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**AN EXPLORATION OF THE NEW CODE OF CORPORATE
GOVERNANCE FOR CREDIT INSTITUTIONS AND INSURANCE
UNDERTAKINGS IN IRELAND**

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ABSTRACT

In late 2010 the Central Bank of Ireland issued codes of corporate governance for credit institutions and insurance undertakings. This marked a significant development in corporate governance in Ireland being the only country in the EU that did not have its own codes of corporate governance for credit institutions and insurance undertakings. This research has four main areas of investigation. Firstly it assesses the corporate governance of banks in Ireland before the introduction of the new codes. Secondly in light of the financial crisis, it analyses the corporate governance disclosures in annual reports from 2005-2011 to assess how well the banks complied with the previous codes on paper and in practice. Thirdly it analyses the level of compliance with the new code since January 1st 2011. Fourthly it compares the new codes of corporate governance with practices in other countries. The main method used to investigate the research topic is secondary data analysis. This is complemented by primary research involving structured interviews. The findings show serious breaches of corporate governance within banks led to the financial crisis and the annual reports were not were not a true reflection of the governance practices. The research finds faults with the Irish code and makes suggestions for further development.

DEDICATION

For my Mother

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1 INTRODUCTION

1.1 Background and Context

The failure of corporate governance in the banking sector has been cited as one of the causes of the financial crisis Nyberg (2011), Regling & Watson (2010) Honohan (2010) This stemmed from poor risk management within banks and a disregard for basic sound principles of lending practice Nyberg (2011) Honohan (2010) Poor governance was not confined to the banks, reports by Nyberg (2011), Regling & Watson (2010) Honohan (2010) have found that both the Financial Regulator and Central Bank failed to foresee or prevent the financial crisis from occurring

1.2 Research Rationale

Ireland was significantly affected by the financial crisis The main causes of this collapse arose from serious breaches of corporate governance Honohan (2010) The area of corporate governance has received much debate in light of the financial crisis and the purpose of this research will be to explore the breaches of governance and the reforms that have been introduced in Ireland Reforms in the area of corporate governance have been introduced with the aim of strengthening the rules to which credit institutions and insurance undertakings adhere to This significant change warrants investigation

The originality of this research will be that it is one of the first papers to conduct an in-depth investigation into the corporate governance codes now in place At the time of writing there is a lack of published critical analysis concerning this matter A gap exists

in the corporate governance literature where the impact of the new code of corporate governance introduced by the Central Bank of Ireland for financial institutions and insurance undertakings has been explored. Currently Ireland is experiencing great change in the area of corporate governance so it is hoped that the research carried out will contribute knowledge and provide information to interest groups and future researchers who wish to study corporate governance.

1.3 Research Objective

The aim of the research is to explore the significant changes in corporate governance arising from the collapse of the financial sector. The financial crisis has brought about a new code of governance for credit institutions and insurance undertakings as set out by the Central Bank of Ireland (2010). The research will establish the reasons for the introduction of the new code of corporate governance for financial institutions and insurance undertaking. This research will explore corporate governance practices pre-crisis and the new codes both through secondary research and empirical methods. The annual reports from 2005 to 2011 from three Irish banking institutions will be analysed using a framework and the quality of the disclosures will be assessed. The findings of reports into the Irish crisis will also be part of the secondary research. Interviews will be conducted with selected personnel from banking institutions examining the area of corporate governance. The research should further the ongoing debate in relation to the changes that have come about as a result of the financial crisis and their impact on the financial sector both at home and abroad.

A review of the code and an examination of previous codes of governance will form part of the research. Comparisons between the UK code of governance and the Irish code will be conducted. Areas such as board structure, risk management, impact on shareholders will be examined. Key to the success of the code will be implementation and strict regulations. The research will explore how this will be carried out. This dissertation will give an overall sense of whether the Irish financial sector will benefit from new governance code and where the code places Ireland internationally.

In addition the research will review the Central Bank of Ireland's Fit and Proper Regime which applies to the recruitment of staff for senior positions and conditions that staff must satisfy to perform functions assigned to them.

1.4 Research Questions

This dissertation is an exploration of the new code of corporate governance for credit institutions and insurance undertakings in Ireland. The study will focus on the following banking institutions each representing three different types of banking organisations in Ireland:

- Bank of Ireland (retail bank)
- EBS (building society)
- Anglo (commercial bank)

The research has four main areas of investigation as follows:

- Assess the corporate governance of banks in Ireland before the introduction of the new code

- Analyse the corporate governance information in annual reports from 2005-2011 to assess how well the banks complied with the previous codes on paper and in practice
- Analyse the level of compliance with the new code since January 1st 2011
- Compare the new codes of corporate governance with other codes

Sir David Walker, a Senior Adviser to US bank Morgan Stanley and former Executive Director of the Bank of England, published an independent Review of Corporate Governance of UK Banking Industry in November 2009. Walker's review (Walker, 2009) recommended extensive reforms to strengthen bank governance and increased disclosure on pay. This content is maintained by the Walker review (Walker, 2009) which will be examined as part of this research. The original Terms of Reference for Walker's review were to examine corporate governance in the UK banking industry and make recommendations (Walker, 2009). The areas of investigation in the report will be used in this research examining the following areas:

- The effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively,
- The balance of skills, experience and independence required on the boards of banking institutions,
- The effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees,
- The role of institutional shareholders in engaging effectively with companies and monitoring of boards, and

- Whether the Irish approach is consistent with international practice and how national and international best practice can be promulgated
- Which parts of the Code have worked well? Do any of them need further reinforcement?
- Have any parts of the Code inadvertently reduced the effectiveness of the board?
- Are there any aspects of good governance practice not currently addressed by the Code or its related guidance that should be?
- What will be the impact of these codes in Ireland and abroad?

1.5 Summary of Findings

The research found failures in governance practices within banks, supervision by the Central Bank and the Financial Regulator, and government policy. Prior to the introduction of the new code banks adhered to the UK code of corporate governance. The corporate governance disclosures in the annual reports generally adhered to this code, however in practice there were serious breaches of corporate governance. Evidence of the agency theory problem is reflected in board practices. Directors are found to be in breach of their duties of care and fiduciary duties as set out in Companies Act. Comparison with the UK code shows a number of weaknesses in the Irish code. Interviews confirm much of the findings of the secondary research and suggestions are made on how to improve implementation of the Irish code.

2 LITERATURE REVIEW

2.1 Introduction

The financial crisis and the resulting turmoil that financial institutions experienced triggered the provision of unprecedented government support to banks and some insurance companies. This outcome has highlighted the importance of aligning good corporate governance with good regulation. The literature review will begin with an examination of the financial crisis with particular concentration on Ireland's experience. A discussion on banks and the laws and regulation they are bound by will follow. Next, the central bank, financial regulator and the department of finance roles in the supervision of banks will be reviewed. This will lead onto corporate governance theory, past and present practices in Ireland and practices in other countries. The literature review will finish with a discussion on corporate governance enforcement.

2.2 Financial Crisis

To understand the financial crisis it is necessary to look first at the causes. Three reports were commissioned by the then Minister for Finance to investigate the causes of the Irish financial crisis. The report of Klaus Regling and Max Watson (2010) deals with macroeconomic developments internationally and in Ireland, as well as monetary and fiscal policies in the period leading up to the crisis. The report by Governor Patrick Honohan (2010) concentrates on the role of the authorities (the Financial Regulator and the Central Bank) in relation to regulatory and financial stability policy prior to the crisis as well as the events leading up to and surrounding the Government Guarantee decision of September 29, 2008. Both of these reports noted the need to understand the failures in the management and operations of Irish Credit Institutions which led to the

crisis. The Honohan report (2010) also suggested that the role of audit and accounting bodies was worthy of investigation. Both reports agree on the failure of the Financial Regulator and the central bank to foresee or prevent the crisis. It was unclear to the authors what the Financial Regulator knew, and when, and why the supervisory response was not more forceful. The Honohan (2010) report furthers this emphasising the way in which the principles-based approach to regulation was implemented. It also notes and discusses the modest policy activity of the central bank despite its responsibility to promote the overall stability of the Irish Financial system. The reports also indicate financial institutions did not adhere to sound practices. The report by Peter Nyberg (2011) provides answers on why a number of institutions, both private and public, acted in an imprudent or ineffective manner, thereby contributing to the occurrences of the Irish banking crisis. Another study states that the reason why some banks fail and others survive in distressed economic conditions is primarily the product of individual corporate governance practise within financial institutions in particular in relation to risk management and internal controls (O' Sullivan & Kinsella, 2011)

2.2.1 The Macro Economic Background

In 2008, Ireland experienced its worst financial crisis to date. While the crisis was not unique to Ireland at that time, the rapidness and severity of Irelands crisis was not seen in many other countries (O' Sullivan & Kennedy, 2010). The macroeconomic conditions contributed to a systematic failure of the banking system. Government's macroeconomic and budgetary policies were deemed to have lead to economic overheating and an unsustainable reliance on the construction sector (Honohan, 2010)

2 2 2 Celtic Tiger

From 1997 during the Celtic Tiger phase of the economy there was unprecedented growth. This saw a large inflow of foreign credit, huge increase in domestic demand and high levels of service exports (O' Sullivan & Kennedy, 2010). The Irish government pursued a neo-liberal and market orientated agenda promoting deregulation, privatisation and the propagation of 'pro-business' policies particularly in the private sector (O' Sullivan & Kennedy, 2010). It also reduced tax rates considerably and introduced tax incentives to stimulate home ownership, resulting in a significantly reduced tax intake relative to other European economies (O' Sullivan & Kennedy, 2010). According to Minsky's five phase credit cycle model, this economic phase is known as displacement (Minsky, 1986).

2 2 3 The Emergence of a Property Bubble

From 1992-2002 there was a sharp increase in investment in the domestic property sector. An increase in population, historically low interest rates and expansive fiscal regime contributed to the property boom becoming a bubble (O' Sullivan & Kennedy, 2010). Anglo Irish bank started developing and embedding relationships with key property developers in Ireland by loosening the terms associated with its credit application process (Nyberg, 2011). Minsky likens this stage of events in an economy to a boom phase in his credit cycle model (Minsky, 1986).

The euphoria stage of the economic cycle (Minsky, 1986) came in 2002 when the European Central Bank pursued a strategy of low interest rates designed to stimulate activity in the German and French economies (O' Sullivan & Kennedy, 2010). This resulted in some peripheral economies, like Spain and Ireland being subject to

historically low interest rates from 2000-2007. This had a dramatic effect on inflating property prices as interest rates were much too low. Perceptions of stability conferred by euro membership allowed Irish banks to borrow at more favourable interest rates in the wholesale inter-bank markets than otherwise had been the case (Nelson, et al., 2010). With continued growth in property lending, banks' deposit base could not keep pace with this growth in lending and the bank's increasingly relied on external funds from the interbank market to finance this expansion. The loan-to-deposit ratio in the Irish banking system grew from 1.19 in 2003 to 1.77 in 2007, one of the highest in the euro zone (O'Sullivan, 2010). Anglo was at the forefront of this surge in lending, approximately two-thirds of its lending was in property developments, a tenth in private and business lending with the remaining associated with land developments (PricewaterhouseCoopers, 2009). Anglo had 15 customers with loans in excess of €500 million and close to one-third of the bank's loan book was lent to just 20 customers (PricewaterhouseCoopers, 2009). Anglo's profits peaked in 2007 to over €1.2 billion (Anglo Irish Bank, 2008). It had a 36 percent annual growth rate which according to Honohan was unsustainable and a warning sign of unacceptable risk exposure, enhancing the probability of credit quality deterioration (Honohan, 2009).

From 2003, the Irish property market which Anglo was so heavily involved in was overvalued (IMF, 2006). The link between asset prices and its fundamental value became detached. Warnings were ignored by Anglo, and it continued to finance property developments, almost doubling its loan book between 2005 and 2007 (Anglo Irish Bank, 2006) (Anglo Irish Bank, 2008). The bank believed that 'the fundamentals'

in the Irish and UK economies were 'sound' and its borrowers were well 'capitalised' with 'robust cash flows' (Anglo Irish Bank, 2008)

The panic phase of Minisky's (1986) credit cycle can be seen in early 2008 following a decline in property prices (Honohan, 2009) This contributed to a contraction in GDP of 7.25 % in 2009 (PricewaterhouseCoopers, 2009) Since 2008, prospective buyers had been holding off their purchases, instead waiting for prices to reach the lowest point Property developers were finding it hard to meet their debt obligations As a result, Anglo Irish bank saw a significant increase in credit defaults, impairments and bad-charges and confidence in the banking system was under threat

2.2.4 Lehman Brothers

The collapse of Lehman Brothers in mid September 2008 saw money markets, a critical element of short-term finance, stop rolling over and interbank interest rates soared (Jones, 2010) A liquidity crisis ensued, which hit Anglo hard given its illiquid asset base and small deposit base Investor confidence diminished which led to a loss of €5.4 billion in deposits in one week alone (PricewaterhouseCoopers, 2009)

In the aftermath of Lehman Brothers' bankruptcy, this reliance on short-term wholesale funds served to undermine liquidity conditions, leading to the government guaranteeing all deposits and other liabilities (Nyberg, 2011) In the months that followed the deposit guarantee, banks' property related exposures were revealed, eventually resulting in the creation of the National Asset Management Agency, or NAMA, which has issued €40 billion in government-guaranteed bonds in return for loans with a face value of roughly double that amount (Honohan, 2010)

In Ireland the Anglo debacle represented a serious failure in governance procedures and raised questions on whether non-executive directors were able to exercise independent and effective judgement particularly in relation to risk management procedures. So far, the government has been forced to issue a guarantee scheme, recapitalise Bank of Ireland and AIB, nationalise Anglo Irish Bank and establish NAMA, to cleanse the banks of its non-performing assets (Kostyuk, et al, 2010). A failure by both Anglo and the regulator to manage their risk responsibilities makes a strong case for introducing new measures in corporate governance procedures in the country.

2.2.5 Crisis Management

2.2.5.1 Crisis Prevention

Failures were not confined to Anglo Irish Bank. They arose from weak risk management, including poor credit appraisal and the overriding of internal guidelines and processes that should have prevented the concentration of credit risk exposure in property (Honohan, 2010). There was a lack of adherence to internal controls that should have warned management of concentrated credit growth (Nyberg, 2011). This kind of weakness in governance was detected by financial authorities and institutions were warned of the need to improve corporate governance and indeed the need for stronger checks and balances on management in some cases (Nyberg, 2011). However, this supervisory reaction was much too weak, and this was a key problem in the run-up to the banking crisis. It found that draft guidelines on corporate governance and on directors' compliance statements were tabled as initiatives but never brought to fruition (Regling & Watson, 2010).

Senior management insight in the regulatory authority could have overridden systems, if needed, to prioritise the documentation of such system-wide concentrations of lending to individual or connected borrowers. What is clear is that the failure to identify, recognise the gravity of, and take tough remedial action to correct such serious governance breaches was a grave error of supervision during this period (Regling & Watson, 2010)

2.2.6 The Reasons for the Introduction of the New Code

Corporate governance regulation forces organisations to adopt better standards of internal governance which results in better risk management strategies for firms (Becht, et al, 2005). Since 2000, companies on the Irish stock Exchange have been required to report on how they applied the UK Combined Code of Corporate Governance in their annual reports, justifying any instance of non-compliance to their shareholders (Financial Reporting Council, 2003). From 2003 the financial regulator adopted a principles-based approach to regulations. While international factors contributed to the banking crisis, many contributory factors were home-made. Both the Honohan report and the report by Messrs, Regling and Watson support this view. Home-made elements included fiscal policy, weak bank governance and risk management, the response of supervisors to the build-up of risks and the absence of forceful warnings on financial stability risks (Central Bank & Financial Services Authority of Ireland, 2010)

Evidence shows serious breaches of basic governance principles concerning identifiable transactions that went far beyond any question of poor credit assessment. The Government's notice on the nationalisation of Anglo Irish Bank, for example, refers to

“unacceptable corporate governance practices” as a triggering factor in the nationalisation (Regling & Watson, 2010) The failings of corporate governance seem to have been much more a problem of deficient implementation than defective guidelines and processes (Regling & Watson, 2010) With internal governance structure such as boards, credit committees, audit committees and external auditors, any systematic problems of this kind in an institution should have come to their attention (Nyberg, 2011) Furthermore, liquidity management and funding policy was in some cases not prudent or conservative, even by the global and euro area standards of the past decade (Regling & Watson, 2010)

Strengthening the corporate governance framework for credit institutions is a priority given that both domestically and internationally corporate governance failings have been identified as one of the causes of the financial crisis These failings brought about the introduction of codes on both corporate and internal governance together with a statutory basis for fitness and probity reviews (Central Bank & Financial Services Authority of Ireland, 2010)

2.3 Banks

2.3.1 Governance and Procedures

The main issues with governance in the Irish banks as found by (Nyberg, 2011) was that structures and controls that had been put in place were relaxed to allow increased growth Managers and the board had poor oversight of consolidation and categorisation of lending which resulted in an incomplete picture of the total and type of property

exposures (Nyberg, 2011) This seems to have been compounded by a collegiate and consensual style among the boards with little serious challenge or debate Problems found in board composition point to an inability of Non-Executive Directors (NED) to carry out their responsibilities due to a basic lack of banking knowledge and expertise that was necessary to assess the lending and funding risks being taken by the banks (Honohan, 2010) The Non Executive Directors while formally independent were in practice, highly reliant on the knowledge, openness and ability of bank management (Nyberg, 2011) There was a belief amongst NED's and senior management that formal policies, structures and procedures were enough for the prudent management of banks For example the introduction of Basel II (Basel Committee on Banking Supervision, 2006) , a more sophisticated model, led to many of the basics being neglected It appears that senior management and boards did not appreciate how general growth targets affected operations lower down in the organisation (Nyberg, 2011)

2 3 2 Structure of the Irish Banking System

2 3 2 1 The Role of the Banks

From 2003 onwards, banks relaxed their credit conditions to compete with new entrants driving the demand for financing packages such as 100% mortgages (Regling & Watson, 2010) Competition in the commercial property lending market also intensified which led to a credit-induced growth in the property sector

2 3 2 2 Market Shares Threatened

Competitive pressure on the leading banks to protect their market share was driven especially by the rapid expansion of one bank, Anglo Irish (whose market share soared

from 3 per cent to 18 per cent in a decade, growing its loan portfolio at an annual average rate of 36 per cent) (Nyberg, 2011)

2.3.2.3 Business Model and Strategy

In response to increased competition and pressure for increased earnings, banks set aggressive targets for profit growth (Regling & Watson, 2010). In many cases, this drive for growth implied a partial change in business model and strategy without the corresponding necessary strengthening of governance, procedures and practices (Nyberg, 2011). Banks' increased exposure seems not to have been realised, and increasing capital buffers to protect against a possible property crash were not put into action (Honohan, 2010). Comfort in lending activities was taken from peer bank practices and the lack of concern among authorities (Nyberg, 2011).

2.4 The Banking Law and Regulation

In Ireland, the statutory corporate governance responsibilities under the Companies Acts 1963 – 2009 (Office of the Attorney General, 2009) are complemented by other regulatory frameworks including the Listing Rules of the Irish Stock Exchange which adopts the Financial Reporting Council's (FRC) (Financial Reporting Council, 2010) Combined Code of Corporate Governance on a comply or explain basis. The evolution of Irish corporate governance is largely based on historical links to the United Kingdom, Ireland's membership of the European Union, initiatives by expert practitioners and industry groups, such as the Company Law Review Group and most recently event-driven developments directly sponsored by the State (Kostyuk, et al., 2010).

