TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

An tAcht um Thithe an Oireachtais
(Fiosrúcháin, Pribhléidí agus Nósanna Imeachta), 2013

REPORT of the Joint Committee of Inquiry into the Banking Crisis

Houses of the Oireachtas
(Inquiries, Privileges and Procedures) Act, 2013

Volume 1: Report
Volume 2: Inquiry Framework
Volume 3: Evidence

INBS: Core Book 40

January 2016

Table of contents – by line of inquiry

B1: Effectiveness of banks' board governance, client relationships and business models

B1a: Composition, skills and experience of board and board subcommittees.

B1b: Integrity of financial reporting.

B1c: Quality of the business model setting process.

B1d: Adequacy of board oversight over internal controls to ensure risk is properly identified, managed and monitored.

B2: Effectiveness of banks' credit strategies and risk management

B2a: Appropriateness of property-related lending strategies and risk appetite.

Description	Bates Number [Relevant Pages]	Page
Project Atlas II Vol 1 – Overview Working Draft 17 Nov 2008 (Extract)	DOF02573 [059-060]	69-70

B2b: Appropriateness of credit policies, delegated authorities and exception management.

Description	Bates Number [Relevant Pages]	Page
Deloitte Commercial and Residential Lending Review 2008 (Extract)	IBRC00950 [001,003-004 , 012-032]	72-95
Credit Committee Operational review July 2008	IBRC00651 [001-008]	96-103
Credit Committee Operational review January 2009	IBRC00652 [001-012]	104-115
Response from INBS to FR dated 29 May 2008	IBRC04857 [001-010]	116-125

B2c: Analysis of risk concentrations in the base, the adverse economic scenarios and the impact on capital structure.

Description	Bates Number [Relevant Pages]	Page
KPMG Statutory Confirmation dated 31 March 2006	IBRC04840 [001-003]	127-129
KPMG Statutory Confirmation dated 27 March 2007	IBRC04841 [001-005]	130-134
KPMG Statutory Confirmation dated 26 Apr 2005	IBRC04843 [001-004]	135-138
KPMG Statutory Confirmation dated 26 March 2008	KPMG00233 [001-006]	139-144
NAMA Annual Report and Financial Statements 2011 (Extract)	NAMA00027 [020]	145
Project Harmony Due Diligence Report 20 June 2007 (Part 2) (Extract)	IBRC04846 [006]	146

B4: Impact of the property valuation methodologies on banks' credit risk management

B4c: Adequacy of internal controls over perfection of security and policy exceptions.

Description	Bates Number [Relevant Pages]	Page
Legal Department Audit - Internal Audit Report Sept 2008	IBRC00681 [001-014]	148-161

B5: Impact of the remuneration arrangements on banks' risk management

B5a: Adequacy of the incentive and remuneration arrangements to promote sound risk governance.

Description	Bates Number [Relevant Pages]	Page
Top 10 Bonus Allocations (2001-2008)	IBRC03851 [001-003]	163-165
INBS Annual Report & Accounts 2008 (Extract)	IBRC00679 [051]	166

B5b: Impact of shareholder or lending relationships in promoting independent challenge by the board and/or executives

Description	Bates Number [Relevant Pages]	Page
Nyberg Report (Extract)	PUB00156 [040]	168

B6: Impact of banks' internal audit processes in supporting effective risk management

B6a: Effectiveness of internal audit oversight and communication of issues related to governance, property-related lending strategies and risks, and funding and liquidity risks.

Description	Bates Number [Relevant Pages]	Page
KPMG Management Letter YE 31 Dec 2008 (Extract)	KPMG00189 [016,017,034]	170-172
KPMG Review of Effectiveness of Internal Audit - Jan 2005 (Extract)	IBRC00957 [001,003,005,012]	173-176
Response from INBS to FR dated 21 April 2008	IBRC04858 [001-002]	177-178
Response from INBS to FR dated 13 Oct 2004	IBRC04853 [001-005]	179-183

THEME: B1

Effectiveness of banks' board governance, client relationships and business models

LINE OF INQUIRY: B1a

Composition, skills and experience of the board and board subcommittees

IRISH NATIONWIDE

www.irish-nationwide.com

Nationwide House, Grand Parade, Dublin 6. Telephone: (01) 6096000 Fax: (01) 6096399

Dr. Liam O'Reilly
Chief Executive
Irish Financial Services Regulatory Authority
PO Box 9138
College Green
Dublin 2

31 March 2005

Review of commercial lending

Dear Liam,

I refer to my letter of 1 February in response to yours of 9 December. In the letter dated 1 February the Society responded to the issues raised in your letter of 9 December and indicated the actions the Society has taken and plans to take to address the concerns raised. Since then the Board of the Society has carried out a high level review of our commercial lending and the board's views and lending strategy are set out below.

Risk profile of the book

The Board reviewed the risk profile of the Society's commercial lending book. A summary of the Society's lending is set out in the table below.

Summary of the Loan Book at 31 December 2004.

	No	Total €m	%	Provisions €m	Total before bad debt provisions	Ireland No	€m	%	UK €m	%
Home loans (Incl. RIP's)	24,899	2,102	38%	-21	2,123	24,544	2,010	56%	113	5%
Housing Development	320	1,632	29%	-42	1,674	193	829	23%	845	40%
Retail, Leisure, Other	1,415	1,450	26%	-40	1,490	1,146	548	15%	942	45%
Offices	54	415	7%	-12	427	30	211	6%	216	10%
	26,688	5,599	100%	-115	5,714	25,913	3,598	100%	2,116	100%
					100%		63%		37%	
									Stg£1,474	

ESTABLISHED IN 1873. A MEMBER OF THE IRISH BUILDING SOCIETIES ASSOCIATION. REGISTERED OFFICE 1 LOWER O'CONNELL STREET, DUBLIN 1. REGISTERED NO. 148 DUBLIN
DIRECTORS: Michael P.Walsh, B. Comm., M.B.S., M.B.A., PhD., *Chairman*. Cornelius P. Power, B. Comm., F.C.I.S., F.C.M.A., F.C.C.A., M.Econ.Sc., D.B.A., Comp.I.E.I., PhD.
Terence J. Cooney, B.Comm., M.Econ.Sc., F.C.A., F.C.C.A., F.I.T.I. John S. Purcell, B.Comm F.C.A.
Michael P. Fingleton, B. Comm., F.C.I.S., F.C.C.A., Barrister-at-law, *Managing Director*

In addition to traditional homeloans the Society has been advancing money for residential investment property, housing development and other commercial property purposes for the past 35 years. In the past decade greater emphasis has been placed on residential investment property, housing development and other commercial property lending where the product is less commoditised. In line with this growth the Society has developed its lending expertise and achieved outstanding results with very low loan losses. Where we have had adverse experiences we have carried out successful workouts. Our pre-tax profits of €135m in 2004 which (excluding exceptional items) was a 35% increase on the 2003 results is an indication of the underlying strength of the Society's commercial lending programme and the repetitive business from long term customer relationships.

The Board's view is that its commercial loan book has an appropriate risk profile having regard to the Society's long experience and expertise, its low loan losses and the quality of our current book.

Systems and procedures to review, monitor and report on lending

KPMG's review of the Society's commercial lending, issued in October 2004, made a number of recommendations to improve systems and procedures. The Board of the Society is fully committed to implementing these recommendations and has made substantial progress to date.

As set out in the letter of 1 February we are in the process of enhancing our commercial lending administration function so as to continually improve the control environment within the Society. The Board will continue to carry out quarterly reviews of our major loan exposures and our commercial lending generally. In addition the Board will engage KPMG to commence work in May 2005 to examine and advise on the continuing improvement of our management information systems with regard to the control of commercial lending.

The Society's lending strategy and appetite for risk

The Society's priority is to maintain its strong customer base built up over the years by continuing to give our borrowers a good service appropriate to the value of their business to the Society. The Society's current lending strategy, which will be subject to regular review, is to seek to maintain 30% of its lending as traditional home loans and in relation to the balance of our lending we will seek to limit our non housing related lending to one third of our overall lending.

The Society views the UK and Ireland as a single market where the allocation of loans will depend on opportunities that arise for safe profitable lending. However within the overall objective of maintaining a secure and simple structure we will seek to maintain our UK lending at levels consistent with our sterling loans and deposits.

In summary: The Board is satisfied with the commercial lending book and the Society's lending strategy. The Society has a tried and trusted business model which is based on maintaining relationships and repeat business with valued customers. However the Society recognises the importance of continually improving the control of lending through enhanced information and reporting systems and we will with the assistance of KPMG continually improve our systems.

Yours sincerely,

Michael Walsh
Chairman

IRISH NATIONWIDE
BUILDING SOCIETY

www.irish-nationwide.com
Nationwide House, Grand Parade, Dublin 6. Telephone: (01) 6096000 Fax: (01) 6096200

Dr. Liam O'Reilly
Chief Executive
Irish Financial Services Regulatory Authority
PO Box 9138
College Green
Dublin 2

1 February 2005.

Dear Liam,

Your letter dated 9 December 2004 and this reply has been discussed in detail by the Board. For ease of reference I have responded using the headings contained in your letter.

1. High Level concerns

(i) Corporate Governance

The Society has not ignored the FSR's request to strengthen the resources at senior / executive management level. On the contrary the Society is always interested in improving the quality of its staff; however we have found it difficult to recruit senior executives as the perception in the recruitment market is that the Society will soon convert to a company and come under new ownership. This has made it difficult to interest suitable candidates in senior / executive management level positions with the Society.

Despite these difficulties the Society has recruited a financial controller, Vincent Holohan, to allow the Society's finance director undertake other management tasks. Mr. Holohan, age 40, is a chartered accountant and joined the Society from KBC Asset Management Ltd where he was Head of Finance. Prior to joining KBC Asset Management, he worked with Anglo Irish Bank for 12 years, initially as Group Internal Auditor and later on as General Manager - Finance of Anglo Irish's Austrian banking subsidiary.

Chief Office: Nationwide House, Grand Parade, Dublin 6. REGISTERED NO. 148 DUBLIN
DIRECTORS: Michael P. Walsh, B.Comm., M.B.S., M.B.A., PhD., *Chairman*. Cornelius P. Power, B.Comm., F.C.I.S., F.C.M.A., F.C.C.A., M.Econ.Sc., D.B.A., Comp.I.E.I., PhD.
Terence J. Cooney, B.Comm., M.Econ.Sc., F.C.A., F.C.C.A., F.I.T.I. John S. Purcell, B.Comm., F.C.A.
Michael P. Fingleton, B.Comm., F.C.I.S., F.C.C.A., Barrister-at-law, *Managing Director*.

The Society also made the following appointments.

- Frank Casey, age 49, was employed to carry out reviews of commercial lending on a full time basis. Mr. Casey worked in Bank of Ireland for thirty years. He was, for the last five years of his career with Bank of Ireland, team leader responsible for group credit review.

- Martin Noonan, age 53, as Mortgage Administration Manager. Mr. Noonan worked with Bank of Ireland for thirty - three years where he gained considerable experience in the mortgage administration area and was Head of Client Services – Mortgages for five years before he left the Bank.

- Dermot O'Malley, age 40, as Human Resources Manager. Mr. O'Malley is a highly qualified and experienced human resources manager. He worked for ten years with the Diageo Group. (Grand Metropolitan and Baileys) in a number of postings in Ireland, the UK and Europe.

In relation to succession planning, there are at least two potential in-house candidates for the position of Managing Director, namely Stan Purcell, Finance Director and Gary McCollum the Society's UK Manager. It is intended that the person who will be recruited as head of commercial lending will be of such calibre to be a third possible internal candidate.

The Society advertised for a Head of Commercial Lending on Friday 28 January 2005. The Society has been actively searching to fill this position and has previously advertised publicly for a Head of Commercial Lending.

(ii) Internal Audit Function

The Society will forward to the FSR a copy of KPMG's report on the internal audit function and the Society's action plan to deal with any recommendations arising.

In addition, the Society is proposing the following to address the FSR's concerns as regards the internal audit function. The Society plans to appoint Killian McMahon (currently Acting Internal Auditor) as Internal Auditor and will also engage specialist service provider(s) to support and guide him to improve the internal audit function so that within a short time-frame, the function will be in a position to work towards operating at best practice levels.

Specialist service provider(s) remit will also be to provide advice, assistance and expertise as and when required to internal audit with respect to the audit of specialist areas such as IT and Treasury. The Society will also recruit qualified accountants with audit experience to strengthen the internal audit team.

The Society is proposing the above course of action for the following reasons. KPMG have indicated that they consider Killian McMahon a suitable person to be appointed as Internal Auditor providing he receives proper mentoring and focused specialist support on an ongoing basis. KPMG's view is that with the recruitment of a suitably qualified accountant to replace Mr McMahon, taken together with a review of the staffing of the internal audit function and with the necessary support and guidance from specialist service provider(s), the internal audit function could be developed to enable the internal audit department review adequately the high risk areas in the Society and work towards a best practice standard for the function generally. The Board is of the view that the proposed approach will achieve the required results at an earlier date and there would be more certainty than the alternative of engaging external consultants manage and run the internal audit function.

(iii) Commercial Lending

Business Plan and Strategy – Lending

The use of the expression "commercial lending" is misleading in the context of the Society's lending. The principal focus of the Society's business is on the provision of finance for housing that includes home loans, residential investment property and housing development. In aggregate, housing related lending accounts for two thirds of our loan book. The balance of our lending is focused on leisure (hotels), retail and offices.

Our strategy is clear and focused particularly since the enactment of the Building Societies Act, 1989. We anticipated the increased level of competition and the consequent pressure on margins. We decided to diversify into non-home lending particularly in the housing development market where we would obtain better margins and this we have done in a gradual and focused manner. The success of our strategy is evident from our results and we have built up a very strong business going forward. Although we are active in the highly competitive home loans market, we do not have the resources to pursue market share. We operate in a niche market with high net worth customers who have a proven record of success. Alongside this strategy we have avoided retail banking and exited from areas such as life and pensions and ATM services. The Board feels that the objective of this strategy has been highly successful as evidenced by the strength of our balance sheet and our Accounts for the current year.

We have built our lending on customer loyalty and relationships developed over time. A substantial part of our lending is repeat business with high net worth individuals. The Society seeks to exploit its built up experience in its chosen markets and focuses on identifying opportunities where there is value in what is proposed at the outset. The combination of repeat business with successful clients and value led opportunities has the effect of reducing the risks in our lending compared with attempting to increase market share by lending to the broader market.

The Society prioritises its home loans business. No one meeting the appropriate credit criteria has ever been rejected for a home loan. However, even though our rates are on a par with most lenders we find it difficult to generate the volumes we would like because of intense competition and the share of the market sourced by brokers who have preferred arrangements with our main competitors. The Society must utilise the funds available to it in other areas of the lending market. Notwithstanding the difficulties with generating home loans, the Society will seek to maintain 30% of our lending as traditional home loans. In relation to the balance of our lending, we will seek to limit our non housing related lending to one third of our overall lending. The Society will also seek to maintain its UK lending at levels consistent with its sterling loans and deposits.

As set out in the summary below, in Ireland 56% of the Society's lending is for home loans (which includes residential investments properties, "RIPs"). 79% of our euro lending is for home loans, residential investment property and housing development. In the UK, the Society's lending is 95% non home loan; however 40% of the UK lending is for housing development. There is no point in financing home loans in the UK as the margins are extremely low and often non-existent due to competition an the high cost of funds.

In summary, although 63% of lending is non home loan, home loans, RIPs and housing development loans account for two third of our total lending.

Summary of the Loan Book at 31 December 2004.

	No	Total €m	%	Provisions €'m	Total before bad debt provisions	Ireland No	€'m	%	UK €'m	%
Home loans (Incl. RIP's)	24,899	2,102	38%	-21	2,123	24,544	2,010	56%	113	5%
Housing Development	320	1,626	29%	-48	1,674	193	829	23%	845	40%
Retail, Leisure, Other	1,415	1,445	26%	-45	1,490	1,146	548	15%	942	45%
Offices	54	415	7%	-12	427	30	211	6%	216	10%
	26,688	5,588	100%	-126	5,714	25,913	3,598	100%	2,116	100%
					100%		63%		37%	
									Stg£1,474	

Systems to effectively monitor, manage and control lending risk.

The Society's lending risk is controlled in the first instance by careful underwriting of new lending in line with its lending strategy. All non home loan applications are dealt with by the Credit Committee. Loans under €635 K can be approved or declined by the Committee. Loans over €635 K are either declined by the committee or recommended to the Board for final approval. Once a loan has been advanced it is monitored through regular contact between the commercial lenders and the borrower as well as an ongoing process of credit review of large and material exposures.

In October 2004 the Society set up a dedicated Commercial Lending Administration Section to enhance the formal control of lending by regular compiling of information and reporting on large exposures including fee sharing arrangements.

This section is managed by Brian Fitzgibbon with Frank Casey carrying out file reviews and checking the large exposures return. There are also a number of support staff in this section.

The Society plans to enhance commercial lending administration in the light of KPMG's recommendations and the FSR's requirements to review and assess the risk of the entire commercial loan book.

The enhancement of commercial lending administration will involve.

- Making available whatever resources are necessary to carry out comprehensive and up to date reporting on the entire loan book on a formalised and regular basis.

- Regular visits to large projects by suitably qualified personnel. Maintaining and documenting the existing constant personal contact with significant borrowers, including a formal assessment of the improvement or deterioration in the credit.

- Supplying the Board with quarterly reports that will monitor and assess the risks on large exposures, profit sharing arrangements, joint venture development arrangements and restructuring and moratorium arrangements.

- The Society will review, with the support of KPMG, the adequacy of our management information systems in relation to all aspects of the Society's lending activities.

In addition to the above the Board will carry out a high level review of the Society's commercial lending.

This review will set out the Board's views on

(1) The risk profile of the existing commercial loan book.

(2) The systems and procedures to review, monitor and report on lending.

(3) The Board's appetite for risk i.e. the type of lending and attendant risk profile the Society plans to take on.

This review will commence immediately and is expected to be concluded by 31 **March 2005.**

KPMG's Review of Commercial Lending

The Society has taken on board the recommendations arising from the KPMG review of commercial lending; however we would make the following observations in relation to certain items raised in KPMG's report.

A. Lack of experience in dealing with a "workout" of a major facility

INBS has been involved in non home lending for the last thirty years. In that time we have been through three recessions and we have not suffered any material loss in this area of activity. We have over the years accumulated sufficient expertise in the market to deal with loans in difficulty.

Since KPMG's report was issued, the Society has successfully (i.e. with a full recovery of all interest and capital advanced) concluded a "workout" loan. The loan in question amounted to €25 mil. The borrower was [redacted] and the security was land in [redacted]. This workout was carried out over a period of three years and was successfully concluded through expertise within INBS.

B. Effect on liquidity of a delay in cashflow associated with a workout of a major facility.

The Society notes KPMG's comment on this item but feels that as long as the Society remains profitable and financially strong it will have access to the funding markets both retail and wholesale to allow it maintain sufficient liquidity. Our liquidity has never been affected by any delay in realising a loan. Since the beginning of January, the Society raised a further €750 mil under its EMTN programme for a three - year term at a favourable margin of 17 bps plus costs. We were offered funding of €1bil. in one day. This is clearly an endorsement by the financial markets of the Society's performance and business strategy.

C. Appendices

In the appendices to this letter the Society has commented on items raised at our meeting on 3 December 2004 and in the Schedule attached to your letter of 9 December 2004.

The additional items dealt with in the appendices are:

1. [redacted]

Concern was expressed at our meeting on 3 December 2004 about this exposure.

As mentioned at our meeting, four members of the Board met [redacted] in July 2003 and visited one of the sites he is currently developing. In the appendix, we have set out an update on this exposure. On the basis of the most recent information, the Society expects to earn fee income in excess of €20 m on these loans.

2. Joint Ventures – subsidiary companies

I have set out the background and a current update of the activities of the joint ventures and subsidiaries. The Society has earned over €38 m in pre-tax profits over the years from its property development subsidiaries.

3. Comment on KPMG's Commercial Lending Review

This section of the appendix sets out the Society's comment on items raised in the commercial lending review.

2. <u>Regulatory follow-up</u>

(a) Capital Adequacy Requirements

The Society notes that the minimum capital adequacy requirement has been increased to ten percent from nine per cent with effect from 1 January 2005 for the reasons discussed at our meeting and set out in your letter of 9 December 2004. The Society is concerned with this increase. The increase does not reflect the performance of the Society, is not commercially justified and will undoubtedly affect our credit rating.

(b) Other Regulatory Requirements

(i) Property development exposure limits

Our primary property development exposure is [redacted] which is discussed in detail in Appendix 2. The Society currently has three property development exposures.

- Four sites in the [redacted] that are being developed for housing. These sites are held in a subsidiary company, Clearstorm Ltd. The Society owns 51% of the shares of Clearstorm Ltd with [redacted] holding the remaining 49%. The Society's total exposure is €111.2 m.

- Property in the [redacted]. This property is not a development property at all; it is an investment property and is treated as such in our Accounts. It was included in the property development schedule following a request made some years ago by the Central Bank. This property will be disposed of in 2006 and 2007. The Society's total exposure is €3.2 m.

- A site in [redacted] which the Society will develop for housing. The Society's total exposure is €0.1 m.

The Society's notes that the FSR has decided to reduce the property development exposure limit from 10% and 25% of Own Funds for an individual and the aggregate development exposure to 5% and 12% respectively. At the end of December 2004 the actual exposure was 7.38% and 17.01% for an individual and the aggregate exposure.

The Society feels strongly that this arbitrary reduction in the ratios which would force the Society to either breach existing legal agreements or result in the Society being in breach of the reduced ratios now being imposed is not justified and the limits of 10% and 25% should remain for the following reasons.

- The Society currently has two joint ventures developments. The Society's first joint venture development began in 1992 and all have been successful to date earning over €38 m with further profits expected over the next few years from the existing ventures.

- The Building Societies Act envisaged Societies investing directly in residential development. The Society's property developments have all been housing developments in line with the aim of the Act.

- The Society's joint venture partners, [redacted] and [redacted] are two of the most successful Irish property development businesses in recent years. Both are well tested and reliable partners in achieving successful and profitable results both in Ireland and the UK.

In any event the Society would ask the FSR to reconsider any immediate reduction of these limits as the Society' actual development property exposure would be in breach of these limits and would remain in breach for some time to come. The Society cannot reduce its current exposures without breaching existing legal commitments given to its joint venture partner [redacted] and risking damaging the relationship with a valued and successful borrower that was built up over the past twelve years.

(ii) Large Exposure Requirements

The Society feels strongly that it is not correct to aggregate the exposure to Clearstorm Ltd of €111 m. with its lending to [redacted] of €77 m. The Society's majority owned (51%) subsidiary, Clearstorm Ltd, is the owner of sites in the [redacted] that were acquired to develop for housing. The sites are included in the Society's Accounts as Other Assets. There is not a full loan-type exposure to [redacted] in respect of the borrowing of our subsidiary Clearstorm Ltd. We would also point out that the sites held by Clearstorm Ltd are among the most profitable opportunities for housing development the Society has engaged in.

The requirement to aggregate the full development property exposure of Clearstorm Ltd with the lending exposure to [redacted] at the reporting date, 31 December 2004, would result in the [redacted] exposure exceeding the 25% limit for a large exposure.

The Society would ask the FSR to reconsider this requirement and would propose that as Clearstorm Ltd is 51% owned by the Society and 49% by [redacted] that 49% of the Clearstorm exposure is included in the [redacted] large exposure.

In Summary, The Board is actively addressing all the matters raised in your letters. However the Board is satisfied that the Society is run in a professional manner as evidenced by the consistent and strong performance with an unbroken record of increased profitability over thirty years. During that period we have annually increased our staff numbers, had no redundancy programmes or closed branches. The Society has built up an exceptionally strong balance sheet with profits before tax for 2004 in excess of €135m and reserves and provisions of over €800m with a return on assets of 1.86% for the year.

Yours sincerely,

Michael Walsh
Chairman

APPENDIX (1)

[redacted]

Exposure at 31 December 2004 €109 m - % of own funds, 16.17%
Projected profits €88 m INBS share €25 m

[redacted]

[redacted] are the principals involved in the [redacted] The [redacted] has undertaken a number of extensive residential and commercial property development schemes within [redacted] and the [redacted].

The Society has three fee agreement loans with the group:-

[redacted]

A €18 m loan to purchase two sites in [redacted] to develop for residential apartments and retail at [redacted] and ten houses on another smaller site, [redacted].

Planning has been submitted for a number of schemes with different densities on the [redacted]. The outcome of a full planning enquiry, as to which scheme has been approved, is expected in the first quarter of 2005. Planning permission has been obtained for ten houses on the [redacted] site and construction is now underway with completion expected in July 2005.

The projected profit on [redacted] site is €12 m approx., the Society's fee is 25% i.e. €3 m.

The projected profit on [redacted] is €3.5 m, the Society's fee is 25% i.e. €875 k.

[redacted]

A €42 m loan to purchase [redacted], a 0.77 acre site zoned for residential use.

[redacted] proposals for a residential scheme to include town houses and apartments are at planning enquiry stage with a final decision on the number of units due in February 2005.
The projected profit on [redacted] is €27 m approx., the Society's fee is 30% , i.e. €8 m.

[redacted] Oir p ?

A €49 m loan to purchase the former [redacted] Oir p at [redacted] Oir p, [redacted] Oir p.

[redacted] Customer Confidenti... Customer C... are to develop the 3.25 acre site into a mixed use residential and commercial scheme incorporating private, affordable and key worker housing, along with commercial, leisure and retail usage. After substantial detailed negotiation with the Local Authority planners, a formal planning application has now been submitted.

The projected profit on [redacted] Oir p is €45 m approx., the Society's fee is 30% **i.e. €13 m.**

APPENDIX (2)

Joint Ventures – Subsidiary Companies

In line with the overall aim of the Building Societies Act, 1989 (as amended) (set out in its explanatory memorandum) that building societies "be a major source of funding for housing by investing directly in residential development", the Society has been involved through its subsidiary companies in residential development with joint venture partners as far back as 1992. In August 1992 Pangrove Ltd, a 100% owned subsidiary, purchased a 70 acre site in [redacted]. This site was profitably developed into 800 houses, apartments and a shopping centre in conjunction with [redacted]. Since then the Society has completed a number of joint venture developments with [redacted] all of which were profitable as set out in the **attached Schedule 2**. This schedule shows profits before tax earned by our subsidiaries to date of over €38 m. At present there are joint venture developments in two subsidiaries and both are expected to generate substantial profits over the next few years.

Vernia Ltd

Vernia in conjunction with [redacted] has been involved in acquiring and developing residential land around [redacted] since 1995. To date profits of €24 m have been booked. At the end of December 2004 Vernia had funds on deposit of €16 m, the remaining land held stands at a cost of €5 m. This land, most of which received planning permission in 2004, is expected to realise profits for Vernia of €4 m to €5 m in 2005.

Clearstorm Ltd

In recent years successful developments with [redacted] in [redacted], through a subsidiary [redacted], earned profits of over €5 m. The Society through its 51% owned subsidiary Clearstorm Ltd is now involved with [redacted] in developing sites in the [redacted]. The Society's total exposure is €111 m. (16.5% of Own Funds) and the Society's share of the projected profit is about €100 m.

The various properties acquired by Clearstorm Ltd have been grouped into three developments.

(1) [redacted]

The planning application for a predominantly residential mixed use development is currently being drawn up for this site. This will comprise the following:

Use	Approx. NIA Sq Ft
2,460 Residential Units	1,293,550
Public Exhibition Space	45,000
Leisure/Health Centre	17,000
Management Office	7,200
Training Centre	6,000
Flexible Workspace	19,000
Restaurant/Retail	47,000
Clinic/Dentist/Nursery	12,000

A further planning application will be submitted for a pedestrian bridge to be constructed over the [redacted] linking [redacted] to [redacted]. In early December 2004 a public exhibition was held to present the "Vision" and draft proposals to local communities. This proved to be very successful. It is anticipated that this planning application will be ready for submission by the end of the first quarter of 2005. Consent is expected to be given in 2006/2007. As the scheme is very dense in nature, Clearstorm Ltd will achieve a low cost per unit in terms of land cost which equates to c£10k per apartment. This excludes the commercial part of the development. Based on the planning densities, a development profit of £120 m is anticipated. INBS's share, 25%, would amount to £30 m, (€40 m.).

(2) [redacted]

A masterplan for these parcels of land is currently being prepared. A preliminary site solution is expected to be finalised by the end of the first quarter of 2005. The planning is likely to consists of 1,300 residential units and a mixture of other units for other uses. A series of meetings with the [redacted] are currently taking place. It is anticipated that the planning application will be ready for submission in the second quarter of 2005 with a decision in 2006. As the [redacted] development is expected to have 1,300 units, this will equate to c£18K land cost per residential unit, which is a low cost per unit. Based on the planning densities, a development profit in the region of £40 m is expected. INBs's share, 25%, would amount to £10 m, (€14m.).

