and does not apply here; it does.

Senator Rose Conway-Walsh: The ECB obviously has a scrutiny role over the Central Bank and Irish banks. Is the ECB missing all this? Why is it ignoring this?

Mr. Cormac Butler: The ECB appears not to be interested in this. That is understandable because it would open a can of worms. When the ECB lends money to an insolvent bank, for example Anglo Irish Bank, it is not allowed to get that money back. Therefore the ECB is not overly enthusiastic about measuring prudence and loan losses correctly. It should be but it is not. We have put that to the ECB but it takes six months for a reply and, when it does reply, it makes reference to things like "constructive ambiguity" and "confidentiality". It is not interested in looking at this area.

This is of extreme importance to Ireland because, when the Exchequer lent money to the banks in 2008, those banks were potentially insolvent but the Government was led to believe they were solvent. Therefore, the Irish Government does not have a liability in respect of those promissory notes or that guarantee and because the money is being paid back at €3 billion per year, or whatever it is, there is a question on the legality of whether that money can be paid back on the grounds that there was never a liability to begin with. The story would be very different if the Irish Government knew the banks were insolvent in 2008. In that case, the Government would have known it was putting money into an insolvent bank. I will give an example-----

Senator Rose Conway-Walsh: Is Mr. Butler saying that the Government did not know at the time-----

Mr. Cormac Butler: In 2008, the Government stated that it assumed all the banks were solvent and this would be the cheapest way to-----

Senator Rose Conway-Walsh: Does Mr. Butler believe that?

Mr. Cormac Butler: I would have believed it in 2008, because it was not well known that banks were insolvent. It only started coming to light in 2010 and in 2010-----

Senator Rose Conway-Walsh: Was there not a close relationship between the key people in the banking system and the Government of the time? That is documented.

Mr. Cormac Butler: It may have been the case that there was a close relationship and the Government knew but that would mean the Government was telling a lie when it said the banks were solvent. I do not think one could prove the Government knew the banks were insolvent. I might be wrong but I do not think one could prove that.

It is certain that, during the banking inquiry, one witness from the Central Bank, I think it was Mr. John Hurley, gave evidence that he assumed that all banks were solvent in 2008. He based his knowledge on a report by PwC, which stated that all banks had sufficient capital to withstand future losses. It could be that some people decided to put this out despite knowing it was completely false but I do not think one could come up with evidence to prove that. In 2008, very few people outside the accounting and banking professions knew that banks were not measuring losses correctly. In fact, in 2008, the International Accounting Standards Board, which designed the international accounting standards, stated in a prepared speech and a letter that, under its rules, banks are not allowed to hide losses. It would not have been able to say that if the world had known the banks were insolvent.

Senator Rose Conway-Walsh: How far away from another banking collapse are we?

Mr. Tim Bush: I will answer that question by finishing Mr. Butler's answer. The key issue when things go wrong is who knew what, when and where. The case of Northern Rock was the first run on a bank in the UK for 100 years in the early autumn of 2007. The day after that, somebody in *The Times* wrote an article asking if the situation was the same as the collapse of the City of Glasgow Bank 100 years previously, that is, this was not a liquidity crisis but a capital crisis and that was why nobody would lend to it. It is as if markets smell that there is a problem. That analysis kind of faded away. Six years later, the Bank of England minutes were released publicly. In that autumn, the bank knew it was lending money to Northern Rock but the public did not know, because it was private. A board member asked if the numbers are right, if the bank was insolvent or if the problem was one of liquidity. Again, that analysis got pushed away because other parties were saying that the banks were all solvent. If an entity has audited a bank, it has an interest in saying that the bank has capital. If it has audited ten banks globally, it has a major problem on its hands if it starts admitting that there is a systemic problem and that the banking crisis is actually a capital crisis. It suited an awful lot of people to call the banking crisis a liquidity crisis when it was actually a capital crisis. Every banking crisis in history has effectively been an insolvency crisis where the assets are overstated and the capital is, therefore, overstated. For years, people were running with a red herring and what was quite remarkable in the UK was that the Walker review, which was conducted in early 2009, came up the liquidity crisis diagnosis but if one talks to people in the capital markets, they knew that was because they suspected that the banks were bust. I worked with somebody who was experienced enough to remember the secondary banking crisis of the 1970s and he suspected that it was a capital crisis in the first part of 2007. There was a disconnect between what I call PR-based analysis and proper fundamental common-sense-based analysis. One interesting feature of all of the studies and reviews during the banking crisis is that the people asking the best questions and coming up with the right answers are elected politicians, like members of this committee, and the press.

Senator Rose Conway-Walsh: Surely governments are there to protect citizens. We are talking about all of this and why it happened but the impact on Irish citizens was enormous. Indeed, there is a continuing impact in terms of vulture funds and the way the banks have behaved towards citizens. The banks have been given a free hand by the Government to do just what they want.

Mr. Cormac Butler: That is correct. Mr. Bush brought this to light in 2010 but it is only now, in 2019, that the accounting profession has admitted that it gave incorrect advice in terms of the delayed recognition process. That is quite a considerable period of time. We have had a few inquiries since, in both the UK and Ireland, but there is no appetite among a certain group of people to bring this to light. It is very important that we do not have another lost decade and that we bring this to light. The committee should be aware that at the moment, banks are claiming that they are making profits when they sell loans to vulture funds but they are not. A bank with a portfolio of loans worth €1 million will claim that when it sells those loans to vulture funds, it will make a profit but that is not the case. The banks are using the same accounting techniques that they used nine years ago. They are writing the loans down to a level the vulture funds are willing to pay and then they sell them to the vulture funds. This matter came to light in an article in the *Financial Times* on 4 November 2018. One bank claimed it was making a profit but when one looks through the figures, one sees that a number of losses were being transferred directly against reserves and it was reasonable to conclude that the bank was potentially making a loss on the sale of the loans.

Senator Rose Conway-Walsh: Why are they selling them if they are not making a profit?

Mr. Cormac Butler: That is a good question and there is no concrete answer. Some are alleging that they are being put under pressure by the ECB to sell the loans. There is also a widely held view that vulture funds will act in a more efficient manner than commercial banks although there is no evidence to support that. We do know that the ECB is telling the banks that if they sell loans to vulture funds, they can delay the recognition of losses on those loans as far as it is concerned. In other words, they can bury the losses into reserves so that, in some cases, they can record an accounting profit even though they have made a loss. If one is worried about the sale of assets to vulture funds, there is a potential defence that one can use here. If a State-owned bank is selling an asset to a vulture fund and that bank is giving a subsidy, then the Government is entitled to know that subsidy. In that way, it can make an informed decision as to whether the vulture fund route is the correct one.