Ireland's corporate governance system is historically an Anglo-American model, a view that focuses on maximising shareholder value to the extent that conflicts can arise with other constituencies (Macey & O' Hara, 2003) Shareholders have the right to vote at general meetings and elect directors, who manage the company on their behalf and report back on their stewardship at shareholder meetings, at which they can either be re-elected as directors or dismissed (Kostyuk, et al , 2010) Irish companies, including Irish banks, universally adhere to a unitary board system however Irish company law does not exclude a two-tier approach (Kostyuk, et al , 2010) Interestingly, the terms and conditions of Irish Credit Institutions (Financial Support) Scheme (Department of Finance, 2008) allow the Minister of Finance to (a) appoint observers who have the right to attend all meetings and have access to all relevant information and (b) establish an independent committee to oversee all remuneration plans of senior executives of covered institutions (Kostyuk, et al , 2010) While this does not reflect the two-tier system common in continental Europe, it may provide some of the benefits of such a system to covered institutions in Ireland (Kostyuk, et al , 2010)

Boards of public limited companies and major companies in Ireland, including banks, typically comprise both executive and non-executive directors While they may have different functions within a bank, all directors of financial services companies have the same responsibilities under law and must meet standards of competence and probity required by the Financial Regulator (Honohan, 2010) In terms of fiduciary duties, the basic Irish legal framework is not dissimilar to that which existed in the United Kingdom prior to the introduction of the UK Companies Act 2006 (Department of Trade and Industry, 2006) Courts apply two broad principles against which to assess

the conduct of directors Duty of care and skill and fiduciary duty Directors owe a duty to act honestly, with a reasonable degree of skill, care and diligence In addition, certain fiduciary duties are imposed on directors as a result of their relationship of trust with the company (Jenson & Meckling, 1976) These include, a duty to act *bona fide* in the best interests of the company, a duty to exercise their powers for their proper purpose and not for any improper motive, a duty to avoid fettering their discretion, a duty not to make a profit from corporate information or corporate opportunities and a duty to try to avoid *conflict of interest situations* (Jenson & Meckling, 1976) Additional duties are owed by directors to a company when the company is insolvent The UK Companies Act 2006 (Department of Trade and Industry, 2006) provides an updated definition of the duty of a director and provides greater guidance on how directors are expected to carry their duties including a wider appreciation of stakeholders other than shareholders e.g employees, suppliers, customers and the community While Companies Bill in Ireland (Department of Enterprise, Trade and Innovation, 2011) provides a statutory basis for directors' fiduciary duties, these duties are not as extensive as those in the UK Act (Department of Trade and Industry, 2006) in terms of stakeholders Instead they are stated in general rather than specific terms and the Company Law Review Group (Company Law Review Group, 2005) have noted that since they are derived from principles established by the courts, they are not intended to be exhaustive

Irish company law provision for audit requirements includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the

company's circumstances, consistently applied and adequately disclosed (Department of Enterprise, Trade and Innovation, 2011)

The Central Bank and Financial Services Authority of Ireland Act 2004 (Department of Finance, 2004) introduced additional accountability requirements for financial service providers with a view to promoting the highest standards of corporate compliance. It requires auditors to make an annual positive statement that they have not encountered in their review of the companies' finances anything that would trigger a duty, under existing legislation, to report to the Financial Regulator (Department of Finance, 2004). The Act imposes an obligation on financial services providers to present the Financial Regulator with a compliance statement, when required to do so (Department of Finance, 2004). The Financial Regulator, as an alternative to Court proceedings, is authorized to impose sanctions directly on financial institutions found to be in breach of legislative requirements (Department of Finance, 2004).

Restrictions and disclosure requirements are imposed under the Companies Acts in relation to contracts of employment, substantial property transactions, share options, loans/quasi-loans and guarantees to director and connected persons (Department of Enterprise, Trade and Innovation, 2011).

Recently, the Companies (Amendment) Act 2009 (Office of the Attorney General, 2009) amended sections 41 and 42 of the Companies Act 1990 to require licensed banks to disclose (a) separately all loans to each individual director in their annual accounts and (b) an aggregate outstanding amount of any relevant transactions with —connected

persons to directors which are above the *de minimis* thresholds, and which are not entered in the ordinary course of business and on normal commercial terms. The Companies (Amendment) Act 2009 (Office of the Attorney General, 2009) imposes automatic liability on every officer of a company for offences in relation to prohibited loans to directors. In 2010 the European Communities (Directive 2006/46/EC) (Amendment) Regulations 2010 (Department Enterprise, Trade and Employment, 2010) was implemented stating the corporate governance statement shall be included as a specific section of the report of the directors the corporate governance code. The company is required to state all relevant information concerning corporate governance practices applied in respect of the company which are additional to any statutory requirement, and where the information on such corporate governance practices is available for inspection by the public (Department Enterprise, Trade and Employment, 2010). A corporate governance statement must be included in the report by the directors of that company under section 158 of the principal Act including a description of the main features of the internal control and risk management systems.

Where the company departs, in accordance with any statutory provision, from a corporate governance code an explanation by the company as to which parts of the corporate governance code it departs from in accordance with the statutory provision and the extent to which it departs from such code and reason for such departure (Department Enterprise, Trade and Employment, 2010). Where the company has decided not to apply any provisions of a corporate governance code, the company shall explain its reasons for doing so (Department Enterprise, Trade and Employment, 2010).

2 5 Public Authorities

The questions posed by the literature include why did the Central Bank the Financial Regulator and the Department Of Finance facilitate banks unsound practices and why were issues not detected earlier and finally when issues were identified why was the policy response so modest (Honohan, 2010) (Regling & Watson, 2010) (Nyberg, 2011)

2 5 1 The Central Bank

The Central Bank was charged with the responsibility of contributing to overall financial stability and directing the Financial Regulator. According to Patrick Honohan, Governor of the Central Bank of Ireland a key weakness of Ireland's pre-crisis model of regulation was the supervisory architecture (Honohan, 2010) Ireland's financial regulator was housed within the central bank but as a separate entity (Honohan, 2010) According to Honohan, the structure fostered confusion and led to a lack of communication between central bankers, charged with maintaining financial stability, and regulators more concerned with monitoring individual firms (Honohan, 2010) In a move to rectify the problem the Central introduced three Reform Bills (Central Bank of Ireland, 2010) the first of which saw the central bank absorb the regulator (Honohan, 2010)

There was a major domestic policy failure at the Central Bank in respect of the maintenance of financial stability (Regling & Watson, 2010) Not only did the Central Bank underestimate the nature and extent of the risks in the Irish financial system but its warnings to credit institutions lacked the required enforcement (Regling & Watson,

2010) If the Central issued stronger warnings (at least confidentially to the Government) or even take appropriate action it may have prevented the escalation of the financial crisis (Regling & Watson, 2010) The Central Bank chose to rely on the Financial Regulator appropriately handling individual bank stability issues, much as the Financial Regulator in turn chose to trust bank leadership (Nyberg, 2011)

2.5.2 The Financial Regulator

The Financial Regulator was responsible for the micro prudential supervision of individual banks as well as other financial service providers (Regling & Watson, 2010) Many have pointed to the failure of the regulator to manage their risk management responsibilities (Nyberg, 2011) (O' Sullivan & Kinsella, 2011) Provided the appropriate structures and processes were in place, the Financial Regulator's approach was to trust bank leadership to make proper and prudent decisions as it was a principles based approach to regulation (Regling & Watson, 2010) However, even when problems were identified and remarked upon, the Financial Regulator did not subsequently ensure that sufficient corrective action was taken (Regling & Watson, 2010) Similarly, the rapid and concentrated lending growth in Anglo, and later in other banks, did not lead to regulatory action, with reliance being placed on management assurances that all was basically well (Regling & Watson, 2010) The Financial Regulator continued to accept these assurances, even after the Guarantee decision in late 2008 (Regling & Watson, 2010)

2.5.3 The Department of Finance

The Department of Finance was responsible for advising the Government on relevant economic and fiscal policy based, *inter alia*, on the findings of the Central bank and financial regulator (Nyberg, 2011). Findings show that the Department was failed to assess to implication of economic policies, had it taken corrective policy action to counteract some of the factors contributing to the various risks to the economy it may have limited the extent of the crisis (Nyberg, 2011).

2.5.4 Role of authorities

The core policy challenge of the authorities was to recognise early warning signs, within banks and the economy, in time to take pre-emptive action and mitigate any potential threats to financial stability. Specifying exactly when such risks should reasonably have been detected by the Central Bank and Financial Regulator is difficult. However, when confronted with the information that was available to these authorities throughout the 2003-2009, it is safe to say that vigilant authorities should have been much more concerned by the end of 2005 (Regling & Watson, 2010) (Nyberg, 2011). By this stage, not only were there numerous signals that pointed to the development of unsustainable macroeconomic and financial imbalances in the economy, but the risks being taken by the Irish banks had increased markedly as well (Regling & Watson, 2010). Clearly the three key public authorities did not intervene effectively (Levine, 2010) (Nyberg, 2011)

2.6 Governance of Bank Supervision

It was not a lack of regulations but poor enforcement by banking supervisors that contributed to the crisis (Levine, 2010) with governance failings being found not only in

the banks but also in the authorities responsible for supervising them. Permanently improving financial stability therefore should perhaps, instead, be done in ways that do not necessarily demand the unfailing attention, prescience or vigilance of ministries, central banks or regulators (Nyberg, 2011). According to Parker (Parker, 2002) a collaborative form of regulation called meta-regulation could improve regulation of the banking system. Meta-regulation is defined as the 'regulation of self-regulation'. This type of regulating authority moves from monitoring individual risks at firm-level to evaluating the firm's risk-management system (Parker, 2002). The objective is to improve the self-monitoring capacity of entities by monitoring and evaluating their self-regulatory techniques (Parker, 2002). The regulator ceases to be concerned about direct controls and proscribing the behaviour of firms and but rather encourages firms have in place 'processes and management systems which are then scrutinised by regulators or corporate auditors' (Gunningham & Grabosky, 1998). Monitoring of compliance at the organisation is undertaken in three layers: at operational level in the work place, next, by the directors of the company, and, finally, by the regulator itself (Parker, 2002). In financial services regulators have had a quasi-meta-risk regulatory responsibility since the introduction of the Basel II (Basel Committee on Banking Supervision, 2006). Under this framework, banks were free to impose their own minimum capital requirements based on their risk management systems and subject to continual monitoring by the regulator of these risk management systems (Basel Committee on Banking Supervision, 2006). However the Irish Banking crisis and the subsequent liquidity problems it is clear evidence that IFSRA failed in this regard (O' Sullivan & Kinsella, 2011).

Effective regulatory regimes rest on the quality of the banks' risk management systems and internal controls together with the regulators ability to evaluate these systems effectively (IFSRA, 2006) Critics argue that the most effective way the regulator can reduce risks in its industry and buffer bank's risk management practices is by shifting its regulatory philosophy toward meta-risk regulation (O' Sullivan & Kinsella, 2011)

2 6 1 A New Structure of Banking Supervision

To deliver on the objectives set out in the Central Bank Reform Bill 2010 (Central Bank of Ireland, 2010) a change in approach to supervision of credit institutions and the banking system is required (Central Bank & Financial Services Authority of Ireland, 2010) There is little point in the corporate codes of governance if the approach to supervision has not changed It is clear that an overhaul of the banking supervision is needed taking into account the shortfalls and ineffectiveness of the authorities in the financial crisis (Honohan, 2010)

According to the Central Bank the requirements for the corporate code of governance draw on leading research and guidance in the governance area including the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), and the Organisation of Economic Co-operation and Development (OECD) principles (Honohan, 2009) The BCBS proposed enhancement to the Basel II framework and Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) advice (Honohan, 2009) It also considers developments arising from the introduction of Solvency II and those relating to changes to the Capital Requirement Directive The Central Bank also reviewed recent G20 proposals to strengthen corporate governance (Honohan, 2009)

2.7 Theory

There are differing views about who corporate governance should serve. One is representing a shareholder based view of governance and the other a stakeholder-based approach (Dermine, 2011) (Macey & O' Hara, 2003). Prior to the financial crisis, the core Irish banks were public limited companies listed on the Irish Stock Exchange and for the most part they reflected an Anglo-American model of corporate governance based on maximisation of wealth for shareholders (Kostyuk, et al , 2010) (Macey & O' Hara, 2003). The Franco- German model, in contrast, considers the corporation to be industrial partnerships in which the interests of long term stakeholders- particularly banks and employee group should be accorded at least the same amount of respect as those of shareholders (Macey & O' Hara, 2003). The Walker review of corporate governance in the UK, supports the shareholder- based view stating

"The role of corporate governance is to protect and advance the interest of shareholders through setting the strategic direction of a company and appointing and monitoring capable management to achieve this " (Walker, 2009, p 23)

However it also includes a list of sound principles for management which suggests other stakeholders must still be considered

"To promote the success of a company, directors must have regard, amongst other matters, to the following six factors

- *The likely consequence of any decision in the long term*
- *The interests of the company's employees*
- *The need to foster business relationships with suppliers, customers and others (fiduciary responsibility)*
- *The impact of the company on the community and environment*
- *The desirability to maintain a reputation (long-term franchise)*

- *The need to act fairly between members of the company*" (Walker, 2009, p 23)

Some critics of the shareholder based approach argue that a financial institutions primary function is to improve allocation of funds within an economy and thus cannot merely be viewed from simply a profit maximisation perspective (Mayer, 2002) The proposals for improved bank corporate governance drawn up by the Basel Committee (2010) and the European Union (2010) favour the stakeholder view (Mulbert, 2009) For instance, the Basel Committee's *Principles for Enhancing Corporate Governance* state

" how the board and senior management

- *Set the bank's strategy and objectives*

- *Determine the bank's risk tolerance/appetite*

-*Operate the bank's business on a day-to-day basis*

-*Protect the interest of depositors, meet shareholder obligations, and take into account the interests of other recognized stakeholders*

- *Align corporate activities and behaviour with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations "* (Basel Committee on Banking Supervision, 2010, pp 5-10)

While the Walker Report (Walker, 2009) refers to a single objective for bank corporate governance, the Basel Committee and the European Union refer to multiple objectives, that of serving the welfare of shareholders, depositors, employees, clients, suppliers and society In contrast the Central Bank of Ireland's codes of corporate governance (Central Bank of Ireland, 2010) issued in 2010 does not explicitly state a preference to shareholders or stakeholders in the list of roles and responsibilities for the board

"-The effective, prudent and ethical oversight of the entity,

- *Setting the business strategy for the institution, and*

-*Ensuring that risk and compliance are properly managed in the institution "*

Before the financial crisis Irish banks were public limited companies listed on the Irish Stock Exchange and for the most part they reflected a shareholder based approach to corporate governance (Kostyuk, et al , 2010) The Irish government intervention in a failing banking system through the Irish Credit Institutions (Financial Support) Scheme in October 2008 (Department of Finance, 2008) has changed the old approach (Kostyuk, et al , 2010) The terms and conditions of the Irish Credit Institutions (Financial Support) Scheme require participating institutions to appoint at least one non-executive director from a panel approved by the Minister, in order to “promote the public interest” (Kostyuk, et al , 2010) In 2009 the Irish government was the sole shareholder in Anglo Irish Bank and had preference shares and associated warrants in AIB and Bank of Ireland which effectively made it their largest shareholder under the recapitalisation programme (Department of Finance, 2009) Unlike other shareholders, the State as a shareholder has a different motivation wider than mere profit maximization It must consider the wider public interest including depositors, employees, suppliers of products and services (Kostyuk, et al , 2010) Indeed, approval and funding from the European Commission was on the basis of systemic risk to the wider Irish economy and financial system including threats to employment In this vein, Irish banks increasingly reflect a stakeholder model of corporate governance (Kostyuk, et al , 2010) But while the government may benefit public interests it has been found that greater state ownership of banks has a distorting effect on resource allocation and lending decisions can often be used as a tool to supply political patronage (Sapienza, 2002) This view is shared by (O' Sullivan & Kinsella, 2011) they also find that the

effectiveness of managerial oversight mechanisms may be negated through government interventions.

Hyman P. Minsky is credited with systemising the somewhat trite observation that creditors become more lax about lending standards in times of stability (Minsky, 1986). Minsky (1986) finds that over a protracted period of good times, capitalist economies tend to move to a financial structure in which there is a large weight of units engaged in speculative and Ponzi-finance. Minsky (1986) showed that firms driven endogenously by the profit motive, undermines good corporate governance practices.

An alternative view, to the general principle of corporate governance is one in which the duties of directors would expand the scope of their fiduciary duties beyond shareholders to include creditors (Macey & O' Hara, 2003). This hybrid approach to corporate governance is a variation of the Anglo American and Franco –German models that would see directors expand their duties and obligations and to take solvency and risk explicitly and systematically into account when making decisions, or else face personal liability for failure to do so (Macey & O' Hara, 2003).

2.7.1 Agency

The agency theory is concerned with understanding the consequences and solutions caused by the conflict of interest which arises because of the separation of ownership and decision-making authority (control) in the company (Bradley, et al., 1999). It has been found that agency theory is made up of two relationships (Jenson & Meckling, 1976). The first of these is the shareholder-debt holder relationship where the debt holder is the principal and the shareholder is an agent (Godfrey, et al., 2010). The second of these is the manager-shareholder relationship, where the manager is an agent

and the shareholder is a principal (Godfrey, et al , 2010) A manager controls the firm on behalf of the shareholder, this results in a manager acting on behalf of the shareholder (Godfrey, et al , 2010) The main objective in agency theory is to structure the contractual relationship between these conflicting groups so that agents take actions to maximise the interests of a principal known as goal congruence (Tiessen & Waterhouse, 1983)

Eisenhardt (1989) argues that under conditions of imperfect information and uncertainty, which is the situation in most companies, gives rise to two agency problems known as adverse selection and moral hazard The first problem arises when the desires or goals of the principal and an agent conflict and it is difficult or expensive for the principal to verify what the agent is actually doing (Eisenhardt, 1989) The problem here is that the principal cannot verify that the agent has behaved appropriately Eisenhardt (1989) refers to this situation as adverse selection

The second agency problem arises when both the principal and agent have different attitudes towards risk The problem here is that the principal and the agent may prefer different actions because of their differing risk preferences This is known as moral hazard (Eisenhardt, 1989) For (Emery, et al , 2004) the answer to this problem lies in creating incentives, constraints and punishments, having reasonable monitoring procedures and identifying and using contracts, at the outset, that minimise the possibility of conflict of interests

Based on the above discussion of the agency theory, it appears that managers should act as the custodians of the company managing in the best interest of the owners of that business (Tiessen & Waterhouse, 1983)

2 7 2 Stewardship

The board of directors and managers act as stewards for the company (Davis, et al , 1997) This theory suggests managers motives are aligned with the organisation working effectively with the board This is in contrast to the Agency theory with focuses on managerial self-interest Donaldson & Davis (1994) suggest that developing good relationships between boards and managers where managers are not overly controlled or treated as opportunistic agents is the most effective way forward

2.8 Corporate Governance

2.8.1 Background

Bob Tricker (Tricker, 1984) is honoured as the person who coined the phrase Corporate Governance in 1984. Since then many reports have been published in the area, such as Sir Adrian Cadbury's The Cadbury report in 1992 (Cadbury, 1992) where he defined corporate governance as 'the system by which companies are directed and controlled'

Definitions of corporate governance have tended to range from a micro view such as those of (Bradley, et al, 1999) which looks at the relationships firms have with their capital providers. Whilst macro views such as (Markarian, et al, 2007) define corporate governance in terms of the relationships a firm has with various groups in determining the direction and performance of corporations. Others such as (Shleifer & Vishny, 1997) define corporate governance in terms of return on investment for a firm's capital provider. Similar to this are the views held by (Denis, 2001) and (Denis & McConnell, 2003) which defines corporate governance in terms of maximising shareholder wealth (Johnson, et al, 2000). Define corporate governance as a set of mechanisms that minimise agency conflicts involving managers (Eisenhardt, 1989). (Keasey & Wright, 1993) define corporate governance in terms of structures and processes within an organisation and include accountability of the organisations agents to insure they behave in the interest of shareholders and other stakeholders. The Central Bank consultation paper (Central Bank of Ireland, 2010) defines corporate governance as

"Procedures, processes and attitudes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and

responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making” (Central Bank of Ireland, 2010)

Through these definitions key elements have emerged. These are reducing the agency problem, maximising firm value and returns for shareholders, and having mechanisms of effectiveness and accountability.