(3) [redacted]

Architects are in the process of being appointed for this development as preliminary concepts are being prepared. It is envisaged planning will consist in the region of 2,500 – 3,000 units with various other uses. It is expected that a planning application will be submitted towards the end of this year. Based on the planning densities, a development profit in the region of £140 m is expected. INBS's share of 25% would amount to £35, (€50 m.).

Cedarclose Ltd – [redacted] ***residential development***

The Society developed houses in [redacted] through its 100% owned subsidiary Cedarclose Ltd. The Society did not operate with a joint venture partner on this development. This development involved the Society developing the houses on its own but there were unforeseen problems including flooding caused by a freak tide that raised concerns by potential customers. In addition, the location was too remote. This development resulted in a loss of €1 m.

APPENDIX (3)

Comment on KPMG's Commercial Lending Review

Joint Ventures and subsidiaries

As mentioned at our meeting on 3 December 2004 the Commercial Lending Review is KPMG's report and we would question whether they fully understood the joint venture operations of our subsidiaries. We would point out that:

- The legal documents and agreements are completed and in place for Clearstorm Ltd and all the property it holds. In the UK the Society uses the services of Howard Kennedy, Solicitors. The partner we deal with is highly regarded in the London property business.

- The Society underwrites its joint venture loans in a proper manner. These advances are discussed and vetted at the highest level in the Society with the principals of our joint venture partners. The progress of the development is monitored and reviewed on an ongoing basis. Updates on the progress of these developments are provided to KPMG Dublin (Vernia) and KPMG London (Clearstorm) as part of the information supplied to enable them carry out the annual audit of the subsidiary companies.

- We disagree with the concern raised about a "potential conflict of interest where a joint venture partner is also a customer of INBS". Our joint venture partners are people we have had successful and profitable dealings with over many years. There are both very high net worth individuals with whom we have built up a good relationship and trust over many years.

- The fact that the Society owns all or a majority of the shares in a joint venture company reduces our exposure to the joint venture partner as the company which INBS controls owns the sites. We feel it is not correct to aggregate joint venture exposures with the borrowings of the joint venture partner to determine the Society's exposure to him as a customer.

Moratoria and "restructured" loans

The issues raised by the report in relation to moratoria and restructured loans are not valid. If a transaction, say a residential development, is not complete or has not reached the stage of completion envisaged at the outset, an extension of the term is practical and expected in the short term. The loan is extended on the basis that it is going well and will come to fruition. The term restructuring is a misnomer in the context of these loans. In order to track moratoria loans we look at what we are involved with in terms of its operation and its success.

The Society is not taking a "punt". As with all lending the Society is making a commercial decision based on our experience with the borrower, assessment of the value on day one, an independent valuation of the property and ongoing reviews and assessment.

Margin on Lending

The report makes reference to the margin on lending. The Society's view is that the return on assets is a better measure of success. To focus just on "margin falling" is not valid. The margin is a function of competition in the lending and borrowing markets. The return on assets results from managing the mix and volume of business and seeking to earn fees in addition to the margin on lending.

Pre-tax profits earned by the Society as a percent of average total assets compares favourable with other credit institutions as set out below:

Return on Assets

Year	2000	2001	2002	2003	2004
INBS	**1.92%**	**1.88%**	**1.95%**	**2.03%**	**1.86%**
EBS	0.47%	0.55%	0.68%	0.68%	
AIB	1.60%	0.69%	1.59%	1.24%	
BOI	1.59%	1.42%	1.38%	1.21%	1.37%
Anglo	1.37%	1.40%	1.43%	1.50%	**1.67%**

SCHEDULE 1

Irish Nationwide Building Society Development Property Exposure at 31st December 2004

		Euro k	Euro k	Development With
Clearstorm - [redacted]			34,243	[redacted]
Clearstorm - [redacted]		12,332		
Clearstorm - [redacted]		14,901	27,233	
Clearstorm - [redacted]		12,260		
To complete		37,463	49,723	
Sub Total			**111,199**	
Portion of [redacted]		21,962		
Less deposits held relating to this property		(18,716)	3,246	
[redacted]			126	
Cedarclose [redacted]	Note 1		Nil	
Total			**114,571**	**(A)**
Own Funds (per Prudential return page 34, December 2004 ref. 340)			**673,461**	**(B)**
(A) as a % of (B)			**17.01%**	
Largest Single Development as a % of (B) [redacted]			**7.38%**	
Total Clearstorm Exposure as a % of Own Funds			**16.51%**	

Note 1:

Cedarclose Ltd has completed its housing development in [redacted] The development resulted in a loss of € 1.1 million which has been written off. In addition to this loss a provision of € 200k remains which relates to the possible cost of remedial work to a foul water sewer. The liability is contingent upon the results of a cctv survey of the foul sewer and any subsequent negotiations with the local authority. The site suffered from a freak tidal flood which affected the construction, marketing and completion of the development.

Note 2:

	€ k
5 % of Own Funds amounts to :	33,673
12 % of Own Funds amounts to :	84,183

SCHEDULE 2

Property Development Subsidiaries – Profit Before Tax 1994 – 2004.

Year	Pangrove	Vernia	Cedarclose	Landor DW Ltd.	Clearstorm	Total
	€	€	€	€	€	€
1994	1,029,146	0	-25,344	0	0	1,003,802
1995	497,339	0	157,276	0	0	654,615
1996	52,327	-130,840	129,210	263,133	0	313,830
1997	102,216	-253,154	41,635	2,005,897	0	1,896,594
1998	745,692	-678,468	-754	21,334	0	87,804
1999	74,899	-202,208	-30,900	35,799	0	-122,410
2000	6,769,339	16,962,617	-148,514	1,499,790	0	25,083,232
2001	37,165	-517,697	-1,473,780	1,424,273	0	-530,039
2002	150,235	6,346,340	-414,078	0	0	6,082,497
2003	1,562,657	326,935	93,221	0	-25,393	1,957,420
2004	112,110	1,056,190	716,607	0	-21,150	1,863,757
Total	11,133,125	22,909,715	-955,421	5,250,226	-46,543	38,291,102

Notes:

1) Results for Landor (DW) Ltd and Clearstorm have been converted from Stg at a current exchange rate of £0.70 = €1.

2) Results for 2004 are draft and subject to audit

3) The total loss of € 955 k for Cedarclose comprises a realised loss on the housing development in [redacted] of € 1.1 million plus a provision of € 200 k to cover possible remedial work to a foul sewer less earlier profits on unconnected developments ie [redacted] & [redacted] of € 345 k.

4) The loss in Clearstorm relates to administrative expenses. Interest is capitalised.

IRISH NATIONWIDE
BUILDING SOCIETY

www.irish-nationwide.com
Nationwide House, Grand Parade, Dublin 6. Telephone: (01) 6096000 Fax: (01) 6096200

Dr. Liam O'Reilly
Chief Executive
Irish Financial Services Regulatory Authority
PO Box 9138
College Green
Dublin 2

8 April 2005

Dear Liam,

I refer to your letter dated 22 March last which has been discussed by the Board. My response uses the headings in your letter for ease of reference.

Corporate Governance

The Society will expedite the process of recruiting a Head of Commercial Lending with the intention, as already stated, of employing a person of sufficient calibre to be appointed as an additional executive director.

The Society will also seek a suitable person to act as a non-executive director before the end of this year if the search for an executive with director potential proves fruitless.

Internal Audit function

The audit committee has been considering a revised audit plan for 2005 in the light of KPMG's report. The committee will submit a revised audit plan to IFSRA before the end of this month.

This year the Society intends to engage specialist service providers to assist the Internal Auditor in audits of I.T, Treasury, and Commercial Lending and Commercial Lending Administration. The Society will employ a leading accountancy and / or a consultancy firm, other than KPMG for independence reasons, to provide specialist services.

The Internal Auditor is working with KPMG who will oversee arrangements in relation to the continuing development of his expertise.

Document ID: 0.7.2321.39593

IRISH NATIONWIDE BUILDING SOCIETY

Commercial Lending

My letter of 31 March last addresses the issues raised under this heading.

Regulatory follow-up

Capital adequacy requirements.

Following the annual audit and signing of the 2004 accounts the Society solvency ratio now stands at 13.9%. The Society has always maintained a solvency ratio in excess of 10% and would intend to continue to do so. However, as we have already indicated, a formal increase in the minimum ratio to 10% will affect our credit rating. We would ask IFSRA to consider retaining the minimum ratio for the time being at 9% with a commitment from the Society that it will continue to maintain a ratio in excess of 10%. As provided in notice BSD S 1/00 this minimum ratio can be reviewed from time to time.

Other Regulatory Requirements

Property development exposure limits.

The Society notes that IFSRA, having considered our comments, expects the Society's development property exposure to be halved to 5% and 12% of Own Funds from 10% and 25% for individual and aggregate exposures, respectively. The development property exposure at 31 March 2005 (see schedule 1) largely consists of loans to Clearstorm Ltd, a 51% owned subsidiary. The Society estimates that repayment of the advances to Clearstorm will commence in 2009 / 2010, which is what we expect to happen based on our past experience of these types of projects.

Large Exposure Requirements

[redacted] Customer Confidentiality

[redacted]

CONTINUATION NO

IRISH NATIONWIDE BUILDING SOCIETY

IFSRA to facilitate the transfer of the Society into new ownership by waiving the 15% restriction in Section 102 as permitted under Section 102 (4) of the Act.

In the light of the above concerns, I would like to meet with you to discuss these issues further.

Yours sincerely,

Michael P. Walsh
Chairman

B1a –Composition skills and experience of board and board subcommittees

B1d – Adequacy of board oversight over internal controls to ensure that risk is properly identified, managed and monitored.

B2b – Appropriateness of credit policies, delegated authorities and exception management

B6a – Effectiveness of internal audit oversight and communication of issues related to governance, property-related lending strategies and risks and funding and liquidity risks

Information Summary (Section33AK)

Note: All references are aggregated

Document Category	Time Period
Correspondence	Q2 – 2002 Q3 - 2004 Q4 – 2004 Q1 – 2005 Q4 – 2006 Q4 - 2007 Q1 - 2008

The financial regulatory authorities[1] (FR) engaged in correspondence with a medium-sized financial institution on multiple occasions throughout the period 2002-08. The Inquiry has identified 8 of these letters for the purposes of pursuing certain of its Lines of Inquiry with witnesses from the institution during the public hearings.

A number of key themes, concerns and issues were identified by the FR throughout the correspondence;

- Corporate Governance
- Lending and credit policies and resources
- Internal Audit – resourcing and functioning
- Treasury and Liquidity – policies and procedures
- Regulatory Reporting

Corporate Governance

Issues identified by the FR included:

- Lack of detail in board minutes as to topics discussed (Q1 2002)– this point was also raised in 1999.
- Over-reliance on a single individual within the management group, small size of the executive management group and the failure to replace a key senior executive after more than a year (Q3 2004).
- Concern over the size and experience of Senior Management group, a lack of succession plans for key executives, the absence of a Head of Commercial Lending and the failure to replace a key senior executive (see point above) after nearly 2 years. FR required the institution to set out plans to deal with each of these issues. (Q4 2004).
- Concern expressed over extent of delegation of board powers to a member of senior management. How is this delegation defined

[1] The term "financial regulatory authorities" is used in this summary to refer to the relevant regulatory authority be it the Central Bank or the Financial Regulator depending on the date of the correspondence.

and monitored? More detail required in board minutes. Need to undertake a board performance review annually. (Q4 2006)

- Concern expressed over the significant degree of approval authority which rests with previously referenced member of senior management (Q1 2008)

- After a number of years of correspondence on these matters, the FR wrote to the institution in Q1 2008 summarising its concerns once again and requiring it to:
    - Recruit 3 additional Directors of which 2 must be experienced INEDS
    - Appoint a Chief Operating Officer
    - Appoint a Head of Commercial Lending
    - Board to consider and report to the FR on alternative strategies in the event that the institution is not sold.

- Composition and Functioning of the Audit Committee (AC)
    - Conduct of AC meetings and maintenance of a quorum (Q2 2002)
    - Requirement to submit a detailed audit plan to the FR and to enlist external assistance to complete the plan (Q1 2005)
    - AC minutes to reflect discussions on adequacy and resourcing of the Internal Audit (IA) function. AC to have responsibility for oversight of the IA function (Q4 2006)
    - AC to meet with the Head of Internal Audit in the absence of management at least annually. Meeting to be minuted (Q4 2006).
    - AC meetings with external auditors to be minuted (Q4 2006).
    - AC requested to review appropriateness and adequacy of IA audit process and independent authority (Q4 2007)

- Composition and Functioning of the Credit Committee
    - Need to have Terms of Reference put in place (Q2 2002)
    - Recording of decisions in relation to credit risk management (Q4 2006)
    - Credit Committee required to report formally to the Board. (Q4 2006)
    - Meetings must have a quorum in order to make a valid decision. Only 3 out of 27 meetings achieved a quorum in 2006. (Q4 2006)
    - FR noted that the operation of the Credit Committee needed to be strengthened (Q1 2008).
    - Minutes should be signed by all attendees. (Q1 2008)

Lending and Credit

- FR concerned general lack of resources in the commercial lending function. Focus on driving new business means that there is insufficient time for review of existing loans (Q2 2002).
- Concern over lack of a formal independent review of commercial lending and a potential lack of adequate oversight (Q2 2002).
- Concern over level of staff turnover in home-loan section and consequent inexperience of underwriting staff (Q2 2002).
- No Head of Function in place for Commercial Lending (following departure of previous incumbent) and lack of progress in extending review process to all Commercial Loans (Q3 2004).
- FR required the institution to have an independent review of the Commercial Loan business carried out and forward the results to them.(Q3 2004)
- FR concerned over significant shift in risk profile of portfolio (from domestic to commercial) in a short period and that control mitigants have not kept pace with these changes. Also concerned that there is no Head of Commercial Lending function in place.(Q4 2004)

- FR required the institution to set out a clear strategy and business plan for its lending business and for its risk appetite. The plan was to be presented to the FR by Q1 2005 (Q4 2004).
- FR recommended that the Commercial Lending Review report include more analysis of the loan book. (Q4 2006).
- Regular contact with significant borrowers should be documented (Q4 2006).
- Loan reviews should include valuations and financial statements. (Q4 2006)
- FR again questions the adequacy of controls and risk management in place for large commercial property. Recommends that a review of connected borrowers' exposures be undertaken at least annually (Q1 2008).
- FR recapped on its previous concerns over credit risk management stretching back to 2004 including the growth in the commercial loan book, increase in borrower concentrations, increase in the size of commercial loans and an increasing reliance on the UK market (Q1 2008)
- FR required the institution to forward a copy of the report on the audit of the commercial loan book to it and to undertake a further review in September (Q1 2008).

Internal Audit Function

- Q2 2002

  FR raised concerns over the level of resources and the experience of staff in the Internal Audit function. Specifically they identified a lack of expertise in IT and Treasury areas (also raised in 2001). They noted that the 2001 plan had not been completed due to lack of resources and also noted a lack of progress in implementing a risk-based methodology for auditing.

- Q3, Q4 2004

  FR noted that the level of resources in Internal Audit continued to be inadequate. Continued lack of expertise in IT, Treasury as well as Commercial Lending. Recommends a comprehensive review of the Internal Audit Function.

  The departure of a senior member of line management heightened the FRs concerns . They required the institution to;

(i) recruit a senior experienced person to manage IA.

(ii) review adequacy and expertise of staffing

(iii) outsource the IA function until both above are resolved.

- Q4 2006

  FR required the Audit Committee to monitor the IA function.

  Expected that an external consultant would carry out the review of Commercial Credit due to be undertaken.

- Q4 2007

  FR surprised at 100% level of positively rated audits in light of serious issues identified in a number of these audits.

Treasury & Liquidity

- Q2 2002

  The FR noted that the Asset and Liability Committee (ALCO) had no Terms of Reference. No reports were prepared for members ahead of meetings and the Committee did not provide any reports or feedback to the Board.

Credit function was not represented on the Committee.

Treasury policies on hedging FX and interest rate risk were unclear. Policies were not reviewed and approved by the Board annually.

There was no proper segregation of duties between front and back office.

- Q3 2004

  FR highlighted that Treasury policies lacked sufficient detail. Neither were there any detailed procedures in place.

  FR required confirmation of segregation of duties between front and back office. (see 2002 comment above.)

- Q1 2008

  FR raised a concern that the institution only had access to funding in the local market. They decided to carry out a review of the management, monitoring and reporting of liquidity in Q1 ’08.

Regulatory Reporting.

- Q2 2002

  FR commented that a breach of Liquidity Ratio in Q4 2001 highlighted a lack of sufficient control and a breakdown in certain existing controls.

- Q3 Q4 2004

  FR concerned by continuing breaches of Large Exposure (LEX) limits and apparent lack of controls around same.

FR decided to increase the institution Min Capital Adequacy from 9% to 10% wef Q1 2005 as a result of its concerns over the shift in risk profile in the institution's loan book.

FR reduced limits for holding and development of land from 10% and 25% of Own Funds to 5% and 12%

FR required the institution to aggregate all exposures to customers including JVs in its LEX report.

- Q1 2005

  The FR confirmed its decision, made in Q4 2004 to increase the institution's Capital Adequacy ratio from 9% to 10%.

- Q1 2008

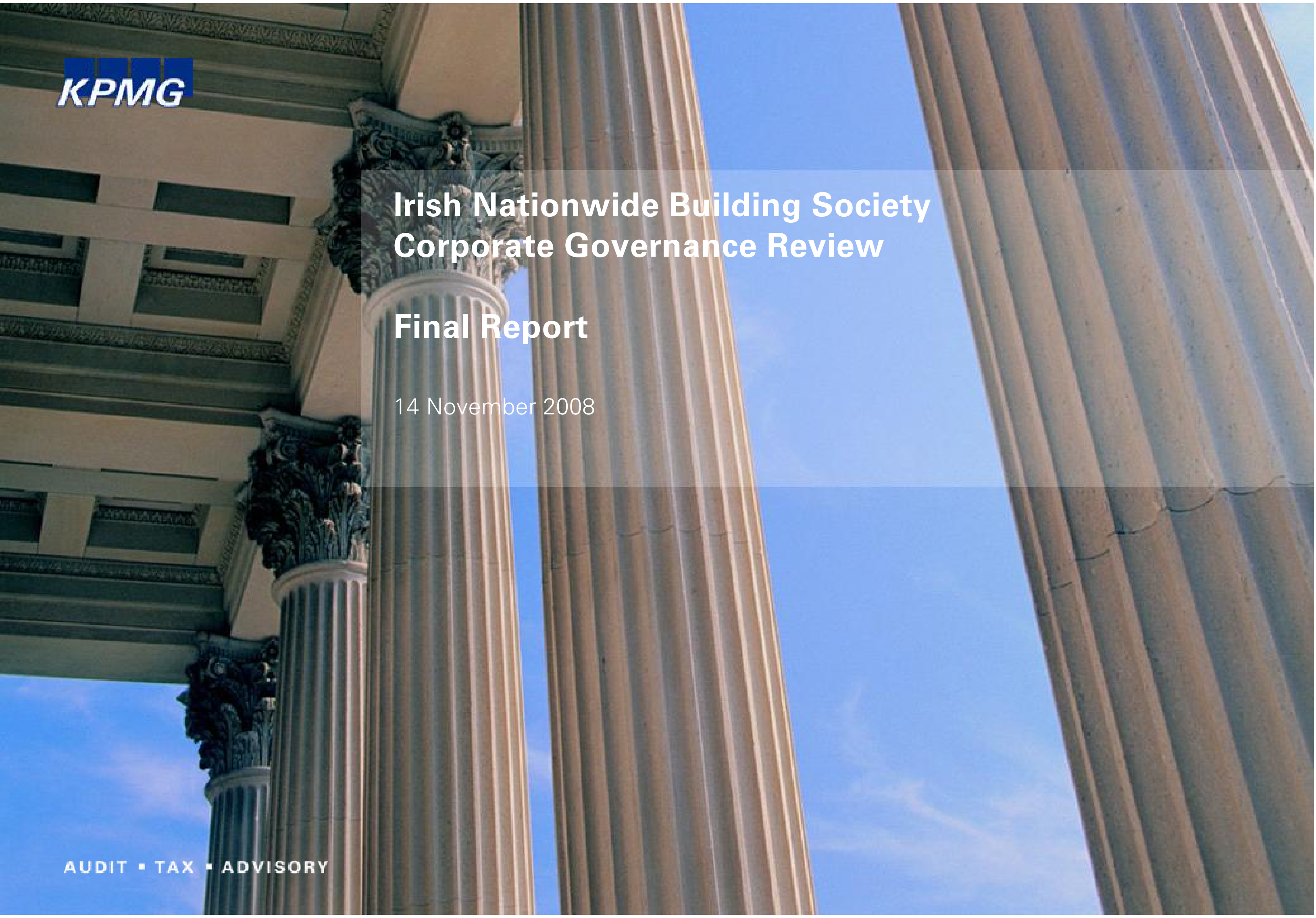
  FR informed the institution that it required the institution to increase its solvency ratio from 10% to 11% due to its ongoing concerns over the issues raised in 2004 concerning the composition and risk of the Commercial loan book.

THEME: B1

Effectiveness of banks’ board governance, client relationships and business models

LINE OF INQUIRY: B1b

Integrity of financial reporting



KPMG

Irish Nationwide Building Society Corporate Governance Review

Final Report

14 November 2008

AUDIT ▪ TAX ▪ ADVISORY

KPMG
1 Stokes Place
St. Stephens Green
Dublin 2

Tel +353 (1) 410 1000
Fax +353 (1) 412 1000

Private & Confidential
Directors
Irish Nationwide Building Society
Grand Parade
Dublin 6

14 November 2008

Dear Sirs

Corporate Governance review

In accordance with our engagement letter dated 27 May 2008, we have completed a review of the Corporate Governance frameworks at Irish Nationwide Building Society ("the Society").

The report primarily addresses recommendations arising from our review of the current Corporate Governance frameworks evaluated against best practice guidance. We have included in Appendices A to I appropriate extracts from a number of sources of guidance on current best practice.

The report is intended solely for your use. Our report is provided on the basis that it is for your information only, and it is not to be copied or disclosed to any third party without our prior written consent. However, we are aware that a copy of the report will be presented to the Financial Regulator, in their capacity as regulator to the Society, and we consent to the use of our report in that regard.

We would like to thank the executive and non-executive directors and senior management of the Society for their time and assistance during this review.

If you have any questions, please do not hesitate to contact us.

Yours faithfully

KPMG
Chartered Accountants

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Contents

The contacts at KPMG in connection with this report are:

Patrick Farrell
Director
Advisory
KPMG Dublin
Tel: 700 4029
Fax: 755 4029
patrick.farrell@kpmg.ie

James Menton
Engagement Partner
Advisory
KPMG Dublin
Tel: 410 1858
Fax: 412 1858
james.menton@kpmg.ie

Alan Boyne
Client Partner
KPMG Dublin
Tel: 410 2645
Fax: 412 2645
alan.boyne@kpmg.ie

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Background, scope and objective

Background

Irish Nationwide Building Society (hereinafter "INBS"), is an Irish Building Society regulated by the Financial Regulator. It is a mutual society owned by its members. The Society operates from a head office in Dublin, with approximately 200 employees, from which a network of branches, agents and brokers is managed. INBS has a network of branches throughout the Republic of Ireland and also has operations in Belfast and the Isle of Man.

The Society operates a niche business model, its primary focus in recent years has been the successful growth of its Commercial Loan book. To date, Commercial Lending has concentrated on a relatively small customer base and its customers are well known to the Society. The speed of decision making (all lending decisions are approved by the Credit Committee or if urgent the Chief Executive and two members of Credit Committee) has provided the Society with a competitive advantage which it believes is recognised and valued by its customers. In recent years, the Society has been successful with this strategy and has attained profitable growth increasingly underpinned by supplemental arrangement fees where it takes a percentage of the final development profit on top of its normal lending return.

Following the enactment of the Building Societies (Amendment) Act 2006, the previous legislative restrictions over the ownership of building societies following conversion had been removed. Since the Act, INBS had actively sought to change its mutual status, and during 2007, the Society had commenced the initial stages of a sales process with interested parties to achieve its core objective of maximising value for members. It was considered that a demutualisation and sale of the business would remove existing funding constraints (minimum share deposit ratio of 30%), provide access to fresh capital and provide the potential to fully realise the value of its Branch network and existing customer relationships.

However, in Q1 2008, credit markets significantly tightened and market conditions deteriorated reducing the probability of an acceptable transaction. The Board of INBS have now refocused their efforts on managing the current loan portfolio and identifying and sourcing, when necessary, adequate funding in both the wholesale and retail markets. Recently, the Board, in conjunction with the Financial Regulator, has recognised the need to strengthen its composition and has appointed two new non-executive directors, thus expanding the number of non-executive directors to five.

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Background, scope and objective

Scope and objective

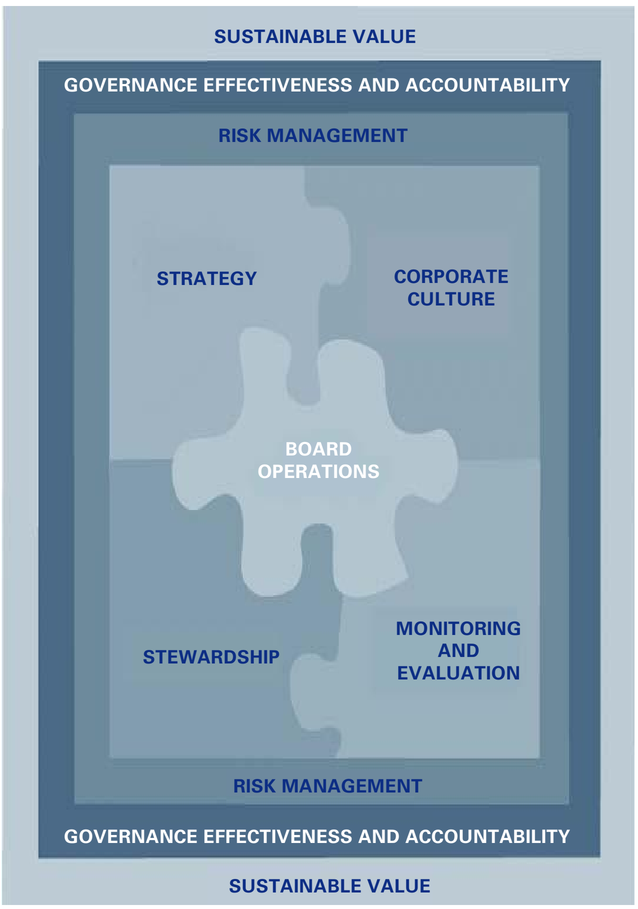
In July 2008, INBS engaged KPMG to review the design of its Corporate Governance frameworks. This entailed a review of the following elements of the Society's framework:

- Board of Directors - Function, composition, remit, frequency of meetings and documentation received.
- Sub-committees of the Board - Function, composition, remit, frequency of meetings and reporting to the Board.
- Controls exercised by the Board of Directors in decision making process, including delegated authorities to operational management.
- Board of Director's responsibility for strategic leadership and oversight.
- Board of Director's responsibility for monitoring and evaluation.

The objective of our review was to perform an independent assessment of current Corporate Governance frameworks and make appropriate recommendations relevant to the organisational profile of the Society.

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Our approach



To effectively review the Corporate Governance structures at INBS we followed KPMG's proprietary Corporate Governance framework. This involves assessing the current INBS structures under 5 key headings:

- **Board Operations –** the Board's ability to manage its own activities: the effectiveness of the leadership is critical to the development of a strong governance structure.
- **Strategy –** the Board's role in the strategy process: the effects of the organisation's oversight and management functions need to be aligned as an important step in realising strategic objectives.
- **Corporate Culture –** the Board's role in overseeing the achievement of ethical behaviour in the organisation: efforts to ensure ethical behaviour and protect the organisation's reputation are part of the fabric of governance.
- **Monitoring and Evaluation –** the Board's role in monitoring management and evaluating its performance against defined goals: it is crucial that what management should be doing is defined and that those activities be measured.
- **Stewardship –** the Board's responsibility towards stakeholders and accountability for their interest: those responsible for the oversight and leadership of enterprises must be appropriately accountable to stakeholders.

Our approach involved:

- A "Desktop" review of relevant documentation. A full list of the documents included in this review is included in Appendix K.
- Interviews with key personnel (Board of Directors and senior management). See Appendix J for a list of interviews performed.
- Evaluate findings against "best practice" Corporate Governance structures appropriate to the organisational profile of INBS.