Senator Rose Conway-Walsh: Could they not do the same thing if they gave a write-down to the person who held the loan in the first instance? I know from individual cases that vulture funds are making enormous profits from the write-downs they are being given.

Mr. Cormac Butler: They are making enormous profits. Such profits should be going to Irish banks in order that they could be used to write down customer loans. The banks are selling loans to vulture funds which are making a significant profit on them. They are buying them at a significant discount. Members may remember the Project Eagle scandal uncovered by Deputy Wallace a few years ago. The Comptroller and Auditor General calculated a subsidy of approximately €300 million which was not disclosed by the National Asset Management Agency, NAMA. It wrote down loans to the amounts the vulture funds were willing to pay. As the vulture funds wanted to make a profit, loans were written down unnecessarily. NAMA should have had a much more open competition to determine the best price it could obtain, but it ran a very restricted competition. The Comptroller and Auditor General was of the view that the price received in the NAMA sale was substantially lower than it ought to have been. If that scandal had been acted on, many of the vulture funds sales would have been questioned.

It is difficult to believe vulture funds are the only groups competent to recover money. The Irish banks are capable of doing so, but, as a result of a flawed incentive, they are selling the assets to vulture funds. They claim that the ECB is putting them under pressure. However, it is not allowed to force banks to do so because if one sells an asset under its value, there is a company law issue as one is effectively paying a dividend. As a result of that company law issue, significant disclosure is required of the true substance of the transaction, not just the artificial accounting. Similarly, in some instances, banks set up a special company such as a global restructuring group. They close a loan and force the sale of an asset, but the asset is dealt with through a separate company which the bank owns. That company can make a profit because it can buy an asset at a distressed price. I have seen evidence that an individual with a property portfolio worth €65 million had their asset sequestrated, effectively, to settle a loan worth €10 million. I have strong evidence that the asset was sold at a distressed price with a relatively high discount. The bank may not necessarily recognise the loss on the loan sale, but it recognises the profit on the sale of the distressed asset.

The banks are using flawed incentive schemes for these transactions. This issue must come to light. When bankers appeared before the committee, members correctly asked them what discounts were being given to vulture funds or other groups. The bankers stated there was a confidentiality clause and that they would not reveal the information to the committee. It is extremely difficult to see how they can justify this legally because if one is the owner of an asset, one is entitled to know whether it was sold at a profit or with a subsidy. If it was sold with a subsidy, there are complications involving a breach of the law because one is not allowed to give a subsidy to vulture funds.

Senator Rose Conway-Walsh: If one is the owner of the asset, one is entitled to know-----

Mr. Cormac Butler: One is entitled to know whether the bank is better off in selling the asset or keeping it and earning money.

Senator Rose Conway-Walsh: Who is entitled to know? Is the owner of the asset entitled to know?

Mr. Cormac Butler: In the case of a State-controlled bank, the Exchequer may own 70% of the shares. Let us take Allied Irish Banks as an example. If it is selling an asset to a vulture fund, one might predict that the vulture fund would make a significant profit on the transaction and give consideration to how much extra money we would make if we were to retain the asset in our portfolio such that one is able to see that the bank is making an informed decision. However, if it is using flawed accounting, one cannot see what is going on and, as such, it could sell the asset to a vulture fund and there could be a significant and unnecessary discount on that asset. One is entitled to know if that is the case. One must know it in order to ensure the directors of the bank are making an informed decision on one's behalf.

Senator Rose Conway-Walsh: Surely, it is the place of the Minister for Finance and the Department of Finance to do that.

Mr. Cormac Butler: When we brought this matter to the attention of the Minister for Finance, Deputy Donohoe, he referred us to the Irish Auditing and Accounting Supervisory Authority, IAASA. The problem with the IAASA and the Office of the Director of Corporate Enforcement, ODCE, is that they are of the view that one can delay the recognition of losses under the accounting standards or the law, but that interpretation is incorrect. If a person says to the ODCE or the IAASA that he or she has a problem and that person wants to clarify whether those bodies think it is legal to delay the recognition of losses, if the bodies say "Yes", they will have a problem because of the AssetCo *v.* Grant Thornton LLP case. If they say "No", they must investigate instances of assets being sold to vulture funds.

Senator Gerry Horkan: I thank the witnesses for their opening statements. There are 11 members of the committee and five of us happen to be accountants. I will not be speaking on behalf of any particular body. Rather, I will ask questions relating to the opening statements.

The concept of a true and fair view is fundamental to what accountants are trained to do. A set of accounts is supposed to reflect a true and fair view. How does the suggestion put forward by the witnesses that banks are able to defer and conceal losses and record loans at amounts that are irrecoverable as far as the witnesses or the bank are concerned sit with the concept of a true and fair view?

Mr. Tim Bush: The purpose of the true and fair view is that, effectively, common sense should prevail irrespective of what is written down in a codified form as to how one produces a set of accounts, and one must not interpret those rules to come up with the wrong answer. One must deliver the right answer. The best analogy is that if one follows a recipe for cooking an omelette but ends up with scrambled eggs, one has not made an omelette. One has put in the correct ingredients but made a mess of it. In the past 20 years, elements of the accounting profession tried to change the meaning of true and fair view to whatever they wanted it to mean. It was a sort of *à la carte* type of true and fair view which was disconnected from company law. It looked about okay, and then people spoke to a few others and asked whether this kind of accounting looked okay, but very often they would not talk to qualified accountants. They talked to analysts or people who did not really know what they were talking about. That would give rise to what I call a distorted output that clearly does not give what the Senator or I would regard as a true and fair view but passes off as such.

Another problem is that if someone in the Department of Finance has a technical problem, he or she will very often pick up the telephone to one of the four accounting firms, who have all got the message right, and really it is always the same person at the end of the telephone. I can almost pin down some of the excuses I have come across to the precise building because I can pick up on the tone, and somebody would not come up with the same ridiculous excuse twice by accident unless it was the same person putting out the same bad excuse.