2.8.2 Concept of Corporate Governance in Irish Banks

This period has produced both incremental change with the gradual enhancement of the Combined Code (Financial Reporting Council) since its first appearance in 1998 and more radical change, such as the significant upheaval brought about by the Sarbanes Oxley Act (Sarbanes & Oxley, 2002) in 2002 (Coates, 2007).

The Central Bank has brought about three Reform Bills the first of which will see the central bank absorb the regulator (Honohan, 2010). A second element of the Bank Reform Bills is a revised regulatory code that removes many of the fundamental tenets of the pre-crisis doctrine (Jones, 2010). For financial services companies, the compliance requirements have become more onerous with the publication of the Central Bank’s Corporate Governance Code for Credit Institutions and Insurance Undertakings (Central Bank of Ireland, 2010) (Grant Thornton, 2011). The new codes cover a broad range of banking indicators such as board composition, risk appetite, audit committees as well as factors such as liquidity, lending practices, experience of staff, and remuneration policies (Central Bank of Ireland, 2010).

2 8 3 The Corporate Governance Code

The Corporate Governance Code for Credit Institutions and Insurance Undertakings was issued in November 2010 and came into effect on January 1 2011 (Central Bank of Ireland, 2010) Institutions had until the 20 June 2011 to implement any necessary changes to systems and structures and until 31 December 2011 where changes to board membership are required (Central Bank of Ireland, 2010) The Central Bank's Code (2010), although it is a new requirement, is largely drawn from existing best practice, as typified by the UK Corporate Governance Code (Financial Reporting Council, 2010), Walker review (2009) recommendations, and other guidelines It has however added a number of new innovations, notably the introduction of specific quantitative limits, such as a maximum number of boards a director can serve on, and minimum numbers of board meetings (Central Bank of Ireland, 2010) At the time of launching the Central Bank's Code the Head of Financial Regulation, Matthew Elderfield (Elderfield, 2011), stated "we do not want to simply match best practice internationally but wish to set a higher standard "

One significant aspect of the Central Bank Code, where it sets a higher standard than accepted existing best practice, is in the area of enforceability of the code (Central Bank of Ireland, 2010) Unlike the UK Corporate Governance Code (Financial Reporting Council, 2010), compliance with the Central Bank Code is not on a 'comply or explain' basis Instead, the code has been incorporated into the existing licensing and supervision regime, making it mandatory for all credit institutions and insurance undertakings, as per the scope of the code This makes it probably the only corporate governance code in existence where the breach of *any* requirement in the code, either quantitative or

qualitative, and regardless of how specifically it is worded, could result in a criminal prosecution (Central Bank of Ireland, 2010) (Grant Thornton, 2011)

2.9 The Provisions of Code

Below is a summary of the key principles of the new code of corporate governance for banking institutions and credit undertakings (Central Bank of Ireland, 2010)

1.0 Scope

“1.4 Institutions are required to disclose in their annual report that they are subject to the Code and whether they are required to comply with the additional requirements for major institutions” (Central Bank of Ireland, 2010, p. 2)

4.0 Reporting to the Central Bank

“4.2 Any institution which becomes aware of a material deviation from this Code shall within 5 business days report the deviation to the Central Bank, advising of the background and the proposed remedial action” (Central Bank of Ireland, 2010, p. 10)

“4.3 The Central Bank also requires each institution to submit an annual compliance statement as set out at Section 25, in accordance with any guidelines issued by the Central Bank, specifying whether the institution has complied with the Code” (Central Bank of Ireland, 2010, p. 10)

6.0 General Requirements

“6.2 The board retains primary responsibility for corporate governance within the institution at all times. Nevertheless, senior management plays an important part in ensuring effective governance and is therefore responsible for operating effective oversight consistent with board policy” (Central Bank of Ireland, 2010, p. 12)

7 0 Composition of the Board

“7 1 The board of an institution shall be of sufficient size and expertise to oversee adequately the operations of the institution and shall have a minimum of five directors ” (Central Bank of Ireland, 2010, p 14)

“7 2 The majority of the board shall be independent non-executive directors (this may include the Chairman) ” (Central Bank of Ireland, 2010, p 14)

“7 7 The number of directorships held by directors of institutions shall be limited The Central Bank requires that the number of directorships of credit institutions and insurance undertakings held by a director shall not exceed five ” (Central Bank of Ireland, 2010, p 15)

8 0 Chairman

“8 1 There shall be a Chairman appointed to the board of every institution ” (Central Bank of Ireland, 2010, p 18)

“8 3 The Chairman shall have relevant financial services expertise, qualifications and background or be required to undertake relevant and timely comprehensive training ” (Central Bank of Ireland, 2010, p 18)

“8 6 The roles of Chairman and CEO shall be separate ” (Central Bank of Ireland, 2010, p 18)

“8 7 The Chairman shall be an independent non-executive director except in the case of a subsidiary where the Chairman may be a group director ” (Central Bank of Ireland, 2010, p 18)

9 0 Chief Executive Officer

“9 1 The Chief Executive Officer is the top executive responsible for the institution with ultimate executive responsibility for the institution’s operations, compliance and performance. The CEO serves as the main link between the board and the executive.” (Central Bank of Ireland, 2010, p 20)

“9 3 The CEO shall have relevant financial services expertise, qualifications and background or be required to undertake relevant and timely comprehensive training.” (Central Bank of Ireland, 2010, p 20)

10 0 Independent Non-Executive Directors

“10 3 The independent non-executive directors shall have a knowledge and understanding of the business, risks and material activities of the institution to enable them to contribute effectively.” (Central Bank of Ireland, 2010, p 21)

“10 4 The independent non-executive directors shall comprise individuals with relevant skills, experience and knowledge (such as accounting, auditing and risk management knowledge) who shall provide an independent challenge to the executive directors of the board.” (Central Bank of Ireland, 2010, p 21)

11 0 Non-Executive Directors and Executive Directors

“11 1 The role of the non-executive directors, under the Chairman’s leadership, is

- To ensure that there is an effective executive team in place,
- To participate actively in constructively challenging and developing strategies proposed by the executive team,
- To participate actively in the board’s decision-making process,
- To participate actively in board committees (where established),

- To exercise appropriate oversight over execution by the executive team of the agreed strategies, goals and objectives and to monitor reporting of performance ”
(Central Bank of Ireland, 2010, p 22)

12 0 Role of the Board

“12 1 The board of each institution is responsible for

- The effective, prudent and ethical oversight of the entity,
- Setting the business strategy for the institution, and
- Ensuring that risk and compliance are properly managed in the institution ”
(Central Bank of Ireland, 2010, p 24)

“12 3 The board shall have

- The necessary knowledge, skills, experience, expertise, competencies, professionalism, fitness, probity and integrity to carry out their duties,
- A full understanding of the nature of the institution’s business, activities and related risks,
- A full understanding of their individual direct and indirect responsibilities and collective responsibilities, and
- An understanding of the institution’s financial statements” (Central Bank of Ireland, 2010, p 25)

13 0 Appointments

“13 3 The board shall be responsible for either the appointment of non-executive directors or where appropriate identifying and proposing the appointment of non-executive directors to shareholders and the board shall ensure that non-executive directors are given adequate training about the operations and performance of the

institution The board shall routinely update the training as necessary to ensure that they make informed decisions ” (Central Bank of Ireland, 2010, p 26)

14 0 Risk Appetite

“14 1The board is required to understand the risks to which the institution is exposed and shall establish a documented risk appetite for the institution The appetite shall be expressed in qualitative terms and also include quantitative metrics to allow tracking of performance and compliance with agreed strategy (e g Value at Risk, leverage ratio, range of tolerance for bad debts, acceptable stress losses, economic capital measures) It shall be subject to annual review by the board ” (Central Bank of Ireland, 2010, p 28)

“14 3The board shall ensure that the risk management framework and internal controls reflect the risk appetite and that there are adequate arrangements in place to ensure that there is regular reporting to the board on compliance with the risk appetite ” (Central Bank of Ireland, 2010, p 28)

“14 4 In the event of a material deviation from the defined risk appetite measure, the details of the deviation and of the appropriate action to remedy the deviation shall be communicated to the Central Bank by the board promptly in writing and no later than 5 business days of the Board becoming aware of the deviation ” (Central Bank of Ireland, 2010, p 28)

“14 7 The board shall ensure that the institution’s remuneration practices do not promote excessive risk taking The board shall design and implement a remuneration policy to meet that objective and evaluate compliance with this policy ” (Central Bank of Ireland, 2010, p 29)

21 0 Audit Committee

“21 2 An Audit Committee shall be composed of non-executive directors, the majority of directors being independent ” (Central Bank of Ireland, 2010, p 38)

“21 3 The Chairman of the Audit Committee shall be an independent non-executive director ” (Central Bank of Ireland, 2010, p 38)

“21 4 The Chairman of the Audit Committee shall be an independent non-executive director ” (Central Bank of Ireland, 2010, p 38)

“21 5 The Audit Committee shall operate in a manner consistent with ensuring its independence and shall report its activities and decisions to the board of directors ” (Central Bank of Ireland, 2010, p 38)

“21 6 Without prejudice to the responsibility of the board of directors, the responsibilities of the Audit Committee shall include at least the following

a) Monitoring the effectiveness and adequacy of the company's internal control, internal audit and IT systems,

b) Liaising with the external auditor particularly in relation to their audit findings,

c) Reviewing the integrity of the institution's financial statements and ensuring that they give a “true and fair view” of the financial status of the institution,

d) Reviewing any financial announcements and reports and recommending to the board whether to approve the institution's annual accounts (including, if relevant, group accounts), and

e) Assessing auditor independence and the effectiveness of the audit process ” (Central Bank of Ireland, 2010, p 29)

22 0 Risk Committee

“22 1 The board shall establish a Risk Committee separately from the Audit Committee with responsibility for oversight and advice to the board on the current risk exposures of the entity and future risk strategy Institutions may propose to the Central Bank that the board itself carry out the functions which would otherwise be delegated to a Risk Committee ” (Central Bank of Ireland, 2010, p 40)

“22 2 The Risk Committee shall ensure that there is an appropriate representation of non-executive and executive directors which is appropriate to the nature, scale and complexity of the business of the institution ” (Central Bank of Ireland, 2010, p 40)

“22 3 The role of the Risk Committee shall be to advise the board on risk appetite and tolerance for future strategy, taking account of the board’s overall risk appetite, the current financial position of the institution and, drawing on the work of the Audit Committee and the External Auditor, the capacity of the institution to manage and control risks within the agreed strategy The Risk Committee shall oversee the risk management function ” (Central Bank of Ireland, 2010, p 40)

“22 4 The Risk Committee shall ensure the development and on-going maintenance of an effective risk management system within the financial institution that is effective and proportionate to the nature, scale and complexity of the risks inherent in the business ” (Central Bank of Ireland, 2010, p 40)

“22 5 The Risk Committee shall advise the board on the effectiveness of strategies and policies with respect to maintaining, on an ongoing basis, amounts, types and distribution of both internal capital and own funds adequate to cover the risks of the institution ” (Central Bank of Ireland, 2010, p 41)

23 0 Remuneration Committee

“23 2 Where possible, all members of the Remuneration Committee shall be independent non-executive directors but, in any event, the majority of members of the Committee shall be independent non-executive directors” (Central Bank of Ireland, 2010, p 42)

“23 3 The Chairman of the board shall not be the Chairman of the Remuneration Committee” (Central Bank of Ireland, 2010, p 42)

24 0 Nominations Committee

“24 1 The majority of members of the Committee shall be independent non-executive directors” (Central Bank of Ireland, 2010, p 43)

25 0 Compliance Statement

“25 1 An institution shall submit to the Central Bank a compliance statement specifying, in accordance with any relevant guideline issued by the Bank, whether the institution has complied with this Code during the period to which the statement relates
This compliance statement shall be submitted to the Central Bank on an annual basis or with such other frequency as the Central Bank may notify to the institution from time to time

In the event of the institution deviating materially from the Code, the compliance report shall include a report on any material deviations, advising of the background to the breach and the actual or proposed remedial action” (Central Bank of Ireland, 2010, p 44)

Additional obligations on Major Institutions

7 0 Composition of the board

“7 1 The board shall have a minimum of seven directors ” (Central Bank of Ireland, 2010, p 45)

“7 2 The board shall have a majority of independent non-executive directors (this may include the Chairman ” (Central Bank of Ireland, 2010, p 45)

“7 7 The number of directorships of credit institutions and insurance undertakings held by a director shall not exceed three where one of the directorships held is in a Major Institution This restriction does not apply to multiple directorships within a financial services group ” (Central Bank of Ireland, 2010, p 45)

“7 8 Where directorships are held outside of credit institutions and insurance undertakings, (i e a non financial institution) the Central Bank considers that an individual holding more than 5 directorships in a non financial institution creates a rebuttable presumption that the director has insufficient time available to fulfil his or her role and functions as a director of a financial institution ” (Central Bank of Ireland, 2010, p 46)

13 0 Appointments

“13 5 At a minimum, a board shall conduct an annual assessment of its own performance and compliance with relevant provisions Every three years an evaluation by an external evaluator shall be undertaken ” (Central Bank of Ireland, 2010, p 47)

15 0 Meetings

“15 1 In any event, the board shall meet at least 11 times during any calendar year and at least once per calendar month for 11 months of the year” (Central Bank of Ireland, 2010, p 47)

18 0 Committee of the Board

“18 1 Major Institutions are required to establish Audit, Risk, Remuneration and Nomination Committees ” (Central Bank of Ireland, 2010, p 47)

2 9 1 Board Composition and Structure

Boards are a critical element to any corporate governance system and are required to review and analyse risk management procedures and ensure that these practices are consistent with previously fixed policies and agreements (Ladipo, et al , 2008) However, there are a number of problems in providing effective oversight of managerial actions in the financial system (O' Sullivan & Kinsella, 2011) These problems are mainly due to the “uniqueness” of banks (Andres & Vallelado, 2008) and mainly hinge around issues such as complexity and opacity of operations together with information asymmetries Moreover even if a company has designed appropriate internal controls, the board of directors may not always represent the interests of shareholders and may be implicitly “captured” by management (O' Sullivan & Kinsella, 2011)

2 9 2 Credit and Lending

The concentration of risks in lending was a feature that made the banking system particularly vulnerable (Honohan, 2010) Loans to the property sector in general, loans to commercial property specifically, and within this latter group, development loans to interests associated with a limited number of key developers of commercial property In this respect, Ireland stands out (Regling & Watson, 2010) It has been widely cited that the business model of expansion through lending for commercial property was

spearheaded by one or two institutions. However, partly through emulation, it became over time a feature of several leading financial institutions and a systemic problem (Regling & Watson, 2010)

2 9 3 Internal Audit

There was an overarching weakness of the internal audit function in banks due to the fact that certain risk areas received inadequate scrutiny (Nyberg, 2011). It was the role of Internal Audit functions to provide independent assurance on the effectiveness of the institutions corporate governance practices (Nyberg, 2011)

2 9 4 External Auditors

The role of External Auditor was to assess the financial statements of banks and give reassurance regarding the financial health of the bank (Nyberg, 2011). All banks received unqualified audit reports throughout the period which were in reality misleading because financial support was required for the banks from the government (Nyberg, 2011)

2 9 5 Remuneration Standards

Executive were rewarded for loan growth at executive and senior levels and also among staff (Nyberg, 2011). As a result prudent risk and sound practices were disregarded in order to achieve demanding targets that were set and the salary rewards (Nyberg, 2011)

2.9.6 Fitness and Probity Regime

Improving corporate governance is not just a question of introducing new codes and regulatory requirements. It is also driven by the integrity, professionalism, skills and experience of directors and senior managers. The Central Bank Reform Bill 2010 (Central Bank of Ireland, 2010) provides for a statutory Fitness and Probity Regime for directors and senior management of financial institutions, including credit institutions.

Along with restructuring the central bank, the Reform Bills grant the institution fitness and probity standards which will enable the Central Bank to regulate the appointment of “significant office holders” and prohibit those deemed unfit for office from carrying out key elements of their role (Central Bank of Ireland, 2010).

2.10 Comparing Corporate Governance Practices

2.10.1 UK

The Higgs Review (Higgs, 2003) proposed 'the creation of a group of business leaders and others to suggest how companies might draw on broader pools of talent with varied and complementary skills, experiences and perspectives to enhance board effectiveness' which Laura Tyson agreed to chair. The Tyson Report (Tyson, 2003) was commissioned by the Department of Trade & Industry (DTI) following the publication of the Higgs Review (Higgs, 2003) of the role and effectiveness of non-executive directors in January 2003. Laura Tyson's report (Tyson, 2003) looked at how companies might recruit non-executives from a wider pool of talent and followed the directive from the Higgs Review (Higgs, 2003) for the group to 'describe the profile of relevant skills

and experience that make an effective non-executive director with a non-commercial background'

In September 2002 the Financial Reporting Council (FRC) established a committee headed by Sir Robert Smith to develop the existing guidance for audit committees. The report of the Smith committee (Smith, 2005) was submitted to the FRC in December 2002 and published in January 2003 and updated in 2005. It was concerned with the independence of auditors in the wake of the collapse of Arthur Andersen and the Enron scandal in the US in 2002 (Smith, 2005). Its recommendations now form part of the Combined Code on corporate governance (Financial Reporting Council, 2010), applicable through the Listing Rules for the London Stock Exchange.

One of the most extensive and influential responses to the banking crisis was the Walker review (Walker, 2009) 'A review of corporate governance in UK banks and other financial industry entities', commissioned by the British government and published in November 2009. It influenced several key corporate governance regulatory changes for listed companies and financial institutions in Ireland and the UK (Walker, 2009).

The combined code was updated in 2010 to incorporate the findings of the Walker Report (2009) and was renamed the UK Corporate Governance Code (Financial Reporting Council, 2010). Across Europe, there has been much activity to strengthen corporate governance and law standards, for example the Cromme Code (Cromme, 2002) in Germany and the Bouton Report in France (Bouton, 2002).

2 10 2 Germany

The (Cromme, 2002) Code addressed all major criticisms levelled against German corporate governance, namely inadequate focus on shareholder interests, the two-tier system of executive board and supervisory board, inadequate transparency of German corporate governance, inadequate independence of German supervisory boards, limited independence of financial statement auditors

2 10 3 France

(Bouton, 2002) Was drawn up following the Enron crisis and aimed at a contribution to restore investor confidence. It suggested a certain number of improvements concerning the board of directors (stronger independence, a higher degree of formalization, better information, and an improved evaluation), the board committees (audit, remuneration, and nominating committees), the independence of legal auditors, and financial information

Overall, the main recommendations contained in the French corporate governance codes are very close to those published in other European countries, such as the Cadbury report in the UK. A comparative study mandated by the European Commission (Weil, Gotshal & Manges, 2002) concludes on the basis of an exhaustive content analysis of 35 European corporate governance codes on a high degree of convergence on such issues as accountability, minority shareholder protection, director independence, board committees and transparency

2 10 4 USA

America's reform of corporate governance is reflected in the Sarbanes-Oxley Act of 2002 and new listing rules (Coates, 2007). The bill was enacted as a reaction to number of major corporate and accounting scandals including Enron, Tyco International, and WorldCom and was designed to fix auditing of U S public companies (Coates, 2007). Section 303 of the Sarbanes-Oxley Act (Sarbanes & Oxley, 2002), for example, makes it a criminal offence for the directors of an organisation to mislead auditors (Institute of Chartered Accountants of England and Wales, 2005), which is what happened in the case of Enron. Furthermore all company CEOs and the chief financial officer (CFO) of any Security Exchange Commission (SEC) registered company have to sign the certification on all quarterly as well as annual reports. In addition, financial statements have to include internal control statements in their annual reports. The Act requires an auditor to confirm and report on any management assessments made as part of the audit.