Much of the current corporate governance requirements apply to listed public companies. However, as INBS is a mutual society and a public interest entity, there are stakeholder expectations that INBS's corporate governance frameworks would mirror best practice guidance where appropriate. As part of this review we have been guided by the following "best practice" guidance:

- Financial Reporting Council – The Combined Code on Corporate Governance.
- European 4th, 7th and 8th Directives.
- Companies Acts and Building Society Acts.
- Standard and Poor's Corporate Governance Scores (CGS) rating criteria.
- Moody's Corporate Governance Assessment
- Basel Committee on Banking Supervision – Corporate Governance principles

KPMG

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Summary of major observations and recommendations

Reference	Major observations	Recommendations
1	• The Society has an established and functioning Board of Directors currently consisting of four Non Executive Directors and one Executive Director (the Finance Director). We note an additional Non Executive Director will shortly be appointed. • The former Managing Director, upon reaching seventy years of age, ceased to be a Director (in accordance with Society Rules) and is now the Chief Executive of the Society. As such, despite being the most senior official within the Society, he does not have the same statutory and fiduciary responsibilities as members of the Board. Furthermore, a formal succession plan has not been put in place for the Chief Executive.	• The Board should consider appointing another Executive Director to balance the composition of the Board and to assist the Board to successfully implement the current strategy. • Furthermore, the Board should develop formal succession plans for Executive and Non-Executive Directors and key senior management positions, in particular the Chief Executive and Commercial Lending Department Manager. As part of this process consideration should be given to strengthening operational management particularly in the Commercial Lending and Liquidity Management functions. • Given the exceptional market circumstances, we believe that the current Chief Executive should be a member of the board, acknowledging the fact that this would require an amendment to the Society Rules. In addition, a formal succession plan should be developed for the current Chief Executive.

KPMG

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Summary of major observations and recommendations

Reference	Major observations	Recommendations
2	• There is no formal determination process of Director independence by the Board prior to nomination/recommendation or on a continual basis following election. We particularly note that Mr. David Brophy was co-opted to the Board in February 2006 and formally elected by members at the April 2007 AGM. At the time of the election Mr. Brophy was Group Director of Corporate Finance with Smurfit Kappa. However, in September 2007, Mr. Brophy was appointed Chief Operating Officer (and subsequently Chief Executive Officer) of *customer confidentiality* [redacted] • Furthermore, while we recognise there is an annual declaration by Directors relating to Interest in Contracts and a register of disclosures is maintained (as per Section 53 of the Act), there is no formal Conflicts of Interest policy which outlines Directors obligations, defines conflicts (with examples) and outlines procedures to declare and manage conflicts on an ongoing basis.	• The Board should implement a formal assessment of Director independence prior to nomination and/or recommendation. This assessment of independence should be performed annually for all Non-Executive Directors. (Further guidance on Director independence is included in Appendix B). • The Board should develop a Conflicts of Interest policy which outlines Directors obligations, defines conflicts (with examples) and outlines procedures to declare and manage conflicts.

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Summary of major observations and recommendations

Reference	Major observations	Recommendations
3	• There is no formally documented and approved Terms of Reference governing the operation of the Board. We further note there is no formal schedule of matters specifically reserved for decision by the Board and no formal detailed delegation of authorities to sub-committees or other key senior management as appropriate. • From an operational perspective, the Chief Executive role is key and significant operational powers have been vested to him by the Board. These powers date back to a Board resolution from 1994 which vested substantial powers to the Managing Director. This resolution has not been updated in the interim period. Specifically, the exact authorities delegated by the Board to the Chief Executive have not been defined. This is of particular importance given that the current Chief Executive has ceased to be a member of the Board upon reaching 70 years of age, in accordance with Society Rules. • The Board has established a number of committees including: Audit; Credit; Asset and Liabilities; Provisioning and Remuneration committees. However, Non Executive Directors are not represented on the Credit, Asset and Liabilities and Provisioning committees. Furthermore, updates from each sub-committee on are not a standard agenda item for Board meetings • For example, the Credit Committee (based on its Terms of Reference) has full authority to approve loan applications and advances. However, the Credit Committee consists solely of the Chief Executive and executive management (it has no executive or non-executive Directors members), as such it cannot be deemed a sub-committee of the Board for delegation purposes. • The Society has a Remuneration Committee that reviews and agrees the Executive Director's and the Chief Executive's salaries. The Committee does not recommend or monitor the level and structure of remuneration for senior management. Moreover, the Terms of Reference for the Remuneration Committee is not formally documented. In addition, the Society Rules do not require members to approve the remuneration policies/packages (including pension rights).	• The Board should formally document a Board Terms of Reference incorporating a comprehensive schedule of material matters specifically reserved for decision by the Board (decision types and materiality levels). This document should also formalise and detail the delegation of authority by the Board to the Chief Executive and sub-committees. • The Board should also assign appropriate Non Executive Directors to each committee to ensure an appropriate level of Board oversight is maintained. Furthermore, the Board should review each sub-committee's Terms of Reference on an annual basis, with particular emphasis on the limits and authorities that the Board has delegated to these committees. Updates from each sub-committee should be standard agenda items for the Board meetings. • Terms of Reference for the Remuneration Committee should be formally documented and submitted to the Board for approval. Specifically, the Remuneration Committee should recommend and monitor the level and structure of remuneration for senior management. Furthermore, the Society Rules should be amended to specifically require members to approve all new long term incentive schemes and significant changes to existing schemes.

KPMG

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Summary of major observations and recommendations

Reference	Major observations	Recommendations
4	• There is a formal Compliance Manual (incorporating a Compliance Policy) which details all relevant obligations for the Society (legislative and regulatory). However, there is no overall compliance framework including a formal programme of Compliance reviews to be performed by the Compliance function. • Furthermore, there is no forum for communication on compliance matters between the business units and the Compliance Manager. The Compliance Manager does not review business unit policies and procedures to ensure that they are appropriate. • Although Compliance matters are considered by the Board, the Compliance Manager does not provide compliance status updates to the Board. • In addition, the position of Compliance Manager is occupied on a temporary basis as the regular Compliance Manager is on an extended leave. However, the acting Compliance Manager does not have direct compliance experience and/or detailed knowledge.	• The Compliance function should be enhanced by developing a compliance framework to include; communication and education, business unit self assessment, a programme of independent compliance reviews to be performed by the Compliance function, and regular Compliance status reporting to the Board/Audit Committee. • The Board should consider recruiting additional personnel for the Compliance function with the requisite skills and knowledge to develop and deliver the enhanced Compliance framework.

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Summary of major observations and recommendations

Reference	Major observations	Recommendations
5	• There are formally documented Lending and Funding strategies which are continually monitored by the Board. However, there is no formally documented business strategy with linked financial and operational action plans. In addition, scenario analysis has not been built into financial planning process. • The Society has documented operational risk management policies in relation areas such as Credit, Liquidity and Interest Rate policies. However, the Society does not have a formal, documented strategic risk assessment process. Strategic risks are not quantified by probability / impact and mitigating controls are not appropriately identified. The current risk management process is focussed on operational risk. There is no formal link to strategic objectives. • A senior executive with overall responsibility for risk management within the Society has not been appointed.	• The Board should incorporate scenario planning into a formal strategic and financial planning process. Assumptions should be stress tested and results analysed to ascertain potential impact on financial performance. • The Board should develop a set of strategic objectives, and Key Performance Indicators (KPI's) in line with the agreed strategic direction. • These KPI's should be monitored regularly by the Board. For example, in the current environment KPI's may include: repayment inflows as % of commercial loan book; share deposit ratio; and pipeline as % of commercial loan book. • The Board should perform an annual strategic risk assessment. • The Board should assign a senior executive with overall responsibility for Risk Management in the Society.

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Summary of major observations and recommendations

Reference	Major observations	Recommendations
6	• Key stakeholders for the Society are the members, customers, staff and the Irish Financial Regulator. Members receive a letter from the Chairman of the Board on an annual basis in advance of the AGM which summarises financial performance, outlines key external events and strategic issues. • However, we note that communications with the Irish Financial Regulator are not coordinated centrally. There is no central point of contact with oversight of all communications with the Regulator. • In addition, there are no regular formal executive management team briefings to facilitate open and appropriate communication between Board and Non-Board executive management.	• The Board should consider assigning formal responsibility for all communications with the Regulator to ensure coordination and consistency of response. Furthermore, a log of all correspondence should be maintained. • Regular executive management team briefings should be established to facilitate open and appropriate communication between Board and senior management.

© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Summary of major observations and recommendations

Reference	Major observations	Recommendations
7	• The Society Secretary has a number of roles within the Society including Finance Director and liaising between Internal Audit and the business. • It is unclear if the Society Secretary role has responsibility for advising the Board, through the Chairman, on Corporate Governance matters.	• The Board should consider separating the role of Society Secretary and Finance Director and assigning specific responsibility for advising the Board on Corporate Governance matters.
8	• Board packs are very detailed and at times lack clarity and structure. For example, there is little market and operational overview and salient financial commentary provided. • The Board packs are distributed to members in advance of Board meetings, but given the current volume of information, the advance timeframe for consideration by Directors is not deemed adequate.	• The format of Board packs should be reviewed to ensure that all information required for Board decision making is presented in a clear and concise manner allowing the Board to utilise their time effectively. Furthermore, there should be Executive reports on operational and market performance and strategic issues with relevant supporting financial commentary for the management accounts.
9	• There is no formal induction programme for new Directors to the Board. However, each Director on the Board has unfettered authority to request ad-hoc information should they require to facilitate an appropriate induction. • There is no personal development or training programme for Executive and Non-Executive Directors.	• The Board should consider facilitating an information needs gap exercise to identify training, development and induction requirements of all Directors
10	• On an annual basis the Board assesses its own and the sub committees performance. However, no formal performance and evaluation criteria are established for the assessment.	• The Board should establish formal performance and evaluation criteria to form the basis for the annual assessment.

KPMG

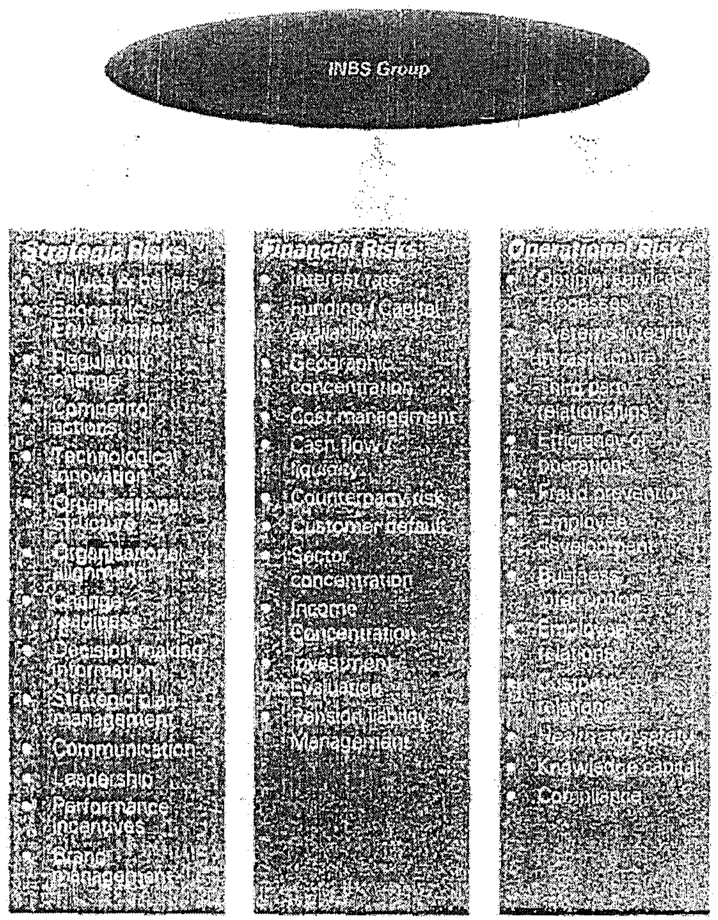
© 2008 KPMG Ireland, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. The KPMG logo and name are trademarks of KPMG International.

Business overview: Risk assessment

The Group does not operate a complex business model and is increasingly focussed on commercial lending which does not require significant investment

The reporting and control structures of the Group mean that in addition to overall direction and governance of the Group, the Board itself is actively involved in all significant lending decisions – all commercial loans greater than €1 million and all residential loans greater than €635,000 require Board approval

Risk assessment



- The Group's profitability and growth are strongly linked to economic developments in Ireland and the UK in particular, with some limited exposure to the rest of Europe
- Residential based lending is concentrated almost entirely in ROI. The Group does not have a significant market share and does not have a significant exposure to high LTVs. The level of advances to first time buyer has decreased from €186 million in FY04 to €129 million in FY06. Management has concentrated on growing its commercial business which has higher margins than its residential business
- Commercial lending growth is increasingly focussed upon the UK market with significant lending to developers of undeveloped sites in London Docklands in particular, who expect to benefit from urban regeneration in the run up to the 2012 Olympics
- Commercial lending is also heavily concentrated in terms of customer base: consequently, the Group is potentially exposed to a customer failure as well as any more general market downturns
- The Group's approach to the assessment and management of such risks is driven by a small core group of people in the organisation, led by the Managing Director, with significant Board involvement. The Board itself is actively involved in all significant lending decisions – currently all commercial and residential loans greater than €1 million require Board approval
- The overall approach to risk assessment would not be described as highly developed given that the Group continues to rely heavily on the Managing Director, does not have sophisticated IT systems, and operates across a limited range of products. This modus operandi would be described by management as fit for purpose, particularly given the degree of Board oversight on the lending approval process

This document is CONFIDENTIAL and its circulation and use are RESTRICTED © 2007 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

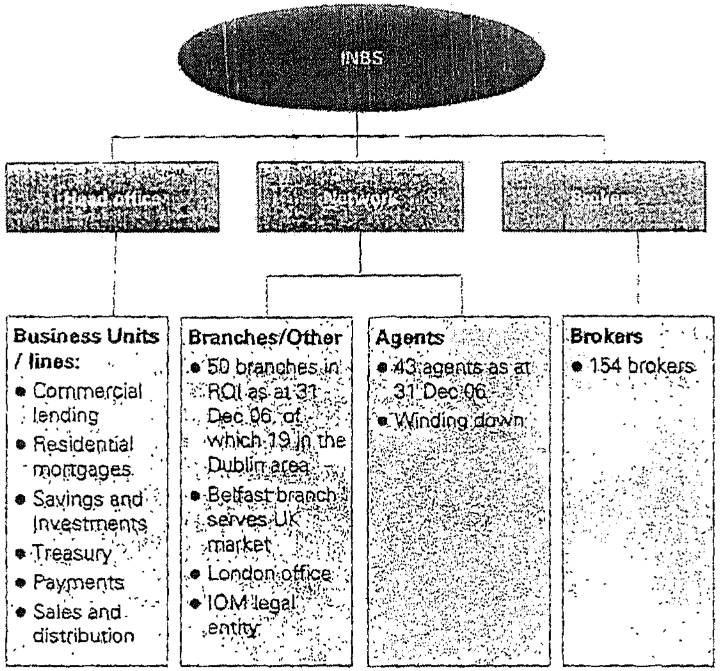
Business Overview: Organisation and product overview

Management of the Group is highly centralised

Commercial lending largely driven by a small group of people in Head office and Belfast

Branch network drives residential lending and savings products although Treasury will also source a significant amount of savings business from high net worth clients

Overview of distribution channels and business lines



Organisational structure

- The Group operates from a head office in Dublin, with approximately 200 employees, from which a network of branches, agents and brokers is managed. Approximately 200 people are employed in the branch network
- The network of 50 branches is geographically well spread throughout the ROI (see overleaf)
- The Society is currently in the process of trying to wind down the majority of its agency business, due to a combination of the increased level of regulation required of agents, the associated potential reputational risk and the limited contribution to the Group's overall business
- Brokers appointed by the Society are well distributed throughout the island of Ireland, with 15 in Connaught, 76 in Leinster (principally Dublin based), 54 in Munster and 9 in Ulster

Product offerings

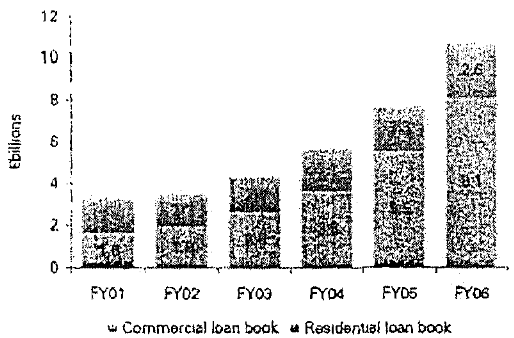
- As stated previously the Group has a narrow product line
- The loan products, broadly distinguished between residential mortgage and commercial lending, can be characterized as follows:
  - residential mortgage products for principal private residences, holiday homes, residential investment property and equity releases. Business is driven by the branch network
  - Within the commercial sector, the Society will consider annuity or interest only loans and repayment methods available include interest only, full capital and interest moratoria loans and bullet repayments which are advanced across a broad range of business sectors but principally to real estate developers. Business is largely driven by Head office and Belfast lending departments but with some business generated through the branch network
- A limited range of savings products is offered (savings and deposit accounts). There is no development pipeline or processes for developing new products internally and the Group limits activity in this area to refining/altering existing products depending on competition in the market (vis-à-vis interest rates offered). The Group is not actively cross-selling other financial institutions products (other than arranging life assurance for residential loans) nor planning any initiatives in this regard

This document is CONFIDENTIAL and its circulation and use are RESTRICTED. © 2007 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Key findings

Issue	Summary observations / points for further consideration	Key analysis
Rapid growth in the Group's loan portfolio Group's loan portfolio is concentrated. Approximately 41% of the Group's total loan book at the end of FY06 (including commitments to lend) is derived from the top 30 exposures	See the loan book chart and points below	Pages 33 – 47
npairment provision hanges in accounting andards has driven a duction in the pairment provision a percentage of oss loans	See the impairment table and points below	Pages 48 – 51

Loan book – FY01 to FY06



Source: Management accounts FY01 to FY06

- The Society's loan book has trebled between FY01 (€3.4 billion) and FY06 (€10.7 billion), with the increase driven by commercial lending
- Although relatively new to the commercial market the Group has been successful in increasing its commercial lending base despite ongoing price competition
- Growth has been attributable to a concentrated customer base. Approximately 41% of the Group's total loan book (including commitments to lend) is derived from the top 30 exposures. When residential lending is excluded from total loans and advances, the top 30 exposures represents 53% of the total commercial exposure at the end of FY06, top 50 represents 69% and top 100 represents 86%
- Management has adopted a strategy of developing close customer relationships with well established property developers in Ireland and the UK providing customers with quick turnaround in lending decisions and access to funds
- By focussing its lending on repeat business customers who have proven track records in their field, the Society seeks to minimise its exposure to bad loans. The contrary view would be that the Society's potential exposure is increased by such a strategy, however it has not experienced impairments on any loans to its top 30 exposures over the period of review. Additionally, the Society's commercial lending policy requires that all loans are adequately secured with the maximum available security taken
- The Central Bank in March 2007 has stated that the annual growth rate of residential mortgages has been in excess of 25% since October 2003. As a result, although the Group's residential loan book has been growing it has been losing market share

Impairment – Balance sheet

€m	Dec 04	Dec 05	Dec 06
Specific impairment	-	41	57
Collective impairment	-	23	25
Provisions for bad and doubtful debts	111	-	-
Total	**111**	**64**	**82**
Gross loans to customers	5,714	7,761	10,675
Impairment provision %	*2.0%*	*0.8%*	*0.8%*

Note: The impairment provision decreased from €111 million in FY04 to €64 million in FY05 due to the application of FRS 26 in FY05

Source: Audited financial statements FY04, FY05 and FY06

- The Group has had a low experience of bad debts
- The calculation of collective impairment is based on the Group's actual losses incurred within the last five years, a period of significant economic growth within the property sector
- The low historic bad debt experience drives much of the collective impairment provision that can be recognised by the Group under new accounting standards which eliminate the ability of entities to maintain 'big bath' provisions. As a result this method of calculation may result in a lower provision to what may be required considering the increase in the loan book between December 2004 and 2006

This document is CONFIDENTIAL and its circulation and use are RESTRICTED © 2007 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Document ID: 0.7.2321.65912

IBRC01B11

IBRC04845-023

Issue	Summary observations / points for further consideration	Key analysis
Quality and availability of management information	• The Group's IT system and management information reporting has developed to meet the requirements of the business in a reactive fashion. As noted previously the Group is cost conscious and does not require a significant investment in such areas for what is a relatively straightforward business model. However, this does mean that system functionality and ability to respond to specific information requests or to generate analysis is not user friendly and requires significant IT department involvement to create and run specific reports. In a changing legislative and regulatory environment (e.g. Basel II) the Group may require a significant investment in IT and man hours to bring the Group's reporting up to the new requirements • We have also noted that there is a high level of end-user recomputing responsible for the generation of management information • Management information generated from the system is also highly reliant upon complete, accurate and up to date information in order to provide management with a relevant, formally documented picture of the business. We have noted historic issues regarding completeness of information and much of the ongoing customer knowledge resides in the small core group of management personnel • Examples of the above include: – Credit ratings of commercial loans is incomplete – there is an ongoing exercise underway in this regard – LTVs: Up to date valuations are not sought as the property development project continues over the life of the loan. 30% or €2.4 billion of capital balances at 31 December 2006 have a LTV in excess of 100%. We understand from management that they believe this is misleading for two reasons (1) it does not necessarily reflect the current status of the underlying development, e.g. a loan may have been on an initial LTV greater than 100% before planning was achieved, planning has since been obtained but the LTV has not been updated to reflect the increased value of the secured property, and (2) the 100% plus LTV can arise where the loan is based not just on the purchase price but also stamp duty and planning fees but the real value that is there at the outset is not fully recognised. Management have represented that they believe that there is real, unrecognised value at the outset but that although the 'value' is present, the valuers will not give a valuation greater than the purchase price – Top 30 exposures and reporting errors therein	Pages 45 – 47, 127
Transition to new financial reporting The Group prepared its financial statements in FY06 under IFRS	• Management prepared its financial statements for the year ended 31 December 2005 under Irish GAAP in line with the prior year, however it adopted and applied FRS 21, FRS 23, FRS25, FRS 26 and FRS 28 which were not retrospectively applied to the FY04 results • The primary changes were as follows: – all derivative financial instruments are now carried at fair value on balance sheet with changes in fair value recognised within the income statement (and also applying hedge accounting rules) – fair valuing supplemental arrangement fees – interest income and interest expense recognised on an effective interest rate basis • The financial statements for FY06 including the comparative results for FY05 were prepared by management under IFRS. The primary changes were in respect of the measurement adopted for 'Investment properties' (IAS 40) and 'Retirement benefits' (IAS 19) • The Group results for FY05 and FY06 as presented throughout our report have been prepared under IFRS. FY04 has been prepared under Irish GAAP	Pages 171 – 177

KPMG

This document is CONFIDENTIAL and its circulation and use are RESTRICTED. © 2007 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Document ID: 0.7.2321.65912

IBRC01B11

IBRC04845-028

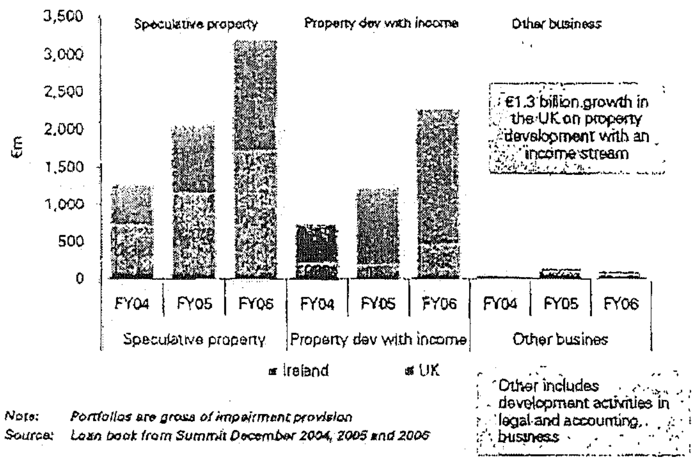
ommercial lending - real estate, renting and business

i terms of growth, the al estate, renting and usiness sector has ignificantly exceeded the ist of the commercial ian portfolio

peculative property ivestments have shown trong growth within both eland and the UK at €1 illion each respectively ietween FY04 and FY06

roperty developments vith contracted rental ncome have increased by :1.3 billion in the UK a :AGR of 83%

Analysis of real estate, renting and business sector FY04 to FY06



Note: Portfolios are gross of impairment provision
Source: Loan book from Summit December 2004, 2005 and 2006

Overview

- Real estate, renting and business lending has increased €3.5 billion from €2.1 billion in December 2004 to €5.6 billion in December 2006. The increase of €3.5 billion is driven predominantly by increases in:
  - 'speculative property' of €1.9 billion and
  - 'property developments with contracted rental income stream' of €1.5 billion
- The growth rate for both categories of real estate lending has been in excess of 50% year on year between FY04 and FY06. Other commercial lending sectors on average recorded a growth rate of 38% between FY04 and FY05 and 20% between FY05 and FY06
- Based on discussions with management the primary reason for the growth in real estate lending is due to the attractiveness of entering into supplemental arrangement fees which are currently forming a common feature on a number of these loans

Speculative property investments

- Speculative property investments have increased €1.9 billion from €1.3 billion in FY04 to €3.2 billion in FY06. There were 638 speculative property investment loans outstanding at 31 December 2006 with the average loan size being €5 million
- Geographically the increase of €1.9 billion can be analysed as follows:
  - Ireland €1 billion; UK €0.9 billion
- Development finance issued on speculative property investments is the main form of lending issued to commercial customers in Ireland. Within Ireland this sector has grown at a CAGR of 53% from €0.7 billion in FY04 to €1.7 billion in FY06
- Similar to the situation in Ireland, strong growth has been recorded in the UK on lending issued in respect of speculative property, with the UK loan book increasing from €0.6 billion in FY04 to €1.5 billion in FY05
- It should be noted that while the average loan size at December 2006 within this sector in the UK was €6.9 million, there was a high concentration as the top ten loans accounted for 44% of the total balance

Property developments with contracted rental income

- Loans for property with contracted rental income have grown at a faster rate than speculative property investments, increasing at a CAGR of 74% from €0.8 billion in FY04 to €2.3 billion in FY05. The average loan size was €7.3 million at December 2006
- Management has indicated that there is a preference to lend for projects with contracted rental income over other types of real estate projects particularly in the UK due to the additional security that the rental income provides together with the fact that the commercial portfolio is becoming increasingly concentrated
- Property developments with contracted rental income are more concentrated in the UK where there has been an increase of €1.3 billion between FY04 and FY06, a CAGR of 83%
- The loan balance for property developments with contracted rental income in Ireland remained low as a percentage of its loan book over the period and stood at €0.5 billion at 31 December 2006

KPMG

This document is CONFIDENTIAL and its circulation and use are RESTRICTED. © 2007 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Document ID: 0.7.2321.6591

Asset quality: LTVs

LTV information is provided in advance of a lending decision being taken; however it is generally not updated and meaningful trend analysis could not be performed; particularly relevant to commercial book

LTV as at 31 December 2006 – per Summit

LTV Band		Dublin City & County Comm €m	Dublin City & County Res €m	ROI ex. Dublin City & County Comm €m	ROI ex. Dublin City & County Res €m	London Comm €m	London Res €m	Rest of UK Comm €m	Rest of UK Res €m	Europe Comm €m	Europe Res €m	Total Comm €m	Total Res €m	Total €m
1	<25%	72.8	69.4	31.7	117.9	40.7	3.7	74.8	0.9	117.3	0.1	337.3	191.9	529.3
2	>25%	206.0	153.4	168.0	391.0	194.0	2.5	243.5	3.1	6.5	0.4	818.0	550.5	1,368.5
3	>50%	141.0	59.6	29.2	202.9	206.6	4.2	106.0	5.0	0.0	20.8	482.7	292.5	775.2
4	>60%	238.3	97.6	45.3	222.2	248.0	2.1	375.0	1.5	25.3	2.7	931.8	326.0	1,257.8
5	>70%	326.5	117.3	71.0	277.1	345.0	1.6	194.5	4.0	99.0	0.3	1,036.0	400.4	1,436.4
6	>80%	237.5	137.0	92.9	337.7	392.2	3.3	333.3	1.3	2.8	0.0	1,058.7	479.2	1,537.9
7	>90%	40.7	55.9	24.6	82.9	232.3	0.0	39.1	0.4	58.1	0.0	395.0	139.2	534.2
8	>95%	46.7	20.0	83.4	36.1	294.3	1.1	80.2	0.6	11.6	3.4	516.3	61.3	577.6
9	>100%	445.6	85.4	398.7	83.6	682.0	5.8	753.2	80.8	117.8	5.0	2,397.2	260.7	2,657.9
Total		1,755.1	795.6	944.9	1,751.5	2,635.0	24.4	2,199.6	97.4	438.5	32.8	7,973.1	2,701.7	10,674.8

Note: Commercial and residential loans by sector will differ marginally to this LTV analysis as it is based on the property that has provided the security for the loan. Some commercial loans have been secured on private property. Source: Summit December 2006

Overview

- As part of the application process the Society obtains LTV information, using a panel of recognised valuers, for all residential and commercial lending
- While the Group maintains LTV information in relation to all commercial and residential lending no meaningful trend analysis can be performed as once LTV information is received it is generally not updated for changes or developments concerning the underlying asset securing the loan

Residential LTVs

- 17% of residential advances have a LTV greater than 80%. Maximum LTV parameters are in place for residential lending and will vary depending on the purpose and size of the loan, whether a first-time buyer and whether customer is resident or non-resident (outlined in Corporate governance/Risk management section of the report). All residential loans greater than €1 million must be approved by the Board. The Society will consider applications in excess of these parameters on a case by base basis, and will generally require additional security before approving a loan

Residential LTVs (continued)

- Although there have been more recent signs of a cooling in the residential market (following on from ECB rate increases and uncertainty over stamp duty), given the overall performance of the market over the last number of years management has indicated it does not believe its risk profile has changed to any significant degree and is not experiencing any significant repossessions or bad debts on the residential portfolio

Commercial LTVs

- LTV parameters are in place for commercial lending, by sector (see also Corporate governance/Risk management section of the report)
- Development finance where lending is advanced in the real estate sector either prior to planning and/or before pre-sales or pre-lets have commenced from plans represents the majority of commercial LTVs greater than 100%. Lending policy for such loans is that each loan is assessed on a case by case basis and all loans greater than €1 million are assessed by the Board.