Senator Gerry Horkan: I accept that loan valuations and debtor write-offs in any company where there is a list of debtors are subjective. There is a level of subjectivity regarding whether a particular party is able to pay. It is the same with inventory. One puts a value on an asset, and somebody else disagrees. Until it is sold, one does not realise the loss or gain or whatever it happens to be. In the case of inventory, it is cost versus net realisable value. I would have thought it was the same for loans, in that one cannot have loans maintained on one's books-----

Mr. Cormac Butler: The Senator is correct in that regard. There are two legal opinions, one from George Bompas and one from Martin Moore. George Bompas certainly links true and fair to prudence, and that broadly means that one can never overvalue a loan. If one expects to recover €300,000, even though one has lent €1 million, the true and fair value is €300,000. It is not €1 million. Martin Moore appears to have reached a similar conclusion, but he does so reluctantly and using very opaque English because he gave his legal opinion on behalf of the accounting standards board. At paragraph 71 of the opinion he claims that prudence is an essential ingredient of true and fair view, which means that the Senator's argument that loans must be shown at the lower of what one advances the loan for or what one can recover is correct. The Oireachtas banking inquiry heard evidence from the accounting profession and from banks that by law they were forced to delay the recognition of losses. That is incorrect. George Bompas disagrees with it and Martin Moore looks as though he disagrees with it. The recent AssetCo case, however, confirms that the Senator's analysis is correct. The report entitled The Future of Audit, which I recommend that members read, also confirms that the Senator's view is correct and that the accounting profession has given incorrect advice on this matter.

Senator Gerry Horkan: Mr. Butler is saying that, by law, banks and the accounting profession were told not to recognise losses. What law?

Mr. Cormac Butler: In essence, when the accounting profession devised accounting standard IAS 39, it claimed that within it is a rule that states one can delay the recognition of losses. This is because the banks were sometimes overestimating their losses and it was thought that if that uncertainty was removed altogether, it could solve the problem. A much bigger problem, however, has been created. Second, although that paragraph is in the guidance notes of IAS 39, it was not approved by the European Union. This is the law they use but that paragraph was not approved by the European Union.

Senator Gerry Horkan: Was it approved by the Houses of Parliament in the UK or by the Houses of the Oireachtas?

Mr. Cormac Butler: No.

Senator Gerry Horkan: When Mr. Butler said they are the laws, are they accounting rules or are they laws?

Mr. Cormac Butler: There is confusion. I will let Mr. Bush come in here.

Senator Gerry Horkan: I am aware that it is quite technical but Mr. Butler is saying that by law they were told to do the opposite of what they would normally do.

Mr. Cormac Butler: They claimed that it was by law, but there is no law. The law says that the accountants may produce accounting standards provided they help people to comply with company law. The accounting firms appear to have said that in America, where there is a different version of company law, they are allowed to hide losses and that "we would like to have that over here, so we will include that paragraph and when the accounting standard is approved we will start to hide losses." The problem is that they put it into the guidance notes only. The main law, which is the IAS 39 standard that is approved, did not allow the banks to hide losses. It gets a little bit technical.

Senator Gerry Horkan: I accept that. I am not sure that everybody watching this would be as familiar with what is going on, but there is a difference between accounting standards and company law. Accounting standards are the rules that the bodies implement and one would expect them to try to adhere to company law at all times. Accounting standards are not law, however. Is the problem with IAS 39 or with some bit of company law? Is Mr. Butler arguing that the IAS 39 standard that came from America or was used in America, which is not approved by the European Union, is the problem?

Mr. Tim Bush: I can send the committee a letter, which I did not include in my evidence, from the then Accounting Standards Board, in April 2005 to the then Department of Trade and Industry in the UK. The letter stated that they know what company law is, that they do not agree with it because they believe it to be outdated, that they are setting standards that are going in a different direction and that they believe the law should be changed to catch up with the standards. The law has not been changed, however. I will supply that letter through the clerk to the committee.

Senator Gerry Horkan: So the law is not the problem.

Mr. Cormac Butler: The law is not the problem.

Senator Gerry Horkan: The accountants said they would like the law to be ignored or changed so that the standard is then legal-----

Mr. Cormac Butler: Yes.

Senator Gerry Horkan: -----and they just went off and adhered to the standard, which is not legal, as opposed to adhering to the law. It is not the law's problem.

Mr. Cormac Butler: Yes.

Senator Gerry Horkan: Nobody pursued people who were breaking the law, or not complying with the law.

Mr. Cormac Butler: That is correct. Members should read "The Future of Audit" report, which states that the accounting profession gave the wrong advice. They were not adhering to what is known as the capital maintenance concept, which ensures that all losses are revealed. That report found that the accounting profession gave the wrong advice.

Senator Gerry Horkan: The accountants went off and said they did not like the law. I am trying to interpret Mr. Butler's words and he can correct me if I have picked them up wrong. The accountants did not like the laws that were there and they created new standards that are in conflict with the law. They prepared accounts and signed off on accounts in compliance with the standards, which are not legal. Who then was supposed to pursue them for preparing accounts that were not prepared lawfully?

Mr. Cormac Butler: The Office of the Director of Corporate Enforcement, ODCE.

Senator Gerry Horkan: Did that office ever do that?

Mr. Cormac Butler: We sent letters to that office, but it is of the view that the accounting standards do comply with the law. The view of the ODCE in this matter is inconsistent with the opinion of George Bompas QC. It is inconsistent with a recent admission by the Institute of Chartered Accountants in England and Wales, and it is inconsistent with one of the conclusions of "The Future of Audit". Its representatives need to be brought in and asked if their view is still the same because of these developments or has it changed. If it has changed then they must investigate.

Senator Gerry Horkan: Clearly, as the witnesses have said, there is much conflict of interest and vested interest. If a person does something illegal and nobody stops that person from doing it, then he or she is at fault for breaking the law. The regulator, however, who should have gone in and said that the law cannot be broken, seems to have been asleep at the wheel and knowingly allowed accounting firms to not comply with the existing laws and to make up their own rules, which are in conflict. I believe that Mr. Butler has suggested it was knowingly allowed as there is a letter written to that effect. Is this what Mr. Butler is saying?

Mr. Cormac Butler: Yes.

Senator Gerry Horkan: So the answer is not about changing the law. We are happy with the law and we do not want the law to be changed to adhere with a standard where one can conceal losses. The problem is corporate enforcement and the regulators not clamping down on people. Is Mr. Butler suggesting that the regulators are not doing this as they wanted to turn a blind eye, because if they started to enforce this the losses would be recognised quicker? Eventually equity stakes were taken in the banks but Mr. Butler has contended that initially they were loans followed by equity participation-----

Mr. Cormac Butler: Yes. It was the wrong way around.

Senator Gerry Horkan: -----and if the losses were recognised immediately then the banks were insolvent, and all of the promissory notes and other aspects would needed to have been equity injections rather than loans, with the consequent difference to losses and so on.

Mr. Cormac Butler: Senator Horkan has got the point. To summarise on that, the Future of Audit report stated that the ICAEW gave incorrect advice. The ICAEW gave advice that was contrary to capital maintenance and, therefore, contrary to law.

Senator Gerry Horkan: To which wrong advice exactly is Mr. Butler referring?

Mr. Cormac Butler: The ICAEW has said that under the IAS 39 one can delay the recognition of losses.