2 11 Measure of Irish standards to International standards

Ireland trailed behind other countries due to the fact that till 2010 Ireland did not have its own code of corporate governance. Irish listed companies prescribed voluntarily to the UK code of corporate governance (Financial Reporting Council, 2003) and some cases some were bound to comply with the United States of Americas (Sarbanes & Oxley, 2002). The UK code was seen as best practice in corporate governance but since its introduction in 1998 compliance has been voluntary and companies also had leeway in that they could choose not to comply with certain aspects of the code. This freedom was subject to abuse as this dissertation will later prove. The Irish codes have endeavoured to go one step further by the (Central Bank of Ireland, 2010) mandatory

2.12 Principles and Regulation Based Supervision

In principle-based regulation an authority sets out basic principles or desirable outcome in a number of different areas such as solvency, governance and consumer protection and then allows banks to determine the compliance provisions on each of these principles. The objective being, in part, to create a regulatory structure that is not over bureaucratic and where its regulations are followed in 'spirit' and not just the 'letter' of a rule (Black, et al., 2007) . Principle-based regulation creates a certain degree of flexibility and innovation by allowing managers the responsibility to develop their own compliance ethos within the context of their own market, legislative backgrounds and cultures (IFSRA, 2004). Principle-based regulation is a type of decentred regulation (Black, 2002), where the state cedes many of its regulatory functions to multiple actors within the system (Black, 2001). Much of the responsibility is transferred to senior managers within the board room and the integrity of the regime rests on their behaviour (Coglianese & Lazer, 2003). Moreover, the effective application of Principle-based regulation required a high degree of mutual trust between participants in the supervisory framework (Black, 2008). Its system of governance relies on self-observing and responsible organisation within its framework that follows robust risk management practices (Parker, 2002) (Power, 2007). Irish Financial Regulatory Authority outlined that 'ethical behaviour' and transparency in business dealings are key attributes expected of senior officials in banks in a principle-based regulation regime (IFSRA, 2006). However the Anglo Irish Bank crisis of 2008 and its spill over effects have placed a question over the effectiveness of this type of regulatory philosophy (O' Sullivan & Kinsella, 2011). The global financial crisis has demonstrated that this benign

approach to supervision is not appropriate in the current business and cultural environment (IFSRA, 2009) In an adaptive financial system, there is a case for principles-based supervision, in conjunction with clear rules (Regling & Watson, 2010) But the “light-touch” approach to supervision has been discredited it sent wrong signals to banks and left supervisors poorly informed about banks’ management and governance, potentially impairing crisis response capacity also (Regling & Watson, 2010)

2.13 Conclusion

2.13.1 Enforcement of Regulations

Ensuring compliance with codes is an essential part of the regulatory regime (Honohan, 2010) The Central Bank has vowed to put in place an assessment of the structures and policies together with their practical application and outputs (Central Bank & Financial Services Authority of Ireland, 2010) Two broad approaches are put forward by (Honohan, 2010) for enforcement, a continuation of the current strategy and an alternative approach Under the new approach suggested by (Honohan, 2010) there would be clearer procedures for escalation, including a greater willingness to use sanctions available to the Financial Regulator in order to ensure prompt responses leading to compliance An importance is place on the enforcer quickly establishing its credibility and reputation (Honohan, 2010) This creates expectations as to how the rules, codes, regulations and principles will be enforced which will, in turn, influence behaviour and would lead to greater compliance by banks (Honohan, 2010)

2 13 2 Learning the lessons of the crisis

At the heart of the crisis were serious failures of bank management and governance, poor supervision, and government policy (Regling & Watson, 2010) Ireland's systemic banking crisis would have been impossible without a widespread suspension of prudence and care by those responsible for bank management as well as by those charged with ensuring responsible financial conduct (Nyberg, 2011)

It seems that it was not mainly structures of corporate governance in banking that were to blame (Honohan, 2010) It was more often a question of how corporate governance was implemented, and the incentive systems put in place for bank management and staff (Regling & Watson, 2010) Remuneration systems in banking have been singled out as one key factor in this respect, however it is not just a question of bonuses and stock options for a few corporate leaders (Regling & Watson, 2010)

A widely accepted lesson of the crisis surrounds the regulatory structures The lesson is that "intrusiveness" in to banks' risk management had been set aside too lightly (Regling & Watson, 2010) A closer supervision rather than the "light touch regulation" that had been adopted, had the potential to identify problems earlier and in some cases prevent or mitigate their effects (Regling & Watson, 2010)

2 13 3 Addressing these Challenges

These challenges will need to be addressed in several ways The introduction of the new codes of corporate governance will need to be enforced by the central bank Changes in approach and culture of supervision of banks and to attitude to governance within banks will need to be brought about to overcome challenges of the past

3 RESEARCH METHODOLOGY

3.1 Introduction

The methodology of an investigation is 'an approach to the process of the research encompassing a body of methods' (Collins & Hussey, 2009, p 73)

3.2 Research Philosophy

The research philosophy influences the research process and so establishing these influences first will form the rationale behind the chosen method of investigation (Horn, 2009) There are three major strands of philosophy, epistemology, ontology and axiology (Saunders, et al, 2009) The research approach underlying this investigation will reflect mainly empirical epistemology Empiricism uses knowledge that is confirmed by the senses that is arrived at through facts that provide the basis for laws and explanations (Bryman & Bell, 2007) This is opposed to the constructivist ontological view, whereby the nature of social entities arises from the perceptions and actions of social actors (Bryman & Bell, 2007) There are two positions associated with ontology, idealism and realism This study takes a common sense approach while accepting that there are different perspectives on it (Popper, 1992)

The objectivism approach advocates the position that social entities exist in reality external to social actors concerned with their existence (Saunders, et al, 2009) In contrast to this the constructivism approach asserts that social phenomena and their meanings are continually being accomplished by social actors (Bryman & Bell, 2007) Collectively the overall aim of this ontology view is to essentially question what exists (Cameron & Price, 2009) This constructivist view, however does not provide a

meaningful philosophical basis for this study as the concept of Corporate Governance has already been established as being in existence by previous investigations conducted which have been outlined in the literature reviewed. Similar studies conducted on corporate governance in banks have been reviewed and their methodologies examined, are in contrast to the ontological view in that a concept

The third strand of philosophy is axiology, that studies judgements about value. The role that the researchers own values play in all stages of the research process is of great importance if the researcher wishes for their results to be credible in the axiological assumption. Researchers articulate their values as a basis for making judgements for the research they are conducting. At all stages in the research process the research would be demonstrating their values. The view point taken for this investigation is one that the researcher's values and biases should not form part of the research itself, this will improve the outcome by the author remaining outside and only observing the research, therefore avoiding bias.

As stated, the philosophical approach of this investigation will be mainly empirical epistemology. The research reflects the principles of critical realism. This investigation is a multilevel study of corporate governance at organisational, group and individual level. Each of these levels has the capacity to change the researchers understanding of that which is being studied. This would be the consequence of the existence of a greater variety of structures, procedures and processes and the capacity that these structures, procedures and processes have to interact with one another (Saunders, et al, 2009)

3.3 Strategy

This dissertation is an exploratory study asking questions and seeking new insights about corporate governance (Robson, 2002). The principles and ways of conducting exploratory research are through literature searching, interviewing experts and conducting focus group interviews (Saunders, et al., 2009). The literature reviewed for this investigation was governments and corporate reports, articles and papers. In addition, personnel chosen from credit institutions were interviewed.

The literature reviewed identified theories and ideas that were then tested in the annual reports of three credit institutions. Through interviews, the opinions of people working in the area of corporate governance with the banks will be gathered and insights will be gained. In this way, the strategy will employ both deductive and inductive methods (Saunders, et al., 2009).

3.4 Data Collection

3.4.1 Analysis of Secondary Data

The main method used for investigating the research topic will be analysis of secondary data. This is complemented by primary research involving structured interviews. The secondary data will consist of corporate governance articles, codes of corporate governance, research papers and books. These are outlined below.

Irish Government Commissioned Reports

- The Irish Banking Crisis and Regulatory and Financial Stability Policy 2003 - 2008, a Report to the Minister for Finance by the Governor of the Central Bank (Honohan, 2010)

- Misjudging Risk Causes of the Systemic Banking Crisis in Ireland (Nyberg, 2011)
- A Preliminary Report on the Banking Crisis (Regling & Watson, 2010)

Codes of Corporate Governance

- Corporate Governance Code For Credit Institutions And Insurance Undertakings (Central Bank of Ireland, 2010)
- Combined Code 2003 (Financial Reporting Council, 2003)
- Combined Code 2006 (Financial Reporting Council, 2006)
- Combined Code 2008 (Financial Reporting Council, 2008)
- UK Combined Code 2010 (Financial Reporting Council, 2010)

UK Government Commissioned Reports

- A Review of Corporate Governance in UK Banks and Other Financial Industry Entities (Walker, 2009)

USA

- Sarbanes-Oxley Act of 2002 (Sarbanes & Oxley, 2002)

The Irish government commissioned reports were analysed and critiqued to find out the reasons for the financial crisis and to examine if there were failings in corporate governance practices in Irish banks. And also to identify what the other contributing factors were to the crisis. Other secondary data for example journal articles were used to identify and answer the question – What were the governance practices in Ireland prior to the introduction of the new codes of corporate governance issued by the central bank issued in 2010 (Central Bank of Ireland, 2010). In order to compare corporate governance codes in Ireland with other countries UK, Germany, France and the USA were reviewed.

The findings that were gathered from the reports mentioned above and the relevant theory's and Company Law applicable to corporate governance will be tested on the annual reports of three banking institutions in Ireland

This was done through a longitudinal study of the annual reports of three credit institutions over a seven year period from 2005 to 2011. The longitudinal study is suitable for mapping changes in business and management research (Bryman & Bell, 2007). The longitudinal approach was chosen after reviewing similar studies such as Tsipouri and Xanthakis (2004) that looked at the compliance of Greek companies with international best practice, against a checklist and scored the companies accordingly. Florou and Galarniotis (2007) similarly looked at Greek companies using a rating system to score their levels of compliance. In Ireland Grant Thornton (Grant Thornton, 2011) also conducted studies into compliance of Irish listed companies.

These studies were mostly concerned with the compliance of companies with corporate governance disclosures in their annual reports with the relevant codes, which in a sense means that these surveys were testing compliance disclosure. This dissertation provides another perspective by assessing the corporate governance statements, pre and post financial crisis and evaluating the quality and truthfulness of the disclosures in the annual reports.

The main findings of the Nyberg, Watson and Honohan reports were synthesised. The compliance questions (see appendix 6.1) from the Grant Thornton study (2011) were used to firstly assess the level of compliance with the codes in place at the time. The codes in place were the combined code (Financial Reporting Council, 2003). The

questions were formulated to assess the main principles and provisions listed in the UK Combined Code (Financial Reporting Council) and were applied to each annual report. The Irish code of corporate governance (Central Bank of Ireland, 2010) was not introduced at the time of publishing the Grant Thornton study (Grant Thornton, 2011) and so the relevant provisions of this code were added along with the combined code. It was found through investigation into the UK combined codes that revisions were made throughout the period being assessed for this dissertation. It was found that 2003, 2006, 2008 and 2010 version of the combined code existed (Financial Reporting Council). It was therefore necessary to compare the provisions in each edition of the code as the provisions being assessed could have changed and may have affected the results. The questions covered a wide a range of critical governance areas and code provisions. Following the compliance assessment of each bank, the quality and truthfulness of statement were compared with the findings from the government reports, theory and company Law. The disclosers were assessed to see if they had complied with company law and corporate governance theory. The new codes of corporate governance for Irish banks came in to effect in 2011 (Central Bank of Ireland, 2010). The level of compliance with the news codes was assessed. Overall the findings will show if corporate governance compliance disclosed in the annual reports differed in practice.

3.4.2 Structured Interviews

The second method of exploring corporate governance was through structured interviews. The goal of this style of interviewing is to ensure interviewees, replies can be aggregated and this can be achieved reliably if these replies are in response to identical cues (Bryman & Bell, 2007). The questions used in the UK commissioned report into the corporate governance (Walker, 2009) were used for the interview but

adapted to suit the Irish context (See appendix 6.2). Three people were approached from two banking institutions by phone and email. The two people who agreed to be interviewed were from EBS. One of the interviewees was a branch manager and the other was head of compliance. The interviews took place at the bank on the 14th and 15th of August, participants were based in different branches. The interviewees represented differently levels of seniority and different engagement with the codes. The criteria for selection of people for interview was that they had to have been working in the bank prior to the introduction of the new codes of corporate governance and that they had a working knowledge of the codes. The findings would be enriched by the perspectives of the interviewee on the codes. Prior to each interview the interviewee were sent a copy of the Corporate Codes of Governance.

3.5 Rationale for Qualitative Methods

(Creswell, 1998) defines qualitative research as, an inquiry process of understanding based on distinct methodological traditions of inquiry that explore a social or human problem. To answer the research questions posed, the information collected from the annual reports had to be evaluated in terms of quality of disclosures. In addition the interviews sought opinions from staff of the bank in order to assess their perspectives on the new codes of corporate governance. Qualitative style research suited the exploratory nature of this investigation.

3.6 Data Analysis

Analysis involved iterative of collecting data from the sources mentioned above, developing and refining emerging idea and relating them to existing theory. Analysis focused on identify if the corporate disclosure in the annual reports of Anglo Irish Banks, EBS, and Bank of Ireland were an accurate account of Corporate Governance Practice over the period 2005-2011. The analysis used categories which covered key areas of the code of corporate governance. Within each category there were questions and each question related to a provision of the code. All the annual reports were subject to the same set of questions which allowed results to be aggregated. Banks were given rating adopted from the Grant Thornton (2011) methodology as a measure of whether they had complied with the provision or not. In most cases bank had to have specific statements in order to be deemed compliant with a provision. For the interviews questions that were used from the Walker report these were again put into over-arching themes. Responses were assessed against findings from secondary data and theory.

3.7 Bias

The view point taken for this investigation is one that the researcher's values and biases should not form part of the research itself, this will improve the outcome by the author remaining outside and only observing the research, therefore avoiding bias.

3.8 Validity and Reliability

The validity of an investigation is the extent to which a test measures what we actually wish to measure (Copper & Schindler, 2006). The researcher is confident that this investigation has a high level of validity given that the methods used were adopted from other significant studies of corporate governance and the material being analysed had

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been shown to fit this methods in these studies The study is reliable in that the methods used have the ability to be reproduced again and in this way the study could be used for further research in corporate governance and provide a greater set of results to compare

4 RESEARCH FINDINGS

4.1 Introduction

This chapter illustrates the findings of the research questions that were posed in the introduction

4.2 The Reasons for the Financial Crisis

One of the aims of the research was to discover the reasons why the financial crisis and if corporate governance practice within banks contributed. This was carried out through secondary research. An in-depth analysis and critique of three major reports into the financial crisis (Honohan, 2010) (Nyberg, 2011) (Regling & Watson, 2010) identified that the crisis was systemic due to system wide failures of banks, bank practices, supervision of banks and government policy.

4.3 Breaches of Corporate Governance

One of the aims of the research was to examine whether corporate governance practices in banks contributed to the financial crisis. The reports also indicate financial institutions did not adhere to sound practices (Honohan, 2010) (Nyberg, 2011) (Regling & Watson, 2010). The findings clearly suggest that there were serious breaches of corporate governance in Anglo Irish Bank while in other banks governance breaches came in the form of high risk strategies with a disregard for the increased exposure to the property sector. This confirms (O' Sullivan & Kinsella, 2011) findings that corporate governance practices in relation to the risk management practices and internal controls are the contributing factors in bank failures in a distressed economy.

4.4 The Role of the Authorities

While this dissertation did not set out to examine financial authorities, it emerged through the research that the Central Bank, the Financial Regulator and the department of finance were part of the system wide failure that led to the financial crisis (Regling & Watson, 2010). The research found that this supervision lacked the robustness and intrusiveness required (Honohan, 2010). The three authorities were found to have facilitated banks' unsound practices (Nyberg, 2011). This was aided by a principles based approach to regulation.

The pro-business strategies of the government led to a deregulated, market orientated economy, and the culmination of low taxes and easy access to credit fuelled investment in the property sector (O'Sullivan & Kennedy, 2010).

4.5 Reforms in Corporate Governance

4.5.1 Corporate Governance in Ireland

Research found that prior to the introduction of the new codes banks were adhering to the UK Combined Code. This was on a voluntary basis and the code has a comply or explain facility as will be shown in the analysis of the annual reports banks did not always comply with the provisions of the code. Regulation in Ireland was principles based with a light touch approach which believed that once structures, procedures and policies were in place banks would prudently manage themselves.

One of the Irish responses to the financial crisis in the area of corporate governance was the introduction of the new codes of corporate governance. Ireland was the only country in the EU to not have a code of corporate governance for banks up to this point.

The codes unlike the UK Combined Code the Irish code does not have the comply or explain option and the board shall have a minimum of 5 directors. The code also applies to building societies.

Annual Report Year	Code in use
2005	Combined Code 2003
2006	Combined Code 2003
2007	Combined Code 2003
2008	Combined Code 2006
2009	Combined Code 2008
2010	Combined Code 2008
2011	UK Corporate Governance Code 2010 & Central Bank Code Of Corporate Governance

Table 1 Corporate Governance Codes Overview

Although the combined code has proven to be widely applicable, and has formed the basis of many other countries' governance codes, it is still designed primarily to reflect UK requirements, a point underscored by the FRC'S renaming of the code to the UK Corporate Governance code (Financial Reporting Council, 2010)

4.6 Quality of Compliance and Disclosures

The next objective was to assess the corporate governance statements, pre and post financial crisis and evaluate the quality and truthfulness of the disclosures in the annual reports. The findings that were gathered from the Nyberg, Watson and Honohan reports, the relevant theory and company law applicable to corporate governance were tested on the annual reports of three credit institutions in Ireland. This was done through a longitudinal study of the annual reports of credit institutions over a seven year period.

from 2005 to 2011 Anglo Irish Bank/ IBRC, Bank of Ireland and EBS were chosen because they represent the cross section of banks in Ireland, namely commercial, retail and building society. The level of compliance with the provisions of the codes is first examined. A total of 21 annual reports were examined. In addition the corporate governance disclosures in the annual reports were evaluated in terms of quality and truthfulness. The sections and questions are below and the relevant reference from the code is quoted with tables and commentary.

4.6.1 Governance Code Compliance

Question 1 Do they claim full compliance with the code?