This document is CONFIDENTIAL and its circulation and use are RESTRICTED. © 2007 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

0% or €2.4 billion of
ommercial capital
alances on LTVs are
reater than 100%

/hile management has
idicated that it does not
elieve its risk profile has
hanged significantly, it
cognises that the
rowth in commercial
nding including such
peculative land projects,
oes require strong
ecurity and close
iteraction with customers

Commercial LTVs (continued)

- Management has indicated that while an assessment of LTV is a key element in the lending process, knowledge of the customer to whom the loan is being advanced and their track record, understanding of the underlying development and risks associated thereon and assessment of the likelihood of a successful development of a site/receipt of planning, are also critical to any lending decision. Where the Board considers that a loan application passes these considerations it will lend at greater than 100% LTV on the basis of the value that will be created by the customer in developing the site or property
- 30% or €2.4 billion of commercial capital balances on LTVs are greater than 100%. We understand from management that they believe this is misleading for two reasons (1) it does not necessarily reflect the current status of the underlying development, e.g. a loan may have been on an initial LTV greater than 100% before planning was achieved, planning has since been obtained but the LTV has not been updated to reflect the increased value of the secured property, and (2) the 100% plus LTV can arise where the loan is based not just on the purchase price but also stamp duty and planning fees but the real value that is there at the outset is not fully recognised. Management have represented that they believe that there is real, unrecognised value at the outset but that although the 'value' is present, the valuers will not give a valuation greater than the purchase price
- While management has indicated that it does not believe its risk profile has changed significantly, it recognises that the growth in commercial lending including such speculative land projects, does require strong security and close interaction with customers

This document is CONFIDENTIAL and its circulation and use are RESTRICTED. © 2007 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Document ID: 0.7.2321.65912

IBRC01B11

IBRC04845-048

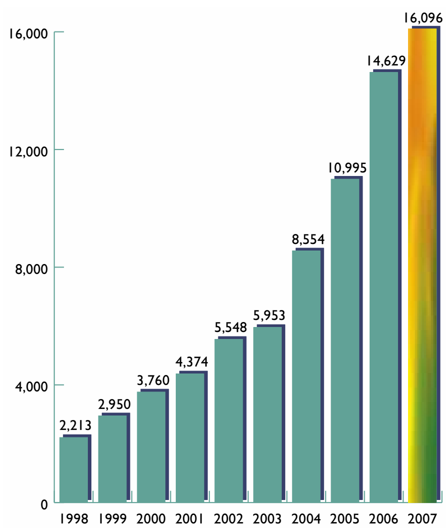
THEME: B1

Effectiveness of banks' board governance, client relationships and business models

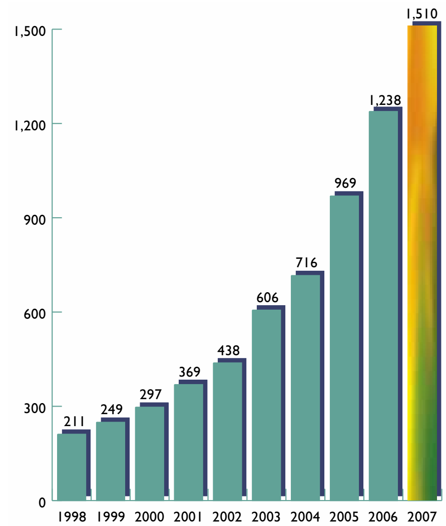
LINE OF INQUIRY: B1c

Quality of business model setting process

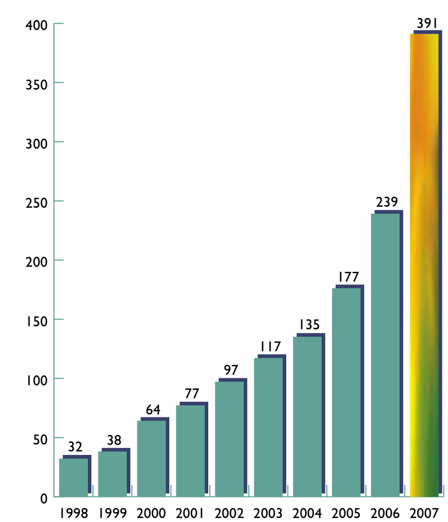
Assets €m



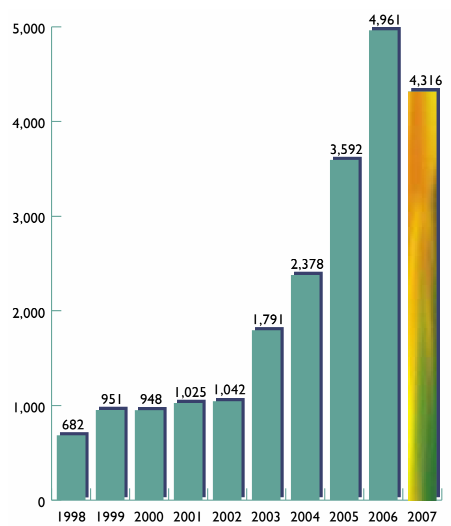
Total Reserves €m



Pre-Tax Profits €m



Loans Issued €m



Notes to the financial statements

21. Other assets

Society 2007 €m	Society 2006 €m		Group 2007 €m	Group 2006 €m
22.0	22.0	Amounts receivable under contractual property arrangements	22.0	22.0
0.7	1.2	Prepayments and accrued income	1.3	2.0
22.7	23.2	At end of year	23.3	24.0

22. Income before taxation

Group and Society	2007 €000	2006 €000
Income before taxation has been arrived at after charging		
Directors' remuneration:		
Fees as directors	313	288
Other emoluments	2,693	2,147
Pensions	492	451
	3,498	2,886

	2007 €000	2006 €000
Auditor's remuneration (including VAT)	224	220

Directors' emoluments 2007

	Salary €000	Fees €000	Bonus €000	Benefits €000	Total 2007 €000	Total 2006 €000
Executive Directors						
Michael P. Fingleton	812	53	1,400	48	2,313	1,836
John S. Purcell	264	53	150	19	486	407

The remuneration (fees) of the non-executive directors was: Michael P. Walsh, Chairman €100,430 (2006: €91,300), Terence J. Cooney €53,240 (2006: €48,400), and David M.J. Brophy €53,240 (2006: €40,600). Pension contributions made by the Society in respect of the executive directors were: Michael P. Fingleton €nil (2006: €388,000) and John S. Purcell €492,000 (2006: €63,000).

THEME: B1

Effectiveness of banks' board governance, client relationships and business models

LINE OF INQUIRY: B1d

Adequacy of board oversight over internal controls to ensure risk is properly identified, managed and monitored

Ms. Mary Burke
Head of Banking Supervision Department
Financial Regulator
PO Box No 9138
College Green
Dublin 2

21 ~~15~~ April 2008

Re: Inspection of Commercial Property Lending Exposures

Dear Ms. Burke,

I refer to your letter dated 8 February 2008 in relation to the above. The Board of the Society considered the contents of your letter at the Board meeting held on 18 February 2008. I have set out below the Boards comments together with details of proposed follow-up actions and timeframes.

Mr. Fingleton – Chief Executive

Mr. Fingleton is closely involved with the U.K. and Ireland commercial lending managers in assessing large commercial loan applications and in ongoing reviews and discussions with large borrowers. The Chief Executive is ultimately responsible for all lending and it is essential that he is involved in all material loans being approved by the Society.

Comments on credit committee

The credit committee's terms of reference were reviewed in December 2007 and its membership was increased. The Society has also implemented the recommendations in relation to M3 – Credit Committee outlined in your letter dated 8 February 2008.

Compliance with S41 of BSA

The Society does not agree that '*INBS declined to provide certain copies of material when requested*'. The staff involved in the inspection have confirmed that any information sought by the inspectors was provided. This matter was not brought up at the closing meeting following the inspection where any misunderstanding would have been resolved. The Society has always provided any information requested in accordance with section **41 of the Act.**

Comments on 'claims on security'

The Society engages external solicitors to perfect security on its behalf however no solicitor will give a 100% guarantee that there are no other claims on such security. The solicitors perform searches on security which the Society relies upon but the timing of these searches can determine the result. With the exception of the [redacted], the Society is not aware of any claims against security other than those disclosed to the Society.

Comments on 'slowdown in residential market and its affect on developers financial capacity'

Many of the Society's large developers are well established and long standing customers of the Society. They have a proven track record within the markets they operate and the Society has a very strong relationship with them. While independently verified financial information is not available for some clients the Society's experience of these clients to date would indicate that they possess a robust financial capacity.

Yours sincerely,

Michael P. Walsh
Chairman

Schedule

General Findings

Recommendation		**INBS Comment**	**Timeframe**
Medium Priority			
M1 – Net Worth Statements			
1.	The inspectors consider that institutions should obtain a Net Worth Statement from those borrowers to which they have a significant exposure. In addition, it would be preferable for institutions to obtain Net Worth Statements which have been certified by a third party. If a Net Worth Statement is not available, credit institutions should justify the basis of their assessment of the repayment capacity of the borrower.	Net worth statements will be sought for those borrowers to whom we have a significant exposure.	April 2008
M2 – Group Indebtedness			
1.	Institutions should review the methodology they use for assessing the overall indebtedness of the groups to which they are exposed. The Financial Regulator would expect credit institutions to assess the overall exposure to all credit institutions of the Group exposures at the loan applications stage and on an-going basis as part of the loan review process.	The Society will seek information on the overall indebtedness of the customer on an annual basis.	April 2008
INBS Specific Findings			
High Priority			
H1 – Credit Reviews			
1.	INBS should conduct and document a comprehensive review of exposures to a group of connected borrowers on at least an annual basis. Such reviews should include, inter alia, an assessment of the following where appropriate – Audited Financial Statements, cash Flow Statements, Rental Income Schedules, Valuations, Quantity Surveyor reports etc.	Up to date valuations will be sought as required in addition to accounts and project appraisals.	**April 2008**

Recommendation		INBS Comment	Timeframe
2.	Details of all credit reviews performed should be forwarded to the Credit Committee.	Credit risk review reports will be submitted to the Credit Committee when reviews are carried out. Reviews are carried out at different intervals depending on the circumstances of the loan. Informal contact with lenders about the content of specific reviews is ongoing as lenders receive updates which result in changes in the risk profile of a given account. Details of accounts graded 4, 5 and 6 will be copied to the lenders on a monthly basis.	May 2008
H2 – Valuations			
1.	The circumstances in which management estimates of valuations may be used should be documented and the methodology used on each occasion should be recorded on the loan file.	If management estimates of valuations are used, the circumstances and the methodology used on each occasion will be recorded on the loan file	May 2008
2.	INBS to confirm whether new/additional facilities provided to borrowers based on existing security are assessed using the most recent independent valuations or on "management estimates".	New/additional facilities provided to borrowers based on existing security are assessed using up to date independent valuations.	April 2008
3.	INBS to confirm that it is satisfied that such management estimates provide reliable, prudent valuations.	Where management estimates of valuations were used they were prudent valuations.	N/A
Medium Priority			
M2 – Watch List			
1.	INBS to confirm whether any of the exposures included in the inspection are on the watchlist.	[redacted] ([redacted]) and [redacted] ([redacted] are graded 4. Grade 4 is Watch List.	N/A
2.	INBS to advise of the circumstances which gave rise to a credit grade of 4 for exposures to [redacted] and [redacted] as at September 2007 and, if no longer on the watchlist, the circumstances which resulted in a regrading of both exposures.	These two accounts relate to a facility for the [redacted]. [redacted] Given the current uncertainty in the home purchase market the borrower has opted to wait until 2008 on the basis that the market will have recovered sufficiently at that time. Given the current position of €59M debt against a	N/A

Recommendation		INBS Comment	Timeframe
		December 2007 independent third party valuation of €80M, the Society is not unduly concerned and has agreed to an extension of the facility until the end of this year but will continue to monitor developments and liaise with the customer. This scheme ([redacted] Customer Conf... was launched last week.	
M3 – Credit Committee			
1.	The minutes of the Credit Committee should be signed by all members in attendance.	The Society has a quorum of three for Credit Committee meetings and three members will sign the minutes.	Implemented from 14 March 2008
2.	Credit Committee minutes should distinguish between members of the Committee and those attending meetings who are not members.	This recommendation is now in place.	Implemented from 14 March 2008
3.	Credit Loan Application Forms submitted to the Credit Committee should not anticipate the Committee's decision.	This recommendation is noted and has been implemented.	Implemented from 14 March 2008
4.	INBS to advise why the majority of Credit Application Forms provided to inspectors contained only one or no signatures.	The Credit Application Forms with no signatures were probably printed from the system rather than those submitted to the Board for formal sanction. Credit Loan Applications have two signatures.	**N/A**

B1d – Adequacy of board oversight over internal controls to ensure that risk is properly identified, managed and monitored.

Information Summary (Section33AK)

Note: All references are aggregated

Document Category	Time Period
Correspondence	Q3 - 2008

In Q3 2008 the Financial Regulator wrote to the Department of Finance regarding a medium-sized financial institution.

The letter included summary information on the composition of the institution's assets as at Q4 2007, including classification of commercial assets and analysis of Loan-to –Value amounts by percentage bands.

Key items of note were:

- Loans and receivables totalled €12.3bn
- Of which 79% (€9.7bn) were Commercial and 21% (€2.6bn) were Residential.
- €6.2bn of loans were in the UK – all commercial.
- 33.9% of total loans had an LTV greater than 100% .
- 50.9% of total loans had an LTV greater than 90%.

THEME: B2

Effectiveness of banks' credit strategies and risk management

LINE OF INQUIRY: B2a

Appropriateness of property-related lending strategies and risk appetite

Approximately 42% of the total loan exposures (drawn and committed) relate to Speculative property investment and Speculative construction activities at 30 September 2008

Total Loan Exposures to Customers - Business Sectoral (CBI Criteria)

€ in millions	CBI Code	Ireland	UK	Europe & Other	Balance	Impairment	%
		30 Sep 2008					
Speculative property investment	K11	1,630.2	2,291.5	322.5	4,244.2	(48.6)	1.14%
Mortgage Finance for PDH	O11	1,665.1	1.2	0.1	1,666.3	(2.4)	0.14%
Property development with contracted rental income	K12	220.1	1,270.0	132.3	1,622.4	(4.7)	0.29%
Construction activities (customer contract)	F02	284.5	493.9	169.3	947.8	(10.3)	1.08%
Speculative construction activities	F01	470.0	409.3	32.5	911.8	(8.4)	0.92%
Accommodation - hotels	H01	116.7	382.5	228.0	727.2	-	0.00%
Mortgage Finance for RIP	O12	663.5	12.9	6.6	683.1	(10.1)	1.48%
Recreation, Sports	N01	113.1	238.0	5.5	356.6	-	0.00%
Other Accomodation	H04	9.3	181.3	-	190.5	(0.8)	0.44%
Bars	H03	30.4	146.2	-	176.6	(0.0)	0.02%
Retail	G03	23.0	127.2	2.2	152.4	(0.1)	0.05%
Travel	I03	2.7	77.3	60.3	140.3	-	0.00%
Hospital & Medical	M01	-	-	115.5	115.5	-	0.00%
Business investment - personal	O03	91.3	3.4	-	94.7	(1.7)	1.85%
Transport	I01	56.0	-	-	56.0	-	0.00%
Loan Sectoral Exposures > €50m		**5,376.0**	**5,634.6**	**1,074.9**	**12,085.5**	**(87.1)**	**0.72%**
Other		65.7	77.2	57.9	200.8	(5.3)	2.63%
Total		**5,441.6**	**5,711.9**	**1,132.8**	**12,286.3**	**(92.4)**	**0.75%**

Source: Credit Risk Management

- The table opposite presents total loan exposures (both drawn and committed) to customers by sectoral and geographic split at 30 September 2008.
- Approximately 42% of the total loan exposures relate to speculative property investment and construction activities (K11 and F01).
- In addition, 62% of the total specific loan loss impairment (€92.4 million) relate to these two sectors.

Land and development (L&D) exposures account for c.59% of the total commercial loan book at 30 September 2008. Of the total L&D exposure of €5.6 billion, 81% relates to speculative property investment and speculative construction activities.

Land and Development Exposures - 30 September 2008

€ in millions		Unzoned	Land Zoned no PP	Land Zoned PP	Construction	Other	Total	Ext. LTV %	Int. LTV %
400284211	[redacted]	-	-	-	-	240.3	240.3	78%	N/A
400206894		-	-	-	164.1	-	164.1	73%	91%
400284321		-	-	-	187.8	-	187.8	135%	96%
400093075		-	-	-	119.8	-	119.8	69%	69%
400234403		-	-	-	76.8	-	76.8	59%	59%
400210916		-	111.3	-	-	-	111.3	72%	82%
400276049		-	91.2	-	-	-	91.2	128%	83%
400251269		-	76.2	-	-	-	76.2	52%	85%
400273046		65.5	-	-	-	-	65.5	94%	101%
400136858		-	-	81.9	-	-	81.9	196%	36%
400234444		-	62.1	-	-	-	62.1	120%	78%
400135072		-	-	-	78.5	-	78.5	69%	56%
400207389		-	-	-	76.2	-	76.2	108%	91%
400276338		-	-	-	72.4	-	72.4	171%	93%
400008504 & 400176854		-	-	-	57.0	-	57.0	71%	88%
400226892		-	55.4	-	-	-	55.4	145%	101%
400234171		-	-	70.1	-	-	70.1	70%	79%
400276191		-	-	-	54.1	-	54.1	69%	69%
400112988		-	-	68.1	-	-	68.1	176%	77%
400251497		-	-	67.9	-	-	67.9	109%	89%
Top 20 Land & Development exposure		**65.5**	**396.3**	**287.9**	**886.7**	**240.3**	**1,876.6**		
Other		111.5	1,687.7	470.1	878.3	538.7	3,686.4		
Total Land & Development exposure		**177.0**	**2,084.0**	**758.0**	**1,765.0**	**779.0**	**5,563.0**		
Top 20 L&D exposures as % of total L&D exposure							33.7%		
Top 20 L&D exposures as % of total commercial loan book							19.8%		
Total L&D exposure as % of total commercial loan book							58.6%		

Source: Credit Risk Management

- We set out opposite the top 20 land & development exposures at 30 September 2008. It should be noted that the figures presented opposite are “drawn only” figures and do not include any commitments.
- The top loan [redacted] under “Other” category is the development of an existing building [redacted].

Key observations

- Top 20 L&D exposures account for 34% of the total L&D exposures and 20% of the total commercial loan book at 30 September 2008.
- Total L&D loans account for 59% of the total commercial loan book at 30 September 2008.
- 47% of the top 20 L&D loans of €1.9 billion is in “Construction” phase.
- 46% of the remaining L&D loans of €3.7 billion is in “Land Zoned without Planning” phase.
- Overall breakdown of total L&D loans of €5.6 billion is as follows: Unzoned (3.2%), Land Zoned without Planning (37.5%), Land Zoned with Planning (13.6%), Construction (31.7%) and Other (14.0%).

THEME: B2

Effectiveness of banks' credit strategies and risk management

LINE OF INQUIRY: B2b

Appropriateness of credit policies, delegated authorities and exception management

Deloitte.

IRISH NATIONWIDE

IRISH NATIONWIDE BUILDING SOCIETY

Commercial and Residential Lending Review

May 2008

Deloitte & Touche
Enterprise Risk Services
Deloitte & Touche House
Earlsfort Terrace
Dublin 2
Ireland
Tel.: (01) 417 2200
Fax.: (01) 417 2300

Deloitte.

IRISH NATIONWIDE

1. Executive Summary

1.1 Background

Irish Nationwide Building Society ('INBS'; 'the Society') is one of Ireland's oldest financial institutions with offices in the Republic of Ireland and the United Kingdom. It was established in October 1873 and has a network of 49 branches and 36 agencies in the Republic of Ireland and one branch in Belfast. INBS is committed to maintaining a strong Society and implementing a successful demutualisation programme as soon as is practicable. Irish Nationwide is regulated in Ireland by the Financial Regulator and by the Financial Services Authority in the United Kingdom.

As at 31st December 2007, commercial lending accounted for 79.3% (70% in 2006) of the total loan book (€12.5 billion). The commercial loan book (circa €9.9 billion) is split 31% to loans within the domestic Irish market, 64% in the United Kingdom, which includes Northern Ireland, the Isle of Man and Channel Islands and the remaining 5% into other geographic areas. The Society's Top 30 customers account for approximately 60.7% (63% in 2006) of the total commercial portfolio (albeit this percentage figure may contain an element of residential lending).

Residential lending accounts for 20.7% of the total loan book. INBS primarily lends on residential properties located within the Republic of Ireland.

INBS has over time developed a relationship driven strategy, particularly for its commercial lending activities where quick decision making, flexible packages and personalised service are, amongst other elements, key to the Society's philosophy.

Appendix I sets out the process flows for both the current commercial and the current residential lending procedures. It should be noted that the Society reviewed and revised its commercial and residential lending policies and procedures in December 2007. Of particular note for commercial lending was the extension of the power of the Credit Committee from the approval of loan applications up to €1 million (pre December 2007) to the approval of all commercial loan applications (post December 2007). The Board is no longer directly involved in the approval of loans; prior to December 2007 the Board approved commercial loan applications in excess of €1 million.

The Commercial and Residential Lending functions are key components of INBS and play key roles in managing the various risks faced by INBS:

Operational Risk
The Commercial Lending and Residential Lending Departments of INBS need to balance the commercial opportunity available to INBS because of its responsiveness to particular lending requests against the risk of loans going bad.

There are a number of factors, which influence the risk from lending within INBS. These potential risks include for example;

- *Governance* - A lack of governance and oversight over the lending functions, from either the Board or Credit Committee;
- *Control* - A lack of control over loan applications, loan products used and approval process through to the payment and collection of the loans. This would include management of the adherence of the loan to the terms of the loan agreement;
- *Process and People* – fraud, incompetence, key man risk, inadequate staffing, improper segregation of duties, improper supervision, deficient project management, non-adherence to internal policies and procedures, and incorrect model inputs;
- *Monitoring and Reporting* – A lack of adequate monitoring and reporting to include value of the loans, spread profile (type, age, customer, industry) and the loan risk exposure;
- *Financial Calculation and Reporting* – Incorrect calculation of the loan interest income received and receivable. Incorrect booking and accounting for the loan and any related arrangement fees and profit sharing arrangements on commercial loans;
- *Regulation and Legal* – INBS fails to remain in compliance with appropriate regulations (Financial Regulator / Basel II) and with legislation.

Credit Risk

The numbers of issues raised by category are:

Priority 1 Critical	Priority 2 Significant	Priority 3 Other
7	**4**	**4**

1.6 Conclusion

We have identified a number of areas where controls could be enhanced and improvements made. The number and grading of these findings indicates that urgent action is required to strengthen the control environment. These findings are set out in detail in Section 2.

Deloitte.

IRISH NATIONWIDE

2. Detailed Findings and Recommendations

1 Adherence to Credit Committee Terms of Reference

Finding	Recommendation	Priority	Management Response	Deadline
The Credit Committee terms of reference are not being fully adhered to. We noted two areas not fully adhered to: • Considering and approving/ declining all commercial loan applications; and • Considering and approving/ declining the residential loan applications where a customer's exposure to the Society exceeds €1 million. No Credit Committee approval was present on a number of reviewed files, mostly relating to loans originating in Belfast. In many cases the Commercial Loan Application was approved by only one member of the Credit Committee, while at least two members are required under the terms of reference to approve these loans.	The Credit Committee should adhere to its terms of reference and should maintain appropriate record keeping arrangements to demonstrate the required approvals have been made.	1	The Credit Committee is and will continue to adhere to its terms of reference and will keep appropriate records to demonstrate that the required approvals have been made. The Drawdown & Control section, as part of the loan payout process, ensure that all loans are approved in accordance with the commercial and residential mortgage lending policies.	Implemented.

Deloitte.

IRISH NATIONWIDE

Finding	Recommendation	Priority	Management Response	Deadline
Residential loans were not approved by the Credit Committee until December 2007, although the policy required such approval if the loan is over €1 million.				

Deloitte.

IRISH NATIONWIDE

2 Board Approval not on file

Finding	Recommendation	Priority	Management Response	Deadline
Until December 2007, Board approval was required for all loans in excess of €1m. In a number of instances, no Board approval could be located (in either the loan file or the Board minutes) for loans which, according to the lending policy in operation at the time, would have required Board approval.	While the Board no longer has a role in the approval of loans, the Society should maintain appropriate record keeping arrangements to demonstrate the required approvals have been made in accordance with policy.	1	Appropriately approved Commercial Loan Applications will be kept on each customer's loan file, in addition to the loan approval being documented in the Credit Committee minutes.	Immediately.

Deloitte.

IRISH NATIONWIDE

3 Amendments to approved loans do not follow best practice

Finding	Recommendation	Priority	Management Response	Deadline
We noted several instances during our audit where we believe lending best practice standards are not being fully met: • The interest rate was manually changed and signed by the Managing Director on the loan offer, with no date noted of the change. We were informed that the change was made before the client signed the offer. • A loan amount was increased by £10 million (from £71 million to £81 million) with the approval of the Managing Director with only the accompanying memo stating that £10,125,000 of VAT monies will be repaid within 3 months time. This is in breach of the rules of commercial lending policy as the increased approval can only be given by the	These instances of discrepancies between the commercial loans approved by the Credit Committee / the Board and the actual loan issued may be considered of minimal importance. However, on a strict reading of the lending policies they are breaches as only the Credit Committee (previously the Board) could so amend the terms of the loan. The Society may wish to consider if there are situations where non-material changes to loans can be made without the approval of the Credit Committee and document this accordingly within the policy. Alternatively, the Society should adhere to the position set out within policy, i.e. any amendments, which are subsequently made to the terms of a loan, must receive the approval of the Credit Committee.	1	Going forward, all amendments to the original terms of a loan will have Credit Committee approval prior to loan payout.	Immediately.

Deloitte.

IRISH NATIONWIDE

Finding	Recommendation	Priority	Management Response	Deadline
Credit Committee and in this case only the Managing Director agreed the increase. • In several instances there was a discrepancy between the amount of the loan approved by the Board or Credit Committee (depending on the amount / circumstances of the loan) and the actual loan amount. We noted in one case the loan offer of €6.25 million was higher then the credit loan approval of €6 million.				

Deloitte.

IRISH NATIONWIDE

4 The loans approval procedures are not performed in the correct sequence

Finding	Recommendation	Priority	Management Response	Deadline
We observed in several cases, that the application date on approved Commercial Loan Applications (CLAs) was later than the letter of offer signed by the customer. In addition, in several instances, we noted that the date of the letter of offer was earlier than Credit Committee / Board approvals, as applicable.	A loan offer forms an integral part of the contract. The application process, including the completion of a CLA, should be undertaken before a signed loan offer is issued.	1	The application process (including Commercial Loan Application completion) will be undertaken before a Loan Offer is issued.	Immediately.

