



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

Settlement Agreement between the Central Bank of Ireland and Ulster Bank Ireland Limited

The Central Bank of Ireland (the “**Central Bank**”) has entered into a Settlement Agreement with effect from 14 November 2012 with Ulster Bank Ireland Limited (the “**Firm**”), a regulated financial services provider, in relation to prescribed contraventions of the Requirements for the Management of Liquidity Risk (June 2009) (the “Requirements”) and the European Communities (Capital Adequacy of Credit Institutions) Regulations 2006 (S.I. 661 of 2006 (as amended)) (the “Regulations”).

Reprimand and fine

The Central Bank reprimanded the Firm and required it to pay a monetary penalty of €1,960,000.

Prescribed contraventions

Five contraventions in total were identified.

Liquidity contraventions

Three liquidity contraventions were identified:

1. During the period 26 January 2011 to 13 September 2011 (the “**Relevant Period**”), the Firm failed to comply with Section 4.1 of the Requirements (“Description of New

Requirements”) by failing to apply the correct haircuts (discounts on cash-flows), or failing to apply any haircuts at all, to four categories of retail and corporate deposits.

2. The Firm failed to comply with Section 1.4 of the Requirements (“Application of Regulatory Document”) by failing to notify the Central Bank immediately of the contraventions of the Requirements referred to in 1 above and 3 below.
3. During the Relevant Period, the Firm failed to comply with Section 3.2.2 of the Requirements (“Senior Management Role”) by failing to establish and maintain effective internal controls for the management of its liquidity risk to ensure that;
 - the correct haircuts were being applied to retail and corporate deposits;
 - the Firm’s behavioural assumptions included all material cash flows; and
 - liquidity reports furnished to the Central Bank reflected the Firm’s true liquidity position.

Capital requirements contraventions

Two capital requirements contraventions were identified:

4. On 31 March 2011 the Firm failed to comply with Regulation 70(2)(a) of the Regulations by failing to hold own funds in excess of the minimum level set out in Regulation 19, as required of the Firm by the Central Bank.
5. The Firm failed to comply with Regulation 65(1) of the Regulations by failing to have sound or effective strategies and processes in place to enable it to:
 - assess the amount of internal capital it considers adequate to cover the nature and level of the risks to which it is or might be exposed.
 - maintain the amount of internal capital it considered adequate to cover the nature and level of the risks to which it was exposed as evidenced by the breach set out in point 4 above.

Background to the liquidity contraventions

On 4 October 2011, the Firm advised the Central Bank in writing (following a verbal notification on 21 September 2011) that it had identified an issue whereby haircuts had not been applied correctly to certain retail and corporate deposit products. The Firm also

reported that it had excluded certain cash inflows from the calculation of its liquidity position. On discovery of the issue, the Firm took immediate corrective action to rectify the contraventions.

The definition of liquidity is set out in the Requirements as follows. *“Liquidity is the ability of a credit institution to meet its on and off-balance sheet obligations in a timely manner as they fall due, without incurring excessive cost, while continuing to fund its assets and growth therein”*. Liquidity management is, therefore, essential to the proper functioning of credit institutions. The Requirements set out both qualitative and quantitative obligations. The contraventions identified in this case relate to “haircuts” (discounts on cash-flows i.e. the application of a specified discount to the value of the cash-flow, as set out in the Requirements) on certain retail and corporate deposits being applied incorrectly or not being applied at all and the failure of the Firm to adequately manage material cash-flows.

Background to the capital requirements contraventions

In 2009, the Central Bank imposed an obligation on the Firm to hold €339 million in additional Pillar II capital as a buffer against the risks (over and above credit, market and operational risk) to which the Firm was exposed. In the Firm’s regulatory return submitted to the Central Bank on 31 March 2011, the Firm reported a capital shortfall in relation to its Pillar II requirement of €313 million. The Firm immediately received a capital injection from its parent company Royal Bank of Scotland Group plc (“RBS”) to rectify the issue. The Firm made significant amendments to its *Capital Management Programme* following a review of the issues which highlighted that the primary cause of the failures was due to inaccurate capital forecasting and other capital management control issues.

The Regulations seek to ensure that credit institutions have sufficient capital to support all material risks they are exposed to. Credit institutions are obliged to hold capital for credit, market and operational risk (Pillar I Requirements). The Regulations set out a framework for the assessment of additional risks relevant to a particular credit institution over and above credit, market and operational risks (Pillar II Requirements). The contraventions identified in this case relate to the Firm’s Pillar II Capital Requirements.

Penalty decision factors

The penalties imposed in this case reflect the importance the Central Bank places on compliance with prudential requirements for credit institutions, including the Requirements and Regulations.

In deciding the appropriate penalty to impose, the Central Bank has taken the following into account:

- the seriousness with which the Central Bank views any contraventions of the Requirements and Regulations;
- the seriousness with which the Central Bank views contraventions of liquidity reporting as it impacts upon the ability of the Central Bank to ascertain with certainty the liquidity position of the Firm;
- the seriousness with which the Central Bank views the failures to have in place an effective *Capital Management Process* which prevented the Firm from accurately predicting the level of capital required;
- compliance with “*Prudential Requirements*”, “*the Timeliness and Accuracy of Information submitted to the Central Bank*” and “*Systems and Controls*” have been identified by the Central Bank as priority enforcement areas for 2012;
- the extended period of time over which the liquidity contraventions occurred unnoticed by the Firm;
- the Firm had access at all times to sufficient liquidity and capital during the period as part of RBS;
- the contraventions do not relate to core Pillar I minimum capital requirements or liquidity ratios;
- the Firm took appropriate action to ensure accountability in relation to the matters outlined above, resulting in individual performance reviews and compensation packages being impacted;
- the Firm identified the issues and brought them to the attention of the Central Bank;

- the Firm took prompt corrective action to address and rectify the issues which led to the contraventions;
- the cooperation of the Firm during the Central Bank's investigation of the issues and in settling at an early stage in the Administrative Sanctions Procedure.

The Central Bank confirms that the matter is now closed.

- End –

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The Central Bank of Ireland also issued a general comment from Director of Enforcement, Peter Oakes:

“This is the first settlement by the Central Bank with a firm for contraventions of capital requirements and the third for contraventions of liquidity requirements. This enforcement action and the penalties imposed reflect the importance the Central Bank places on compliance with all aspects of key prudential requirements regardless of whether or not contraventions of core Pillar I minimum capital requirements or liquidity ratios arise.

Regulated firms must fully comply with their liquidity and capital requirements including, establishing and maintaining effective internal controls for the management of liquidity risk and having in place sound and effective strategies and processes to address internal control requirements. Failing to meet these basic requirements represents an unacceptable risk to a regulated financial service provider's business and to the Central Bank achieving its statutory objectives.

We remind firms that compliance with “Prudential Requirements”, the “Timeliness and Accuracy of Information submitted to the Central Bank” and “Systems and Controls” are priority enforcement areas for 2012. Where contraventions of these important regulatory requirements occur, regulated financial services providers should expect the Central Bank to act”.