Senator Gerry Horkan: Have they now admitted this was wrong?

Mr. Cormac Butler: They have never admitted it for nine years. This has been written about. Mr. Bush brought it up in 2010 and wrote to the Irish Government on this. It appears that 2019 is the first time the ICAEW has said the accounting standard IAS 39 is not in compliance with capital maintenance and, therefore, not in compliance with company law.

Senator Gerry Horkan: So they are finally getting around to saying what we have just discussed for the past ten minutes.

Mr. Cormac Butler: Yes.

Mr. Tim Bush: Since these issues have been quite well aired in the UK over the past year, particularly around the presence of the 2005 letter, the Financial Reporting Council, FRC, has been wound up as a body and will be replaced by a body called the audit, reporting and governance authority, which will be a properly constituted public body with a constitution set by Parliament. There has been one odd thing in the middle of all of this: everybody was acting as if the FRC was a private sector body. It was operating with private sector wages, was not subject to freedom of information and was not subject to public sector procurement rules. A journalist submitted a freedom of information request and found that the Office of National Statistics, which determines whether an entity in the UK is a public body, determined in 1990 and again in 2005 that the FRC was a public body. The FRC was acting, however, as if it was a private sector body. The new authority is in the process of implementing the necessary safeguards to be a public body with public pay, which might need pay capping, and changes will include not being able to use the same firms of lawyers that the accountancy firms use, and an obligation to respond to freedom of information requests. It is quite remarkable that a body such as the FRC had been operating in that way for so long.

Senator Gerry Horkan: Mr. Bush was a member of the urgent issues task force of the Accounting Standards Board. Is it correct to say that the FRC was a self-governing set-up that was paid for by its members or was it funded by the State?

Mr. Tim Bush: It had received small amount of residual funding from the former Department of Trade and Industry, but the bulk of funding came from the accounting institutes and there was also a voluntary levy on listed companies.

Senator Gerry Horkan: A voluntary levy?

Mr. Tim Bush: Yes. This was also interesting. The levy was voluntary in as much as the companies could not be sued for not paying it, but the FRC drafted an invoice that made it look as though it compulsory to pay it. It was a little bit of trickery going. Some companies were paying it and -----

Senator Gerry Horkan: We have a voluntary contribution scheme for schools in Ireland and it sounds a little like that.

Mr. Tim Bush: Given how bad the standards were, if companies thought they were paying for this voluntarily a lot of them would rather have given their cheque to Oxfam instead. The wording on the invoice was quite carefully written to make it look as though companies had to pay it.

Senator Gerry Horkan: Was most of the funding from ICAEW members?

Mr. Tim Bush: Yes.

Senator Gerry Horkan: What was the breakdown of the funding to the FRC from the bodies or the accounting institutes, which ultimately were the members, relative to other companies?

Mr. Tim Bush: I do not have that number to hand. It was between one quarter to one third or one half relative to other companies.

Senator Gerry Horkan: Who paid for that?

Mr. Tim Bush: The institutes paid.

Senator Gerry Horkan: And either two thirds or three quarters was paid by listed companies which were doing this voluntarily.

Mr. Tim Bush: Yes.

Senator Gerry Horkan: What kinds of figures are we talking about?

Mr. Tim Bush: The budget of the Financial Reporting Council, FRC, was approximately £20 million the last time I looked. It had grown from approximately £2 million in the period from 2004 until-----

Senator Gerry Horkan: The FRC was looking at financial reports, adjudicating and getting involved while ultimately being funded by the people whose accounts it was looking at.

Mr. Tim Bush: That is correct. It was also remarkable what happened in the event that an audit firm was fined for a problem. Take for example the time after the Farepak case in which EY was fined. An auditing firm would be fined £1 million, which was not the amount in that case but I use it as an example, following which the proceeds go back to the accounting institute of which the auditing firm is a member. It, effectively, gets a dividend because the fine is deemed to be income of the professional body whose member was fined. That goes into the general pot and finds its way back to the auditing firm.

Interestingly, the FRC had an agreement with the Department of Trade and Industry whereby if it lost a court case then the State underwrote the costs of the loss.

Senator Gerry Horkan: However, the FRC kept the profits.

Mr. Tim Bush: Yes.

Senator Gerry Horkan: That is a nice business model. I presume our guests are familiar with the concept of NAMA and so on.

Mr. Tim Bush: Yes.

Senator Gerry Horkan: NAMA has reported "profits". If assets of €100 billion are written down to €30 billion before they are inherited and are then sold for €31 billion, the argument is that NAMA made a profit when ultimately the State has already picked up the loss of €70 billion in the first place. It is a reduction of the loss from €70 billion to €69 billion. Is that basically the same point that Mr. Bush is making about the subsidies for vulture funds? An asset has been written down from €100 million to €30 million. That is sold for €32 million to a vulture fund and a profit is claimed. Mr. Bush said they are then basing bonuses on that €2 million, or something, but was there not a point in time when that €70 million was hit straight into the accounts?

Mr. Cormac Butler: I will go through the slight difference between the two. Obviously, when Irish banks were in trouble, they sold assets to the National Asset Management Agency. They may have sold them at a discount of, say, 40% which means that NAMA would have acquired a portfolio of loans worth €1 billion for €600 million. NAMA then sells those loans on, say, for €700 million and therefore makes a legitimate profit but, in terms of the overall transaction, there is a considerable loss to the State in the order of €400 million.

Senator Gerry Horkan: It would also depend on the amount of the bank that the State owned, whether that was 100% or less, as in the case of Bank of Ireland.

Mr. Cormac Butler: Yes.

Senator Gerry Horkan: The State and all of us were either taking the full hit or slightly less.

Mr. Cormac Butler: Everyone was taking a full hit even though it looked as if a profit was being made on the sale of the loan. Consider a situation in which a commercial bank sells a loan to a vulture fund. That bank might have a portfolio of €1 billion in loans. It sells it to the vulture fund for €600 million. There is clearly a loss to the bank. What the bank can do is bury that loss in reserves, under IFRS 9, so the bank does not have to state that it has made a loss.

Senator Gerry Horkan: It never hits the actual income, profit and loss account.

Mr. Cormac Butler: It never hits the profit and loss account. It may do so in stages in the future but generally it never does. The problem with that is that if the vulture fund says that a portfolio worth €1 billion is actually worth €700,000 and the fund will only pay €500,000 for it-----

Senator Gerry Horkan: We are moving between millions and thousands.

Mr. Cormac Butler: I apologise. Take the situation of a bank which has a portfolio that is worth €1 billion, it is actually worth €700 million because that is all that can be recovered and it is sold to the vulture fund for €400 million. The bank does not have to recover the loss and two losses have been suffered. The first was when the loan was written down from €1 billion to €700 million.