Deloitte.

IRISH NATIONWIDE

5 Documentation supporting loan approval is not complete

Finding	Recommendation	Priority	Management Response	Deadline
We identified in many cases that required information was not being retained on file. The most frequent gaps in the required information relate to: • Completed checklists not on file (for most cases) • Insurance Policy of the building • No Board resolution regarding the commercial loan • Audited accounts • Credit history checks - There is limited evidence of credit history on files. In accordance with the revised lending policies, we were informed that ICB checks are requested only for new customers • Profit share agreements • TCC/ P60 • Valuation report • Planning Permission • Loan to value • Net Worth Statement • Audited accounts of financial information.	We recommend the Society seeks ways to ensure the checklist, which is a key control, is fully completed as a matter of routine. A frequent and robust quality assurance or quality control check should be implemented to ensure checklists are being completed fully and correctly, e.g. a 10 – 20% monthly files check.	1	The Drawdown & Control section will ensure all commercial files have a fully complete checklist on file before the loan can be paid out. A monthly quality control check will be performed on a sample of new loans issued to ensure checklists are being completed fully and correctly.	Immediately.

Deloitte.

IRISH NATIONWIDE

6 LTV for related parties

Finding	Recommendation	Priority	Management Response	Deadline
When new advances are considered and Commercial Lending Applications prepared for approval, commercial lenders have information on total exposure for the Group. In the CLA there is no information on the additional, linked exposures with the borrowing Group. There is no evidence that the total value of Group exposure is compared with the total value of securities held by the Society. There is no regular report that would allow for a comparison of the total Group exposure with the total Group value of security on Summit. The LTV parameter for the whole Group is not calculated. LTV is calculated only in individual cases before the new loan is approved.	Where the Society has many significant related Group loans there should be a key check and management review prior to new advances being considered for approval.	1	Going forward, the Society will ensure that the total Group exposure is compared with the total value of Group security held by the Society and this information will be documented on each individual loan's Commercial Loan Application.	Immediately.

Deloitte.

IRISH NATIONWIDE

7 Documentation supporting residential lending incomplete

Finding	Recommendation	Priority	Management Response	Deadline
In one instance we noted a Home Loan Application was not fully completed. In particular this loan application, with an LTV of 100%, contained no evidence of an affordability check being conducted. In other cases, income details were not found on the manual file or on the system.	We recommend that the Society adhere to is residential mortgage policy and related procedures. Determining affordability and retaining the evidence on file is crucial in several respects, not least in being able to demonstrate responsible lending and to address any complaints or disputes which may arise with the borrower at a later stage.	1	The Society's underwriters will strictly adhere to the residential mortgage policy and related procedures. The Drawdown & Control section, as part of the loan payout process, ensure that all loans are approved in accordance with the residential mortgage lending policy, that each loan is underwritten correctly and that all loan files have minimum documentation requirements. In addition to this, management will perform monthly spot checks to ensure that affordability is determined and evidence supporting this is held on file.	Implemented.

Deloitte.

IRISH NATIONWIDE

8 Speculative / Development lending

Finding	Recommendation	Priority	Management Response	Deadline
In a number of cases the LTV was higher than 100%. In these cases planning had not been obtained and it is expected that following planning being successful the LTV will become less than 100%.	As this is higher risk lending for the Society there needs to be a policy in place to track these loans and to provide a sufficient level of oversight.	2	In future, if loans are advanced with an LTV of 100% or greater, one of the Commercial Mortgage Offer conditions will ensure that quarterly updates are provided to the Society on the planning and development process. These updates will be substantiated by reports from appropriate professionals i.e. planning consultants/project managers.	30/4/08

Deloitte.

IRISH NATIONWIDE

9 Valuation of additional securities for the loans is not evident

Finding	Recommendation	Priority	Management Response	Deadline
The LTV methodology utilised by the Society is based on the value of the first mortgage. To establish the value of a cross charge, the value of the collaterals for the other loans needs to be established. Details of any such collaterals for other loans for cross charge calculations are now available only for Top 50 exposures. Cross charge is used in the following cases: the next loan to the borrower may be approved only if there is a low LTV parameter for the previous loan to given to this customer. The total value of exposure is compared with the total value of security – before the next loan advance is approved. At present the commercial lenders consider these parameters at the customer level, not an account	There is information available on additional securities for the loans in the Group but they are not valued in the Summit system. We noted that these additional collaterals are sometimes the same for various loans within the Group. The Society should consider implementing a database consisting of the nature and value of additional securities.	2	The Society is working towards enhancing its current systems to provide a more accurate reflection of a loan's LTV where further charges/cross charges are perfected on existing security(s).	30/9/08

Deloitte.

IRISH NATIONWIDE

Finding	Recommendation	Priority	Management Response	Deadline
level. INBS is required to report on an account level (for Basel II purposes). Thus approval of loans (cross charges) on total/customer level will result in higher capital requirements. The Society is in the process of establishing the data required for credit risk purpose (using a pro forma due diligence report). We are unclear whether the information gathered will include the value of additional securities, e.g. in section "Security Beyond Underlying Property" in the due diligence report.				

Deloitte.

IRISH NATIONWIDE

10 Urgently required commercial credit decisions

Finding	Recommendation	Priority	Management Response	Deadline
The Commercial Mortgage Lending Policy dated 1 December 2007 states: *"In the event that a credit decision is required urgently and it is not possible to convene a meeting with the Credit Committee, the credit decision must be approved by the Managing Director and any two of the following Credit Committee members:* • *Tom McMenamin* • *Martin Noonan* • *Gary McCollum* *Any loan so approved should be signed off by the Credit Committee as soon as practicable" (Page 13).* It is unclear what this (post approval) Credit Committee sign off will entail. If a loan offer has been signed and issued to the borrower the Credit Committee review would appear to be a	We recommend the Lending Policy be clarified in respect of what this signing-off by the Credit Committee will constitute.	2	The policy will be amended to read 'Any loan so approved will be presented to the Credit Committee as soon as practicable'. This presentation ensures all Credit Committee members are notified of the advance made for overview and information purposes.	Implemented.

Deloitte.

IRISH NATIONWIDE

Finding	Recommendation	Priority	Management Response	Deadline
formality. It is unclear if there will be any Board oversight of the number and size of any credit decisions so made.				

Deloitte.

IRISH NATIONWIDE

11 Not all commercial loans are subject to regular review by Credit Risk

Finding	Recommendation	Priority	Management Response	Deadline
There are Credit Risk meetings held approximately every week to discuss Top 50 loans (constituting approximately 76% of the commercial loan book). Within the Access database used by Credit Risk for its analysis, there are 950 accounts (although we noted some of these accounts were already redeemed and some may no longer reflect Top 50 exposures). Credit review checks are routinely made only for loans exceeding EUR 10 million and those within the top 50 exposures. The collection of relevant data, particularly related to cross-charges has presented the Credit Risk department with difficulties in obtaining robust information. The Credit Risk Department is currently working on: • The transfer of data from Access to SAS • Assigning new risk profiles to the	The appointment of a Credit Risk Manager (with support staff) has been a major initiative undertaken by the Society over the last two years. We recommend the Society consider if the Credit Risk Manager has been allocated sufficient resources, both human and IT, to establish and embed Basel II compliant processes and associated risk management procedures.	2	The Society is actively recruiting another staff member for the Credit Risk Department and will monitor the staffing requirements of the Department on an on-going basis.	31 July 2008

Finding	Recommendation	Priority	Management Response	Deadline
accounts (constituting a transfer from 4 to 6 grades). It is intended that this process will be completed within Q2 2008 for the risk profiles for the Top 50 exposures.				

Deloitte.

IRISH NATIONWIDE

12 Protection of relevant documentation

Finding	Recommendation	Priority	Management Response	Deadline
Some of files are kept at the commercial lenders' desks until all documentation is gathered. Current files are with the lenders (where documentation is being completed). Files of redeemed loans are archived in the warehouse. During our fieldwork we observed on one occasion a cheque book was found to be in an insecure location on a member of staff's desk in the Drawdown and Control section.	The Society may wish to review its file keeping arrangements. This may include a review of the relevant record keeping sections of the Society's Business Continuity Plans for both sites (Dublin and Belfast). The cheque book should be held in a secure location and not left in an open environment for any length of time.	3	The Society continually reviews its file keeping arrangements. The commercial lenders will be reminded to ensure all documentation is gathered on customer files and to ensure the customer files are kept in the Fileroom each night. The cheque book will be kept in a secure location.	30/4/08

Deloitte.

IRISH NATIONWIDE

13 Account is set up on the computer system before loan approval by the Credit Committee

Finding	Recommendation	Priority	Management Response	Deadline
Contrary to the Society's procedures, in several cases, accounts were set up/ made active on the Summit system, before the loan was approved by the Credit Committee. The procedures dictate that a 'Commercial Advances Checklist' listing all documentation is required prior to account set-up. The last step in the lending procedures is the set-up of the account, as it follows the payment of the advance. Prior to payment all information is controlled by the Quality Controller.	New Account set up is the final stage in the Society's lending procedures. This has the effect of, inter alia, controlling the number of loan account numbers created and reducing the likelihood of any fraudulent accounts being created. The Society should adhere to its procedures in this respect.	3	In future, the procedures will be adhered to and a 'Commercial Advances Checklist' will be completed prior to account set-up.	Immediately.

Deloitte.

IRISH NATIONWIDE

14 Staff Training

Finding	Recommendation	Priority	Management Response	Deadline
There is a training plan in place for the Commercial Lending Department, drafted in 2006. This plan has not been updated since it was originally drafted.	The training plan should be reviewed (and reviewed in future on a regular basis) by relevant management to ensure the plan is fit for purpose and is being implemented.	3	The training plan will be reviewed by the Commercial Lending manager.	31/7/08

Deloitte.

IRISH NATIONWIDE

3. Comparison 2006 (INBS) / 2008 (Deloitte)

SUMMARY OF RISK AREAS AND COMMENT ON RATINGS

We present in the table below the summary of our findings as the results of our benchmarking exercise between the Society's Internal Audit review conducted by the Society's Internal Audit department in 2006 and our review, which is subject of this report. For all the Internal Audit risk areas, all the Society's Internal Audit findings are compared with our findings and presented in Appendix II of this report.

In the table below the findings and comments are aggregated under more general headings/ Risk areas.

Risk areas for Commercial Lending review	**Rating by Internal Audit based on findings in 2006**	**Commentary based on Deloitte findings in 2008**
Documentation held on file	Adequate	Finding
Approvals (Credit Committee / Board)	Very good	Significant finding
Evidence of repayment capacity	Good	Significant finding
Fee agreement/ Profit share	Good	Finding
Exposures / credit reviews	Very good	Finding
Other risks	Very good	N/A

Credit Committee Operational Review

Internal Audit Report

July 2008

Killian McMahon
Internal Audit Department

Table of Contents

1. Executive Summary

1.1 Objective and Scope of Audit

Internal audit conducted an audit of the operation of the credit committee from January 2008 to June 2008. This limited scope review will focus on the frequency of and attendance at meetings, documentation supplied at the meetings, details recorded in the minutes and a view on the quality of its operations.

The audit consisted of detailed testing performed to assess the risks identified in Section 1.2 of this report.

The audit seeks to provide assurance on the effectiveness of the controls in place. The audit will seek to identify new controls and make recommendations that will enhance the Society's control environment.

The audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

This is the first review undertaken by the Internal Audit Department of the Credit Committee process since the Belfast audit in January 2008. The controls in place have been tested for their effectiveness and adequacy and the department/section procedures have been assessed for potential weaknesses in process.

This report will be circulated to Mr. Fingleton and the Audit Committee.

Killian McMahon completed the audit field work and Patricia Canniffe reviewed the audit file.

The fieldwork was completed on 14 July 2008.

In the course of this report (except where otherwise defined):

"the Society" refers to Irish Nationwide Building Society.

1.2 Overall Rating

Internal Audit has conducted a review of the credit committee from January to June 2008. The following areas were reviewed and assessed:

Risk	Risk Weighting	Rating
The Credit Committee may not meet with sufficient frequency	Medium	Good
A quorum may not be maintained at the meetings	Medium	Excellent
The documentation provided at Credit Committee meetings may not be sufficient	High	Adequate
Credit Committee minutes may not be adequate and may not represent an accurate description of each meeting	Medium	Good
The Credit Committee may not be adhering to its Terms of Reference	High	Good
The Credit Committee may not be completing all tasks within its scope	Medium	Good
The Credit Committee operations may not meet the Society's requirements	Medium	Very Good

OVERALL RATING	GOOD (4.33)

The overall rating is calculated as follows:

$$\frac{\sum (\text{Risk Weighting}^1 \text{ X Risk Rating}^1) + (\text{Risk Weighting}^2 \text{ X Risk Rating}^2) + \ldots\ldots\ldots + (\text{Risk Weighting}^n \text{ X Risk Rating}^n)}{\sum \text{Risk Weighting}^1 + \text{Risk Weighting}^2 + \ldots\ldots\ldots + \text{Risk Weighting}^n}$$

(Where n = no. of risks)

An overall rating less than 1.5 results in an **Excellent** rating, an overall rating from 1.5 to 2.5 results in a **Very Good** rating, an overall rating from 2.5 to 4.5 results in a **Good** rating, an overall rating from 4.5 to 8.5 results in an **Adequat**e rating, an overall rating from 8.5 to 16.5 results in a **Room for improvement** rating, and an overall rating of 16.5 or greater results in an **Unsatisfactory** rating.

Explanation of Risk Weightings Used

Value	Rating	Explanation
1	Low	This risk is either not expected to occur or if controls fail, the loss to the Society would not be significant.
2	Medium	Such a risk may occur and if it did occur, the loss to the Society may be material.
4	High	If this risk is not controlled, the Society may incur a great loss in monetary and/or reputation terms.

Explanation of Risk Ratings Used

Value	Rating	Explanation
1	Excellent	Commendable standards attained.
2	Very good	High standards generally evident. A few areas for improvement are evident but these are not considered to represent serious control weaknesses.
4	Good	Generally good standards attained, but areas for improvement are evident.
8	Adequate	Average standards attained. Controls are in place but weaknesses have become evident.
16	Room for improvement	Below expected standard with room for improvement. Control weaknesses may become serious unless addressed.
32	Unsatisfactory	Inadequate level of standards evident – remedial action required.

1.3 Main issues arising

Two moderate weaknesses were noted in the operation of the Credit Committee:

1. The Credit Committee members receive minimal documentation prior to each meeting.
2. The approval process for three payouts was not in accordance with the Society's payout policy.

1.4 Overall Conclusion

There have been thirteen credit committee meetings between January and June 2008. The meeting frequency has significantly declined from a high of five meetings in January to only one meeting each in April, May and June. However, meetings are only called when there are loans to approve and loan approvals have decreased since January 2008. John Murphy has attended all thirteen meetings. Tom McMenamin, Martin Noonan and Alan Deering have each attended twelve meetings. Michael Fingleton has attended eight meetings while Gary McCollum has attended one meeting via a phone link.

The overall rating of Good reflects that the Credit Committee is assessing loans within its remit and loan approval exceptions are decreasing. However, relevant documentation must be prepared and circulated prior to each meeting taking place to ensure all members have complete loan information.

2. Exceptions and Recommendations

2.1 Credit Committee Meetings

No.	Exception(s)	Recommendation	Rating	Deadline
2.1.1	Discussions concerning loan applications were the only matters detailed in the meeting minutes. There were no documented discussions about moratoria extensions, non-performing loans, relevant MIS reports or other issues concerning the credit committee.	The Credit Committee must receive information on and consider the other items within its remit.	2	31 Aug 2008

2.2 Credit Committee Terms of Reference

No.	Exception(s)	Recommendation	Rating	Deadline
2.2.1	The Terms of Reference are still referring to Mr. Michael Fingleton as the Managing Director.	The Terms of Reference should be updated to refer to the Chief Executive only.	1	31 Aug 2008
2.2.2	The Credit Committee Terms of Reference makes no reference to terms extensions.	The Credit Committee should be given responsibility for approving terms extensions on all commercial loans and residential loans greater than €1 million.	2	31 Aug 2008

2.3 Credit Committee Minutes

No.	Exception(s)	Recommendation	Rating	Deadline
2.3.1	The Credit Committee minutes do not detail the customer's account number. The account number is especially pertinent when a customer has a number of different accounts with the Society.	The customer's account number should be recorded in the Credit Committee minutes.	2	31 Aug 2008

2.4 Credit Committee Documentation

No.	Exception(s)	Recommendation	Rating	Deadline
2.4.1	The Credit Committee members receive minimal documentation prior to each meeting. They receive a copy of the case summary for residential loans prior to the meeting but only receive the Commercial Loan Applications at the actual meetings.	The Credit Committee members should receive the case summary or Commercial Loan Application for each loan at least 24 hours prior to the scheduled meeting.	3	31 Aug 2008

2.5 Approval Process

No.	Exception(s)	Recommendation	Rating	Deadline
2.5.1	All 39 agreed advances exceeding €1 million entered on Summit between 1/1/08 and 29/6/08 were tested to ensure the correct approvals were received before payout. The following exceptions were noted: • Three loan payouts were made for a different amount to the approved amount. *However, two of the payouts were for a lesser amount and the other payout exceeded the approved amount because the admin fee was added to the loan.* • Five approval exceptions were noted. Two of these exceptions were authorised by a signed Commercial Loan Application and three were authorised by a signed Payout Approval sheet. Only two of the approval exceptions were in compliance with the Credit Committee Terms of Reference.	All loan payouts must be made in accordance with Society policy.	3	Immediately.

Internal Audit Exception Ratings Key

Rating	Type	Description
4	Critical	Serious control weakness with a high probability of significant financial loss, misstatement of financial results, compliance implications or reputational impacts, if left unaddressed.
3	Significant	Significant control weakness with a real possibility of significant financial loss, misstatement of financial results, compliance implications or reputational impacts, if left unaddressed.
2	Moderate	Moderate control weakness with some possibility of significant financial loss, misstatement of financial results, compliance implications or reputational impacts if left unaddressed.
1	Minor	Minor control weakness, which is unlikely to result in financial loss, misstatement of financial results, compliance implications or reputational impacts, if left unaddressed.

Credit Committee Operational Review

Internal Audit Report

January 2009

Killian McMahon
Internal Audit Department

Table of Contents

1. Executive Summary

1.1 Objective and Scope of Audit

Internal audit conducted an audit of the operation of the credit committee from July 2008 to 15 December 2008. This limited scope review will focus on the frequency of and attendance at meetings, documentation supplied at the meetings, details recorded in the minutes and a view on the quality of its operations.

The audit consisted of detailed testing performed to assess the risks identified in Section 1.2 of this report.

The audit seeks to provide assurance on the adequacy and effectiveness of the controls in place and to assess the department/section procedures for potential weaknesses in process. The audit will seek to identify new controls and make recommendations that will enhance the Society's control environment.

The Internal Audit Department's purpose, role, responsibilities, status and authority are derived from the Internal Audit Charter. The audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

This is the first review undertaken by the Internal Audit Department of the Credit Committee process since July 2008. This is a high risk category within the Society.

This report will be circulated to Tom McMenamin, Mr. Fingleton and the Audit Committee.

Killian McMahon completed the audit field work and Patricia Canniffe reviewed the audit file.

The fieldwork was completed on 9 January 2008.

In the course of this report (except where otherwise defined): *"the Society" refers to Irish Nationwide Building Society.*

1.2 Overall Rating

Internal Audit has conducted a review of the credit committee from July to December 2008. The following areas were reviewed and assessed:

Exception No.	Risk	Risk Weighting	Risk Rating
2.1	The Credit Committee may not meet with sufficient frequency	Medium	Adequate
2.2	A quorum may not be maintained at the meetings	Medium	Good
2.3	The documentation provided at Credit Committee meetings may not be sufficient	High	Adequate
N/a	Credit Committee minutes may not be adequate and may not represent an accurate description of each meeting	Medium	Very Good
2.4	The Credit Committee may not be adhering to its Terms of Reference	High	Good
2.5 & 2.6	The Credit Committee operations may not meet the Society's requirements	Medium	Room for improvement

OVERALL RATING	ADEQUATE (6.75)

1.3 Main issues arising

One critical weakness was noted in the operation of the Credit Committee:

1. The Society has made multiple agreed additional commercial advances, which have not been presented or approved by the Credit Committee.

Three significant weaknesses were noted in the operation of the Credit Committee:

1. The Credit Committee only met five times between July and December 2008 and is not meeting with enough frequency to fulfil all its duties.
2. A loan amount advanced to refinance an existing Society loan exceeded the Credit Committee approved amount.
3. A loan for €10,000,000 was advanced without sufficient backup documentation and without receiving credit committee approval.

1.4 Overall Conclusion

The Overall Rating[1] of 'Adequate' reflects that the Credit Committee is not meeting with sufficient frequency. The rating also reflects that a number of loans are being advanced without credit committee approval and that the Committee is not considering all tasks under its remit.

[1] The Overall Rating and Exception Rating system descriptions are available in Appendix 1.

2. Exceptions, Risks and Recommendations

2.1 Frequency of Credit Committee Meetings

No.	Exception(s)	Recommendation	Management Response	Rating	Deadline
2.1	The Credit Committee has only met five times between July and December 2008. A number of loans were approved and advanced on the same date. In the absence of regular credit committee meetings, loans may be advanced, which were not approved in accordance with the Society's lending policies.	The credit committee should schedule its meetings at the start of each month; send this schedule to all committee members and schedule/meet at least twice a month.	The Credit Committee is scheduled to meet on the second and last Tuesday of every month.	3	27/2/09

2.2 Credit Committee Quorums

No.	Exception(s)	Recommendation	Management Response	Rating	Deadline
2.2	The UK General Manager, who is responsible for all Society 4 loans, has only attended one credit committee meeting in 2008. In the absence of the UK General Manager at these meetings, Society 4 loans are only being assessed based on a memo prepared in Belfast and no active discussion can take place on the loans.	The UK General Manager should participate (in person or by phone) in credit committee meetings where Society 4 loans are presented to the committee.	The UK General Manager will attend in future and UK loans will be presented by him.	2	31/3/09

2.3 Credit Committee Documentation

No.	Exception(s)	Recommendation	Management Response	Rating	Deadline
2.3	The Credit Committee members receive minimal documentation prior to each meeting. They receive a copy of the case summary for residential loans prior to the meeting but only receive the Commercial Loan Applications at the actual meetings. In the absence of loan information being provided in a timely manner, an informed decision cannot be made by credit committee members on the loans being presented.	The Credit Committee members should receive the case summary or Commercial Loan Application for each loan at least 24 hours prior to the scheduled meeting.	The case summary and CLA are now presented to each member at least 24 hours prior to each meeting.	2	27/2/09

2.4 Credit Committee Terms of Reference

No.	Exception(s)	Recommendation	Management Response	Rating	Deadline
2.4	The current Terms of Reference detail two committee members who have left the Society. The Terms do not make any reference to term extensions. In the absence of an accurate Terms of Reference, the Credit Committee may act outside its scope or may not consider all relevant items at meetings.	The Credit Committee Terms of Reference must be updated to appoint new committee members and a reference must be made to the consideration of term extensions.	The Terms of Reference have been amended and were approved by the Board on 19/12/08.	1	31/12/08

2.5 Approval Process

No.	Exception(s)	Recommendation	Management Response	Rating	Deadline
2.5.1	[redacted] was advanced to refinance [redacted] This was Board approved on 26/7/07. The amount approved was £3,750,000. However, the actual loan advanced was £4,025,000 as this was the account balance on account no. [redacted] at the redemption date (i.e. 4/7/08). In the absence of an amount variation clause, the Society could advance a redemption amount that exceeds the credit committee approved amount.	Where a loan is advanced to refinance an existing Society loan, the Commercial Mortgage Offer should indicate that the approved loan amount is subject to variation.	The Commercial Mortgage Offer will include a new variation clause.	3	31/3/09
2.5.2	The Credit Committee approved a £4 million additional loan on account no. [redacted] However, the UK General Manager issued a new loan facility of £10 million to refinance the existing debt of £6 million and release £4 million equity. In the absence of the full loan amount being presented to the Credit Committee, the refinance element of the new loan may be advanced on terms, which would not have been accepted by the Credit Committee.	If a customer submits an application to refinance an existing loan and borrow an additional amount, the Credit Committee must approve the total application amount.	Agreed.	2	27/2/09
2.5.3	The Credit Committee sanctioned a €4m loan for account no. [redacted] wrote to the Credit Committee on 26/5/08 to explain that the loan amount had been amended to €3.6m. This was not minuted by the Credit Committee.	All material amendments made to Credit Committee approved loans should be represented to the Credit	All material amendments to Credit Committee approved loans will be minuted accordingly.	1	27/2/09

	In the absence of complete minutes, it cannot be deduced whether the memo was presented to the Credit Committee.	Committee and minuted accordingly.			
2.5.4	A €10,000,000 additional advance on account no. [redacted] paid out on 2/9/08. This advance was not presented to the Credit Committee until 15/9/08, which retrospectively sanctioned the loan. This advance was part of an overall approved advance of €38.47 million. However, a DAA was posted for €10,000,000 to account no. [redacted] and a DAA was posted for €38,470,000 for account no. [redacted] Therefore, a total agreed advance of €48,470,000 was incorrectly posted to these accounts. The Society advanced this loan without adequate backup documentation. A number of documents supporting the loan decision were received after the loan was advanced. In the absence of Credit Committee approval, loans can be advanced that do not meet the Society's lending criteria and which the Society would have no risk appetite for.	All commercial loans must be presented to the Credit Committee prior to a loan offer and a payout being made.	The Drawdown & Control section will ensure that there is proper approval for all payouts.	3	27/2/09

2.6 Agreed Additional Advances

No.	Exception(s)	Recommendation	Management Response	Rating	Deadline
2.6	The Society has made sixteen separate advances on account no. [redacted] totalling £282,942.85	The Society must ensure that all commercial advances are	The Drawdown & Control section will	4	31/3/09

	between July and December 2008. The Society has made thirty-eight separate advances in 2008 on this account totalling £1,766,116.99. The current debt on the account is approximately £23.5 million. The Society is financing the completion of this development. However, the Credit Committee has not formally approved this expenditure. The Credit Committee has discussed th [redacted] loan on 18/12/08. The [redacted] advances are not being approved correctly as exceptions as only two members of the Credit Committee are approving the drawdowns. To a lesser extent, agreed advances have also been made on account no. [redacted] to protect the Society's interests. There are a number of credit committee approved amounts for this loan but the loan is being entered in stages on Summit and it is difficult to ascertain, which drawdown relates to which approved amount. An advance on account no. [redacted] was not approved correctly as an exception as only two members of the Credit Committee approved the drawdown. The advance was for €226,680.36 but the Society's exposure is over €3.7 million on this loan. Three advances (account numbers [redacted], [redacted] and [redacted]) were not approved correctly as only one member of the Credit Committee approved each drawdown. One advance on account no. [redacted] was not approved by any signed document and was advanced based on a request from the UK General Manager.	referred to the Credit Committee. Where the Society is advancing funds to protect its own interests, the Credit Committee should approve the reasons for the agreed additional advances and the committee should also receive regular updates on the loan's status.	ensure that there is proper approval for all payouts. Commercial lenders will update the Credit Committee at regular intervals on the status of loans where the Society has to finance the completion of developments to protect its security.		

	A number of the above advances should not have been classified as advances. Solicitor fees should have been classified as SFDs on Summit, valuation fees can be classified as VALs on Summit and fees incurred after repossession can be classified as REPs. Internal Audit has instructed the Summit Development Manager to set up a new code called NCI, which will be applied to Necessary Costs Incurred on loan accounts to protect the Society's security, maximise the Society's profit and/or minimise any Society loss. Whilst Internal Audit acknowledges that the Society is protecting its interests by financing the completion of developments, in the absence of credit committee approval for DAAs, the Society is not complying with the current Commercial Mortgage lending Policy.				

Appendix 1

Overall Rating

The overall rating is calculated as follows:

$$\frac{\sum (\text{Risk Weighting}^1 \times \text{Risk Rating}^1) + (\text{Risk Weighting}^2 \times \text{Risk Rating}^2) + \ldots\ldots\ldots + (\text{Risk Weighting}^n \times \text{Risk Rating}^n)}{\sum \text{Risk Weighting}^1 + \text{Risk Weighting}^2 + \ldots\ldots\ldots + \text{Risk Weighting}^n}$$

(Where n = no. of risks)

An overall rating less than 1.5 results in an **Excellent** rating, an overall rating from 1.5 to 2.5 results in a **Very Good** rating, an overall rating from 2.5 to 4.5 results in a **Good** rating, an overall rating from 4.5 to 8.5 results in an **Adequat**e rating, an overall rating from 8.5 to 16.5 results in a **Room for improvement** rating, and an overall rating of 16.5 or greater results in an **Unsatisfactory** rating.