Reference from the combined code

“In the case of a listed company incorporated in Ireland, the following additional items must be included in its annual report

A statement as to whether the listed company has

- A A complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code, or*
- B not complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code and if so, setting out*
 - I those provisions, if any, it has not complied with,*
 - II in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions,*
 - III the company’s reasons for non-compliance”*

(Irish Stock Exchange, 2011, p. 683(7))

“The obligation to submit an annual compliance statement to the Central Bank pursuant to Section 25 of the Code shall be imposed by notice under Section 25 of the Central Bank Act 1997” (Central Bank of Ireland, 2010, p. 8)

	BOI	EBS	ANGLO/IBRC
2005	Explains non compliance	Claims full compliance	Claims full compliance
2006	Explains non compliance	Claims full compliance	Claims full compliance
2007	Explains non compliance	Claims full compliance	Claims full compliance
2008	Claims full compliance	Claims full compliance	Claims full compliance
2009	Explains non compliance	Claims full compliance	Explains non compliance
2010	Explains non compliance	Claims full compliance	Explains non compliance
2011	Explains non compliance	Claims full compliance	Claims full compliance

Table 2 Statement of compliance with the Combined Code

“Claim Full Compliance The Company deems itself fully compliant with the code

Explains Non-Compliance Companies who do not claim full compliance are expected to list the provisions they have not complied with Since the code is applied in a comply or explain basis, this is deemed acceptable, once adequately explained ”

(Grant Thornton, 2011) (Financial Reporting Council, 2003)

Disclosure of full compliance is high, none were explicitly non compliant The banks who explained non compliance showed minimal change in their explanations provided year on year Unlike the UK Corporate Governance Code (Financial Reporting Council, 2010), compliance with the Central Bank Code is not on a ‘comply or explain’ basis Instead, the code has been incorporated into the existing licensing and supervision regime, making it mandatory for all credit institutions and insurance undertakings, as per the scope of the code This makes it probably the only corporate governance code in existence where the breach of *any* requirement in the code, either quantitative or qualitative, and regardless of how specifically it is worded, could result in a criminal prosecution (Central Bank of Ireland, 2010) (Grant Thornton, 2011)

Question 2 Of the banks which do not claim full compliance with the code, for which provisions do they most commonly provide explanations?

Examination of the Corporate Governance statements for the banks that disclosed non compliance provided the following explanations BOI in 2005 state that they complied with the provisions of the combined code except that the Governor chaired the group remuneration committee (Bank of Ireland, 2006) Secondly neither an external search consultancy nor open advertising was used for the appointments of non-executive Directors and the Notice of the 2004 Annual General Court was not issued at least 20 working days before the meeting (Bank of Ireland, 2006)

In 2006 BOI state except in relation to membership of the Group Remuneration Committee In addition, two of their 17 Directors were unable to attend the Annual General Court in July 2005 (Bank of Ireland, 2007)

In 2007 BOI state except for the fact that three of the then 14 Directors were unable to attend the Annual General Court in July 2006 and the Governor is a member of the Group Remuneration Committee (Bank of Ireland, 2008)

In 2009 BOI state except in the case of non-executive directors Tom Considine's membership of the Group Audit Committee and Joe Walsh's membership of the Group Remuneration Committee (Bank of Ireland, 2010)

BOI 2010 except (i) in the case of Tom Considine's membership of the Group Audit Committee and Joe Walsh's membership of the Group Remuneration Committee and, (ii) that the Annual General Court of the Bank held on 19 May 2010 was convened on 21 calendar days' notice, instead of 20 working days' notice (Bank of Ireland, 2011)

Again in 2011 they state Tom Considine's membership of the Group Audit Committee and Joe Walsh's membership of the Group Remuneration Committee (Bank of Ireland, 2012)

In Anglo there were short intervals during the financial period when the requisite number of members for the Board Committees fell below the minimum requirement as set out in the Combined Code (Anglo Irish Bank, 2010) In addition following the resignation of Frank Daly on 22 December 2009, and with the exception of the Nomination and Succession Committee, the Board Committees do not have the requisite number of independent non-executive directors to comply with the provisions of the Combined Code (Anglo Irish Bank, 2010) Again in 2010 they stated that there were intervals when the requisite number of members for the Board Committees was below the minimum requirements (Anglo Irish Bank, 2011)

The Central Bank code of corporate governance has stated the maximum number of boards a director can serve on, and minimum numbers of board meetings (Central Bank of Ireland, 2010)

4 6 2 Non-Executive Directors

Question 3 Is at least half of the board comprised of independent non-executive directors?

" at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent "

Combined Code A 3 2 (2010 code B 1 2)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

"The majority of the board shall be independent non-executive directors (this may include the Chairman) " (Central Bank of Ireland, 2010, p 14)

	EBS	BOI	ANGLO/IBRC
2005	8/11	14/17	8/12
2006	7/10	11/14	8/13
2007	8/12	9/14	8/13
2008	10/14	10/15	7/12
2009	11/13	9/15	2/4
2010	10/12	8/14	4/6
2011	4/5	5/9	6/8

Table 3 Board Balance

Independent non-executive / Board

The role of non-executive directors has come under increased scrutiny in the past few year years due to poor corporate governance and high-profile corporate failure (Grant Thornton, 2011) Independent non –executive directors are an integral component of the board and should provide independent challenge to the executive directors of the board (Central Bank of Ireland, 2010) As shown in the above table all three banks for the period 2005-2001 maintained the correct balance of independent non-executive to executive directors on their respective boards

The Fitness and Probity regime introduced by the Central Bank has set new standards of competence for Board and senior management positions (Central Bank of Ireland, 2010) This follows findings Non Executive Directors while formally independent were

in practice, highly reliant on the knowledge, openness and ability of bank management (Nyberg, 2011)

Question 4 How well do companies describe the consideration of independence?

“The board should identify in the annual report each non-executive director it considers to be independent. The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director’s judgement

The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director

- *has been an employee of the company or group within the last five years,*
- *has, or has had within the last three years, a material business relationship with the company ,*
- *has received or receives additional remuneration from the company apart from a director’s fee, participates in the company’s share option or a performance-related pay scheme, or is a member of the company’s pension scheme,*
- *has close family ties with any of the company’s advisers, directors or senior employees,*
- *holds cross-directorships or has significant links with other directors ,*
- *represents a significant shareholder, or*
- *has served on the board for more than nine years from the date of their first election ”*

Combined Code A 3.1 (2010 B 1.1)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

“Independent non-executive directors shall be identified clearly in the institution’s annual report. The independent non-executive directors shall comprise individuals with relevant skills, experience and knowledge (such as accounting, auditing and risk management knowledge) who shall provide an independent challenge to the executive directors of the board ”

(Central Bank of Ireland, 2010, p 21)

	EBS	BOI	ANGLO/IBRC
2005	Limited Information	Informative	Limited Information
2006	Informative	Informative	Limited Information
2007	Informative	Informative	Limited Information
2008	Informative	Informative	Limited Information
2009	Informative	Informative	Uninformative
2010	Informative	Informative	Limited Information
2011	Limited Information	Informative	Limited Information

Table 4 Quality of Independence Disclosures

In order to be fully compliant, a company must clearly disclose whether or not each director is considered independent, and where a director is considered independent despite the existence of circumstances as described above, the company must clearly state the justification for this conclusion (Financial Reporting Council) The quality of the disclosures was reviewed and rated them as being ‘informative’, having ‘limited information’ or being ‘uninformative’ (Grant Thornton, 2011) “An ‘informative’ rating was given where the company

- identified the individuals not considered to be independent in accordance with the code, explicitly identified the criteria that affect their independence,
- explained why the board nevertheless deems the individuals to be independent, and
- disclosed additional information in support of this decision” (Grant Thornton, 2011)

“A ‘limited information’ rating was applied to independence statements where they provided some information about directors’ independence but they did not explain how the board reached its final decision regarding the determination of independence” (Grant Thornton, 2011)

Bank of Ireland had full compliance with this provision over the period while Anglo did not disclose how they reached a decision of the independence of the director in

question While banks such as Bank of Ireland showed full compliance with the code, the findings of Nyberg have shown, that Independent non-executive directors lacked the knowledge and expertise required (Nyberg, 2011) In addition, there was a belief amongst NED's and senior management that formal policies, structures and procedures were enough for the prudent management of banks (Nyberg, 2011)

Question 5 Do the Senior Independent Directors and non-executive directors appraise the chairman's performance?

"Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance "

Combined Code A 1 3 (2010 code A 4 2)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

"The board shall formally review its overall performance and that of individual directors, relative to the board's objectives, at least annually The review shall be documented " (Central Bank of Ireland, 2010, p 26)

	EBS	BOI	ANGLO/IBRC
2005	No	Yes	Yes
2006	No	Yes	Yes
2007	No	Yes	Yes
2008	No	Yes	No
2009	No	Yes	No
2010	No	Yes	Yes
2011	No	Yes	Yes

Table 5 SID and NED appraisal of chairman's performance

Appraising the performance of the chairman is an integral part of the role of non-executives, as the chairman is the leader of the board and has significant influence over

the decisions taken by the board (Grant Thornton, 2011) The banks held formal meetings to appraise the chairperson's performance Anglo/IBRC 2011 conducted an annual performance evaluation of the chairman led by the Senior Independent director, in private consultation with each of the Directors and the results were shared with the chairman and the board with agreed points for improvement (IBRC, 2012) EBS used an external consultant who carried out the performance review of the chairman but did not comment on the independence of the external consultant (EBS, 2006)

4 6 3 The Board

Question 6 Is there a statement of how the board operates and how its duties are discharged effectively?

"The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management "

Combined Code A 1 1 (2010 code A 1 1)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

"The role and responsibilities of the board shall be clearly documented The board may delegate authority to sub-committees or management to act on behalf of the board in respect of certain matters but, where the board does so, it shall have mechanisms in place for documenting the delegation and monitoring the exercise of delegated functions The board cannot abrogate its responsibility for functions delegated "

(Central Bank of Ireland, 2010, p 24)

	EBS	BOI	ANGLO/IBRC
2005	Yes	Yes	Yes
2006	Yes	Yes	Yes
2007	Yes	Yes	Yes
2008	Yes	Yes	Yes
2009	Yes	Yes	Yes
2010	Yes	Yes	Yes
2011	Yes	Yes	Yes

Table 6 Statement of Board Operation and how its Duties are Discharged

The structure of the board and its committees, and the independence of directors, is critical to ensuring that a board performs well. The three banks fully complied with this provision over all years. In many of the reports it was difficult to understand the composition of the board and positions of each of the directors. Often information was spread over different sections of the annual report. While there is an overall high compliance with this provision, in reality boards did not carry out its duties effectively and internal control function were also ineffective at controlling the amount of risk banks were exposed to (Honohan, 2010)

Question 7 Are the roles of the chairman and chief executive divided and exercised by different individuals and is there a statement that the divisions of responsibilities between the chairman and chief executive have been clearly established and agreed by the board?

“The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.”

Combined Code A 2.1 (2010 code A 2.1)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

"The roles of Chairman and CEO shall be separate "

(Central Bank of Ireland, 2010, p 19)

	EBS	BOI	ANGLO/IBRC
2005	Yes	Yes	Yes
2006	Yes	Yes	Yes
2007	Yes	Yes	Yes
2008	Yes	Yes	No
2009	Yes	Yes	No
2010	Yes	Yes	Yes
2011	Yes	Yes	Yes

Table 7 Roles and Responsibilities of the Chairman and Chief Executive

The Irish code does not provide a statement to say that the division between the responsibilities should be set out in writing and agreed by the board. The purpose of this statement is to ensure that one person does not assume responsibilities that should be reserved for the other, thereby leading to a situation where the board no longer has appropriate balance. There was strong compliance with this provision apart from 2008 and 2009 in Anglo Irish Bank where Donal O' Connor held both the role of chairman and Group Chief Executive (Anglo Irish Bank, 2009)

Question 8 Is it disclosed how the performance of the board, committees and individual directors are evaluated?

"The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted "

Combined Code A 6.1 (2010 code B 6.3)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

“The board shall formally review its overall performance and that of individual directors, relative to the board’s objectives, at least annually The review shall be documented ”

(Central Bank of Ireland, 2010, p 26)

	EBS	BOI	ANGLO/IBRC
2005	Yes	Yes	Yes
2006	Yes	Yes	Yes
2007	Yes	Yes	Yes
2008	Yes	Yes	Yes
2009	Yes	Yes	Yes
2010	Yes	Yes	Yes
2011	No	Yes	Yes

Table 8 Evaluation of Board, Committees and Individual Directors Performance

There was strong compliance with this provision of the code. Reviewing the detail of how evaluations were conducted showed a variety of techniques were employed. These techniques included interviews, discussions, questionnaires and reviews by external providers. EBS was the only institution to use an external consultant to perform the evaluation. However the annual report failed to disclose that the provider did not have any other connection with the company, as required by the 2010 code (Financial Reporting Council, 2010). EBS was acquired by the AIB group so duties of the board would be disclosed in the annual reports of AIB.

Question 9 Is it disclosed that the terms of reference for the audit, remuneration and nomination committees are available for inspection?

“The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available ”

Combined Code C 3.3 (2010 code C 3.3)

“Committees shall have documented terms of reference evidencing all functions delegated to them ”

(Central Bank of Ireland, 2010, p 33)

“The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board ”

Combined Code B 2 1 (2010 code D 2 1)

“The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board ”

Combined Code A 4 1 (2010 code B 2 1)

“The authority functions, membership and reporting lines of the committees as well as meeting frequency, voting rights and quorums shall be clearly outlined in the written terms of reference established by the board ”

(Central Bank of Ireland, 2010, p 37)

	EBS	BOI	ANGLO/IBRC
2005	Available publicly	Available publicly	Available on request
2006	Available publicly	Available publicly	Available on request
2007	Available publicly	Available publicly	Available on request
2008	Available publicly	Available publicly	Available on request
2009	Available publicly	Available publicly	Available on request
2010	Available publicly	Available publicly	Available on request
2011	Not disclosed	Available publicly	Available on request

Table 9 Disclosure of the Terms of Reference for the Audit, Remuneration and Nomination Committees

The terms of reference were available by request from the secretary of the Board or available on the website of the institutions

4 6 4 Audit Committee

Question 10 *Are all audit committee members independent non-executive directors?*

“The board should establish an audit committee of at least three, or in the case of smaller companies two, independent non-executive directors ”

Combined Code C 3 1 (2010 code C 3 1)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

“An Audit Committee shall be composed of non-executive directors, the majority of directors being independent”

(Central Bank of Ireland, 2010, p 38)

	EBS	BOI	ANGLO/IBRC
2005	Yes	Yes	Yes
2006	Yes	Yes	Yes
2007	No	Yes	Yes
2008	No	Yes	Yes
2009	No	Yes	No
2010	No	Yes	Yes
2011	not applicable	No	Yes

Table 10 Non-Executive Membership of Audit Committee

Audit committees are required to monitor external auditor independence and explain, where non-audit services are provided by the external auditor, how objectivity and independence are safeguarded Bank of Ireland only had two independent non-executive directors on the committee and (Bank of Ireland, 2012) Similarly Anglo did not have the required number of independent non-executives in 2009 (Anglo Irish Bank, 2010) In the case of EBS as executive directors were attending meetings and in 2011 was deemed not applicable as the subcommittee were assumed by the AIB group (EBS, 2012)

Question 11 Does the audit committee have at least one member with recent and relevant financial experience?

“The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience ”

Combined Code C 3 1 (2010 code C 3 1)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

When appointing committee members, the board shall review and satisfy itself as to the relevant expertise, skill of members and their ability to commit appropriate time to the committee

(Central Bank of Ireland, 2010, p 35)

	EBS	BOI	ANGLO/IBRC
2005	No	Yes	No
2006	No	Yes	No
2007	No	Yes	No
2008	Yes	No	No
2009	Yes	No	No
2010	Yes	No	No
2011	Yes	No	Yes

Table 11 Recent and Relevant Financial Experience

“Compliance with this provision could only be granted if there was an explicit disclosure and identification of the member with the appropriate experience, and the disclosure stated that the experience was both ‘recent and relevant’” (Grant Thornton, 2011) (Financial Reporting Council, 2003) Anglo Irish Bank was the least compliant with this provision while Bank of Ireland and the EBS were non compliant the majority of years In BOI in 2008 and 2011 the annual reports stated they were not disclosing the financial expertise of individuals opting instead to state that the collective skills of the groups were sufficient (Bank of Ireland, 2009) (Bank of Ireland, 2012)

Question 12 *Is there a separate section of the annual report which describes the work of the committee?*

“A separate section of the annual report should describe the work of the committee in discharging those responsibilities [i.e. the responsibilities contained in the terms of reference]”

Combined Code C 3.3 (2010 code C 3.3)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

	EBS	BOI	ANGLO/IBRC
2005	Uninformative	Limited Information	Limited Information
2006	Uninformative	Limited Information	Limited Information
2007	Uninformative	Limited Information	Limited Information
2008	Uninformative	Limited Information	Limited Information
2009	Uninformative	Limited Information	Limited Information
2010	Uninformative	Limited Information	Limited Information
2011	Uninformative	Limited Information	Informative

Table 12 Quality of Disclosures on the Work of the Audit Committee

The Irish Code did not have a provision similar to the UK code. To consider the quality of the disclosures were rated Informative, limited information or uninformative. “An ‘informative’ rating was given where the company

- explicitly identified the roles and responsibilities of the committee,
- provided details of committee activities in the period,
- provided details of the outcome of the committee effectiveness review, and
- outlined details of the prohibited non-audit services provided by external auditors”

(Grant Thornton, 2011)

A 'limited information' rating was applied where a company listed the committee roles and responsibilities and outlined how external auditor independence was considered in the provision of non-audit services" (Grant Thornton, 2011) Bank of Ireland and Anglo Irish Bank had mostly limited information with the exception of 2011 while EBS failed to disclose any adequate information throughout all years and so was rated uninformative

4 6 5 Internal Audit

Question 13 Does the company have an internal audit function or equivalent, and if not is the absence explained?

"Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report "

Combined Code C 3 5 (2010 code C 3 5)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

"Control Functions These shall include the Internal Audit, Risk Management, Compliance, and Actuarial Functions and any other controlled function prescribed as such by the Central Bank pursuant to its power to do so under the Central Bank Reform Act 2010 "

(Central Bank of Ireland, 2010, p 6)

	EBS	BOI	ANGLO/IBRC
2005	Fully Compliant	Fully Compliant	Fully Compliant
2006	Fully Compliant	Fully Compliant	Fully Compliant
2007	Fully Compliant	Fully Compliant	Fully Compliant
2008	Fully Compliant	Fully Compliant	Fully Compliant
2009	Fully Compliant	Fully Compliant	Fully Compliant
2010	Fully Compliant	Fully Compliant	Fully Compliant
2011	Fully Compliant	Fully Compliant	Fully Compliant

Table 13 Internal Audit Function

Internal audit plays an important role in a company’s governance processes, and the expectations of internal audit have increased with the realisation of the importance of this role and the potential to make a significant contribution. The audit committee is required to monitor and review the effectiveness of the internal audit function. All banks had an internal audit function.

Question 14 Does the audit committee monitor and review the effectiveness of internal audit activities?

“The audit committee should monitor and review the effectiveness of the internal audit activities.”

Combined Code C 3.5 (2010 code C 3.5)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

“The Audit committee shall monitor the effectiveness and adequacy of the company’s internal control and internal audit ”

(Central Bank of Ireland, 2010, p 39)

	EBS	BOI	ANGLO/IBRC
2005	Yes	Yes	Yes
2006	Yes	Yes	Yes
2007	Yes	Yes	Yes
2008	Yes	Yes	Yes
2009	Yes	Yes	Yes
2010	Yes	Yes	Yes
2011	Yes	Yes	Yes

Table 14 Specific mention of Internal Audit Effectiveness Review

The results show high compliance with this provision. Disclosures stated that review had been conducted to determine the effectiveness of this function. Again the findings in the annual reports differ from the findings by (Nyberg, 2011). It was the role of Internal Audit functions to provide independent assurance on the effectiveness of the institutions corporate governance practices however there was an overarching weaknesses of the Internal audit function in banks due to the fact that certain risk areas received inadequate scrutiny (Nyberg, 2011)

4.6.6 External Audit

Question 15 If the external auditor provides non-audit services, is there a statement as to how the auditor's objectivity and independence is safeguarded?