Senator Gerry Horkan: Did that figure make the profit and loss account?

Mr. Cormac Butler: It is not clear. It may or may not have done. We would have to look into each individual transaction. The €200 million lost in the drop from €700 million to €500 million would not have made it to the profit and loss account. It ought to have but it has not.

Senator Gerry Horkan: The argument the banks are using is that the ECB is forcing them to sell these quickly to reduce their non-performing loans.

Mr. Cormac Butler: Yes.

Senator Gerry Horkan: Mr. Butler's contention is that the ECB wants to have the loans in, but there is no requirement.

Mr. Cormac Butler: One of the stated objectives of the ECB is that banks reduce non-performing loan portfolios but the only way to do that is to value them correctly. Once a non-performing loan is valued correctly, relative to the amount expected to be recouped from the customer, it ceases to be non-performing and becomes a proper loan. The Irish banks are saying that, because the loans are non-performing, they are forced to sell them to vulture funds. It does not make any economic sense to do that. Banks would be better off valuing loans correctly down to, say, €700 million and trying to recover that amount rather than selling it to the vulture fund for €500 million.

Senator Gerry Horkan: Does Mr. Butler think that the reason banks are engaging with vulture funds is because the banks do not want the reputational damage of evicting people, repossessing houses and all that?

Mr. Cormac Butler: I do not think that is the motivation because, if one thinks about it, banks suffer huge reputational damage at the point of sale of loans to vulture funds.

Senator Gerry Horkan: Yes.

Mr. Cormac Butler: I do not think that is the motivation.

Senator Gerry Horkan: They do not suffer the reputational damage on an individual house-by-house and transaction-by-transaction basis. They have, in a way, deferred that personal grief.

Mr. Cormac Butler: If the Senator got a letter from a bank-----

Senator Gerry Horkan: What is the motivation for a bank selling an asset worth €700 million for €400 million?

Mr. Cormac Butler: On the first point, if the Senator got a letter from a vulture fund stating that his bank has now transferred his loan to a vulture fund, he would have a negative feeling towards that bank.

Senator Gerry Horkan: Less so than if people in yellow jackets turn up to evict me.

Mr. Cormac Butler: Pardon?

Senator Gerry Horkan: Less so than if people turn up in hi-vis jackets on a Sunday morning and evict me.

Mr. Cormac Butler: A letter from a vulture fund stating it now owns the loan is nearly as stressful as an eviction, although not quite. The point is I do not think the banks are doing it for reputational reasons. Unfortunately, the ECB has allowed banks, when they sell assets to vulture funds, to bury the loss into reserves and the bank does not have to give details of the loss it has suffered. The ECB has a policy of reducing non-performing loans and seems to have taken the view that when assets are sold to vulture funds, non-performing loans are reduced. That is not a correct approach. It is the approach being taken but it is not the correct one.

Senator Gerry Horkan: Take the example of a chief executive of a bank who has taken the hit from €1 billion to €700 million on a loan, who thinks it is recoverable at the latter value and is selling it for €400 million because the ECB has told him or her to do so.

Mr. Cormac Butler: Some banks record a pure accounting profit on the sale of assets to vulture funds. That might be a motivation.

Senator Gerry Horkan: How does one record accounting profit when one has lost €300 million?

Mr. Cormac Butler: I will give a simple example that is the same as Project Eagle, NAMA's Northern Ireland property loans portfolio. A bank has a portfolio of €1 billion in loans. That is written down to €380 million and sold to a vulture fund for €400 million.

Senator Gerry Horkan: The bank in that example never took the hit of €620 million.

Mr. Cormac Butler: Not in the profit and loss account. It is buried in the reserves.

Senator Gerry Horkan: The €20 million is taken into the profit and loss account.

Mr. Cormac Butler: Yes, which is crazy.

Senator Gerry Horkan: Is nobody in the Office of the Director of Corporate Enforcement, ODCE, or the accounting bodies saying that is not okay? That is opposite to anything I ever learned during my training.

Mr. Cormac Butler: It is. The only thing I can do is to recommend that the Senator reads the article of 4 November in the *Financial Times*. It gives an indication of a bank recording an accounting profit where it has transferred €300 million to Mazars, which is effectively a loss.

Senator Gerry Horkan: Mr. Butler's contention is obviously that the liquidity issue that was argued for at the time of the guarantee was not a liquidity issue but a solvency issue. The Minister and the Government were told by the banks it was a liquidity issue. I was not a member of the banking inquiry, or a Member of these Houses when it was conducted, but the inquiry was told that the Government was told it was a liquidity issue when it was really a solvency issue. Mr. Butler's contention is that, if that is true, then all these promissory notes are-----

Mr. Cormac Butler: It is illegal to repay them because there is no liability. The best comparison I can give is with health insurance. One pays for a premium which protects against something that will happen in the future but, if one already has a health condition and has failed to tell the insurance company, the insurance company cannot be liable for the health condition that one has already suffered. It is the same with the guarantee. The Government gave a guarantee against future losses. It did not give a guarantee against hidden losses and much of the promissory note repayments relate to losses accrued up to 2008. The health condition was already in existence at that time and therefore, when the Government repays the funds, it is not cancelling an existing liability because there is no liability to begin with.

Senator Gerry Horkan: Mr. Butler's contention is that the Government probably did not know about the solvency crisis, it was told there was a liquidity crisis and accepted that, but the ECB knew there was a solvency crisis.

Mr. Cormac Butler: As I pointed out, there are letters from the ECB from 2001 and 2003 which show that it was aware of the weaknesses of the accounting standard. Brian Lenihan said that the guarantee in 2008 would be the cheapest bailout in the world, which indicates that he had not intended to bail out past losses. A report from PwC confirmed that all banks had sufficient capital to withstand future losses, which indicated that all the banks were solvent. It was admitted in the banking inquiry that when the accountancy firms were measuring solvency they did not take into account losses they were not allowed to recognise under IAS 39. This effectively means that solvency was measured incorrectly. With regard to the repayment of the promissory notes, when the cheque for the €3 billion repayment is authorised an existing liability is not extinguished; money is given away that is not due or payable.

Senator Gerry Horkan: Obviously it is in the ECB's interests that it is repaid.

Mr. Cormac Butler: Obviously, yes.

Senator Gerry Horkan: If it was not repaid it would be a loss to the ECB rather than to the State. I have a final point on asset stripping. We heard evidence relating to GRG in particular. This GRG organisation was allegedly set up to help its customers and to bring them through the processes, but it became very difficult and businesses were lost. The group took over businesses, made them difficult to run, and then repossessed and sold them. Does Mr. Butler have much evidence of that happening?