Explanation of Risk Weightings Used

Value	Rating	Explanation
1	Low	This risk is either not expected to occur or if controls fail, the loss to the Society would not be significant.
4	Medium	Such a risk may occur and if it did occur, the loss to the Society may be material.
8	High	If this risk is not controlled, the Society may incur a great loss in monetary and/or reputation terms.

Explanation of Risk Ratings Used

Value	Rating	Explanation
1	Excellent	Commendable standards attained.
2	Very good	High standards generally evident. A few areas for improvement are evident but these are not considered to represent serious control weaknesses.
4	Good	Generally good standards attained, but areas for improvement are evident.
8	Adequate	Average standards attained. Controls are in place but weaknesses have become evident.
16	Room for improvement	Below expected standard with room for improvement. Control weaknesses may become serious unless addressed.
32	Unsatisfactory	Inadequate level of standards evident – remedial action required.

Exception Ratings

Rating	Type	Description
4	Critical	Serious control weakness with a high probability of significant financial loss, misstatement of financial results, compliance implications or reputational impacts, if left unaddressed.
3	Significant	Significant control weakness with a real possibility of significant financial loss, misstatement of financial results, compliance implications or reputational impacts, if left unaddressed.
2	Moderate	Moderate control weakness with some possibility of significant financial loss, misstatement of financial results, compliance implications or reputational impacts if left unaddressed.
1	Minor	Minor control weakness, which is unlikely to result in financial loss, misstatement of financial results, compliance implications or reputational impacts, if left unaddressed.

Correlation between Exception Ratings and Overall Ratings

Each risk area's rating is based on the results of the auditor's testing. There can be a subjective element to each risk area's allocated rating and the risk rating may be based on the auditor's opinion.

The exception rating indicates the exception's potential impact if action is not taken to address it. The higher the exception rating, the lower the risk rating will be. A critical exception rating (i.e. 4) should not result in a risk rating exceeding 'Adequate', a significant exception rating (i.e. 3) should not result in a risk rating exceeding 'Good', and a minor or moderate exception rating (i.e. 1 or 2) should not result in a risk rating exceeding 'Very Good'. Where risk ratings contravene these general criteria, an explanation will be provided within the exception field. The highest exception rating in a risk area should determine the risk rating.

If a risk area has one or two exception ratings of the same value, the above criteria apply.

If a risk area has three to five exception ratings of the same value, the risk rating for that area should automatically decrease one level e.g. if a risk area has three significant exceptions, the best risk rating that the area can receive is 'Adequate' (i.e. the best risk rating the area can achieve has decreased one level from 'Good').

If a risk area has six or more exception ratings of the same value, the risk rating for that area should automatically decrease two levels e.g. if a risk area has six significant exceptions, the best risk rating that the area can receive is 'Room for improvement' (i.e. the best risk rating the area can achieve has decreased two levels from 'Good').

IRISH NATIONWIDE
BUILDING SOCIETY
www.irish-nationwide.com

Nationwide House
Grand Parade
Dublin 6
Tel: 01 6096490
Fax: 01 6096499

Mr. Con Horan
Prudential Director
Financial Regulator
P.O. Box 9138
College Green
Dublin 2

29 May 2008

Dear Con,

I refer to your letter dated 7 March 2008 and our subsequent conversations. I apologise for the delay in formally responding to you but I was anxious to make some progress.

1. Proposals for the implementation of corporate governance issues

a) The Society intends to increase the Board by the addition of three non executive directors. We expect, subject to Regulatory approval, to be in a position to appoint the first two of these in early July. The proposed appointments are Mr. Liam Barron, former Director General of the Central Bank, and Mr. Sean Carey, former Deputy City Manager of Dublin, who has a planning and finance background. Both individuals are preparing the fit and proper questionnaires for submission to the Regulator. We are continuing to seek an appropriate third person, in the light of the varied experience of the expanded group of non-executive directors.

b), c) To meet part of the current needs of the Society and in particular to strengthen the management and review of existing commercial loan customers the Society has appointed Michael Goggins as Risk Evaluation

Executive. Mr. Goggins, aged 58, is a qualified accountant, is experienced in property and lending having previously worked with ICC Bank Ltd, property development companies and as Housing Director with the Construction Industry Federation (CIF). As you will be aware the Society, from a lending perspective, is primarily focussed on managing its existing book rather than seeking to do new lending. Mr. Goggins brings valuable experience to this endeavour.

The Society is also looking to recruit at least one other individual who will have a broader mandate.

2. Credit risk management

The audit of lending conducted by Deloitte was submitted to the Financial Regulator on 23 April 2008 last. The Society will ensure that Deloitte will conduct a further review of the operation of appropriate credit processes at end September 2008 and the resultant report will be submitted to the Financial Regulator.

3. Liquidity risk

The inspection which focused on liquidity was completed on site on 2 April last. A letter dated 2 May 2008 in relation to the findings of the inspection has been received by the Society. I am sending, under separate cover, a reply to this letter to-day.

In relation to MBPN, the Society is now in a position to tender for MBPN funds, and to ensure that everything is in order, has tendered for €100 million earlier this week and received the full allocation.

4. Delay in the demutualisation and sale process

The Board has considered the question of alternative plans for the Society should the sale not proceed. The Board's view is that, due to the credit crunch and the market view of property in Ireland and the UK, a sale is unlikely to be agreed in 2008. However potential purchasers have recently said that they are still interested in the opportunity but they now need to show more caution. The Society is continuing to work with Goldman Sachs to review its options. The Society intends to sell at the earliest possible opportunity. However the ability to consummate a sale in whole or in part is very dependent on the state of the credit and property markets. A trade sale of the entire business in 2009 or 2010 is still the Board's preferred option, however all options are open for consideration including sale of part(s) of the loan book.

The Society asked Goldman Sachs to:

1. Provide an update on the capital markets environment;
2. Provide a summary of the Society's strategic alternatives.

A copy of their memorandum dated 7th May 2008 is enclosed.

Yours Sincerely,

Michael P. Walsh
Chairman

MEMORANDUM

Goldman Sachs

To: Stan Purcell

From: Goldman Sachs

Date: 7 May 2008

Re: Project Harmony

Goldman Sachs has been asked to prepare this memorandum to:

1. Provide an update on the capital markets environment; and
2. Provide a summary of Harmony's strategic alternatives.

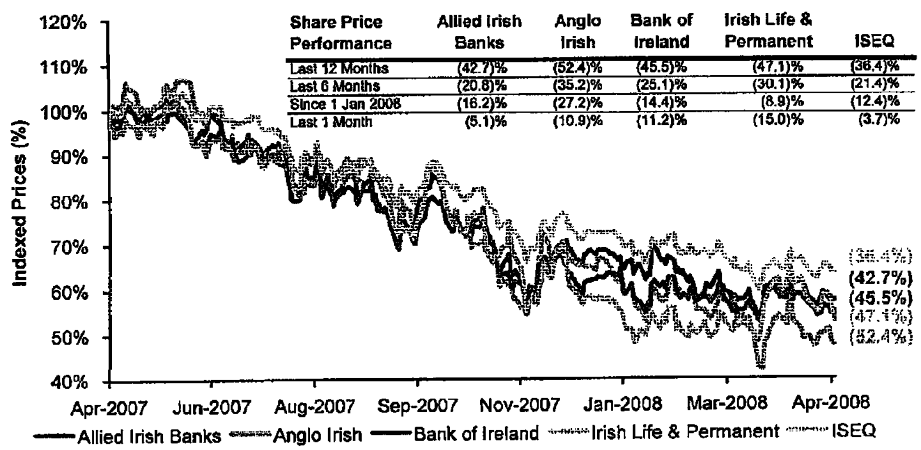
1. Capital Markets Update

Equity Markets

- Q1 2008 was the worst quarter for global equity indices since Q3 2002, with European banks down 18.4%
  - Equity market volatility remains high with stocks reacting nervously to credit market developments and macro economic indicators
  - Further European corporate earnings downgrades are expected with consensus forecasting c.7% earnings growth in 2008 relative to 2007 vs. GS Investment Research estimates of a 12% fall
- The shares of Irish banks have underperformed the ISEQ in the past 12 months (see table below)
- The average performance of BOI, AIB and ILP has been -46.8% since the beginning of 2008 and the performance of the ISEQ has been -36.4% during the same period; Anglo was -52.4% on the same basis
- The sell-side analyst research community has a number of concerns around the Irish banking sector in general
  - House prices are expected to continue to fall. Ireland has seen strong growth in asset prices over the past 10 years. Since 1997, house prices have increased by over 200%, however, given the fall in house prices over the past year, there are indications that the cycle has turned
  - Forecasts of 30% downside to commercial property values for commercial rental yields to return to historic levels
  - The risk of higher impairments is rising. While the environment has remained sound thusfar, analysts believe a slowing economy and falling asset prices may lead to increased impairment charges over coming years

— There is a general negative outlook on Ireland as a whole given the substantial growth of the past number of years

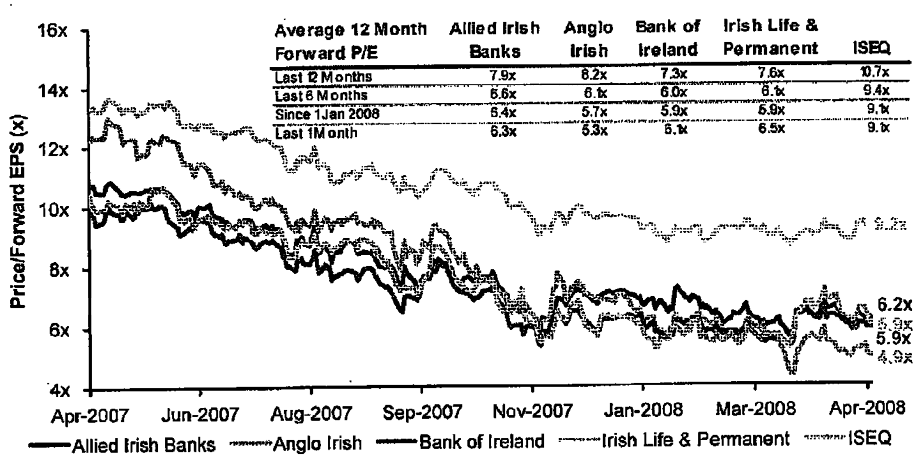
Figure 1: Irish Banks' Share Price Performance – Last 12 Months



Share Price Performance	Allied Irish Banks	Anglo Irish	Bank of Ireland	Irish Life & Permanent	ISEQ
Last 12 Months	(42.7)%	(52.4)%	(45.5)%	(47.1)%	(36.4)%
Last 6 Months	(20.8)%	(35.2)%	(25.1)%	(30.1)%	(21.4)%
Since 1 Jan 2008	(16.2)%	(27.2)%	(14.4)%	(8.9)%	(12.4)%
Last 1 Month	(5.1)%	(10.9)%	(11.2)%	(15.0)%	(3.7)%

Source: Datastream as of 24-Apr-2008

Figure 2: Irish Banks' Price/Earnings Ratio – Last 12 Months



Average 12 Month Forward P/E	Allied Irish Banks	Anglo Irish	Bank of Ireland	Irish Life & Permanent	ISEQ
Last 12 Months	7.9x	8.2x	7.3x	7.6x	10.7x
Last 6 Months	6.6x	6.1x	6.0x	6.1x	9.4x
Since 1 Jan 2008	6.4x	5.7x	5.9x	5.9x	9.1x
Last 1 Month	6.3x	5.3x	6.1x	6.5x	9.1x

Source: Datastream as of 24-Apr-2008
Note: Price/Forward EPS represents a one year forward looking P/E based on the expected next twelve months earnings

Table 1: Broker EPS Forecasts for Irish Banks (€, Calendarised)

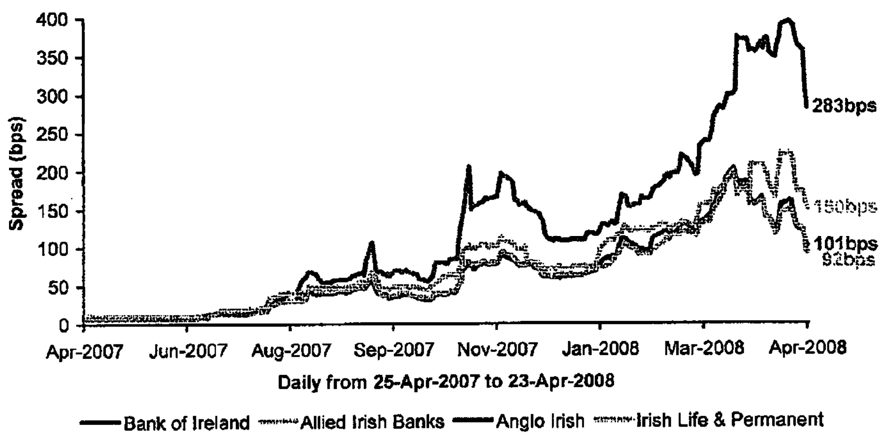
Broker EPS Forecasts (€)		Calendarised EPS Estimates Dec-2008	Calendarised EPS Estimates Dec-2009	Growth Rates 2008	Growth Rates 2009	Growth Rates 2007 - 2009 CAGR
Allied Irish Banks	Consensus	2.10	2.14	1.9 %	1.9 %	1.9 %
	GS Research	2.03	2.13	(1.5)%	4.9 %	1.7 %
Anglo Irish	Consensus	1.54	1.59	10.6 %	3.6 %	7.0 %
	GS Research	1.35	1.37	0.0 %	1.7 %	0.8 %
Bank of Ireland	Consensus	1.51	1.52	1.2 %	0.7 %	0.9 %
	GS Research	1.46	1.44	(2.5)%	(1.0)%	(1.8)%
Irish Life & Permanent	Consensus	1.83	1.86	(5.2)%	1.6 %	(1.8)%
	GS Research	1.89	1.87	(2.1)%	(1.1)%	(1.6)%

- March and April 2008 saw the announcement of numerous bank recapitalisations via a combination of rights issues and other capital raisings including Societe Generale (SG), Lehman Brothers, UBS, Washington Mutual, Wachovia, National City and Royal Bank of Scotland (RBS)
  - Since Q3 2007 total announced bank equity and equity-linked capital issuance has exceeded $130bn
  - SG's issue was to cover fraudulent trading losses while Lehman Brothers' issue was more opportunistic and increased flexibility rather than 'plugging' capital holes. The other issues were to shore up capital following structured credit write downs and to increase overall capitalisation levels in more challenging markets
  - Investors are generally of the view that there is more equity issuance to come from European banks, but are becoming more comfortable with visibility on potential structured credit write downs and the more conservative approach banks are taking to marking portfolios
  - A growing trend towards de-leveraging balance sheets and a return to funding-driven business models is changing bank managers' and regulators' approach to risk
- Outlook for the remainder of 2008
  - The macro environment remains difficult, which could result in continuing highly volatile equity markets with little short-term upside. There is some potential for upside later in the year as investors look through to an expected modest recovery in 2009

Credit Markets

- Credit indices reached their widest ever levels in March 2008 on the back of continuing negative newsflow (e.g. the Bear Stearns failure) and investor nervousness over the true capital positions of financial institutions
  - The iTraxx Main index, which measures the cost of insuring bonds against default via Credit Default Swaps (CDS), traded out to c.150bps versus c.25bps pre the credit market dislocation
- However, credit spreads have tightened in April 2008 with the iTraxx Main index falling c.50% from March levels as efforts by the FED improved market sentiment and fears over the future of US monoline insurers reduced. Irish Banks' CDS levels also tightened in April, although Anglo's CDS remains at much wider levels due to lower credit ratings relative to peers and ongoing concerns over its commercial real estate exposure

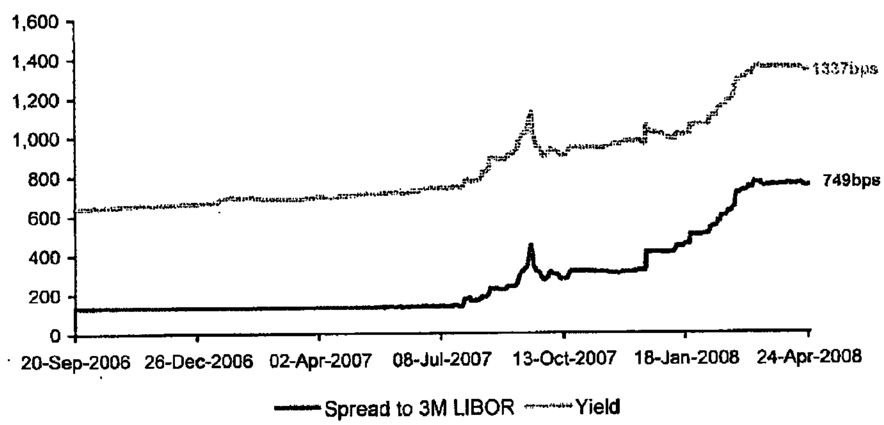
Figure 3: Irish Banks' CDS Levels (Last 12 Months, 5 year Senior CDS)



Source: Markit

- The spread of Anglo's Tier 1 capital instruments, which rank just above equity in the capital structure, has also increased dramatically since the end of 2007
  - — The current yield on this security is approximately 13.4%, implying the cost of equity for the bank could be significantly higher

Figure 4: Anglo Irish Tier 1 Instrument Trading Levels



Source: GS Database

Real Estate Financing Markets

- Rating agencies currently view the real estate environment in the UK and Ireland as weak and are anticipating a downturn as the cycle turns further. They expect the volumes of residential and commercial lending to subside in 2008 and the asset quality to deteriorate as asset prices fall, particularly affecting more vulnerable, speculative developments. This is expected to have a severe impact on significant commercial real estate lenders.
- Commercial real estate is also a key area concern for brokers. GS Research estimate that over 75% of loans have been originated in the last three years and 30% of the market is due to refinance in the next two years
- For the sector, GS Research estimate that CRE impairments could rise to 95bps in 2009, but in a negative scenario could be as high as 200bps, which is close to the previous peak in corporate provisioning of 250bps in 1992. Under this scenario profits would be hit by 30%
- The commercial property market remains broadly at risk, with limited office demand in the City, Canary Wharf and the West End of London driven by the uncertainty in the financial sector
- Activity in the UK's commercial property construction industry fell for a fifth consecutive month in March. The monthly survey by Savills noted that its Total Commercial Development Activity Index showed a net balance of -16.4% in March compared with -6% in February
- In the UK, the Credit Default Swap (CDS) level on a 'AAA' rated Commercial Mortgage Backed Security (CMBS) is currently c.225bps, compared to 10 - 20 bps in the first half of 2007 and 100bps three months ago
- The Bank of England's inclusion of 'AAA' rated CMBS issued prior to 2007 as qualifying collateral for its new £50bn repo facility is positive news for the sector and should alleviate some concerns around refinancing risk

2. Summary of Harmony's Strategic Alternatives

- Finalising the commercial loan book data and third party valuation exercise is a pre requisite for pursuing any of the options summarised below:

	Comments	Benefits	Issues
Continue with Sale of Entire Business to One Party	■ Re-engage with potentially interested parties ■ Distribute loan book data and process letters	✓ Straight-forward if interested parties remain engaged ✓ Process clear and prepared	? Buyer appetite and ability to fund a transaction in current environment ? Timing in the context of capital markets conditions and the real estate cycle
Consider Break up of Business for Sale to Different Parties	■ Consider selling assets to different purchasers – e.g. sell commercial real estate book to one purchaser and the retail business to a different purchaser	✓ Provides Harmony greater flexibility in dealing with potentially interested partners for different parts of business	? Increased complexity of transaction ? Buyer appetite and ability to fund transactions in current environment × Weak markets
Postpone Demutualisation Process	■ Continue to prepare business for sale ■ Consider reinitiating the process in more favourable conditions	✓ Potentially more interested parties in more favourable macro and real estate environment	? Management team for immediate future ? Market perception ? Unclear duration of market dislocation
Public Offering to Members	■ Demutualise via a public listing of members' shares	✓ Complete demutualisation process ✓ Access to public equity capital	× Significant organisational and logistical commitment × Weak markets
Domestic Merger Solution	■ Approach Irish listed banks with merger proposal — Members receive Irish listed paper in exchange for member shares	✓ Completes demutualisation process ✓ Share-for-share offer could improve capital position of acquirer	? Partner availability and interest ? Relative valuation × **Weak markets**

THEME: B2

Effectiveness of banks' credit strategies and risk management

LINE OF INQUIRY: B2c

Analysis of risk concentration in the base, the adverse economic scenarios and the impact on capital structure

KPMG
Chartered Accountants
1 Harbourmaster Place
IFSC
Dublin 1
Ireland

Telephone +353 1 410 1900
Fax +353 1 412 2873
Internet www.kpmg.ie

Ms Yvonne Madden
Banking Supervision Department
Financial Regulator
P.O. Box 559
Dame Street
Dublin 2

Our ref: ak/398551

31 March 2006

Dear Ms Madden

Statutory Duty Confirmation: Statement by the auditors for Irish Nationwide Building Society to the Irish Financial Services Regulatory Authority ('IFSRA')

The annex to this letter lists the reporting periods in which we acted as auditors of Irish Nationwide Building Society and therefore are subject to the 'statutory duty' as described by S.89 of the Building Societies Act 1989 and Regulation 7 of the Supervision of Credit Institutions, Stock Exchange Member Firms and Investment Business Firms Regulations, 1996 ('the Post BCCI Regulations'). We submit this statement to you in accordance with the instructions to credit institutions issued by the Financial Regulator.

Respective responsibilities of directors and auditors

It is the responsibility of the directors of the Society:

- to take appropriate steps to provide reasonable assurance that the Society complies with the Building Societies Act 1989 and also the statutory instruments enacted and administrative notices issued in relation to EU Directives that relate to the supervision of credit institutions ('the Supervisory Requirements'). Administrative provisions, as referred to above, also include the IFSRA's Licensing and Supervision Requirements and Standards for Credit Institutions;

- to establish arrangements designed to detect material non-compliance with the Supervisory Requirements, and to report any breaches to you;

- to report to the Financial Regulator any information which they know or have reasonable cause to believe is of material significance for Financial Regulator's supervisory functions under the Supervisory Requirements.

Denis O'Connor • Darina Barrett • Gary Britton • Keith Browne • Sharon Burke • Niall Campbell • Brian Clavin • Jim Clery
Colm Clifford • Mark Collins • Ivor Conlon • Michele Connolly • Adrian Crawford • William Cunningham • Brian Daly • Jon D'Arcy
Robert Dix • Paul Dobey • Eamonn Donaghy • Michael Farrell • Michael Flaherty • Gerard Flood • Caroline Flynn • Michael Gaffney
Laura Gallagher • Donall Gannon • Ruaidhri Gibbons • Roger Gillespie • Seamus Hand • Michael Hayes • Paul Hollway • Ray Jackson
Declan Keane • Jonathan Lew • Liam Lynch • Olivia Lynch • David Kennedy • Tom McEvoy • Pat McDaid • Paul McGowan
Niamh Marshall • David Meagher • James Menton • Cliona Mullen • Shaun Murphy • Arthur O'Brien • Colin O'Brien • Conor O'Brien
Pat O'Brien • Kevin O'Donovan • Conall O'Halloran • Sean O'Keefe • Garrett O'Neill • Terence O'Neill • Terence O'Rourke
Conor O'Sullivan • Vincent Reilly • Colm Rogers • Eamonn Russell • Anna Scally • Seamus Taaffe • Eric Wallace • Kieran Wallace
Richard Whelan • David Wilkinson Consultants (qualifications other than Chartered Accountant): John Bradley • Robert Dowley
Colm Gorman • Ken Hardy • John McGlone • Sean Mooney

Offices: Dublin, Belfast, Cork and Galway

KPMG, a partnership established under Irish law, is the Irish member firm of KPMG International, a Swiss cooperative

KPMG is authorised by The Institute of Chartered Accountants in Ireland to carry on Investment Business.

Document ID: 0.7.2256.15192

Our responsibilities, with respect to our statutory duty to report to you matters which come to our attention in the course of our work as auditors and of regulatory concern to you, are as set out in the Building Societies Act 1989.

Basis of statement

In discharging our statutory duties to report to you under the Building Societies Act 1989, we have had regard to Practice Note 19 (Banks in the Republic of Ireland). In doing so, we are required to consider matters of which we have become aware in the capacities as auditors listed in the Annex to this letter.

The basis of the work done in respect of each capacity is referenced in the Annex to this letter. We are not required to carry out any additional work to identify matters to be reported under the statutory duty.

Statement

We understand that the Society has already informed you, both verbally and in writing, of the following matters:

<u>(1) Sectoral Return, 2005</u>

The aggregate exposure to the construction ("F") and real estate ("K") sectors exceeded 250% of own funds limit and the real estate sector exceeded 200% of own funds limit during the period from January 2005 to December 2005.

We understand that the Society has corresponded with you on this matter during 2005 and this may continue to be an issue during 2006.

<u>(2) Prudential Return December 2005</u>

Following internal review of the Prudential Return the Society identified an error in the level of non-performing loans reported in its December return. The amount was understated by €38.8 million and accordingly restated to €160.8 million.

We understand that the Society resubmitted to you a its revised Prudential Return on 29 March 2005.

<u>(3) Large Exposures return March and December</u>

(I) Following a request by the Financial Regulator the Society resubmitted its Large Exposures return for the month of March 2005. The revised return included 100% of the [redacted] exposure as part of the [redacted] total exposure category.

The society submitted to you the amended report to reflect the above matter under its cover letter dated 31 March 2005.

KPMG

(II) The Society re-submitted the Large Exposures return for the month of December 2005 as two exposures to financial institutions reported under Schedule 2 of the return were not listed on the 'New Clients' schedule. These financial institutions were not new to the Society but had not appeared on the previous quarter Large Exposures Return.

The Society submitted to you the amended report to reflect the above matter under its cover letter dated 26 January 2006.

Should you wish to discuss further any of the above matters, please do not hesitate to contact Vincent Reilly (Direct Line 410 1378).

Yours faithfully

KPMG

KPMG

cc Board of Irish Nationwide Building Society.

KPMG
Chartered Accountants
1 Harbourmaster Place
IFSC
Dublin 1
Ireland

Telephone +353 1 410 1000
Fax +353 1 412 1122
Internet www.kpmg.ie

Ms Yvonne Madden
Banking Supervision Department
Financial Regulator
P.O. Box 559
Dame Street
Dublin 2

Our ref: aob/398551

27 March 2007

Dear Ms Madden

Statutory Duty Confirmation: Statement by the auditors for Irish Nationwide Building Society to the Financial Regulator

The annex to this letter lists the reporting periods in which we acted as auditor of Irish Nationwide Building Society and therefore are subject to the 'statutory duty' as described by S.89 of the Building Societies Act 1989 and Regulation 7 of the Supervision of Credit Institutions, Stock Exchange Member Firms and Investment Business Firms Regulations, 1996 ('the Post BCCI Regulations'). We submit this statement to you in accordance with the instructions to credit institutions issued by the Financial Regulator.

Respective responsibilities of directors and auditor

It is the responsibility of the directors of the Society:

- to take appropriate steps to provide reasonable assurance that the Society complies with the Building Societies Act 1989 and also the statutory instruments enacted and administrative notices issued in relation to EU Directives that relate to the supervision of credit institutions ('the Supervisory Requirements'). Administrative provisions, as referred to above, also include the Financial Regulator's Licensing and Supervision Requirements and Standards for Credit Institutions;

- to establish arrangements designed to detect material non-compliance with the Supervisory Requirements, and to report any breaches to you;

- to report to the Financial Regulator any information which they know or have reasonable cause to believe is of material significance for Financial Regulator's supervisory functions under the Supervisory Requirements.