"The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded "

Combined Code C 3.7 (2010 code C 3.7)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

"The Audit committee shall assess auditor independence and the effectiveness of the audit process "

(Central Bank of Ireland, 2010, p. 39)

	EBS	BOI	ANGLO/IBRC
2005	Yes	Yes	Yes
2006	Yes	Yes	Yes
2007	Yes	Yes	Yes
2008	Yes	Yes	Yes
2009	Yes	Yes	Yes
2010	Yes	Yes	Yes
2011	No Mention	Yes	Yes

Table 15 Safeguarding of Objectivity in the Provision of Non-Audit Services

Audit committees are required to monitor external auditor independence and explain, where non-audit services are provided by the external auditor, how objectivity and independence are safeguarded. There was a high level of compliance with this provision, however, banks gave little detail on how they assessed the auditor's objectivity and independence. For example EBS in the 2009 state *"This committee is responsible for monitoring the integrity of the financial statements and internal control systems. The committee also assesses the effectiveness of the internal audit and regulatory compliance functions, as well as the independence and objectivity of the external auditors"* (EBS, 2010, p. 19). While in 2011 there was no mention however these duties were subsumed to the AIB group which acquired EBS in 2010 (EBS, 2012). Given the minimal amount of information provided by the banks on the independence of auditors, the disclosure around this decision could be improved.

The fact that banks required bailouts by the government so soon after they have received unqualified reports on the quality of their financial statement as evidenced (Nyberg, 2011) reports clearly suggests there was serious failings in this process.

4 6 7 Remuneration Committee

Question 16 *Are there at least three members, all of whom are independent non-executive directors?*

"The board should establish a remuneration committee of at least three, or in the case of smaller companies two, independent non-executive directors "

Combined Code B 2.1 (2010 code D 2.1)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

"Where possible, all members of the Remuneration Committee shall be independent non-executive directors but, in any event, the majority of members of the Committee shall be independent non-executive directors "

(Central Bank of Ireland, 2010, p 42)

	EBS	BOI	ANGLO/IBRC
2005	Yes	Yes	Yes
2006	Yes	Yes	Yes
2007	Yes	Yes	Yes
2008	Yes	Yes	Yes
2009	Yes	Yes	Yes
2010	Yes	Yes	Yes
2011	Not Applicable	Yes	Yes

Table 16 Remuneration Committee Composition

Executive remuneration has come under increased scrutiny by shareholders. Remuneration committees are trying to balance the expectations of executive with the needs of the shareholders and the company. There was strong compliance with this provision over the period assessed.

Question 17 *Does the chairman sit on this committee, and if so, does he/she chair it?*

" the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman "

Combined Code B 2 1 (2010 code D 2 1)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

“The Chairman of the board shall not be the Chairman of the Remuneration Committee ”

(Central Bank of Ireland, 2010, p 42)

	EBS	BOI	ANGLO/IBRC
2005	Not Compliant	Not Compliant	Fully Compliant
2006	Not Compliant	Not Compliant	Not compliant
2007	Fully Compliant	Fully Compliant	Fully Compliant
2008	Fully Compliant	Fully Compliant	Fully Compliant
2009	Fully Compliant	Fully Compliant	Fully Compliant
2010	Fully Compliant	Fully Compliant	Fully Compliant
2011	Not Applicable	Fully Compliant	Fully Compliant

Table 17 Chairmen’s position on the Remuneration Committee

This provision allows for the company chairman to be a member of, but not chair, the remuneration committee. The results showed BOI had the then deputy chairman, Denis O’Brien also in the position of chairman of the remuneration committee (Bank of Ireland, 2007). ESB too failed to comply through 2005 with Brian Joyce and 2006 with Mark Moran in both chairman roles (EBS, 2006), (EBS, 2007). In Anglo, Sean Fitzpatrick was chairman in both roles in 2006 (Anglo Irish Bank, 2007).

Question 18 Does the company state the basis for remuneration including performance related elements?

“The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive ”

Combined Code B 2 3 (2010 code D 2 3)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

“The Remuneration Committee shall establish remuneration policies and procedures within the institution based on best practice and any requirements which the Central Bank may issue ”

(Central Bank of Ireland, 2010, p 42)

	EBS	BOI	ANGLO/IBRC
2005	Fully Compliant	Fully Compliant	Fully Compliant
2006	Fully Compliant	Fully Compliant	Fully compliant
2007	Fully Compliant	Fully Compliant	Fully Compliant
2008	Fully Compliant	Fully Compliant	Fully Compliant
2009	Fully Compliant	Fully Compliant	Fully Compliant
2010	Fully Compliant	Fully Compliant	Fully Compliant
2011	Not Applicable	Fully Compliant	Fully Compliant

Table 18 Disclosing the Basic for Remuneration

The results indicate a high compliance with this provision with the three banks stating the basis for remuneration of directors As EBS became part of the AIB group this was not applicable Despite being fully compliant with this provision banks remuneration practices encouraged risky lending practices by executives and senior management Remuneration rewards encouraged unsound practices (Nyberg, 2011)

Question 19 Does the company state that performance related elements of remuneration form a significant proportion of the total remuneration package of executive directors?

“Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose ”

Combined Code B 1 (2010 code D 1 8)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

“The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give these directors keen incentives to perform at the highest levels ”

Combined Code B 1 1 (2010 code supporting principle D 1)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

	EBS	BOI	Anglo/IBRC
2005	Fully Compliant	Fully Compliant	Fully Compliant
2006	Fully Compliant	Fully Compliant	Fully Compliant
2007	Fully Compliant	Fully Compliant	Fully Compliant
2008	Fully Compliant	Fully Compliant	Fully Compliant
2009	Fully Compliant	Fully Compliant	Fully Compliant
2010	Compliant with Exceptions	Fully Compliant	Fully Compliant
2011	Not Applicable	Fully Compliant	Fully Compliant

Table 19 Disclosing the Significance of Performance Related Elements of Remuneration

There is no similar provision in the Irish Code for the bank to state performance related elements of remuneration. The results showed a high level of compliance with the exception of EBS in 2010 due to the fact that it did not state the significance of the performance related elements of the total remuneration package. The banks disclosed that remuneration packages are designed to attract, retain and motivate people of the highest calibre. These people are expected to perform to the highest standards.

4.6.8 Internal Control and Risk Management

Question 20 *Is there a statement that the review of the effectiveness of the system of internal controls covers all material controls including financial, operational and compliance controls and risk management systems?*

“The review should cover all material controls, including financial, operational and compliance controls and risk management systems.”

Combined Code C 2.1 (2010 code C 2.1)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

“The system of governance shall be subject to regular internal review. The board shall ensure that it receives timely, accurate and sufficiently detailed information from risk and Control Functions.”

(Central Bank of Ireland, 2010, p 12)

	EBS	BOI	Anglo/IBRC
2005	Fully Compliant	Fully Compliant	Fully Compliant
2006	Fully Compliant	Fully Compliant	Fully Compliant
2007	Fully Compliant	Fully Compliant	Fully Compliant
2008	Fully Compliant	Fully Compliant	Fully Compliant
2009	Fully Compliant	Fully Compliant	Fully Compliant
2010	Fully Compliant	Fully Compliant	Fully Compliant
2011	Fully Compliant	Fully Compliant	Fully Compliant

Table 20 Material Controls Review

The findings in relation to internal control and risk management demonstrate a high level of compliance in disclosing that the required structures, processes and reviews are in place. However findings show that risk management structure failed to fulfil their prudent responsibilities as evidenced by the over exposure through loans to the property sector (Nyberg, 2011)

Question 21 Does the company disclose that any necessary actions have been or are being taken to remedy any significant failings or weaknesses?

“In relation to Code provision C 2 1, the board should summarise the process it has applied in reviewing the effectiveness of the system of internal control and confirm that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review.”

Turnbull Guidance, paragraph 36

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

“The Board shall ensure that the internal controls reflect the risk appetite and that there are adequate arrangements in place to ensure that there is regular reporting to the board on compliance with the risk appetite”

(Central Bank of Ireland, 2010, p 28)

	EBS	BOI	ANGLO/IBRC
2005	Non specific overall comment	Non specific overall comment	Non specific overall comment
2006	Non specific overall comment	Non specific overall comment	Non specific overall comment
2007	Non specific overall comment	Non specific overall comment	Non specific overall comment
2008	Non specific overall comment	Non specific overall comment	Non specific overall comment
2009	Non specific overall comment	Non specific overall comment	Non specific overall comment
2010	Non specific overall comment	Non specific overall comment	Non specific overall comment
2011	Non specific overall comment	Non specific overall comment	Non specific overall comment

Table 21 Disclosure of Internal Control Weaknesses

This question is the critical compliance requirement in relation to internal control and risk management, unlike the questions above, which can be satisfied with a simple disclosure of the existence of structures or processes, this provision requires details of weaknesses or an explicit statement that there were none. The findings show lower levels of compliance when it comes to disclosing any details, such as those regarding any significant failings or weaknesses in internal control. All the banks were rated as being non specific in regard to their comment meaning there was an overall comment on effectiveness but no mention weaknesses identified or remediated. BOI provided an overall comment on effectiveness of internal controls but there was no mention of specific failings or weakness or how they would be remedied if they occurred (Bank of

Ireland, 2008) While it is understandable that companies may not wish to discuss their weaknesses, it is a requirement of the Code to say more than they currently do Disclosure in this area appears to be where the banks did not embrace the spirit of the code

4 6 9 Shareholder Relations

Question 22 Does the board demonstrate the steps taken to understand the views of major shareholders?

“The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about their company ”

Combined Code D 1 2 (2010 code E 1 2)

(Financial Reporting Council, 2003) (Financial Reporting Council, 2006) (Financial Reporting Council, 2008) (Financial Reporting Council, 2010)

	EBS	BOI	ANGLO/IBRC
2005	PLC - Not applicable	Yes	Yes
2006	PLC - Not applicable	Yes	Yes
2007	PLC - Not applicable	Yes	Yes
2008	PLC - Not applicable	Yes	Yes
2009	PLC - Not applicable	Yes	No
2010	No- Sole share holder AIB	Yes	No
2011	No- Sole share holder AIB	Yes	No

Table 22 Understanding the views of major shareholders

While the shareholder relations section in the Combined Code is two pages, there are no similar provisions for shareholder in the Irish codes of corporate governance (Central Bank of Ireland, 2010) Anglo /IBRC were not compliant from 2009-2011 as the nationalisation of the Bank and the transfer of all shares to the Minister the provisions of the UK Corporate Governance Code relating to shareholder relations and conduct at

the Annual General Meeting are no longer applicable (Anglo Irish Bank, 2010) EBS had similar wording in the 2011 annual report Now AIB plc is now the sole holder of the issued share capital (EBS, 2011) Meanwhile Bank of Ireland claimed communications with stockholders were given high priority and that Directors are kept informed on investor issues through regular reports from Group Investor Relations as well as feedback from stockholders, our brokers and investment banker (Bank of Ireland, 2006)

4.7 Interviews

As outlined in the methodology chapter interviews took place with personnel from EBS Interviews were held with a branch manager and the head of compliance Various people within Bank of Ireland declined requests for interview stating “Our position in relation to corporate governance and compliance with the codes is set out pretty comprehensively in our Corporate Governance Statement There is very little in the Central Bank code that we were not already materially complying with before the Code came into force and it is very consistent with our own views on good corporate governance practice ” The interviews questions (see appendix 6 2) were adopted from Walker report on corporate governance in the UK (Walker, 2009) For the purposes of confidentiality Initials will be used to differentiate candidate responses Full transcripts can be found for interviews in appendix 6 3 and 6 4 Throughout this chapter and the discussion chapter the initial ‘J’ will be used for the EBS Branch Managers and ‘H’ will be used for the EBS head of compliance

4 7 1 Theme 1 - Implementation, Guidelines and Process

Reports commissioned by the government into the financial crisis have stated that the failings of corporate governance seem to have been much more a problem of deficient implementation than defective guidelines and processes (Honohan, 2010) The interviewees were asked whether they agreed or disagreed with this statement J's response disagreed with the statement

"Well I think the guideline weren't there I know that if we had an awful lot of these standards in place 5-10 years ago we wouldn't have reached the level we reached with the crisis in the last couple of years We would still have a crisis but not at the level it is at "

Meanwhile H's did not agree with the statement either but for a different reason

"No I don't agree There was very poor regulation of banks the fact that Irish Nationwide and Anglo were able to concentrate so much of their lending in development finance, that was poor regulation "

H was more critical of the regulation of banks while J cited the lack of guidelines as being the reason the reason for failures in corporate governance H's criticisms of the regulator are consistent with the (Nyberg, 2011) J's response is contrary to the findings thus far due to the fact that banks were subject the same codes of corporate governance now as they were pre-crisis

4 7 2 Theme 2 – Supervision

The three reports into the financial crisis analysed were all critical of the regulators They found a lack of intrusiveness and assertiveness on the part of regulators in challenging the bank Interviews were asked whether they agreed or disagreed with this statement H response was in agreement with this statement

"The Central Bank certainly played its part in failing to regulate lending The Central Bank have since stepped up and are now much more prescriptive about the type of lending that banks can engage in"

J's response furthers this sentiment but it also critical of the board that had the overall responsibility

"If the regulator had been regulating correctly and if the various boards of the banks had been constituted in such a way that it didn't have a level of favouritism and cronyism around the place Then things would have been better "

H also points out how the central bank failed

"The Central Bank didn't have the expertise themselves"

This point was also made in the reports studied (Regling & Watson, 2010) H goes on to say that that central bank were not focused on the liquidity problems in banks

"From about 2006 onwards they concentrated on the consumer agenda which was the consumer protection code and the minimum competencies for people selling retail banking products over the counter in the bank were appropriately qualified Resources in the Central Bank were focused on the consumer side of banking They weren't really focused on the prudential side and by the time they focused on the prudential side the damage had been done By the prudential side I mean how banks are capitalised whether they had liquidity whether they had appropriate lending policies, all of that the Central Bank came to it too late "

4 7 3 Theme 3 – Skills with Banks

The interviewees were asked if they felt the new codes of corporate governance would address skills, experience and independence required on the board and across senior and middle management levels

J's response reflected back to problems at senior level in the past

"Well what was happening was they were selecting people for these boards from the same gene pool So if I was a member of the board of Bank of Ireland and I retired by rotation after 3 or 6 years chances are I might have been picked up by one of the others There was no hard regulation about that type of business And I think bad habits developed and bad management decisions developed because they felt they could get away with anything but that is me personally saying "

However, J could only speak on how the code impacts him

"I am just the end user of the code We are on the ground in the trench so I have no knowledge of how the board and senior management will be changed by the code Those directives, they are quite high level in terms of how it impacts on us We just are the end user to the code "

His response signals a gap in the levels of awareness at the front end of the organisation to those working in headquarters as H's response shows H's opinion is that the code will not change skills and experience at these levels however the Fitness and Probity regulation (Central Bank of Ireland, 2010) will help transparency (Central Bank of Ireland, 2010)

"No I don't think it changes it at all I think in the past if a bank were recruiting a Chief executive they would have ensured they had appropriate financial services expertise And I think again Micheal Fingleton who ran Irish Nationwide probably did have the appropriate expertise but through greed or whatever he miss-directed Irish Nationwide A lot of the financial deals that Irish Nationwide did, Michael Fingleton was a personal investor and stood to gain personally There was a huge conflict of interest there That went unchecked by the Central Bank I think the Central Bank has a more recently introduced a fitness and probity regime that requires banks to assess the qualification of most of their staff but again I think banks are much more conscious of recruiting appropriate skilled people I think that was always the case but I think now there is just more of a paper trail around that "

The fitness and probity regime (Central Bank of Ireland, 2010) was introduced in the Central Banks reform Bill (Central Bank of Ireland, 2010) While they may have different functions within a bank, all directors of financial services companies have the same responsibilities under law and must meet standards of competence and probity required by the Financial Regulator

4 7 4 Theme 4 - Effectiveness of Board, and Audit, Risk, Remuneration Committees

The effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees are important governance structures in banks Interviewees were asked if the felt failures in these areas caused the financial crisis and if new codes would strengthen these structures J's response again showed a gap in the level of

awareness so full extent of the code and how it would impact the other levels in of the organisation

"Things wouldn't be the way they are if the various boards of banks had been constituted differently There was bad management practices, there was cronyism, and this all led to bad decision making But then you had the regulator who didn't regulate correctly The boards are high level and I as a bank manager don't have any interaction at that level whatsoever so I don't know, how the codes will change things I'm only told what I have to do to meet the requirements "

H's response suggests that the issues banks had in past have not been corrected by the codes

"No not particularly I don't think the code will change this The financial crisis happened because banks didn't control their lending There was a lending rush because they had access to ECB funding But I think banks have all learned their lesson now "

The interviewee's were asked the impact of stricter codes for corporate governance and if they felt the code advertently or inadvertently inhibited the board (executive, non executive directors) H's response is critical of the provisions of the code

"No I don't think the codes are strict I think a lot of the Irish code is very woolly You can't measure the things it says like for example "a non executive director must constructively challenge and participate actively and shall comprise individuals with relevant skills experience and knowledge who shall provide and independent challenge" You can't measure any of that These concepts are all too woolly "

H's opinions suggest that the codes do not inhibit the executive or non-executive of the board A view matched by J

J "I don't think the codes are much different to combined code They are similar to the combined code It don't think they would be inhibited by the code What is in the code is fairly straight forward in what it says about the board "

4 7 5 Theme 5 – Risk

The Central Bank have stated in the code that they must be informed if there is a deviation from the set risk level put in place in a bank. Interviewees were asked their opinion on these tighter controls and if they felt these measures would have consequences for efficient and competitive banking practices.

H felt that this measure should have always been in place but has reservation as to whether the code is the right place for this kind of regulation.

“I’m not sure if the corporate governance code is the correct place for that piece of regulation. It was only when the code came in that central bank told Irish Banks to have a risk appetite statement. That is not something you typically see in the Corporate Governance code, that’s not in the UK combined code. The Central Bank had lax regulation and there was also lax standards by the banks themselves not to have had things like risk appetite statements measuring concentration risk. Banks should have had limits on the types of lending. There was concentration in apartment lending and to first time buyer etc. so the banks and the Central Bank have come to it very late.”

Meanwhile J felt it was a positive move.

J “I’m not sure how it would affect practices but if we had those kinds of standards in place 10 yrs ago things might not have went the way they did. I think it’s a good measure to have and probably should have always been there.”

The interviewees were asked did they think the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively were to blame for the financial crisis. J’s response was reflected views found through secondary research.

“Yes it did. Now though on the lending side that is all tightened up but if you look at the investment side, what would have happened in the past, now I never did but I know people who did, the 10year bond was sold to the 85year old. You know? Now you can’t have an 85year old in your office unless they have somebody with them. And then you give them all the information. And you tell them to not to even comeback to your for at least 2 weeks and you are not allowed contact them in the 2 week period. And things like that. It’s what should have been there though. But you know common-sense would have told me that 15 years ago but the rules didn’t tell me that.”