Mr. Cormac Butler: I have quite a lot of evidence. We have to bring it down to concrete evidence, to looking at the letters and seeing the links, but from what I have seen so far, small businesses in Ireland that had property would normally be given loans on a term basis. This means that, if a business had a property, it would be given a loan for 20 years and that it paid part of the interest in principle. Some of those small business owners were given letters stating that, under the new facilities, the loans would operate as on-demand loans rather than term loans. When these loans were transferred to recovery groups these groups were free to demand all of the money from the customer the next day and to sell the company's assets if it was not provided.

Senator Gerry Horkan: The contention is that the bank was definitely wrong to have sent those letters but that, equally, the customer should have picked up on that at the time.

Mr. Cormac Butler: This issue has been picked up in both the UK and Ireland. It is wrong to change a term loan to an on-demand loan. It is simply illegal. There is a second point to be made. Many of these companies were sold what are known as "hedge products". A loan would be given for 20 years but then the customer would be told it would be an on-demand facility and asked to take out a fixed-rate swap. The customer might sign up to that not fully understanding what is going on. The problem is that if a lender gives a customer a fixed-rate swap on an on-demand facility and interest rates go against the lender and in the customer's favour, as it is an on-demand loan the lender can cancel it and demand the money the following day, thereby cancelling the swap. It was a one-way bet for the bank. It would make money if interest rates went down but would not lose money if interest rates went up. There was mis-selling, the consequence of which is that all of these small businesses were paying more interest than they should have been and that increase in interest pushed them into bankruptcy. It is a bit like the issue of tracker mortgages. Once the companies went into GRG they were subjected to a management fee and were also exposed to restrictions. Some were told that certain assets could not be sold and that approval was needed even to sell something like a car. There was the risk that GRG would delay such approval in order to create a distressful situation.

Senator Gerry Horkan: Mr. Butler has outlined a solution. It was the case that accountants did not comply with the law and everyone turned a blind eye.

Mr. Cormac Butler: Broadly speaking, the solution is to bring the bankers and accountants before this committee and to ask them whether they have a problem with AssetCo v. Grant Thornton, with the future of audit, or with the admission of the Institute of Chartered Accountants in England and Wales. If they say "No", the committee must ask them to restate their accounts so that all losses are revealed. If they do that their true solvency position will be shown. A few consequences may arise from that. First, it would be very obvious whether they had been insolvent in 2008. If they were, there is a question mark over the repayment of the promissory notes. Second, if the accounts were prepared correctly it would become very obvious whether the banks were selling customers' assets on a distressed basis after calling in loans. If correct accounting rather than artificial accounting were used, the banks would also have to reveal the subsidy they had given to vulture funds. It would solve numerous problems. An opportunity arose in Project Eagle, in respect of which subsidies were given. Somebody should have said that, as we do not want this to happen again, corrected procedures must be put in place. If that had happened we would not have as many sales to vulture funds today.

Senator Gerry Horkan: We would never have been in this situation if people had stuck to the basics such as true and fair view, going concerns, and recording things at recoverable value - which is one of the four basic prudence principles in accounting that one learns on one's first day. They should have taken the hit when it was realised. If they had, we would not have had all these issues with promissory notes and so on. I have probably taken up enough of everybody's time. I thank the two witnesses for their points.

Deputy Michael McGrath: I welcome Mr. Butler and Mr. Bush. I apologise for being late. I ask the Chair to let me know if I am repeating any questions that have already been asked so that I can desist. Mr. Butler has said that if non-performing loans, NPLs, had been valued correctly by the banks on their balance sheets there would have been no need to offload or sell them. Is it his understanding of the European Banking Authority, EBA's technical definition of an NPL that if loans are valued correctly or if the provision made for them is adequate they are not classified as NPLs on the bank's balance sheet?

Mr. Cormac Butler: I cannot say that is definitely the case because the rules in respect of non-performing loans have changed quite a lot. If a loan is given to someone whose salary is €100,000 but that person's salary suddenly decreases to €30,000, the lender will clearly be unable to recover that loan. The lender then has to ask what is the maximum loan it would give to that person today and to write down the loan by an amount equal to the difference. The loan then becomes a performing loan. Under its definitions the EBA might say that this customer defaulted because he or she did not meet the conditions of the original terms sheet. It could therefore be an NPL by definition. The EBA definition, however, should not come into play. We in Ireland should classify loans as non-performing if the full amount cannot be recovered and such loans should therefore be valued down. If the full amount can be recovered, the loan should be left alone. It should be that simple. Getting into EBA definitions would create more confusion than is necessary.

Deputy Michael McGrath: The regulator is working to that definition.

Mr. Cormac Butler: The regulator is working to the EBA definition but I do not know how strictly regulators are enforcing it. Once the value of a loan hits the recoverable amount and the customer is willing and able to pay on that new basis, that loan should be classified as performing.

Deputy Michael McGrath: In Mr. Butler's view there should be no requirement for extra capital to be put aside for loans if they have been correctly provided for or revalued to their real value.

Mr. Cormac Butler: Exactly. Having said that, when the loan is revalued downwards the lender is going to lose money, which will eat into the capital. Once that is done, however, there should not be a need for extra capital.

Deputy Michael McGrath: It is something we will tease out further but, under the EBA's rulebook, loans do not become not non-peforming even if adequate provision is made. That is one of the reasons the banks are selling these on, a practice with which I do not agree.

Mr. Cormac Butler: This is the problem with which we are faced. Sometimes the EBA and ECB have rules with regard to non-performing loans and so forth that are inconsistent with common sense. Under pillar 2, regulators are sometimes given facilities to correct those defects. We should look out for those opportunities.

Deputy Michael McGrath: With regard to the UK House of Commons committee report - and it is fair enough if the witnesses have already addressed this - do Mr. Butler or Mr. Bush agree with the recommendation to break up the big four auditing companies? What is their view on the view that the consulting businesses are being used as cash cows and should be separated from the overall companies?

Mr. Tim Bush: The UK House of Commons supports that view. That recommendation is being put into regulations for consultation by the Competition and Markets Authority. Most people who have an investment interest in a company would support the separation of the two functions so that auditors go back to what they should be doing, which is auditing for the shareholder, creditor and public interest. Consulting is something different. The future of audit inquiry is looking at it also because there is a school of thought that people do not find auditing an interesting career and they hear the message that the consulting side of a firm is more interesting and propping up the audit side. It is a relatively recent phenomenon to have that consultancy mindset and has corresponded with what is quite clearly a decline in standards in audits of company accounts. It has reached proportions where companies such as Carillion disappear overnight, even though the warning signs were there up to eight years ago.

