

# Settlement Agreement between the Central Bank of Ireland

# and

## **KBC Bank Ireland Plc**

KBC Bank Ireland Plc fined €1,400,000 by the Central Bank of Ireland for breaches of its Code of

Practice on Lending to Related Parties

The Central Bank of Ireland (the 'Central Bank') has fined KBC Bank Ireland Plc ('KBC' or the 'Firm') €1,400,000 and reprimanded it for breaches of the Code of Practice on Lending to Related Parties 2010, and the Code of Practice on Lending to Related Parties 2013 (collectively 'the Code'). The breaches have been admitted by the Firm. This is the first enforcement action brought by the Central Bank against a credit institution for breaches of the Code.

The Central Bank introduced the Code in 2011 to guard against abuses in lending to related parties and as part of the Central Bank's regulatory approach following the financial crisis. Under the Code, relevant firms must obtain the prior approval of their Board or a subcommittee thereof, before they can enter into, or vary loan transactions with related and/or connected parties, which include directors, senior managers, significant shareholders of the firm and spouses or domestic partners.

The breaches of the Code occurred from 26 September 2012 to 23 February 2016, during which time the Firm failed, on eighteen separate occasions to:

- Have adequate policies and processes in place, which are adhered to, to identify loans to related parties;
- Obtain the prior approval of its Related Party Lending Committee prior to (i) granting a
  loan to a related party and (ii) extending the maturity dates on 12 separate occasions in
  respect of five existing loans; and
- Obtain prior approval of the Related Party Lending Committee on five separate occasions in respect of the management of four loans to two related parties.

Director of Enforcement, Derville Rowland said:

"Related party lending is an issue of significant prudential concern for the Central Bank, particularly in the context of identified failings at the time of the financial crisis when loans were issued to related parties without adherence to internal controls and procedures. This Code represents an important component of the Central Bank's response to failings associated with related party lending and was introduced to seek to prevent abuses and address possible conflict of interests in this area.

The Central Bank is committed to robust, appropriate and proportionate Enforcement action, to ensure there is a credible deterrent and to promote compliance in the firms that we regulate. Such repeated breaches of the Code, in spite of on-going Central Bank intervention and engagement with the Firm, is unacceptable and demonstrates a failure on the part of the Firm to have in place and adhere to the necessary policies and processes to ensure effective compliance with the Code; this is reflected in the level of the fine and the reprimand issued today and accepted by the Firm.

The Central Bank requires all firms to ensure full compliance with the Code. Where firms fall short of the required standards, the Central Bank will continue to take the necessary enforcement action."

### **BACKGROUND**

KBC was incorporated in Ireland on 14 February 1973 and is authorised under Section 9 of the Central Bank Act 1971. Its principal activities are retail banking, including the provision of residential mortgage finance, deposit accounts, current accounts and consumer finance products.

In June 2013 the Central Bank raised concerns with the Firm regarding its compliance with the Code and required the Firm's Internal Audit Department to carry out a review of its compliance with Central Bank Codes generally.

On 8 May 2014, and again on 26 June 2014, the Firm notified the Central Bank (as obliged to do so under the Code) of three related party lending transactions which were potential breaches of the Code. In December 2014, following these notifications and the completion of the annual Full Risk Assessment of the Firm, the Central Bank raised further concerns relating to KBC's compliance with the Code and required the Firm to prepare a detailed report for the Central Bank demonstrating that it had taken remedial actions to ensure staff were adhering to the procedures and therefore preventing similar breaches of the Code occurring in the future.

On 25 February 2015 the Central Bank notified the Firm of its decision to commence an investigation into suspected breaches of the Code.

Between 25 February 2015 and 29 February 2016, and following a detailed internal review, the Firm reported a further fifteen occasions of non-compliance in relation to existing loans which were potential breaches of the Code.

#### PRESCRIBED CONTRAVENTIONS

The Central Bank's investigation confirmed a number of breaches of the Code, occurring during the period September 2012 to February 2016, namely:

# Failure to have adequate policies and processes in place and adhered to.

Section 6(f) of the Code imposes, among other matters, an obligation on the Firm to ensure that it has "policies and processes" in place, which are "adhered to, in order to identify individual loans to a related party as well as the total amount of such loans and to monitor and report on such loans through an independent credit review process".

During the period 26 September 2012 to 23 February 2016, the Firm failed to obtain necessary prior approval for eighteen actions (as described below) involving loans to related parties.

In light of these breaches which occurred over a period of more than three years, the policies and processes which were in place during this time were not adequate to identify loans to related parties. In particular:

- There was a lack of awareness by staff across three separate Divisions regarding the processes which were required to be followed in relation to related party lending;
- There has been an acknowledgement by the Firm that the breaches of the Code occurred, in part, as a result of a gap in training processes; and
- Procedural weaknesses resulted in actions in respect of the management of a loan to a related party being processed automatically, prior to the necessary approvals being obtained.

Failure to obtain approval of the Related Party Lending Committee prior to granting a loan to a related party or varying the terms of that loan.

