Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach

An Comhchoiste um Airgeadas, Caiteachas Poiblí agus Athchóiriú, agus an Taoiseach

Opening Statement – Cormac Butler 1.30pm 28th May 2019

Thank you for inviting us here to speak about the banking sector, its impact on Ireland's housing crisis, and the role of vulture funds.

For twenty years I have advised on financial institution risk in London and globally. I wrote books on risk measurement and financial instrument accounting and trained over 100 Central Bank regulators globally. I gave evidence to two UK House of Commons inquiries.

I am joined by Tim Bush a former member of the Urgent Issues Task Force 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 do 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 won't – instead we could have bigger problems.

Amongst the problems created are:

- **Subsidies to vulture funds -** Some banks claim they profited from loan sales to vulture funds. This is extremely unlikely. Thanks to flawed accounting standards, banks can bury loan write downs into reserves and therefore record an artificial accounting profit. These transactions are potentially illegal if the true subsidy is concealed. The matter was covered in an article *Questions Raised over €1.1 billion loan sale*[i] on 4th November last year by the Financial Times.

- **Insurance against past losses -** Irish banks were not solvent on the night of the September 2008 guarantee. Unlike the Irish government, the ECB was aware of this yet insisted that the Irish government should pay for these hidden losses Under EU law, the Irish government is not liable – indeed the cancellation of the Promissory Notes may be illegal.

- **Liquidity difficulties -** 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 -** One UK bank with operations in Ireland may have pushed small but healthy businesses into liquidation by calling in loans unnecessarily. A group of small business owners gave evidence to you on this. This was partly motivated through flawed bank bonuses and incentive schemes. The UK Thames Valley Police Commissioner Anthony Stansfeld has publicly expressed concern at similar practices in the UK and claims that the problem is widespread, advising those affected to read the Project Turnbull report which was produced by a bank whistle-blower.

- **Abuse of company law -** A few 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 off into another company and were unpaid – contrary to the spirit of company law.

- **Pension/Reputation -** In the UK the recent collapse of London Capital & Finance, Patisserie Valerie and Carillion caused havoc for those in private sector pensions. UK politician Kevin Holinrake MP has asked for an inquiry into compensating investors.

- **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.

- **Subsidised loans -** The accounting profession may have exploited accounting standards to conceal subsidies given to developers – a matter that Deputy Catherine Murphy attempted to investigate. There is the risk that IBRC exploited the accounting standards when measuring these subsidies

The Solution

In April, a House of Commons Report titled *The Future of Audit* has concluded that banks concealing losses are potentially breaking the law and that advice by the various accounting bodies, including a legal opinion which they commissioned is incorrect. Under the Capital Maintenance rules, banks are not allowed to pay dividends out of capital (Ponzi schemes). A 2019 case Assetco v Grant Thorton also confirms this.

Tim Bush presented this in 2010 at a House of Lords Inquiry and has, on behalf of the UK Local Authority Pension Funds Forum (LAPFF) obtained a legal opinion from George Bompas QC which set out the law in a way such that some witness statements given to the Irish bank inquiry were incorrect. A 2019 case in the UK High Court *Assetco v Grant Thornton* also confirms this interpretation of the law

When bankers appear before your committee in the future, we would strongly suggest that you ask them to restate their published accounts in order to comply with the law. If they do, banks will have to reveal that they were insolvent at the time of the guarantee and therefore the ECB loans will have to be reclassified as capital. This would automatically resolve the legality surrounding the repayment of Promissory Notes and more importantly, would 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 they fail to do so, they will have to come up with a legal opinion confirming that the UK House of Commons Report is wrong, as is the recent admission by the 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.

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[i] https://www.ft.com/content/841a4538-dea7-11e8-9f04-38d397e6661c