Deputy Michael McGrath: Should that issue, the break-up of the big four, also be on the agenda in Ireland?

Mr. Tim Bush: Absolutely. The best indication of the effectiveness of the recommendations of the UK Parliament and the Competition and Markets Authority is the extent to which the big four are lobbying against them. They will start their sentences by saying they support some of the recommendations or that they welcome the report, but when it gets down to it, they do not like it. My understanding is one of the big four wants to seek a judicial review to challenge the split.

Deputy Michael McGrath: What is the advice of the delegates to the committee on what we should do? They made their opening statements and engaged on our questions. The committee can do further work in examining what is on the public record and the delegates have also agreed to send us further correspondence. Where do they suggest the committee go with all of this material and with whom should we engage? Should we engage with the Irish Auditing and Accounting Supervisory Authority, IAASA; the Office of the Director of Corporate Enforcement, ODCE; the prescribed accountancy bodies; the Central Bank and the Department of Finance? It is a technical area. We might have a reasonable understanding of it, but we need to engage expertise to tease it out properly.

Mr. Tim Bush: My first suggestion is that the committee try to compare notes with the politicians at Westminster on the committee who have come to a view on the issue. It is a cross-party view. It transcends political parties because they see the effect it has on the people they represent. The interesting thing is that much of the disinformation in this House and at Westminster is the same stuff that is being recirculated. However, the politicians have seen through it, as have members here. I would certainly compare notes. The other reason for doing so is we made an analysis of what we called the banking crisis in the United Kingdom and Ireland. Many do not realise Ulster Bank is under RBS and that Bank of Ireland does a great deal of business in Ulster, to the extent that it even issues bank notes in pounds in the North. HBOS had enormous loan holdings in the Republic. The banking systems in the United Kingdom and Ireland are amazingly intertwined; therefore, some communication between the two islands would be beneficial. Both are suffering from effectively the same disease.

Deputy Michael McGrath: Mr. Bush believes it would be a good step to engage with the committee at Westminster in the first instance.

Mr. Cormac Butler: The committee could do a second thing. I mentioned it previously, but I will repeat it. When representatives of the banks appear before the committee, members could ask them whether the report on the future of audit is correct, whether they agree with the judgment in AssetCo *v*. Grant Thornton and whether they agree with the George Bompas opinion. If they agree with all of them or if they raise no objections, they are of the view that it is not legal to delay the recognition of losses. Therefore, they will need to restate their published accounts.

Deputy Michael McGrath: How far back would they have to restate them?

Mr. Cormac Butler: It is automatic. Once they agree to the restatement, they will have to look at instances where they borrowed money from the ECB while they were insolvent and restate their capital. In theory, they would have tp go back to 2005, but there are much easier ways to deal with it. The first thing, however, is getting an admission that the published accounts might not be correct and then looking at the consequences. If the published accounts were not correct, it follows that the repayment of the promissory notes was not necessarily legal. It follows that the subsidies given to the vulture funds would come out into the open. Therefore, there is the question as to whether the vulture funds should have become involved in Irish operations. Regarding people who have suffered such as small business owners who have seen their businesses collapse, it will be obvious for what the assets were sold for whether the bank made a profit on those transactions. One will, therefore, be able to see the conflicts of interest.

Deputy Michael McGrath: Is Mr. Butler saying the banks should not have been given the emergency liquidity assistance by the euro system and the ECB because they were insolvent and had not been recognising the losses?

Mr. Cormac Butler: That is correct.

Deputy Michael McGrath: By extension, therefore, the promissory note cancellation could be challenged.

Mr. Cormac Butler: Yes. I will put it in plain English. In 2008, the banks were insolvent. The Central Bank had loaned money up to that point so it had suffered a loss at that point. What happened was that everybody said it was a liquidity crisis, not a solvency crisis, and they got the Government to put money into the banks. That money went to the ECB. What should have happened is the ECB should have said: "These banks are insolvent and need an equity injection, so once we put the money in we cannot take it out again". If that correct procedure had been carried out, the Government would not have been exposed to this huge liability. As a result, the repayments of the promissory note as they are taking place today are not cancelling the liability but effectively giving a present to the ECB.

Deputy Michael McGrath: What are the witnesses' views on the current regulatory architecture in Ireland for accounting and auditing? We have the Irish Auditing and Accounting Supervisory Authority, IAASA, which involves ministerial appointments and the prescribed accountancy bodies are represented on it as well. As I understand it, the role of IAASA is to oversee the regulation of the profession by the prescribed bodies. What are their views on that in the context of the EU's directive on audit regulation? What are their views on that structure? Is it working, is it deficient and what should change?

Mr. Tim Bush: The first thing that is anomalous is the extent to which the UK and Ireland were intertwined within the FRC structure. The objective of the FRC was to oversee the professions, despite the fact that in Ireland things operate on pre-1920s boundaries. The North and the South are treated as one and, therefore, the UK and Ireland are treated as one. There was the bizarre anomaly that the Auditing Practices Board, whose chairman is appointed by the Secretary of State in London, was issuing guidance on how to audit the Central Bank of Ireland. It is astonishing to see these pieces of paper coming from London telling auditors in another state how its central bank should be audited. It is quite remarkable. Some of that is being pulled out, but there are still anomalies whereby things happening in London are having a direct effect in Ireland without any real sense of accountability. One of the reasons I wrote to the late Brian Lenihan when I was on the urgent issues task force is that I was aware I was on a committee that was affecting two jurisdictions and I thought it was only right that I showed a degree of accountability to both states rather than just the one in which I happened to be born and lived.

Deputy Michael McGrath: Can Mr. Bush tell us and the people watching this meeting who is the regulator of the accountancy and auditing professions in Ireland, as he sees it?

Mr. Tim Bush: It is still, unfortunately, the accounting profession. The Institute of Chartered Accountants in Ireland sets the accounting standards by basically copying the outputs of the FRC. It franks them as Irish. There is also the IAASA and a body called the Office of the Director of Corporate Enforcement, which should be policing company law. That is quite a tough nut to crack given that there seem to be so many breaches of company law. What is needed is some architecture that delivers what is in company law.

Deputy Michael McGrath: Is Mr. Bush describing it as essentially self-regulated?

Mr. Tim Bush: It is, effectively, self-regulated.

Deputy Michael McGrath: It would dispute that, but that is Mr. Bush's interpretation.

Mr. Cormac Butler: I should add that the IAASA and the ODCE are on record as stating that their interpretation of the law is that banks can delay the recognition of losses under IAS 39. They cannot, therefore, operate as regulators. If that is their interpretation, they can only penalise bankers who are not following their interpretation of the law. This came up at the FRC. They have been accused of letting major disasters go unchecked. As they are on record as stating that banks are allowed to delay the recognition of losses they become ineffective as regulators. I will not go into the engineering as to whether there should be self-regulation, but if they hold this view they cannot operate as regulators. If they were told that the law says all losses must be recognised and, therefore, any banks that do not do so are penalised, they would be much more effective.