Terence O'Rourke • Darina Barrett • Alan Boyne • Gary Britton • Keith Browne • Sharon Burke • Niall Campbell • Patricia Carroll
Brian Clavin • Jim Clery • Colm Clifford • Mark Collins • Ivor Conlon • Michele Connolly • Adrian Crawford • Hubert Crehan
William Cunningham • Brian Daly • Jon D'Arcy • Michael Daughton • Robert Dix • Paul Dobey • Eamonn Donaghy • Michael Farrell
Michael Flaherty • Gerard Flood • Caroline Flynn • Michael Gaffney • Laura Gallagher • Donall Gannon • Ruaidhri Gibbons
Roger Gillespie • Seamus Hand • Johnny Hanna • Michael Hayes • Selwyn Hearns • Paul Hollway • Ray Jackson • Declan Keane
David Kennedy • Jonathan Lew • Liam Lynch • Olivia Lynch • Tom McEvoy • Pat McDaid • Paul McGowan • Niamh Marshall
David Meagher • James Menton • Cliona Mullen • Shaun Murphy • Arthur O'Brien • Colin O'Brien • Conor O'Brien • Pat O'Brien
Kevin O'Donovan • Conall O'Halloran • Sean O'Keefe • Garrett O'Neill • Terence O'Neill • Conor O'Sullivan • Eoghan Quigley
Vincent Reilly • Colm Rogers • Eamonn Russell • Anna Scally • Seamus Taaffe • Eric Wallace • Kieran Wallace • Richard Whelan
David Wilkinson • Tom Woods

Consultants (qualifications other than Chartered Accountant): John Bradley • Robert Dowley • Colm Gorman • Ken Hardy • John McGlone
Sean Mooney

Offices: Dublin, Belfast, Cork and Galway

KPMG, a partnership established under Irish law, is the Irish member firm of KPMG International, a Swiss cooperative

KPMG is authorised by The Institute of Chartered Accountants in Ireland to carry on Investment Business.

Our responsibilities, with respect to our statutory duty to report to you matters which come to our attention in the course of our work as auditor and of regulatory concern to you, are as set out in the Building Societies Act 1989.

Basis of statement

In discharging our statutory duties to report to you under the Building Societies Act 1989, we have had regard to Practice Note 19 (Banks in the Republic of Ireland). In doing so, we are required to consider matters of which we have become aware in the capacities as auditor to the entities listed in the Annex to this letter.

The basis of the work done in respect of each capacity is referenced in the Annex to this letter. We are not required to carry out any additional work to identify matters to be reported under the statutory duty.

Statement

We understand that the Society has already informed you, both verbally and in writing, of the following matters:

<u>(1) Prudential Return March 2006</u>

Following a request by the Financial Regulator the Society had to resubmit the Prudential Return for March.

The Society was requested to amend an error in the classification "Financial Fixed Asset Revaluation Reserves" which was reallocated to "Minority Interests in Tier Two Elements". The Society also resubmitted the December 2005 return amending it for the same error.

The Society was queried on the classification of "Off balance sheet instruments held for trading purposes: assets" in the March return. The amount of €13,917 was later reclassified as "unallocated assets" in the resubmitted return on 9 June 2006.

The Society was requested by IFSRA to amend another misclassification of "Central Government – Other Funding sources – debt securities issued" reported in the March return. The amount of €39,842 was accordingly reclassified as "Central government Deposits" following queries surrounding the June return. The return also contained an error where a certain share had been recorded at cost rather than at market value, this was also amended in the 12/09/06 return.

We understand that the Society amended these classifications in their resubmitted reports on 9/06/06, 5/07/06 and 12/09/06.

<u>(2) Prudential Return June 2006</u>

Following a request by the Financial Regulator the Society resubmitted the prudential return for June five times.

The return originally submitted had contained an error on the hard copy that was sent to the Financial Regulator, however the soft copy was updated. As a result the Society resubmitted this sheet changing the **SSIA figure**.

KPMG

The Society had sought advice from the Financial Regulator for the treatment of a cross currency swap. On receipt of this advice, the return was again resubmitted.

The Financial Regulator queried many of the movements within the return and following the realisation of errors within the return submitted, the Society had to amend both the June and March returns to allow for misclassifications. The Society had amended the June GOVDEP and GOVDSC classifications for the June return and was advised to resubmit the March return also reflecting the reclassification that occurred (see above (1)).
The June return was also amended to reflect the incorrect recording of the positive replacement cost (BBRPCI) of €21.102m as €29.202m. The return also contained an amended value for the cross currency swap as both the sterling and the euro legs had been included before giving a total of €2b, whereas it should have been €1b.

The Society resubmitted their June return again amending the cross currency swap figures. In this case they changed the long and short positions reported where a slight variance was noted.

The Society resubmitted their December Prudential Return amending it for a link formula in the DBI section. The net positive replacement cost was amended. The Society decided to resubmit the June and September returns also on 2/02/07.

Following these errors, the Financial Regulator added that it was "concerned with the number of errors reported" and requested that the Society should outline what controls they will put in place to ensure that errors do not reoccur.

We understand that the Society amended these classifications in their resubmitted reports on 11/08/06, 23/08/06, 12/09/06, 18/10/06 and 2/02/07.

(3) Prudential Return September 2006

The Society resubmitted their December Prudential Return amending it for a link formula in the DBI section. The net positive replacement cost was amended. The Society decided to resubmit the June and September returns also on 2/02/07.

We understand that the Society amended these classifications in their resubmitted report on 2/02/07.

(4) Prudential Return December 2006

The Society resubmitted their December Prudential Return following an enquiry by the Financial Regulator. An error was noted in the soft copy concerning the cross currency interest rate related derivative contracts as the future credit exposure should be 5% rather than .5%. They also amended the balance sheet risk asset as it should include cash in course of collection. As a result of these queries the Society decided to resubmit the updated section of the return on 25 January 2007.

The Society resubmitted their December Prudential Return amending it for a link formula in the DBI section. The net positive replacement cost was amended. The Society decided to resubmit the June and September returns also on 2/02/07.

We understand that the Society amended these classifications in their resubmitted reports on 25/01/07 and **2/02/07.**

(5) Large Exposure Return June 2006

The Society resubmitted the LEX return for June following a request by the Financial Regulator. The exposure to directors figure was amended to 0.06% from the original incorrect figure of 0%.

The June LEX return was resubmitted on one further occasion at the request of the Financial Regulator. In this instance the Society was using a client code that was not recognised by IFSRA in relation to Customer Confidential. Again the Society amended the errors and resubmitted the return.

We understand that the Society amended the Return and resubmitted it on 28/07/06 and again on 8/08/06.

(6) Large Exposure Return September 2006

The Financial Regulator requested that the Society amend the client codes in relation to three clients; Customer Confidential. This was due to incorrect codes being used. For Customer Confidential the unique client exposure code was used rather than the group code, an incorrect code was input for Customer Confident... .

Following a further request from IFSRA, the Society resubmitted the September Return a second time. This is due to the exposure of Customer Confidential which was incorrectly entered on the return as a connected client. The amended return included the exposure in correct exposure group. It also contained an explanation of the Customer Confidential exposure as this had exceeded the 25% of Own Funds limit within the Return.

We understand that the Society resubmitted the revised Returns under the cover letters dated 7/11/06 and 10/11/06.

(7) Large Exposure Return December 2006

The December LEX Return has been resubmitted on 5 February 2007. This is again due to incorrect client codes being used for exposure groups. In this case Customer Confidential and Customer Confidential were amended from the original Return and resubmitted it under the cover letter dated 5/02/07.

Should you wish to discuss further any of the above matters, please do not hesitate to contact Vincent Reilly (Direct Line 410 1378).

Yours faithfully

KPMG

KPMG

cc Board of Irish Nationwide Building Society.

KPMG

Annex to Statutory Duty Confirmation

Capacity	Reporting period	Reference to basis of work
Auditor of Irish Nationwide Building Society	Financial year ended 31 December 2006	Audit report
Auditors of the following bodies closely linked by control to Irish Nationwide Building Society: • Pangrove Limited • Vernia Limited • Cedarclose limited • Irish Nationwide (I.O.M.) Limited • Clearstorm Limited • INL&P Limited	Financial year ended 31 December 2006	Audit report

KPMG

KPMG
Chartered Accountants
1 Harbourmaster Place
IFSC
Dublin 1
Ireland

Telephone +353 1 410 1000
Fax +353 1 412 2873
Internet www.kpmg.ie

Mr Dermot Finneran
Banking Supervision Department
Irish Financial Services Regulatory Authority
P.O. Box 559
Dame Street
Dublin 2

Our ref: ak/398551

26 April 2005

Dear Mr Finneran

Statutory Duty Confirmation: Statement by the auditors for Irish Nationwide Building Society to the Irish Financial Services Regulatory Authority ('IFSRA')

The annex to this letter lists the reporting periods in which we acted as auditors of Irish Nationwide Building Society and therefore are subject to the 'statutory duty' as described by S.89 of the Building Societies Act 1989 and Regulation 7 of the Supervision of Credit Institutions, Stock Exchange Member Firms and Investment Business Firms Regulations, 1996 ('the Post BCCI Regulations'), from 24 April 2004 to 26 April 2005.

Respective responsibilities of directors and auditors

It is the responsibility of the directors of the bank(s):

- to take appropriate steps to provide reasonable assurance that the bank(s) complies with the Building Societies Act 1989 and also the statutory instruments enacted and administrative notices issued in relation to EU Directives that relate to the supervision of credit institutions ('the Supervisory Requirements'). Administrative provisions, as referred to above, also include the IFSRA's Licensing and Supervision Requirements and Standards for Credit Institutions;

- to establish arrangements designed to detect material non-compliance with the Supervisory Requirements, and to report any breaches to you;

- to report to IFSRA any information which they know or have reasonable cause to believe is of material significance for IFSRA's supervisory functions under the Supervisory Requirements.

Our responsibilities, with respect to our statutory duty to report to you matters which come to our attention in the course of our work as auditors and of regulatory concern to you, are as set out in the Building Societies Act 1989.

Denis O'Connor • Darina Barrett • Gary Britton • Keith Browne • Sharon Burke • Niall Campbell • Brian Clavin • Jim Clery
Colm Clifford • Ivor Conlon • Adrian Crawford • Christopher Cullen • William Cunningham • Brian Daly • Jon D'Arcy • Robert Dix
Paul Dobey • Eamonn Donaghy • Michael Farrell • Paul Finnerty • Michael Flaherty • Gerard Flood • Caroline Flynn • Michael Gaffney
Laura Gallagher • Donall Gannon • Ruaidhri Gibbons • Roger Gillespie • Seamus Hand • Michael Hayes • Paul Hollway • Ray Jackson
Declan Keane • Jonathan Law • Liam Lynch • Olivia Lynch • David Kennedy • Pat McDaid • Paul McGowan • Niamh Marshall
David Meagher • James Menton • Cliona Mullen • Shaun Murphy • Arthur O'Brien • Colin O'Brien • Conor O'Brien • Pat O'Brien
Kevin O'Donovan • Conall O'Halloran • Sean O'Keefe • Garrett O'Neill • Terence O'Neill • Terence O'Rourke • Conor O'Sullivan
Vincent Reilly • Colm Rogers • Eamonn Russell • Anna Scally • Seamus Taaffe • Eric Wallace • Kieran Wallace • Richard Whelan
David Wilkinson
Consultants (qualifications other than Chartered Accountants): John Bradley • Robert Dowley • Ken Hardy • Sean Mooney

Offices: Dublin, Belfast, Cork and Galway

KPMG, a partnership established under Irish law, is the Irish member firm of KPMG International, a Swiss cooperative

KPMG is authorised by The Institute of Chartered Accountants in Ireland to carry on investment business.

KPMG

Basis of statement

In discharging our statutory duties to report to you under the Building Societies Act 1989, we have had regard to Practice Note 19 (Banks in the Republic of Ireland). In doing so, we are required to consider matters of which we have become aware in the capacities as auditors listed in the Annex to this letter.

The basis of the work done in respect of each capacity is referenced in the Annex to this letter. We are not required to carry out any additional work to identify matters to be reported under the statutory duty.

Statement

We understand that the Society has already informed you, both verbally and in writing, of the following matters:

(1) Large Exposure Return (LEX), March 2004

Following an internal review of the large exposures reporting process the Society identified 6 understated and 2 overstated exposures arising due to a clerical errors resulting in the total understatement of €55 million in the LEX Return for 2004.

We understand that the Society submitted to you the amended LEX, i.e. revised to reflect the above matter, under cover of its letter dated 4 June 2004.

(2) Sectoral Return, 2004

The aggregate exposure to the construction ("F") and real estate ("K") sectors exceeded 250% of own funds limit and the real estate sector exceeded 200% of own funds limit during the period from January 2004 to December 2004.

We understand that the Society has corresponded with you on this matter during 2004 and this may continue to be an issue during 2005.

(3) (i) Prudential Return January to June 2004

The Society did not disclose the positive replacement cost associated with a Sterling SWAP in the Prudential Return during the period from January 2004 to June 2004.

We understand that the Society submitted to you a revised Prudential Return to reflect this matter, under the cover of its letter on 13 August 2004.

Except as noted above, no matters have come to our attention, in our capacity, described in the Annex attached to this letter, that have given rise to a statutory duty for us to report to you under the Building Society Act, 1989 and the **Post BCCI Regulations.**

Document ID: 0.7.2321.39593

KPMG

3) (ii) Prudential Return December 2004

The Society included a guarantee of €2m in error in its Prudential Return at 31 December 2004. We understand that the Society has corresponded with you on this matter in its letter dated 22 April 2005.

Should you wish to discuss further any of the above matters, please do not hesitate to contact Vincent Reilly (Direct Line 410 1378).

Yours faithfully

KPMG

KPMG

cc Board of Irish Nationwide Building Society.

IBRC01B10

137

IBRC04843-003

Document ID: 0.7.2321.39593

KPMG

Example Annex to Statutory Duty Confirmation

Capacity	**Reporting period**	**Reference to basis of work**
Auditor of Irish Nationwide Building Society	Financial year ended 31 December 2004	Audit report dated 15 March 2005.

IBRC01B10

IBRC04843-004

KPMG
Chartered Accountants
2 Harbourmaster Place
IFSC
Dublin 1
Ireland

Telephone +353 1 410 1000
Fax +353 1 412 1122
Internet www.kpmg.ie

Ms Yvonne Madden
Banking Supervision Department
Financial Regulator
P.O. Box 559
Dame Street
Dublin 2

Our ref: VR/AK/EOC/0006L

26 March 2008

Dear Ms Madden

Statutory Duty Confirmation: Statement by the auditors for Irish Nationwide Building Society to the Financial Regulator

The annex to this letter lists the reporting periods in which we acted as auditor of Irish Nationwide Building Society and therefore are subject to the 'statutory duty' as described by S.89 of the Building Societies Act 1989 and Regulation 7 of the Supervision of Credit Institutions, Stock Exchange Member Firms and Investment Business Firms Regulations, 1996 ('the Post BCCI Regulations'). We submit this statement to you in accordance with the instructions to credit institutions issued by the Financial Regulator.

Respective responsibilities of directors and auditor

It is the responsibility of the directors of the Society:

- to take appropriate steps to provide reasonable assurance that the Society complies with the Building Societies Act 1989 and also the statutory instruments enacted and administrative notices issued in relation to EU Directives that relate to the supervision of credit institutions ('the Supervisory Requirements'). Administrative provisions, as referred to above, also include the Financial Regulator's Licensing and Supervision Requirements and Standards for Credit Institutions;

- to establish arrangements designed to detect material non-compliance with the Supervisory Requirements, and to report any breaches to you;

- to report to the Financial Regulator any information which they know or have reasonable cause to believe is of material significance for Financial Regulator's supervisory functions under the Supervisory Requirements.

Terence O'Rourke • Marie Armstrong • Darina Barrett • Alan Boyne • Gary Britton • Keith Browne • Sharon Burke • Niall Campbell
Patricia Carroll • Brian Clavin • Jim Clery • Kevin Cohen • Colm Clifford • Mark Collins • Ivor Conlon • Michele Connolly
Adrian Crawford • Hubert Crehan • Pat Cullinan • Brian Daly • Jon D'Arcy • Michael Daughton • Robert Dix • Paul Dobey
Eamonn Donaghy • Michael Farrell • Michael Flaherty • Gerard Flood • Caroline Flynn • Michael Gaffney • Andrew Gallagher
Laura Gallagher • Conall Gannon • Frank Gannon • Ruaidhri Gibbons • Roger Gillespie • Seamus Hand • Johnny Hanna • Michael Hayes
Selwyn Hearns • Paul Hollway • Declan Keane • David Kennedy • Jonathan Lew • Liam Lynch • Olivia Lynch • Tom McEvoy
Pat McDaid • Peter MacDonald • Paul McGowan • Niamh Marshall • David Meagher • James Menton • Cliona Mullen • Shaun Murphy
Arthur O'Brien • Colin O'Brien • Conor O'Brien • Pat O Brien • Barrie O'Connell • Kevin O'Donovan • Conall O'Halloran • Sean O'Keefe
Eoin O'Lideadha • Garrett O'Neill • Terence O'Neill • Conor O'Sullivan • Eoghan Quigley • Vincent Reilly • Colm Rogers
Eamonn Russell • Anna Scally • Seamus Teaffe • Eric Wallace • Kieran Wallace • Richard Whelan • David Wilkinson • Tom Woods

Consultants (qualifications other than Chartered Accountant): John Bradley • Robert Dowley • Colm Gorman • Ken Hardy • John McGlone
Sean Mooney • Paul Toner

Offices: Dublin, Belfast, Cork and Galway

KPMG, a partnership established under Irish law, is the Irish member firm of KPMG International, a Swiss cooperative

KPMG is authorised by The Institute of Chartered Accountants in Ireland to carry on Investment Business.

Our responsibilities, with respect to our statutory duty to report to you matters which come to our attention in the course of our work as auditor and of regulatory concern to you, are as set out in the Building Societies Act 1989.

Basis of statement

In discharging our statutory duties to report to you under the Building Societies Act 1989, we have had regard to Practice Note 19 (Banks in the Republic of Ireland). In doing so, we are required to consider matters of which we have become aware in the capacities as auditor to the entities listed in the Annex to this letter.

The basis of the work done in respect of each capacity is referenced in the Annex to this letter. We are not required to carry out any additional work to identify matters to be reported under the statutory duty.

Statement

We understand that the Society has already informed you, both verbally and in writing, of the following matters:

Sectoral return

The aggregate exposure to real estate ("K") exceeded 200% of own funds limit during the period from January 2007 to December 2007.

We understand that the Society has corresponded with you on this matter and this may continue to be an issue in 2008.

(1) Prudential Return March 2007

Following a request from the Financial Regulator, the Society resubmitted the March Prudential Return as an error was identified in the EMTN programme split between "Monetary Financial Institutions" and "Non-Government".

We understand that the Society amended the split and resubmitted the March Prudential return in late August 2007.

Furthermore, the Society identified that the changes made to rectify the split between "Monetary Financial Institutions" and "Non-Government" resulted in a change to the "Non-Government – other funding sources" on a separate part of the return.

We understand that the Society resubmitted the amended report on 19 October 2007.

As part of an internal review, the Society identified an error in the Top 10 largest deposits as a percentage of the total deposits.

We understand that the Society amended this identified error and resubmitted reports on 26 April 2007.

(2) Prudential Return June 2007

Following a request from the Financial Regulator, the Society resubmitted the June Prudential Return following an error identified in the EMTN programme split between "Monetary Financial Institutions" and "Non-Government".

We understand that the Society amended the split resubmitted the June Prudential return in August 2007 along with the March Prudential Return noted earlier.

Furthermore, the Society identified that the changes made to rectify the split between "Monetary Financial Institutions" and "Non-Government" resulted in a change to the "Non-Government – other funding sources" on a separate part of the return.

We understand that the Society resubmitted the amended report on 19 October 2007.

The Society was queried by the Financial Regulator on the movement of €0.495m in the figure "Other mortgages" in the June return. Upon investigation the Society resubmitted their June Prudential Return with a reclassification of the amount €0.495m from "Other mortgages" to "Loans up to & including 1 year".

We understand that the Society amended these classifications in their resubmitted reports on 5 December 2007.

The Society identified an error in relation to the reclassification of €2m between "Fixed Assets" and "Capital Reserves" with both balances being reduced by €2m following the revaluation for Dun Laoghaire being entered twice in error.

We understand that the Society amended these classifications in their resubmitted reports on 9 September 2007.

(3) Prudential Return September 2007

The Society was queried by the Financial Regulator on the movement of €0.1m in the figure "Other mortgages" in the September return. Upon investigation the Society resubmitted their September Prudential Return with a reclassification of the amount €0.1m from "Other mortgages" to "Loans up to & including 1 year".

We understand that the Society amended these classifications in their resubmitted report on 5 December 2007.

(4) Prudential Return December 2007

The Society identified an error in relation to a deposit reclassification of Stg£5m from Non-Government to Monetary Financial Institutions (MFI) and resubmitted the December return as a result. The Society advised that the Stg£5m in the Non-Government deposits should have been classified as a MFI under other credit institutions. This error also resulted in the reclassification of accrued interest which the Society has accounted for.

We understand that the Society amended these classifications in their resubmitted report on 23 January 2008.

Furthermore, the Society has had to resubmit the December Prudential Return in regards to the 2 Clearstorm Guarantees. At the time of initial submission of the return, no valuation reports were available on the guarantees however recent information has become available and a value of €78.2m can be attributed to the guarantees.

We understand that the Society amended the return to include these guarantees in their resubmitted report on 6 March 2008.

(5) Resident Return January 2007

The Society identified an error in relation to the balance with the Bank of England of €3.921m which was included in error in the report. This was reclassified to Non Resident office as this was due to business that the Belfast office carries out.

We understand that the Society amended this error in their resubmitted report on 13 February 2007.

(6) Resident Return March 2007

The Society identified an error in relation to the market value of quoted securities by Monetary Financial Institutions which was overstated by €25.902m due to the insertion of the Isle of Man (IOM) share capital of Stg£18m.

We understand that the Society amended this error in their resubmitted report on 25 April 2007.

(7) Resident Return June 2007

The Society identified an error in relation to an over statement in the commitments figure. This was done in error due to the inclusion of two letters of offers that had since been declined.

Furthermore, the Society identified an error in relation to the market value of the cross currency swaps which was entered as zero in error.

We understand that the Society amended these errors in their resubmitted report on 20 July 2007.

(8) Resident Return December 2007

The Society identified an error in relation to a deposit classification between "Non-Government" and "Monetary Institutions". The Society advised the Financial Regulator that the Stg£5m deposit which was included in "Non-Government" deposits should have been classified as a MFI under other credit institutions. This error also resulted in the reclassification of accrued interest which the Society has been accounted for.

We understand that the Society amended these errors in their resubmitted report on 23 January 2008.

(9) Large Exposures Return June 2007

The Society received a request from the Financial Regulator in relati[redacted] schedule to include [redacted] Exposure Group, [redacted] Client and sectoral codes for [redacted]

We understand that the Society amended these errors in their resubmitted report on 31 July 2007.

The Society identified an error in relation the revaluation reserve which was overstated in the Prudential return by €2m and therefore resulted in the "Own Funds" being overstated.

We understand that the Society amended this error in their resubmitted report on 9 August 2007.

(10) Large Exposures Return August 2007

The Society received a request from the Financial Regulator in relation to the "New Clients" schedule to include Client [redacted].

We understand that the Society amended this error in their resubmitted report on 30 October 2007.

(11) Large Exposures Return August 2007

The Society identified an error in relation to the exposure to Connected Client [redacted] which was incorrectly stated at €3.785m in the original return.

We understand that the Society amended this error to reflect the confirmed net exposure of €3.803m in their resubmitted report on 15 November 2007.

The Society identified an error in relation to the exposure of €100m to Unique Client [redacted] which was excluded from the original return. This was due to a formatting error in the return preparation. Furthermore, this client was also excluded from "New Clients" schedule.

We understand that the Society amended these errors in their resubmitted report on 15 November 2007.

The Society identified an error in relation to the exposures to clients [redacted] and [redacted] which were incorrectly stated due to a formatting error in the return spreadsheet.

We understand that the Society amended these errors in their resubmitted report on 15 November 2007.

(12) Large Exposures Return December 2007

The Society resubmitted the December 2007 return to include two guarantees in relation to Clearstorm Ltd connected client of [redacted]. This arises as planning permission was granted on 7 December 2007 and value can now be attributed to the guarantees, and which equates to €78.2m.

We understand that the Society amended the December 2007 return to reflect the value of these guarantees in their resubmitted report on 25 February 2007.

Should you wish to discuss further any of the above matters, please do not hesitate to contact Vincent Reilly (Direct Line 410 1378).

Yours faithfully

KPMG

KPMG

cc Board of Irish Nationwide Building Society.

KPMG

Annex to Statutory Duty Confirmation

Capacity	Reporting period	Reference to basis of work
Auditor of Irish Nationwide Building Society	Financial year ended 31 December 2007	Audit report

Acquired Loan Assets

NAMA was established in December 2009 following the enactment of the National Asset Management Agency Act, 2009 in November of that year. Five institutions (and their subsidiaries) were designated as participating institutions by the Minister for Finance in February 2010: Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, Irish Nationwide Building Society and EBS Building Society[4].

LOAN ACQUISITION

The first loan transfers occurred in late March 2010. **Table 2** below summarises the major phases of the loan acquisition process:

TABLE 2: Phases of loan acquisition

	€bn	Date of transfer
Tranche 1	15.3	March – May 2010
Tranche 2	11.9	June – August 2010
Bulk transfer*	44.0	October – December 2010
Transfers in 2011	2.8	March and October 2011
TOTAL	**74.0**	

**At the request of the Minister for Finance, the transfer of the third and later loan tranches was accelerated as part of a bulk transfer in the last quarter of 2010.*

96% of the portfolio (€71.2 billion) was acquired within a nine-month period between March and December 2010.

Transfers in 2011 took place in two phases: a transfer of €1.1 billion in March (loans which were deemed eligible by AIB in late 2010) and a transfer of €1.7 billion in October. After the Supreme Court judgements in the **Dellway** case, NAMA instituted a process of consultation in June 2011 with debtors whose loans had not, at that stage, yet been acquired. Debtors were invited to make written representations to NAMA in respect of the possible acquisition of their loans and, in particular, as to any adverse effect such acquisition was likely to have on their interests. Debtors were also provided with an opportunity to make representations as to the eligibility of the loans by reference to the criteria for eligibility set out in the Act and in the Regulations.

Following a review of submissions received from debtors, the NAMA Board exercised its discretion, under Section 84 of the Act, to acquire loans totalling €1.7 billion and this acquisition was completed in October 2011. In the case of another €400m, the Board exercised its discretion not to acquire the loans concerned. Loans totalling €260m were deemed to be ineligible following a review of additional information received in debtor representations.

ACQUISITIONS BY INSTITUTION

Table 3 below summarises the transfers by institution:

TABLE 3: Loan acquisitions by institution (€ billion)

	AIB	ANGLO	BOI	EBS	INBS	TOTAL
Loan balances transferred	20.4	34.1	9.9	0.9	8.7	**74.0**
Consideration paid	9.0	13.4	5.6	0.4	3.4	**31.8**
Discount	56%	61%	43%	57%	61%	**57%**

Table 4 below provides a breakdown of debtor connections[5] by size of nominal debt acquired by NAMA (many of the debtors are also indebted to non-NAMA financial institutions).

TABLE 4: Distribution of NAMA debtor connections by size of nominal debt

Nominal Debt	Number of debtor connections	Average nominal debt per connection €m	Total nominal debt in this category €m
In excess of €2,000m	3	2,758	8,275
Between €1,000m and €2,000m	9	1,549	13,945
Between €500m and €999.9m	17	674	11,454
Between €250m and €499.9m	34	347	11,796
Between €100m and €249.9m	82	152	12,496
Between €50m and €99.9m	99	68	6,752
Between €20m and €49.9m	226	32	7,180
Less than €20m	302	7	2,117
TOTAL	**772**	**96**	**74,015**

4 *The business of Irish Nationwide Building Society transferred to Anglo Irish Bank on 1 July 2011 and the merged entity now trades as Irish Bank Resolution Corporation Ltd. (IBRC). EBS Building Society was acquired by Allied Irish Banks plc. on 1 July 2011 and now operates as a subsidiary of AIB.*

5 *Debtor connections may consist of one debtor or a number of closely-connected debtors whose aggregate debt is considered by NAMA to be best managed as one cohesive connection rather than managed through separate debtor entities.*

Historic experience: Fee income FY04 to FY06

73% or €48 million of FY06's fees received on supplemental arrangements were received from nine customers

This income source is 'lumpy' in nature

These arrangements are weighted towards the UK commercial loan book

Management has indicated that no disputes have arisen with customers in respect of these arrangement fees

Supplemental arrangement fees received in cash

€m	FY04	FY05	FY06
UK fees received	n/a	36	57
Ireland fees received	n/a	27	9
Total	**40**	**63**	**66**

Source: Management accounts FY04, FY05 and FY06

Supplemental arrangement fees received in cash in FY06

	Stg£m	€m
UK loan book		
[redacted]	8.4	12
	9.9	15
	3.0	4
	2.2	3
	1.6	2
	1.5	2
	1.5	2
Other UK supplemental fees received (all <€1 m)	11.2	17
	38.8	57
Euro loan book		
[redacted]		5
		3
Other		1
Total		66

Note: Foreign exchange rate used was the average sterling/euro rate in FY06 0.6821
Source: Management accounts FY06

Overview

- On a loan per loan basis, loans with these attached additional fees are the most profitable arrangements currently in place with the Group. €66 million was received in cash in FY06 with €48 million being derived from nine customers. The fees received from these nine customers has been documented on the following pages
- Overall the Group's capacity to generate non-interest income on commercial loans affords the Group greater flexibility and reduces its exposure to margin erosion on its residential mortgage and savings products

Supplemental arrangement fees received in cash in FY06

- In FY06 €57 million or 86% of cash received in respect of these arrangements were in respect of developments in the UK. Loan agreements with these extra fees attached are weighted towards the UK commercial loan book
- Fees derived from Ireland decreased from €27 million in FY05 to €9 million in FY06 indicating that these sources of revenue are 'lumpy' in nature. However management has indicated that there are a number of large projects nearing completion and cash receipts are expected in FY07 pending agreement of final accounts
- Management has indicated that no disputes have arisen with customers in respect of these arrangement fees

KPMG

This document is CONFIDENTIAL and its circulation and use are RESTRICTED. © 2007 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

THEME: B4

Impact of the property valuation methodologies on banks' credit risk management

LINE OF INQUIRY: B4c

Adequacy of internal controls over perfection of security and policy exceptions

IRISH NATIONWIDE
www.irish-nationwide.com

Legal Department Audit

Internal Audit Report

September 2008

Ronan Guckian
Internal Audit Department

Table of Contents

SECTION	PAGE
1. Executive Summary	2 - 5
2. Exceptions and Recommendations	6 - 13

1. Executive Summary

1.1 Objective and Scope of Audit

Internal audit conducted an audit of the Legal Department from June to August 2008.