Section 6(b) of the Code imposes an obligation on the Firm to ensure that all loans to a related party, or any variation to the terms of a loan to a related party, are subject to individual prior approval by the Board or a subcommittee thereof.

Between September 2012 and November 2014 the Firm breached the requirements of Section 6(b) by failing to seek or obtain the approval of its Related Party Lending Committee before it entered the following transactions:

- Extension of the maturity date on a €6.6m loan facility to a related party entity on eight separate occasions in the period September 2012 to October 2014;
- Extension of the maturity date on a €5.3m loan facility to a related party entity in September 2012;
- Extension of the maturity date on a €5.7m loan facility to a related party entity in November 2013;
- Extension of the maturity dates on two Risk Participation Agreements with a related party entity in the amounts of €3.7m and €1.9m in March 2014; and
- A credit card facility in the amount of €2,000 was extended to a related party individual in April 2014.

Failure to obtain approval of the Related Party Lending Committee prior to carrying out actions in respect of the management of a loan.

Section 6(c) of the Code imposes an obligation on the Firm to ensure that actions in respect of the management of a loan to a related party (including but not limited to permitting interest roll-up, granting a grace period for payment, loan write-off in whole or in part, provisioning against a loan,

decisions to take or not to take enforcement action) are subject to individual prior approval in writing by the board or a subcommittee thereof.

Between December 2013 and February 2016 the Firm breached the requirements of Section 6(c) by failing to seek or obtain the approval of its Related Party Lending Committee before undertaking the following actions in respect of the management of a number of loans to related parties:

- The automatic processing of an impairment provision in respect of three separate mortgages
  to a related party individual over the course of a year, and separately, implementation of a
  short-term alternative repayment arrangement in respect of one of those mortgages; and
- Increasing internal provisioning by €0.7m in respect of a loan to a related party entity in November 2015.

### **PENALTY DECISION FACTORS**

In deciding the appropriate penalty to impose, the Central Bank considered the following matters:

- The multiple business areas across which the breaches occurred;
- The period of time over which the breaches occurred, spanning the period 26 September 2012 to 23 February 2016;
- The fact that most of the breaches occurred after on-going Central Bank intervention and engagement with the Firm regarding its compliance with the Code;
- The action taken by the Firm to address the breaches once made aware of them and the fact
  that no loans were granted to a related party on more favourable terms than loans to a nonrelated party;
- The co-operation of the Firm during the investigation and in settling at an early stage in the Central Bank's Administrative Sanction Procedure; and
- The need for an effective deterrent impact on other regulated entities.

The Central Bank confirms its investigation into the Firm in respect of this matter is closed.

#### **NOTES TO EDITORS**

- 1. The fine reflects the application of the maximum percentage settlement discount of 30%, as per the Early Discount Scheme set out in the Central Bank's "Outline of the Administrative Sanctions Procedure" which is <a href="https://example.com/here.">here.</a>
- The Code of Practice on Lending to Related Parties 2010, which is <a href="here">here</a>, was effective from 1 January 2011, and the Code of Practice on lending to Related Parties 2013, which is <a href="here">here</a>, (collectively the "Code") was effective from 1 July 2013.
- 3. The Code defines a Related Party as "A director, senior manager or significant shareholder of the credit institution or an entity in which the credit institution has a significant shareholding, as well as a connected person of any of the aforementioned persons." The Code defines Connected Persons and Clients as "(a) a spouse, domestic partner, civil partner (within the meaning of the Civil Partnership and Certain Rights and Obligations of Cohabitants Act 2010) or child (whether natural or adopted) of a person; (b) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or (c) two or more natural or legal persons between whom there is no relationship of control as set out in point (b) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties."
- 4. The Firm became subject to direct supervision in prudential matters by the European Central Bank ("ECB") as of 4 November 2014. This was because the Firm is a subsidiary of a "Significant Institution", KBC Group N.V, a Belgian incorporated credit institution, which pursuant to Articles 4 and 6 of the Council Regulation (EU) No 1024.2013 of 1 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (the "SSM Regulation"), brought the Firm within the direct supervision of the ECB.
- 5. By decision dated 4 March 2016, the ECB instructed the Central Bank under Article 18(5) of the SSM Regulation to open proceedings in respect of the Firm in relation to the prescribed contraventions of the Code. The prescribed contraventions fall within the ECB's jurisdiction under the SSM Regulation in circumstances where the Code constitutes a transposition of Directive 2013/36/EU ("CRD IV").
- 6. The Firm was found to have breached section 6(b) of the Code where the maturity date of two Risk Participation Agreements with a Related Party were extended without prior approval by the Board or a subcommittee thereof. In this context, the term 'Risk Participation Agreement' means an agreement where the Firm and the Related Party, entered into a commercial arrangement, whereby a loan was provided to a third party equally on a 50:50 basis. The Related Party provided 100% of the loan to the third party and the Firm guaranteed 50% of that loan exposure via a Risk Participation Agreement.