Chairman: Arising from the exchanges up to now, it is clear that we would like the banks to respond to this debate. We might send them the transcript of the meeting and ask for their response. With the support of members present, I invite the witnesses to set out the type of questions they believe we should ask the banks. They have done so in their evidence to the committee but they might formally put together the questions they believe are relevant for the past, present and future in order that we can be clear regarding what we need to ask. With the permission of the committee, we might consider whether we can invite the ODCE and regulatory bodies before the committee to respond to the transcript with which they will be provided, and we can take things from there. Is that agreed? Agreed.

Returning to the opening statement and exchanges, what did Mr. Butler and Mr. Bush think of the banking inquiry?

Mr. Cormac Butler: The banking inquiry was helpful in that bankers admitted that they concealed or delayed the recognition of losses. They said they were well aware of the problems with IAS 39 but went along with it. That part of the inquiry was very helpful as there was factual information and evidence, all of which was given under oath. The part of the inquiry I did not agree with were the witnesses who said that under law they were forced to delay the recognition of losses. It is now clear that if the IAS 39 standard is interpreted in that way, it is interpreted incorrectly. It was known all along by many people that one cannot fail to comply with company law if one thinks that an accounting standard says that one can go in another direction because the role of the accounting standard is to help people to comply with company law. One cannot rely on an accounting standard alone to justify the delayed recognition of losses. They have claimed that the law is there and that they are allowed to do so and that is incorrect. They say that we should not go back to the inquiry because everything has been done and conclusions drawn but it is very clear now that their conclusions on the delayed recognition of losses in terms of the law is incorrect.

Chairman: The conclusions of the banking inquiry, therefore, were incorrect, if, in fact, the banking inquiry drew conclusions, because they were basing it on incorrect information from banks and did not take that into consideration. Perhaps they could not have on issues that only came to light recently, in the last -----

Mr. Cormac Butler: No, it would have come to light. In 2010, as Mr. Bush will explain, he blew the whistle on the delayed recognition of losses. He got a legal opinion from Martin Moore QC who agreed that the recognition of losses cannot be delayed. The witnesses at the banking inquiry should have been aware that under company law, a company may never misrepresent its financial position. They told the committee that the law is that losses can be hidden.

Chairman: They were wrong about that.

Mr. Cormac Butler: Yes, they were definitely wrong.

Chairman: Did they mislead the inquiry?

Mr. Tim Bush: Yes, they misled the inquiry. The trick of these inquiries is to look at the evidence, not necessarily at the conclusion. The helpful part of the evidence is that they admitted that they were hiding losses; the unhelpful part is their interpretation of the law. Overall, they drew the wrong conclusion but there was a lot of evidence at the inquiry.

Chairman: Does Mr. Bush have a view on the banking inquiry?

Mr. Tim Bush: No, because I did not look at it in enough detail. My only observation is if they are told they there is a defective standard - and they effectively got to a point where they admitted it - hey always say that it is about to be changed or fixed but that never happens. They have not been as clear as they could have been, given the seriousness of the problem being looked at.

Chairman: They were hoodwinking us, basically.

Mr. Tim Bush: Basically, yes.

Chairman: Then we come to today's evidence. I am not an accountant. I have been in different small businesses all my life and it angers me greatly to hear the witnesses' account of things. While they might think it is technical and so on, it is easily understood. When people are robbed, they know they have been robbed. To be robbed over and over again is utterly incredible. The banks can hide their losses, they can get away without paying taxes, they can use vulture funds to do all sorts that they cannot do, and treat people badly and so on. Then there is the GRG issue where businesses were destroyed which should not have been. That is essentially what Mr. Butler and Mr. Bush are saying. Mr. Butler, in particular, has set out in stark terms the wrongdoings of the State and the banks on all these issues, and he stands over everything he says. I presume that Mr. Bush does likewise. If only half of this is true, it begs some sort of intervention from the State, from the Government. Do they agree?

Mr. Cormac Butler: Yes.

Chairman: We are paying back a debt that we should not be paying back.

Mr. Cormac Butler: Yes, in my view, we are paying back a debt that we should not be paying back.

Chairman: And we are imposing austerity on people in the pursuit of repayment of that debt that we should not do.

Mr. Cormac Butler: That is correct. For small businesses which have suffered, there is always the argument that if there was a wrongdoing, they can take the bank to court but, as Anthony Stansfeld, a police commissioner in the UK has said, that option is not open to them because the banks with always out-lawyer the individuals.

Chairman: It is certainly not an option in the Irish courts anyway.

Mr. Cormac Butler: No, it is not.

Chairman: They seem to have a particular view of the banks. We are not supposed to comment on the courts but that is my view.

Mr. Butler and Mr. Bush will provide us with the information and perhaps a roadmap as to what direction the committee should take. Is the letter they sent to the late Deputy Brian Lenihan something the committee should have?

Mr. Tim Bush: I will find that. I will see if I can also find the response.

Chairman: Yes. We might be looking back but I am afraid that we have to learn. The other issue is that we are paying for it still.

The committee is aware of most of what Mr. Butler has been saying in the context of the general thrust of his submission, and similarly with Mr. Bush. We should meet the committee in the UK and see if we can perhaps further a joint approach.

I will finish on a general question. When auditing the books of banks, businesses or anything else, is there an obligation on the auditors to tell the truth?

Mr. Cormac Butler: Yes, it is known as the true and fair concept.

Chairman: Yes, it is not just as the auditor sees it.

Mr. Cormac Butler: An auditor cannot follow a pattern or checklist; he or she must make sure that the financial position of the bank is correctly portrayed.

Chairman: They too were wrong.

Mr. Cormac Butler: They too were wrong, yes.

Chairman: Does Mr. Butler stand over that?

Mr. Cormac Butler: I stand over that.

Chairman: Will Mr. Butler and Mr. Bush return before the committee if required?

Mr. Cormac Butler: Yes.

Mr. Tim Bush: Yes.

Chairman: They have done a wonderful job of presenting the overall story. It is up to the political system to respond to what they have said. I am repeating myself but to get clarity, the transcript needs to be sent to the banks, the Minister and the accounting bodies for their response, and then the committee will take the further action on which it is generally agreed, and which we will discuss further to finalise. Is that agreed? Agreed.

I thank Mr. Butler and Mr. Bush for attending.

The joint committee adjourned at 3.30 p.m. until 10 a.m. on Thursday, 30 May 2019.