H "Risk wasn't handled effectively, and people did stand to gain from the deals that were done All the banks were doing it and the regulator didn't regulate correctly "

This concurs with the finds on remuneration that showed remuneration lacked effective modifiers for risk therefore rapid loan asset growth was extensively and significantly rewarded at executive and other senior levels in most banks (Nyberg, 2011)

In H's opinion "A lot of it was down to greed, there was conflict of interest"

The interviewees were asked if they felt that risk management and remuneration were adequately addressed in the new reforms in corporate governance

J "I don't think the codes are very different to what we had to comply with before, but things have tightened up in those areas "

H "No I don't think there is anything different in the code I think banks have learned their lessons I think the problem that happened to all the Irish banks was that there was a rush to lend, property prices went up and then subsequently the crash in property values meant that all the banks were over exposed and required capital to re-build their balance the sheets The capital could only come from one place which was the state Again the corporate governance code doesn't address any of that The central bank at the time when all of this lending was all going on the Central Bank wasn't scrutinising concentration risk, were banks lending too much to first time buyers, were the banks having too much of a concentration in Dublin or too much of a concentration in apartments "

This statement is consistent with findings on risk management whereby management and boards did not fully appreciate the exposures to funding development projects and that in many institutions governance, systems and processes were also inadequate (Nyberg, 2011)

4 7 6 Theme 6 – Attitudes to Risk Management, Compliance and Regulatory Requirements

Interviewees were asked did they think the banks had taken sufficient measures to address deficiencies in attitudes amongst staff at all levels towards risk management as well as compliance with internal policies and regulatory requirements

J “Processes have tightened up and documentation has changed Processes have changed in terms in of sales process There are certain things we should not do unless we have done A, B and C “You know you give the terms and conditions and conditions to that investment bond to that person before you sign them up to it rather than after it In other words go off and read that and make sure that you are happy with everything I have said and it meets your needs Then come back and complete the sale Don’t do it all as a hard sell So there would be a certain items that have to be done before you can complete a sale And that is fair enough ”

H “Other than changing procedures and rules there isn’t much else banks can do to change attitudes But I do think the Fitness and Probity regime will help tighten things up at board level for new people coming in, so people will at least have the right skills but you need the regulator doing their job correctly too that didn’t happen in the past”

4 7 7 Theme 7 - Institutional Shareholders

Interviewees were asked did they think the role of institutional shareholders in engaging effectively with banks and monitoring the boards was a cause of the financial crisis They were also asked if the engagement with the bank and corporate governance be improved by the new reforms

J “No there were bigger problems with the banks on the lending side, that was the main problem”

In relation to changes in reforms having an impact institutional engagement J stated

J “I doubt it would but I’m not that familiar with that area as I’m on the ground level I wouldn’t have any interaction on matters like that”

H *"No not particularly, the main problem was with the lending practices and poor regulation*

In relation to changes in reforms having an impact institutional engagement H stated

H *"I don't feel that code will change anything in relations to shareholder "*

4 7 8 Theme 8 – Code Implementation

Interviewees were asked did they feel banks could have different interpretations of the codes than those intended by the central bank and if so, how could this be avoided

J *"We can only implement the interpretation the EBS have put on it I don't know what interpretation other institutions have put on it Problems would come down to implementation more so than interpretation But at the same time you still got to implement correctly if you don't implement this correctly you could leave yourself open and you would have the ombudsman man on top of you and you'll have the director of corporate enforcement if it's a certain issue on that side so you would have various things on top of you and the fines are large And that bank isn't going to stand over you if you are the one in the middle "*

H *"No I don't think so There's isn't any ambiguity in the understanding of the codes They are very similar to the combined code which banks were already complying with"*

The interviewees were asked if they felt there were any challenges around the implementation of the codes and how could implementation of the Codes be improved at all levels, from headquarters to local branches?

H *"The main challenge I see is with measurability It's just there is no point in putting stuff in a code that is mandatory if you cannot measure it So short of the Central Bank sitting in every board meeting and having a check list for each director for how many times they've spoke , what did they say, you can't measure these things That was a bit of knee jerk regulation there What is the point in regulation if you can't measure compliance against it I think Ireland being such a small pool of people that there was certainly that boards there was too much familiarity amongst board members There was too much lack of challenge and lack of independence So what has happened now is the Central Bank is forcing people to take Directors from abroad, that isn't in the code The likes of AIB was always subject to the UK combined code and talks about having independent directors but all the directors were Irish and you know in Ireland , everyone knows everyone type of thing, now the Central Bank is forcing AIB It has a lot of English Directors on the board, it has a couple of American directors So the Central Bank is forcing banks to broaden their pool of knowledge of the directorate But again that's not written in the code that your non-executive directors must be foreign I think the code was a bit knee jerk regulating from the Central Bank "*

J "If I don't implement then there is a fine and there is an issue to be addressed. But at a higher level we are not involved in the implementation processes we are not involved in interpreting what the central bank are saying. I don't know if what we are doing is the same as the guy in BOI or AIB. We probably are but I can't be certain. Again at a high level through the banker's federation and dealing with the central bank the people that are in compliance are dealing with that"

Comments raised by the interviewees would suggest that within institutions there should be more incentives for leadership and staff to openly discuss and challenge strategies and their implementations. Lower levels of staff could be more frequently consulted on implementation issues and their implications (Nyberg, 2011)

The interviewees asked what their opinion was on having combined training on corporate governance codes implementation, whereby people receive the same information at the same time, and training could include a mixture of people from all levels i.e. board, and senior middle to lower management

J "Maybe there is a need for that. I remember 15-20 years ago where they were defining process for sales or work flows when they were designing computers and implementing work flow patterns and how to put them into computers. We had many project teams which took people from all across the organisation. Be it the junior clerk, the branch manager, the supervisor in at the top in head office or the head of function in a particular department. They put us all together in different teams so we would have been part of a team of 8 or 9 designing the work flows etc. And that way you can appreciate what the people at the top had to do and what people below you had to do

But that was different. Now should they do that as part of training, it would be no harm if they did? Maybe in a seminar or put in as part of the annual planning that we must do two of these a year and we must have all branch managers at it and all heads of functions at it. But they don't do that, maybe they should. It would improve awareness. It wouldn't make you do your job better but it would improve awareness and I suppose if awareness was improved it would make sure you change to suit it better."

4.7.9 Theme 9 – Impact of Codes

Interviewees were asked if they felt any aspects of good governance practice not currently addressed by the Code

H *"The current new CG code doesn't deal with the composition of your lending book to credit policy to the type of business you can engage in the CG code just looks at composition of your board "*

J *"These will be tweaked next year and the year after Because some bank will go into the central bank and say "look that's not really working and here is the reason why" and the central bank might say "yeah that makes sense we will change that" I can't determine nor have I an impact on the policy I can only implement what is given to me They are just following or doing because they have to do it I don't have a choice because it is in the jobs spec But people at a higher level they are the people that are deciding what fits with the central bank and we have no impact on that "*

4 7 10 Theme 10 – Crisis Prevention

Interviewees were asked if they felt if the new standard of corporate code of governance for banks and insurance undertakings had been in place in the pre-crisis years that the crisis would have been prevented or minimised

J *"If these were in place years ago maybe we wouldn't have had the crisis to the level it reached All these codes in the last number of years would have tightened up on the miss selling and churning "*

H *"I think the central bank corporate governance code hasn't really changed anything If the corporate governance code was in place 10 year s ago we would still be in the same crisis that we are in today What the Corporate Governance code has done is given the central bank a yard stick against which to measure banks If you had them in place say 10years ago we would have still faced this We would still have access to cheap credit from the ECB We would have still been a lending rush to lend and there would have still been the negative equity problem that is around today The Corporate Governance code wouldn't have changed any of that Because the Corporate Governance code is not very descriptive it says a non-executive director should be independent and should challenge But that has always been the case Most of the large Irish banks were either obliged to comply with the UK corporate governance, the old combined code or in the case of the ESB voluntarily adhered to the code So I don't think the code would have changed anything if the Irish code had of been in place at the time "*

4 7 11 Theme 11 - Preventing a Future Crisis

Interviewees were asked if they felt that strengthening the codes of governance for banks will prevent future crises. Their responses suggest more needs to be done and codes alone are not enough to prevent a future crisis.

H *"All the codes talk about is the composition of your board, non-executive directors and what you should do but none of that again would change the position we now find ourselves in "*

J *"I don't think we are at the end yet. And I think the current regulator that we have a wants' to do more "*

5 DISCUSSION AND CONCLUSION

5.1 Introduction

The objective of the research was to explore the new code of corporate governance for credit institutions and insurance undertakings (Central Bank of Ireland, 2010). The main method used for investigating the research topic was analysis of secondary data. This is complemented by primary research involving structured interviews. This chapter summarises the findings of the literature review and the empirical evidence collected. Conclusions are drawn on the basis of the research results. Recommendations are made on how to improve implementation of the code.

5.2 The Irish Code of Corporate Governance

The main strength of the new code lies in the introduction of specific quantitative limits, such as a maximum number of boards a director can serve on, and minimum numbers of board meetings (Central Bank of Ireland, 2010). Unlike the UK Corporate Governance Code (Financial Reporting Council, 2010), compliance with the Central Bank Code is not on a 'comply or explain' basis. Instead, the code has been incorporated into the existing licensing and supervision regime, making it mandatory for all credit institutions and insurance undertakings, as per the scope of the code. This makes it probably the only corporate governance code in existence where the breach of *any* requirement in the code, either quantitative or qualitative, and regardless of how specifically it is worded, could result in a criminal prosecution (Central Bank of Ireland, 2010) (Grant Thornton, 2011).

While these restrictions are notable, the code is not as extensive as the UK code of corporate governance. Throughout the assessment of the annual reports the UK code was compared with the Irish Code. The Irish code has no provisions for shareholder relations or performance related remuneration. Comments from interviewees highlighted a lack of “measurability” with the code provisions for example requirements for non-executive directors to challenge the board. The code lacked the descriptiveness of the UK code and remarks by interviewees suggested the codes were “woolly”. There was an overall consensus that more needs to be done and codes alone would not be sufficient to prevent risks in the future, view echoed through the literature.

5.3 Quality of Compliance and Disclosures

The annual reports of EBS, Bank of Ireland and Anglo Irish Bank/IBRC have been analysed. This showed how well they complied with the combined code and the Irish code of corporate governance. The code came into effect in January 2011 so the annual reports of for 2011 was the first year banks had to comply with code. Quality of disclosures varied amongst the banks in question. The disclosures ranged in the levels of information given from informative to uninformative. Banks did not comply with all provisions of the code.

5.4 Agency Theory

The agency theory is concerned with understanding the consequences and solutions caused by the conflict of interest which arises because of the separation of ownership and decision-making authority (control) in the company (Bradley, et al, 1999). The research found that bank managers acting on behalf of the shareholder took risks that were consistent with the agency problem. One interviewee stated that in some

institutions directors stood to gain personally from loans given to property developers. Directors and senior managers' prudence was inhibited because they stood to gain generous bonuses for reaching growth targets. In this way boards members and senior management were working in their own interests and not those of shareholders.

5.5 Minsky Theory

Hyman P. Minsky is credited with systemising the somewhat trite observation that creditors become more lax about lending standards in times of stability (Minsky, 1986). Minsky (1986) showed that firms driven endogenously by the profit motive, undermines good corporate governance practices. This was certainly the case in the banks at board level and senior management. The corporate governance structures and procedures were overridden in a quest to grow balance sheets.

5.6 Directors Responsibilities

Responsibilities of directors have long been associated with shareholders. Banks such as Anglo stated in their annual reports their responsibilities in safeguarding the assets of the Company and of the Group and in preventing and detecting fraud and other irregularities (Anglo Irish Bank, 2006). However, comments from interviewees and the literature are not consistent with this statement. It was recommended in the literature that directors expand their duties and obligations to take solvency and risk into account when making decisions, or else face personal liability for failure to do so (Macey & O'Hara, 2003). This does not seem unduly harsh given the disregard for risk and long term solvency of banks by directors.

5 7 Non-Executive Directors

While they may have different functions within a bank, all directors of financial services companies have the same responsibilities under law and must meet standards of competence and probity required by the Financial Regulator (Honohan, 2010) While the annual reports are in compliance with basic provisions of the code they give little information on the non-executive directors ability to challenge the board decision making The Non Executive Directors while formally independent were in practice, highly reliant on the knowledge, openness and ability of bank management (Nyberg, 2011) This resulted in a lack of challenge to the board and a belief that formal policy, structures and procedures were enough for the prudent management of banks

5 8 Supervision

The ineffectiveness of supervision was highlighted through the secondary research and the interviews Interviewees claimed the financial regulator lacked the required expertise A view echoed in the literature The research found there is little point in the corporate codes of governance if the approach to supervision has not changed (Honohan, 2010) Remarks from interviewees state there was a lack of focus on the prudential matters This reinforces suggestions in the literature that effectiveness of regulatory regimes rests not only on banks but on the regulators ability to evaluate banks' risk management and internal control systems effectively (IFSRA, 2006) However other view suggest that permanently improving financial stability should be done in ways that do not demand the unfailing attention, prescience or vigilance of ministries, central banks or regulators (Nyberg, 2011)

5 9 Companies Act

In addition to the codes of corporate governance, restrictions and disclosure requirements are imposed under the Companies Acts in relation to contracts of employment, substantial property transactions, share options, loans/quasi-loans and guarantees to director and connected persons (Department of Enterprise, Trade and Innovation, 2011) The highly controversial loans to directors at Anglo Irish Banks is a clear example of how the annual reports failed to disclose to shareholder a true and fair account of governance practices within the bank

Irish company law provision for audit requirements includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed (Department of Enterprise, Trade and Innovation, 2011) Banks failed to adequately disclose in their annual reports a true and fair account of the financial health This again highlights governance disclosures on paper were not carried out in practice

5 10 Duty of Care and Fiduciary Duty

Courts apply two broad principles against which to assess the conduct of directors Duty of care and skill and fiduciary duty Directors owe a duty to act honestly, with a reasonable degree of skill, care and diligence In addition, certain fiduciary duties are imposed on directors as a result of their relationship of trust with the company (Jenson & Meckling, 1976) These include, a duty to act *bona fide* in the best interests of the

company, a duty to exercise their powers for their proper purpose and not for any improper motive, a duty to avoid fettering their discretion, a duty not to make a profit from corporate information or corporate opportunities and a duty to try to avoid conflict of interest situations (Jenson & Meckling, 1976) While it is argued that a board can only rely on information it received from its management and the knowledge and expertise of that management, it is, nevertheless, incumbent on the board to have sufficient understanding and awareness of the risks associated with the business for which it has oversight responsibility on behalf of the shareholders. However the banks failed to ensure sufficient checks and balances were in place. For example, the high growth strategies employed by Anglo Irish Banks from 2003-2006 held no regard for the risks to the banks long term solvency. It also shows they did not fulfil their duties to shareholders by failing to protect company assets. These actions were in breach of the principles of duty of care and fiduciary duty.

5.11 The Board

Duties of the board are extensive in the UK code and to a lesser extent in the Irish Code. The annual reports showed a high level of compliance with these provisions. Comments made by the boards on performance were positive despite warning signs in the macroeconomy. The comments by Brian J Goggin, Group Chief Executive in Bank of Ireland's annual report of 2005, claimed a strong performance in their business position and growth was due to a benign economic background. Consumer spending, underpinned by strong employment growth, low inflation and interest rates, together with favourable demographics, were stated as the key drivers of this growth (Bank of

Ireland, 2006) However the macroeconomic developments were already exhibiting signs in 2005-2006 that reasonably should have caused concerns (Nyberg, 2011) Goggin's also states in the report that asset quality remained strong while acknowledging that they were operating in an increasingly competitive environment Goggin's also stated how they had taken steps to strengthen the asset management side of the business This was done through the appointments of high a number of "high-calibre" "senior appointments" to the investment team Bank of Ireland in reality was relying on wholesale funding and growing its exposure to the property market

5.12 Shareholder Relations

The combined code states the board has a responsibility for ensuring that a satisfactory dialogue with shareholders (Combined Code D.1) (Financial Reporting Council, 2003) The Irish code fails to provide any provisions for shareholder relations in the Irish codes of corporate governance (Central Bank of Ireland, 2010) This area will need to be developed in line with the UK code which has extensive provisions on duties to shareholders Most of the annual reports complied with the UK code stating they had investor relations programmes

5.13 Internal Control and Risk Management

Internal control systems should be subject to regular monitoring of the effectiveness This is informed by the work of the internal audit function, the audit committee, external audit and management staff BOI claimed

“The Group’s exposure to operational risk is governed by policy formulated by the Group Operational Risk Committee and approved by the Group Risk Policy Committee and, where appropriate, by the Court. The policy specifies that the Group will operate such measures of risk identification, assessment, monitoring and management operational risk management is designed to safeguard the Group’s assets while allowing sufficient operational freedom to earn a satisfactory return to Stockholders” (Bank of Ireland, 2006)

The Board is required to understand the risks to which the institution is exposed and shall establish a documented risk appetite for the institution” (Central Bank of Ireland, 2010, p 28) This area of the code showed banks did not embrace the spirit of the code. Banks should be encouraged to go above and beyond the minimum requirements of the code and disclose any weaknesses they find in their annual report. This lack of information makes it difficult to gain insight into how the board was safeguarding the assets of the company. Statements in their annual reports are in direct contrast to the findings in the literature. For example Bank of Ireland stated the Group recognises that the effective management of market risk is essential to the maintenance of stable earnings, the preservation of stockholder value.

In BOI the court of directors were responsible for approving high level policy and providing strategic direction in relation to the nature and scale of risk that the Group is permitted to assume to achieve its corporate objectives. BOI Group Risk Policy Committee was responsible for risk management and members included Executive Directors. It was stated in the annual report that they had to consider specific risk issues and overall Group risk. This committee, in turn, delegated responsibility for oversight of the major classes of risk to four subcommittees. With the various risk committees charged with providing internal control it is difficult to see how the risks were not dealt with. The bank states the Group continues to follow the regulatory developments and

manage risk appetite and capital utilisation in order to generate improved returns for our investors. However, the banks were increasing their exposure and putting in jeopardy that long term viability of the bank, contradicting their statement about creating better return for investors.

5.14 Comply or explain

The comply or explain approach has been a feature of the UK corporate governance code since 1998. This approach allows companies not to comply with a provision if they can exhibit that good governance can still be achieved. However, in these cases the explanations provided by the companies must “aim to illustrate how its actual practices are both consistent with the principle to which the particular provision relates and how they contribute to good governance.” In some cases, banks failed to ‘explain’ non-compliance and merely noted which provisions they were not compliant with and in some cases did not describe the alternative governance measures put in place.

5.15 Credit Policy

Banks claimed that structures and procedure were in place to manage risk effectively. Anglo claimed lending caps would be put in place when it was considered appropriate to limit exposure to certain sectors. However, the findings show these practices and procedures were ineffective as there was a gradual adoption of lower credit standards by Anglo and a number of Irish banks. There was no apparent realisation of the implications of these actions.

5.16 External Auditors

The auditors signed off on the annual reports of the banks according to existing rules and regulations. Is it striking that the governance and procedural problems in the banks were not reported by the external auditor. Over the period investigated, auditors did not report excesses in lending nor did they raise any concerns with the Financial Regulator. Even if they had, it appears unlikely that anything would have been done about it as in general the Financial Regulator was already aware of such limit excesses.

5.17 Preventing Future Crises

The financial crisis has shown that despite having codes and regulations in place these were not adhered to by banks or enforced by the, Central Bank, the Financial Regulator, or the Department of Finance. Unless there is adequate enforcement and willingness on the part of boards of management to abide by good governance practice, these codes are worthless. Findings from the interviews also support this view and the literature (Hamill, et al , 2010)

5.18 Conclusion

The research has found that weaknesses in corporate governance played a significant part in the financial services crisis in Ireland and has been a key driver for the reform that is currently being brought about by the new corporate governance code. These issues concern breakdowns in risk management approaches and in some cases the unwarranted or excessive overriding of internal guidelines. It is surprising that there was not a stronger reaction within the banks themselves and among supervisors to lending trends that saw a progressive build-up of concentrated loan exposures to and within the commercial property sector. It would be valuable to establish the reasons for the absence of reaction, within banks and in the regulatory authority, since this was a critical factor that contributed to the overall level of risk exposure in the system. Again, it should be established how and why internal checks and balances failed, whether supervisors perceived the risks, and why the response of supervisors was not more forceful.

The annual reports of banks show disclosures made on paper in relation to governance did not hold much resemblance to management practices. Boards and senior management practices were in breach of their fiduciary duties to the shareholders. There was strong evidence of the agency problem and a lack of compliance with the spirit of good corporate governance. The findings show that corporate governance in Irish Banks was a mere ticking-off exercise and masked the serious problems arising from poor governance.

The Reform Bills introduced by the Central Bank have not done much to change attitudes towards corporate governance. Interviewees see the introduction of the codes as knee-jerk regulation. It is clear from comparison with the UK codes that the Irish code needs more development particularly in the area of measurability. The provisions of the code lack the robustness of the combined code and do not cover all areas for example shareholder relations. In spite of the failures at board level the codes have not changed or strengthened provisions that were already in place for responsibilities of the board and non-executive directors. Other areas such as risk appetite that contributed heavily to the financial crisis lacked the robustness required and do not even meet the standards currently in the UK code.

The code lacks the strength to make a forceful impression on Irish banking industry, with interviewees stating the code would not change anything and was no different to the code currently in place. What strongly came across through the research is a need for proper enforcement by the Central Bank of existing codes and to put in place real consequences for lack of compliance. The new code does not match current standards and seems to be little more than a PR exercise to try to rebuild the Central Bank's damaged reputation.

While the aim of the code was to strengthen corporate governance the new measures will not result in greater transparency and more disclosure of information. The Irish code lacks the comprehensiveness of the UK combined code. The Irish code does not provide any provisions for shareholder relations or performance related elements of remuneration. The code's main strength is the fact that all major credit institutions must

adhere to the code. The findings suggest it is doubtful the codes and will result in greater effectiveness of the boards. As the code provisions concerning remuneration, risk and audit have not been strengthened it is difficult to see how greater protection for shareholders can be achieved.

As found throughout this investigation regulators and banks embraced the same policies. The result, as shown by the crisis, was that risk-taking practice got out of control. It is not beyond doubt that strategies taken by banks in the future could bring about another crisis. Many of the reforms, the new codes of corporate governance included, have been undertaken at short notice, to shore up the functioning of the present financial system could turn out, once again, to be ineffective.

5.19 Suggestions for Further Research

The area of corporate governance will continue to receive debate and literature will broaden extensively. Further research could entail a full examination of all banks operating in Ireland assessing compliance with the new codes.

6 APPENDIX

6.1 Compliance and Disclosures Questions

Governance Code Compliance

Question 1 Do they claim full compliance with the code?

Question 2 Of the banks which do not claim full compliance with the code, for which provisions do they most commonly provide explanations?

Non-Executive Directors

Question 3 Is at least half of the board comprised of independent non-executive directors?

Question 4 How well do companies describe the consideration of independence?

Question 5 Do the Senior Independent Directors and non-executive directors appraise the chairman's performance?

The Board

Question 6 Is there a statement of how the board operates and how its duties are discharged effectively?

Question 7 Are the roles of the chairman and chief executive divided and exercised by different individuals and is there a statement that the divisions of responsibilities between the chairman and chief executive have been clearly established and agreed by the board?

Question 8 Is it disclosed how the performance of the board, committees and individual directors are evaluated?

Question 9 Is it disclosed that the terms of reference for the audit, remuneration and nomination committees are available for inspection?

4 Audit committee

Question 10 Are all audit committee members independent non-executive directors?

Question 11 Does the audit committee have at least one member with recent and relevant financial experience?

Question 12 Is there a separate section of the annual report which describes the work of the committee?

Question 13 Do the terms of reference include the following responsibilities?

5 Internal audit

Question 14 Does the company have an internal audit function or equivalent, and if not is the absence explained?

Question 15 Does the audit committee monitor and review the effectiveness of internal audit activities?

6 External audit

Question 16 If the external auditor provides non-audit services, is there a statement as to how the auditor's objectivity and independence is safeguarded?

7 Remuneration committee

Question 17 Are there at least three members, all of whom are independent non-executive directors?

Question 18 Does the chairman sit on this committee, and if so, does he/she chair it?

Question 19 Does the company state the basis for remuneration including performance related elements?

Question 20 Does the company state that performance related elements of remuneration form a significant proportion of the total remuneration package of executive directors?

9 Internal control and risk management

Question 21 Is there a statement that the review of the effectiveness of the system of internal controls covers all material controls including financial, operational and compliance controls and risk management systems?

Question 22 Does the company disclose that any necessary actions have been or are being taken to remedy any significant failings or weaknesses?

10 Shareholder relations

Question 23 Does the board demonstrate the steps taken to understand the views of major shareholders?

6 2 Interview Questions

Implementation, Guidelines and Process

Reports commissioned by the government into the financial crisis have stated that the failings of corporate governance seem to have been much more a problem of deficient implementation than defective guidelines and processes. To what extent do you agree or disagree with this statement and could you give me some examples?

Supervision

It was found in the Honohan report that there was a lack of intrusiveness and assertiveness on the part of regulators in challenging the banks- to what extent do you agree or disagree with this statement and could you give me some examples?

Skills within banks

In terms of the balance of skills, experience and independence required on the boards, senior management and middle management, to what extent will these areas be strengthened or improved by the new requirements of the code of corporate governance?

Effectiveness of board, and audit, risk, remuneration committees

The effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees are important governance structures in banks, to what extent did the failures in these areas cause the financial crisis in your opinion? Will these be corrected by the new reforms?

In your opinion what is the impact of stricter codes for corporate governance. In particular do you feel the Code advertently or inadvertently inhibits the board (executive, non-executive directors)? Explain your views

Risk

The new codes have stated that the central bank must be informed if there is a deviation from the set risk level put in place in a bank. Do you think these tighter controls will have consequences for efficient and competitive banking practices?

To what extent do you think the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively were to blame for the financial crisis?

Do you think that risk management and remuneration are adequately addressed in the new reforms in corporate governance?

Attitudes to risk management, compliance and regulatory requirements

Do you think the banks have taken sufficient measures to address deficiencies in attitudes amongst staff at all levels towards risk management as well as compliance with internal policies and regulatory requirements? Explain your views or give examples

Institutional shareholders

In assessing the role of institutional shareholders in engaging effectively with banks and monitoring the boards, do you feel this was a cause of the financial crisis?

Will their engagement with the bank and corporate governance be improved by the new reforms?

Codes Implementation

Do you feel that banks can have different interpretations of the codes than those intended by the central bank? If so, how in your opinion could this be avoided?

In your experience are there any challenges around the implementation of the codes? If so, how could implementation of the Codes be improved at all levels, from headquarters to local branches?

What is your opinion on having combined training on corporate governance codes implementation, whereby people receive the same information at the same time, and training could include a mixture of people from all levels i.e. board, and senior middle to lower management?

Impact of codes

Are there any aspects of good governance practice not currently addressed by the Code?

Crisis prevention

Do you feel that if the new standard of corporate code of governance for banks and insurance undertakings had been in place in the pre-crisis years that the crisis would have been prevented or minimised?

Preventing a future crisis

Do you feel strengthening the codes of governance for banks will prevent future crises? Explain your view

6.3 Interview Transcripts

Implementation, Guidelines and Process

Question 1. Reports commissioned by the government into the financial crisis have stated that the failings of corporate governance seem to have been much more a problem of deficient implementation than defective guidelines and processes. To what extent do you agree or disagree with this statement and could you give me some examples?

J: "Well I think the guideline weren't there. I know that if we had an awful lot of these standards in place 5-10 years ago we wouldn't have reached the level we reached with the crisis in the last couple of years. We would still have a crisis but not at the level it is at."

H: "No I don't agree. There was very poor regulation of banks the fact that Irish Nationwide and Anglo were able to concentrate so much of their lending in development finance, that was poor regulation."

Supervision

Question 2. It was found in the Honohan report that there was a lack of intrusiveness and assertiveness on the part of regulators in challenging the banks- to what extent do you agree or disagree with this statement and could you give me some examples?

J: "If the regulator had been regulating correctly and if the various boards of the banks had been constituted in such a way that it didn't have a level of favouritism and cronyism around the place. Then things would have been better."

H: "The Central Bank certainly played its part in failing to regulate lending. The Central Bank have since stepped up and are now much more prescriptive about the type of lending that banks can engage in. And also the Irish bank's lending rush was due to the fact that we had access to ECB funding through the euro being introduced. That wasn't the case in the UK because it never had access to ECB funding so there were huge unique factors. That's a differentiation between Ireland and the UK. And a second problem was the Central Bank didn't have the expertise themselves. From about 2006 onwards they concentrated on the consumer agenda which was the consumer protection code and the minimum competencies for people selling retail banking products over the counter in the bank were appropriately qualified. Resources in the Central Bank were focused on the consumer side of banking. They weren't

really focused on the prudential side and by the time they focused on the prudential side the damage had been done By the prudential side I mean how banks are capitalised whether they had liquidity whether they had appropriate lending policies, all of that the Central Bank came to it too late ”

Skills within banks

Question 3 In terms of the balance of skills, experience and independence required on the boards, senior management and middle management, to what extent will these areas be strengthened or improved by the new requirements of the code of corporate governance?

J “Well what was happening was they were selecting people for these boards from the same gene pool So if I was a member of the board of Bank of Ireland and I retired by rotation after 3 or 6 years chances are I might have been picked up by one of the others There was no hard regulation about that type of business And I think bad habits developed and bad management decisions developed because they felt they could get away with anything but that is me personally saying I am just the end user of the code We are on the ground in the trench so I have no knowledge of how the board and senior management will be changed by the code Those directives, they are quite high level in terms of how it impacts on us We just are the end user to the code ”

H “No I don’t think it changes it at all I think in the past if a bank were recruiting a Chief executive they would have ensured they had appropriate financial services expertise And I think again Micheal Fingleton who ran Irish Nationwide probably did have the appropriate expertise but through greed or whatever he miss directed Irish Nationwide A lot of the financial deals that Irish Nationwide did, Michael Fingleton was a personal investor and stood to gain personally There was a huge conflict of interest there That went unchecked by the Central Bank I think the Central Bank has a more recently introduced a fitness and probity regime that requires banks to assess the qualification of most of their staff but again I think banks are much more conscious of recruiting appropriate skilled people I think that was always the case but I think now there is just more of a paper trail around that ”

Effectiveness of board, and audit, risk, remuneration committees

Question 4 The effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees are important governance structures in banks, to what extent did the failures in these areas cause the financial crisis in your opinion?

Will these be corrected by the new reforms?

J "Things wouldn't be the way they are if the various boards of banks had been constituted differently There was bad management practices, there was cronyism, and this all led to bad decision making But then you had the regulator who didn't regulate correctly The boards are high level and I as a bank manager don't have any interaction at that level whatsoever so I don't know, how the codes will change things I'm only told what I have to do to meet the requirements "

H "No not particularly I don't think the code will change this The financial crisis happened because banks didn't control their lending There was a lending rush because they had access to ECB funding But I think banks have all learned their lesson now "

Question 5 In your opinion what is the impact of stricter codes for corporate governance In particular do you feel the Code advertently or inadvertently inhibits the board (executive, non-executive directors)? Explain your views

J I don't think the codes are much different to combined code They are similar to the combined code It don't think they would be inhibited by the code What is in the code is fairly straight forward in what it says about the board

H "No I don't think the codes are strict I think a lot of the Irish code is very woolly You can't measure the things it says like for example "a non executive director must constructively challenge and participate actively and shall comprise individuals with relevant skills experience and knowledge who shall provide and independent challenge" You can't measure any of that These concepts are all too woolly "

Risk

Question 6 The new codes have stated that the central bank must be informed if there is a deviation from the set risk level put in place in a bank Do you think these tighter controls will have consequences for efficient and competitive banking practices?

J I'm not sure how it would affect practices but if we had those kinds of standards in place 10 yrs ago things might not have went the way they did I think it's a good measure to have and probably should have always been there

H "I'm not sure if the corporate governance code is the correct place for that piece of regulation It was only when the code came in that central bank told Irish Banks to have a risk appetite statement That is not something you typically see in the Corporate Governance code, that's not in the UK combined code The Central Bank had lax regulation and there was also lax standards by the banks themselves not to have had things like risk appetite statements measuring concentration risk Banks should have had limits on the types of lending There was concentration in apartment lending and to first time buyer etc so the banks and the Central Bank have come to it very late "

Question 7 To what extent do you think the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively were to blame for the financial crisis?

J "Yes it did Now though on the lending side that is all tightened up but if you look at the investment side, what would have happened in the past, now I never did but I know people who did, the 10year bond was sold to the 85year old You know? Now you can't have an 85year old in your office unless they have somebody with them And then you give them all the information And you tell them to not to even comeback to your for at least 2 weeks and you are not allowed contact them in the 2 week period And things like that It's what should have been there though But you know common-sense would have told me that 15 years ago but the rules didn't tell me that "

H Risk wasn't handled effectively, and people did stand to gain from the deals that were done All the banks were doing it and the regulator didn't regulate correctly

Question 8 Do you think that risk management and remuneration are adequately addressed in the new reforms in corporate governance?

J I don't think the codes are very different to what we had to comply with before, but things have tightened up in those areas

H "No I don't think there is anything different in the code I think banks have learned their lessons I think the problem that happened to all the Irish banks was that there was a rush to lend, property prices went up and then subsequently the crash in property values meant that all the banks were over exposed and required capital to re-build their balance the sheets The capital could only come from one place which was the state Again the corporate governance code doesn't address any of that The central bank at the time when all of this lending was all going on the Central Bank wasn't scrutinising concentration risk, were banks lending too much to first time buyers, were the banks having too much of a concentration in Dublin or too much of a concentration in apartments "

Attitudes to risk management, compliance and regulatory requirements

Question 9 Do you think the banks have taken sufficient measures to address deficiencies in attitudes amongst staff at all levels towards risk management as well as compliance with internal policies and regulatory requirements? Explain your views or give examples

J "Processes have tightened up and documentation has changed Processes have changed in terms in of sales process There are certain things we should not do unless we have done A, B and C "You know you give the terms and conditions and conditions to that investment bond to that person before you sign them up to it rather than after it In other words go off and read that and make sure that you are happy with everything I have said and it meets your needs Then come back and complete the sale Don't do it all as a hard sell So there would be a certain items that have to be done before you can complete a sale And that is fair enough "

H "Other than changing procedures and rules there isn't much else banks can do to change attitudes But I do think the Fitness and Probity regime will help tighten things up at board level for new people coming in, so people will at least have the right skills but you need the regulator doing their job correctly too that didn't happen in the past"

Institutional shareholders

Question 10 In assessing the role of institutional shareholders in engaging effectively with banks and monitoring the boards, do you feel this was a cause of the financial crisis?

J "No there were bigger problems with the banks on the lending side, that was the main problem"

H "No not particularly, the main problem was with the lending practices and poor regulation"

Question 11 Will their engagement with the bank and corporate governance be improved by the new reforms?

J "I doubt it would but I'm not that familiar with that area as I'm on the ground level I wouldn't have any interaction on matters like that"

H "I don't feel that code will change anything in relations to shareholder "

Codes Implementation

Question 12 Do you feel that banks can have different interpretations of the codes than those intended by the central bank? If so, how in your opinion could this be avoided?

J "We can only implement the interpretation the EBS have put on it I don't know what interpretation other institutions have put on it Problems would come down to implementation more so than interpretation But at the same time you still got to implement correctly if you don't implement this correctly you could leave yourself open and you would have the ombudsman man on top of you and you'll have the director of corporate enforcement if it's a certain issue on that side so you would have various things on top of you and the fines are large And that bank isn't going to stand over you if you are the one in the middle "

H "No I don't think so There's isn't any ambiguity in the understanding of the codes They are very similar to the combined code which banks were already complying with"

Question 13. In your experience are there any challenges around the implementation of the codes? If so, how could implementation of the Codes be improved at all levels, from headquarters to local branches?

J "If I don't implement then there is a fine and there is an issue to be addressed. But at a higher level we are not involved in the implementation processes we are not involved in interpreting what the central bank are saying. I don't know if what we are doing it the same as the guy in BOI or AIB. We probably are but I can't be certain. Again at a high level through the banker's federation and dealing with the central bank the people that are in compliance are dealing with that"

H: "The main challenge I see is with measurability. It's just there is no point in putting stuff in a code that is mandatory if you cannot measure it. So short of the Central Bank sitting in every board meeting and having a check list for each director for how many times they've spoke , what did they say, you can't measure these things. That was a bit of knee jerk regulation there. What is the point in regulation if you can't measure compliance against it. I think Ireland being such a small pool of people that there was certainly that boards there was too much familiarity amongst board members. There was too much lack of challenge and lack of independence. So what has happened now is the Central Bank is forcing people to take Directors from abroad, that isn't in the code. The likes of AIB was always subject to the UK combined code and talks about having independent directors but all the directors were Irish and you know in Ireland , everyone knows everyone type of thing, now the Central Bank is forcing AIB. It has a lot of English Directors on the board; it has a couple of American directors. So the Central Bank is forcing banks to broaden their pool of knowledge of the directorate. But again that's not written in the code that your non-executive directors must be foreign. I think the code was a bit knee jerk regulating from the Central Bank."

Question 14. What is your opinion on having combined training on corporate governance codes implementation, whereby people receive the same information at the same time, and training could include a mixture of people from all levels i.e. board, and senior middle to lower management?

J "Maybe there is a need for that. I remember 15 -20 years ago where they were defining process for sales or work flows when they were designing computers and implementing work flow patterns and how to put them into computers. We had many project teams which took people from all across the organisation. Be it the junior clerk, the branch manager, the supervisor in at the top in head office or the head of function in a particular department. They

put us all together in different teams so we would have been part of a team of 8 or 9 designing the work flows etc And that way you can appreciate what the people at the top had to do and what people below you had to do

But that was different Now should they do that as part of training, it would be no harm if they did Maybe in a seminar or put in as part of the annual planning that we must do two of these a year and we must have all branch managers at it and all heads of functions at it But they don't do that, maybe they should It would improve awareness It wouldn't make you do your job better but it would improve awareness and I suppose if awareness was improved it would make sure you change to suit it better "

H "I think possibly there is a need for training though, I think that would be a matter for the Central Bank, where they would provide training session on the codes But I'm sure if that could be done"

Impact of codes

Question 15 Are there any aspects of good governance practice not currently addressed by the Code?

J "These will be tweaked next year and the year after Because some bank will go into the central bank and say "look that's not really working and here is the reason why" and the central bank might say "yeah that makes sense we will change that" I can't determine nor have I an impact on the policy I can only implement what is given to me They are just following or doing because they have to do it I don't have a choice because it is in the jobs spec But people at a higher level they are the people that are deciding what fits with the central bank and we have no impact on that "

H "The current new CG code doesn't deal with the composition of your lending book to credit policy to the type of business you can engage in the CG code just looks at composition of your board "

Crisis Prevention

Question 16 Do you feel that if the new standard of corporate code of governance for banks and insurance undertakings had been in place in the pre-crisis years that the crisis would have been prevented or minimised?

J "If these were in place years ago maybe we wouldn't have had the crisis to the level it reached. All these codes in the last number of years would have tightened up on the miss selling and churning "

H "I think the central bank corporate governance code hasn't really changed anything. If the corporate governance code was in place 10 years ago we would still be in the same crisis that we are in today. What the Corporate Governance code has done is given the central bank a yard stick against which to measure banks. If you had them in place say 10 years ago we would have still faced this. We would still have access to cheap credit from the ECB. We would have still been a lending rush to lend and there would have still been the negative equity problem that is around today. The Corporate Governance code wouldn't have changed any of that. Because the Corporate Governance code is not very descriptive it says a non-executive director should be independent and should challenge. But that has always been the case. Most of the large Irish banks were either obliged to comply with the UK corporate governance, the old combined code or in the case of the ESB voluntarily adhered to the code. So I don't think the code would have changed anything if the Irish code had of been in place at the time "

Preventing a future crisis

Question 17 Do you feel strengthening the codes of governance for banks will prevent future crises? Explain your view

H "All the codes talk about is the composition of your board, non-executive directors and what you should do but none of that again would change the position we now find ourselves in "

J "I don't think we are at the end yet. And I think the current regulator that we have a want's to do more "

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