The audit consisted of detailed testing performed to assess the risks identified in section 1.2 of this report.

The audit seeks to provide assurance on the effectiveness of the controls in place. The audit will seek to identify new controls and make recommendations that will enhance the Society's control environment.

The audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

This is the first review undertaken by the Internal Audit Department of the Legal Department since November 2004. The testing performed was based on the Legal Department Risk Assessment prepared by Marion Kiernan. The controls in place have been tested for their effectiveness and adequacy and the department/section procedures have been documented and assessed for potential weaknesses in process.

The Legal Department is a medium risk category within the Society. It has a total risk score of 3.13 based on the 2008 Risk Assessment.

This report will be circulated to Marion Kiernan, Mr. Fingleton and the Audit Committee.

Ronan Guckian completed the audit field work and Killian McMahon reviewed the audit file.

The fieldwork was completed on the 29th August 2008.

In the course of this report: "the Society" refers to Irish Nationwide Building Society.

1.2 Overall Rating

Internal Audit conducted a review of the Legal Department from June to August 2008. The following areas were reviewed and assessed:

Risk	Risk Weighting	Rating
Destruction or misplacing of title deeds. Title deeds may be lost in a fire.	High	Adequate
Advances may be made without security	High	Good
ATR fees may not be collected and fees may not be sufficient to cover administration costs	Low	Very Good
Problems with title to properties arises damaging Society security	Medium	Very Good
Solicitor's undertakings may be discharged incorrectly or may not be complied with	High	Good
Solicitor may not be adequately insured to discharge undertakings	High	Good
All title documents may not be returned by the customer's solicitor to the Society	High	Very Good
The vacate process may take too long	Low	Good
Complaints to the Legal Department may not be logged	Low	Good
The Society's Legal Department may deal with loans, which they do not have the expertise to deal with	High	Adequate
Transfers/Release of Society security may not be administered correctly	High	Very Good
Society standard legal documentation and customer letters may be out of date, inconsistent or not in compliance with prevailing legislation	High	Adequate
Society security may be undermined by solicitor's failure to register security on time	High	Room for Improvement
Society may lose legal files and fail to follow-up on security	High	Room for Improvement

OVERALL RATING	**ADEQUATE (6.71)**

The overall rating is calculated as follows:

$$\frac{\sum (\text{Risk Weighting}^1 \text{ X Risk Rating}^1) + (\text{Risk Weighting}^2 \text{ X Risk Rating}^2) + \ldots\ldots\ldots + (\text{Risk Weighting}^n \text{ X Risk Rating}^n)}{\sum \text{Risk Weighting}^1 + \text{Risk Weighting}^2 + \ldots\ldots\ldots + \text{Risk Weighting}^n}$$

(Where n = no. of risks)

Explanation of Risk Weightings Used

Value	Rating	Explanation
1	Low	This risk is either not expected to occur or if controls fail, the loss to the Society would not be significant.
2	Medium	Such a risk may occur and if it did occur, the loss to the Society may be material.
4	High	If this risk is not controlled, the Society may incur a great loss in monetary and/or reputation terms.

Explanation of Risk Ratings Used

Value	Rating	Explanation
1	Excellent	Commendable standards attained.
2	Very good	High standards generally evident. A few areas for improvement are evident but these are not considered to represent serious control weaknesses.
4	Good	Generally good standards attained, but areas for improvement are evident.
8	Adequate	Average standards attained. Controls are in place but weaknesses have become evident.
16	Room for improvement	Below expected standard with room for improvement. Control weaknesses may become serious unless addressed.
32	Unsatisfactory	Inadequate level of standards evident – remedial action required.

1.3 Main issues arising

One critical weakness was noted in the Legal Department control environment:

1. The Department has no system for following up on solicitor's undertakings to ensure the Society's security is correctly registered within a reasonable timeframe. The Department is failing to adequately protect the Society's interests.

The following seven significant weaknesses were noted in the Legal Department control environment:

1. There are an excessive number of legal files logged out to various staff members and numerous files are still logged out to staff who have left the Society.
2. There were an excessive number of legal files logged out to individual staff members at any one time.
3. Files located on the 6th Floor are not being stored in a secure location.
4. A number of files reviewed had been discharged without all of the conditions of the mortgage offer being met.
5. A number of files reviewed did not have the authority from the borrowers to release title deeds to third parties for the purpose of vacating the mortgage.
6. There is no documented policy concerning commercial loan undertakings.
7. There is no formal communication between Residential Advances and the Legal Department.

1.4 Overall Conclusion

The Legal Department has performed well in a number of areas, but there is room for improvement with respect to the registration process and the security of legal files. Internal Audit is also of the opinion that significant work is also required on the Legal Department's current policies and procedures, which are not sufficiently control orientated at present. The Legal Department must assume a position as one of the major control points in the Society's lending processes and move away from a purely administrative function.

The overall rating of 'Adequate' correctly reflects the number of control weaknesses identified.

2. Exceptions and Recommendations

2.1 File Creation & Storage of Title Deeds

No.	Exception	Recommendation	Management Response	Rating	Deadline
2.1.1	The Legal Safe has identified numerous legal files still logged out to members of staff who are no longer employed with the Society.	Any legal files logged out to former staff members must be located.	Agreed	3	31/12/08
2.1.2	There are no documented procedures currently in place directing legal staff leaving the Society to account for all files logged out to them under their names prior to their departure.	The Legal Department must formulate and implement a policy concerning files logged out to members of staff who are leaving the Society's employment.	Agreed	2	31/12/08
2.1.3	There were an excessive number of legal files logged out to individual staff members at any one time e.g. one person had over 100 legal files logged out to them, with several of these files logged out since 2006.	The limit of thirty legal files per person must be adhered to and the Legal Safe must enforce this limit.	Agreed	3	Immediately
2.1.4	It was noted that several boxes of pre-2000 redeemed legal files were located in various parts of Warehouses 1 and 2 and not in the main storage location in Warehouse 1.	A search of both warehouses must be undertaken and all legal file boxes located are to be returned to the main location in Warehouse 1.	Warehouse 1 is Full – Provision to be made in Warehouse 2	1	31/12/08

2.1.5	Internal Audit noted large numbers of active legal files containing title deeds on desks and in other unsecured locations on the 6th Floor at close of business each day.	Legal files on the 6th floor must be stored in secure locations.	Agreed	3	Immediately

2.2 Cheque Issue & Solicitor Undertakings

No.	Exception	Recommendation	Management Response	Rating	Deadline
2.2.1	The Legal Department has no independent customer specimen signatures recorded on the legal file for authentication purposes.	The Legal Department should keep a copy of the signed Offer Letter on the legal file.	Agreed	2	Immediately
2.2.2	The Legal Department has no procedure to compare and verify the signatures of borrowers who have signed solicitor undertakings.	Staff members requisitioning loan cheques should examine and verify the borrower's signatures on undertakings.	Agreed	2	Immediately
2.2.3	The Legal Department does not have any current Law Directory to verify solicitor qualifications and addresses other than those available to the Society's solicitors.	The Legal Department must obtain and use a current Law Society Directory to verify the authenticity of solicitors signing undertakings.	Agreed	1	Immediately

2.3 Perfection of Title & Discharge of Undertakings

No.	Exception	Recommendation	Management Response	Rating	Deadline
2.3.1	The Legal Department does not currently have an adequate capacity level to process and review title documents received from solicitors attempting to discharge their undertakings. *Note: This volume has increased due to the Society's registration project.*	The Legal Department must assign a second experienced member of staff to review title deeds and discharge undertakings.	To Be Discussed With HR	2	31/1/09
2.3.2	Internal Audit noted that three loans (10%) discharged in 2007 were done so without first requesting that the solicitor comply with the specific conditions laid down in the mortgage offer.	Undertakings must not be discharged until all the conditions of the mortgage offer have been met.	Agreed	3	Immediately

2.4 Professional Indemnity & Conflicts of Interest

No.	Exception	Recommendation	Management Response	Rating	Deadline
2.4.1	Internal Audit noted that three legal files (15%) did not have any evidence of the undertaking solicitor's professional indemnity cover prior to the issue of the loan cheque.	Loan cheques must not be issued to borrowers without first receiving a copy of the solicitor's professional indemnity cover.	Agreed	3	Immediately
2.4.2	There are no procedures in place to ensure there are no possible conflicts of interest between the undertaking solicitor and the borrower, other than when the solicitor is the customer.	The Legal Department must draft guidelines on the duty of a borrower's solicitor to disclose to the Society any potential conflict of interest.	Agreed	1	31/12/08

2.4.3	Internal Audit noted that the Legal Department does not maintain a record of solicitors who have been struck off by the High Court.	A list of all solicitors struck off in the last 6 years must be obtained.	Agreed	2	31/12/08

2.5 Vacates Process

No.	Exception	Recommendation	Management Response	Rating	Deadline
2.5.1	Internal Audit noted that three (15%) of the legal files tested in 2007 had no authority from the borrower recorded allowing the release of title deeds to third parties.	The Legal Department must ensure that adequate authority is obtained from borrowers prior to the release of their title documents.	Agreed	3	Immediately
2.5.2	Internal Audit noted that at least three (15%) of the legal files tested in 2007 were only vacated after a delay of two months or more.	The redemptions report should be sent directly to the vacates section to prevent unnecessary delays.	Agreed	1	31/12/08

2.6 Customer Complaints

No.	Exception	Recommendation	Management Response	Rating	Deadline
2.6.1	Internal Audit noted that at least one complaint concerning the loss of title deeds by the Society had not been adequately recorded on the customer complaints database. *See accoun*[redacted] customer confidentiality	All complaints from customers must be logged on the complaints database.	Agreed	2	Immediately
2.6.2	Internal Audit noted that there was no official policy and procedure to handle the loss of title deeds by the Society.	The Legal Department must document the procedures for the replacement of title deeds.	Agreed	2	31/12/08

2.7 Policies & Legal Documentation

No.	Exception	Recommendation	Management Response	Rating	Deadline
2.7.1	Internal Audit could not find any record of staff meetings held by the Department within the last 12 months.	The Legal Department must hold staff meetings on a quarterly basis.	Agreed	1	31/12/08
2.7.2	Internal Audit noted that the current policies and procedures for the Legal Department are disparate, disjointed and incomplete.	The Legal Department must formulate a complete policy manual covering all areas of the Department's operations.	Agreed	2	31/12/08
2.7.3	Internal Audit noted that there was no official policy in place concerning, which commercial loans could and could not be administered by the Legal Department.	The Legal Department must formulate an undertaking acceptance policy covering loan types and sizes, which the Department will administer the legal process on.	Agreed - subject to advances policy	3	31/12/08

2.7.4	Internal Audit noted that initial correspondence to solicitors enclosing loan cheques is routinely undated.	All correspondence to borrowers' solicitors must be dated.	Agreed	1	Immediately
2.7.5	Internal Audit noted a lack of any formal directions/communication issued to Commercial and Residential Advances by the Legal Department with no advice given to the Drawdown & Control section on legal requirements.	All legal requirements for residential and commercial lending must be communicated to Drawdown & Control indicating the different limits and requirements in relation to additional loans and cross-charges.	Agreed – subject to advances policy	1	1/11/08

2.8 Registration of Society Security

No.	Exception	Recommendation	Management Response	Rating	Deadline
2.8.1	The following exceptions were noted when examining whether the Society's charges had been registered and the length of time taken to comply with registration. These were as follows: ▪ In 1 case (3%), there was no correspondence from the solicitor concerning registration of charges for 12 months. ▪ In 1 case (3%), there was no correspondence from the solicitor concerning the registration of charges for 8 months and no reminders were sent. ▪ In 4 cases (13%), there was no correspondence from the solicitor concerning the registration of charges for 6 months and no reminders were sent. ▪ In 4 cases (13%), there was no correspondence from the solicitor concerning the registration of charges for 3 months and no reminders were sent.	All undertakings for registration of Society charges must be followed up within 3 months of the cheque issue, obtaining at a minimum a dealing number, book number or adequate explanation for delay in registration. Any solicitor, providing an undertaking, who has failed to respond to the Society within 3 months, should be issued with a warning letter. The status of the registration of Society charges must be automatically tracked to prevent undue delays in registration.	Agreed Agreed Agreed	4	Immediately
2.8.2	There is no formal procedure in place on how and when to complain to the Law Society about solicitors failing to discharge their undertakings to the Society.	The Legal Department must set up a procedure to systematically initiate complaints concerning non-compliant solicitors.	Agreed	1	31/12/08
2.8.3	Internal Audit could find no systematic recording of complaints taken against solicitors for failing to discharge their undertakings.	A record must be kept of all complaints initiated against non-compliant solicitors and the loans to which these complaints relate.	Agreed	1	Immediately

Internal Audit Exception Ratings Key

Rating	Type	Description
4	Critical	Serious control weakness with a high probability of significant financial loss, misstatement of financial results, compliance implications or reputational impacts, if left unaddressed.
3	Significant	Significant control weakness with a real possibility of significant financial loss, misstatement of financial results, compliance implications or reputational impacts, if left unaddressed.
2	Moderate	Moderate control weakness with some possibility of significant financial loss, misstatement of financial results, compliance implications or reputational impacts if left unaddressed.
1	Minor	Minor control weakness, which is unlikely to result in financial loss, misstatement of financial results, compliance implications or reputational impacts, if left unaddressed.

THEME: B5

Impact of the remuneration arrangements on banks' risk management

LINE OF INQUIRY: B5a

Adequacy of the incentive and remuneration arrangements to promote sound risk governance

Irish Nationwide Building Society
2001 – 2008
Top 10 Bonus Allocations

Notes to this Submission

- The documents in Submission 4 are not pre-existing documents and have been created by the Joint Special Liquidators from the information contained in the books and records that are available to the Joint Special Liquidators, specifically the annual reports and accounts for Irish Nationwide Building Society ("INBS") for the years 2004-2008 and HR records. The information contained therein relates to the period prior to the Joint Special Liquidators' appointment. In such circumstances, the Joint Special Liquidators are unable to provide any guarantee or assurance regarding the accuracy or completeness of this information.

- Furthermore, the Joint Committee should note that the information contained therein may be relevant to on-going High Court proceedings, prosecutions and /or other investigations and therefore is confidential and is being provided strictly on the basis that it is for the purposes of the Inquiry only and will not be disseminated or used for any other purpose.

- Irish Nationwide Building Society did not offer Shares based bonus schemes.

- This submission includes provisional bonus payment details based on the data that has been retrieved from INBS legacy files and systems to date. We have been unable to source any additional bonus information other than that as presented, for the years 2001 and 2003.

- The Joint Special Liquidators have been unable to retrieve any bonus records for the years 2002 and 2004. However, a document retrieved from the INBS server included details of total bonus payments for those years that reflect the following cumulative amounts:

    - 2002 – Total Bonus Amount €591,399
    - 2004 – Total Bonus Amount €731,554

- All amounts are quoted in Euro currency, unless otherwise stated.

Highly Confidential - Provided to the Joint Committee of Inquiry into the Banking Crisis on 23 February 2015

Irish Nationwide Building Society
2001 – 2008
Top 10 Bonus Allocations

2001		
Name	**Bonus**	**Total Bonus**
[redacted]	237,700	237,700

2003		
Name	**Bonus**	**Total Bonus**
[redacted]	277,000	277,000
[redacted]	52,000	52,000

2005		
Name	**Bonus**	**Total Bonus**
[redacted]	500,000	500,000
[redacted]	75,000	75,000
[redacted]	27,500	27,500
[redacted]	20,000	20,000
[redacted]	7,000	7,000
[redacted]	6,000	6,000
[redacted]	5,000	5,000
[redacted]	4,000	4,000
[redacted]	4,000	4,000
[redacted]	3,000	3,000

2006		
Name	**Bonus**	**Total Bonus**
[redacted]	1,000,000	1,000,000
[redacted]	GBP250,000	GBP250,000
[redacted]	100,000	100,000
[redacted]	55,000	55,000
[redacted]	40,606	40,606
[redacted]	25,000	25,000
[redacted]	7,500	7,500
[redacted]	7,000	7,000
[redacted]	5,000	5,000
[redacted]	5,000	5,000

Highly Confidential - Provided to the Joint Committee of Inquiry into the Banking Crisis on 24 February 2015

This information must be considered in conjunction with the Notes disclosed on page 1 of this report.

Irish Nationwide Building Society
2001 – 2008
Top 10 Bonus Allocations

2007		
Name	**Bonus**	**Total Bonus**
[redacted]	1,400,000	1,400,000
[redacted]	150,000	150,000
[redacted]	GBP300,000	GBP300,000
[redacted]	50,000	50,000
[redacted]	51,362	51,362
[redacted]	10,000	10,000
[redacted]	10,000	10,000
[redacted]	6,000	6,000
[redacted]	6,000	6,000
[redacted]	6,000	6,000

2008		
Name	**Bonus**	**Total Bonus**
[redacted]	1,000,000	1,000,000
[redacted]	GBP300,000	GBP300,000
[redacted]	40,000	40,000
[redacted]	29,174	29,174
[redacted]	10,000	10,000
[redacted]	7,500	7,500
[redacted]	6,000	6,000
[redacted]	5,000	5,000
[redacted]	5,000	5,000
[redacted]	5,000	5,000

Highly Confidential - Provided to the Joint Committee of Inquiry into the Banking Crisis 23 February 2015

This information must be considered in conjunction with the Notes disclosed on page 1 of this report.

Notes to the financial statements

23. Other assets

Society 2008 €m	Society 2007 €m		Group 2008 €m	Group 2007 €m
22.0	22.0	Amounts receivable under contractual property arrangements	22.0	22.0
1.2	0.7	Prepayments and accrued income	1.5	1.3
23.2	22.7	At end of year	23.5	23.3

In February 2009, the Society's interest in amounts receivable under a contractual property arrangement relating to an IFSC property was settled for €22m.

24. (Loss)/profit before taxation

Group and Society	2008 €000	2007 €000
(Loss)/profit before taxation has been arrived at after charging		
Directors' and chief executive remuneration:		
Fees as Directors	304	313
Other emoluments	2,697	2,693
Pensions	213	492
	3,214	3,498

	2008 €000	2007 €000
Auditor's remuneration (including VAT)	350	224

Remuneration of Directors and Chief Executive 2008

The Group's key management personnel are the Chief Executive and the Executive Director.

	Salary €000	Fees €000	Contract Bonus €000	* Other Payments €000	Benefits €000	Total 2008 €000	Total 2007 €000
Chief Executive							
Michael P. Fingleton	893	4	1,000	450	70	2,417	2,313
Executive Director							
John S. Purcell	264	53	-	-	20	337	486

The remuneration (fees) of the non-executive directors was: Michael P. Walsh, Chairman €100,430 (2007: €100,430), Terence J. Cooney €53,240 (2007: €53,240), David M.J. Brophy €53,240 (2007: €53,240), John T. Carey €26,620 (2007: €nil), and Daniel J. Kitchen €13,310 (2007: €nil). Pension contributions made by the Society in respect of the executives were: Michael P. Fingleton €nil (2007: €nil) and John S. Purcell €213,000 (2007: €492,000).

*Other payments consists of payments made on a monthly basis which do not form part of salary or bonus and a payment of €50k in lieu of directors fees.

THEME: B5

Impact of the remuneration arrangements on banks' risk management

LINE OF INQUIRY: B5b

Impact of shareholder or lending relationships in promoting independent challenge by the board and/or executives planning permission, which generally increased the value of the site, was attained it was intended that another bank would refinance the loan and INBS would be repaid. Loan contracts tended to include profit share agreements, with INBS receiving typically between 25% and 50% of the profit if and when a project was concluded successfully.

2.4.9 This business model was, in principle and in practice, risky because of the planning permission risks involved and because of the reliance on the refinancing of borrowers by other banks. These risks were seen by INBS as significantly mitigated by accepting, as borrowers, only developers who had a long and successful history of doing such projects. The model was in some ways closer to that of a venture-capital financier than that of typical banks. Its key risks were a decline in property values and a disturbance in the refinancing abilities of other banks.

2.4.10 INBS's overarching driver was demutualisation and sale. This was frequently expressed by management, the Board and INBS members and was expected to result in a cash windfall for all parties.[30] As the value of INBS would dictate the size of the windfall, it is noteworthy that the bank's most significant growth spurt was during the years leading up to the expected demutualisation.

Other Banks

2.4.11 The four other banks can be broadly divided into the two bigger full-service banks (AIB and BoI) and the two smaller institutions primarily concentrating on providing residential mortgages and other similar products (Educational Building Society (EBS)[31] and Irish Life and Permanent (IL&P)[32]).

2.4.12 The strategies of the two bigger banks included a desire to maintain their independence. To drive share price growth, and thereby increase their market capitalisations, it was felt that banks needed to show sufficiently strong growth in earnings and at least maintain market share. Strong market capitalisations, in turn, somewhat protected the banks from takeover by a domestic or foreign competitor. Both banks viewed Anglo as a major threat: it was growing rapidly and it was greatly admired by many market commentators and advisors both domestically and abroad.[33] Also, as illustrated in Figure 2.12 below, Anglo had a higher price-earnings ratio than the other listed Irish banks for most of the Period.

[30] An amendment to the Act in 2006 repealed a rule which provided that, after demutualisation, a building society could not be sold to a single entity for five years. The INBS had been lobbying for this change for many years and a trade sale would have resulted in a windfall for members and a substantial bonus for management. When the legislation was passed, the INBS did not achieve a sale straight away. This was probably because the 2007 financial results were to have yielded a higher valuation and consequently a higher sale price. However, the economic collapse meant that the planned trade sale never materialised.

[31] In the case of EBS, the Commission focused primarily on its commercial property lending.

[32] In the case of IL&P, the Commission focused only on the banking arm of the institution.

[33] For instance, as late as 2007, a well-respected external consultancy firm presented Anglo, at an AIB seminar, as an example to which AIB should aspire.

THEME: B6

Impact of the banks' internal audit processes in supporting effective risk management

LINE OF INQUIRY: B6a

Effectiveness of internal audit oversight and communication of issues related to governance, property-related lending strategies and risks, and funding and liquidity risks

1.11 Internal Audit

Observation:

Following our review of internal audit procedures in the current year, KPMG noted that the Society's Internal Audit department needs to build up its experience and training in order to perform reviews of key risks areas which are currently outsourced to a third party service provider. It was noted that when audit procedures are outsourced to a third party service provider, Internal Audit do not necessary get involved in the close out of findings.

It was also noted by KPMG that Internal Audit perform compliance work (e.g. money laundering procedures), which means that it is fulfilling a compliance function and no longer acting in its expected role as a second line of defence.

Recommendation and benefit:

KPMG recommend that Internal Audit should be more focused in the key risk areas of the Society. If the Society continues to outsource key risk areas (e.g. commercial and residential loan review), we recommend that Internal Audit become more involved in the scoping of outsourced reviews and in the close out of findings.

KPMG recommend that Internal Audit do not perform any compliance work. Rather Internal Audit should be involved in the review of compliance work to ensure that it meets required standards.

Management response:

Internal Audit will focus on the key risk areas of the Society. The Society has and will continue to outsource the audit of key risk areas as directed by the Financial Regulator.

The responsibility for AML/CFT will be migrated to the Chief Risk Officer.

Responsibility and due date: Internal Audit and Chief Risk Officer.

Status:

Grade: C

KPMG

2009 KPMG, the Irish member firm of KPMG International, a Swiss cooperative All rights reserved

1.12 Security perfection

Observation:

During the work we performed on behalf of the Board to facilitate the Boards reporting to the Financial Regulator we noted the following observations in respect of the Society's security perfection procedures:

- There is no Service Level Agreement in place with the legal panel solicitors acting on behalf of the Society in the Republic of Ireland
- no formal letter of instruction is sent to solicitors acting on behalf of the Society in the Republic of Ireland requesting them to act in respect of security perfection and hence no formal response received from the solicitor confirming action to be taken
- There is no procedure in place for monitoring security perfection to ensure that security is indeed perfected and that it is completed on a timely basis or to record where cross charges exist
- There is no procedure currently in place for follow up of insurance certificates. Whilst insurance certificates are received when advancing a loan ongoing confirmation that insurance in place is not required from the borrower.

Recommendation and benefit:

The Society should review security perfection controls and process and at a minimum it should

- Formally document Service Level Agreements with panel solicitors and implement a process which requires formal letters of instruction to be sent to all panel solicitors prior to them acting on transactions for the Society
- The Society should consider implementing a system which records all security in place, charges which are in progress but not yet in place for follow up and cross charges to reduce the risk to the Society that collateral may be inappropriately released
- Introduce a procedure which requires the lending team obtain up to date insurance certificates as part of the ongoing loan review process.

Management response:

1. The Legal Department are currently drafting a Service Level Agreement which should be finalised and agreed with all panel solicitors by the end of August 2009.
2. The Legal department has implemented a policy for security perfection in relation to residential loans whereby a letter issues to the solicitor acting, three months after cheque issue. This letter contains a request to update the Society regarding registration of the Society's charge, this is followed up at specified time intervals. Security is recorded on Summit and Filetrail.
3. Procedures which require the lending team to obtain up to date insurance certificates as part of the ongoing loan review process will be implemented.

Responsibility and due date:

Responses 1 & 2: Legal department , 31 August 2009

Response 3: Commercial lending managers; 31 August 2009

Status:

Grade: B

2009 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved.

2.11 Commercial lending: Stress testing

This matter was also raised in the 2004 Management Letter

Issue and effect:

Stress testing is performed by the Society on both individual residential loans and portfolio basis when requested by the regulator. No formal policy is currently in place for the ongoing monitoring of the effects of adverse changes in economic conditions on the commercial portfolio.

Over the last number of years the Society has become increasingly exposed to concentration risk in respect of its commercial portfolio. This arises due to increases in the absolute value of loans and value of the top 30 exposures.

Stressed markets are often characterised by a material loss of liquidity. Without stress testing the portfolio, management may be unaware of the potential effects that unexpected adverse market conditions may have on the Society's portfolio and the resultant strain this may have on the Society's funding base.

Recommendation:

We recommend the loan portfolio be stress tested regularly using a number of assumptions which are workable, realistic and timely and that the results of this analysis be reported to the board. The stress testing may be performed in two ways to predict;

- the loss if a particular scenario occurs;
- what event's could occur that would cause a reduction in equity of specified amounts

Examples of the type of factors to be applied may include the following:

- extension of all moratoria accounts by specified periods
- reduction in customer/deposit base by specified amounts
- increase in arrears on non-moratoria loans
- reducing security value to a fire sale price
- effects on profitability given different stressed interest rates

Management response:

A stress test was carried out in 2006 and a summary report was sent to the Board on 24 October 2006 and to the Financial Regulator on 10 November 2006. A stress test of the mortgage book was carried out in last quarter of 2006 and is due to go to the Board in February 2007.

The Society will stress test its mortgage book on an annual basis.

Responsibility and due date:

Credit Risk Manager

Status:

Ongoing, Stress testing performed on loan book as at 31 December 2005.

Stress testing of the 31 December 2006 loan book is due for completion by end of Q2 2007.

Management response 2007:

Credit Risk Department submitted a stress test of the entire mortgage book to the Board in February 2007 based on the 31st December 2005 data for the mortgage book. This exercise will be repeated on the 31st December 2006 data and is due for completion by end of Q2, 2007.

Status 2008:

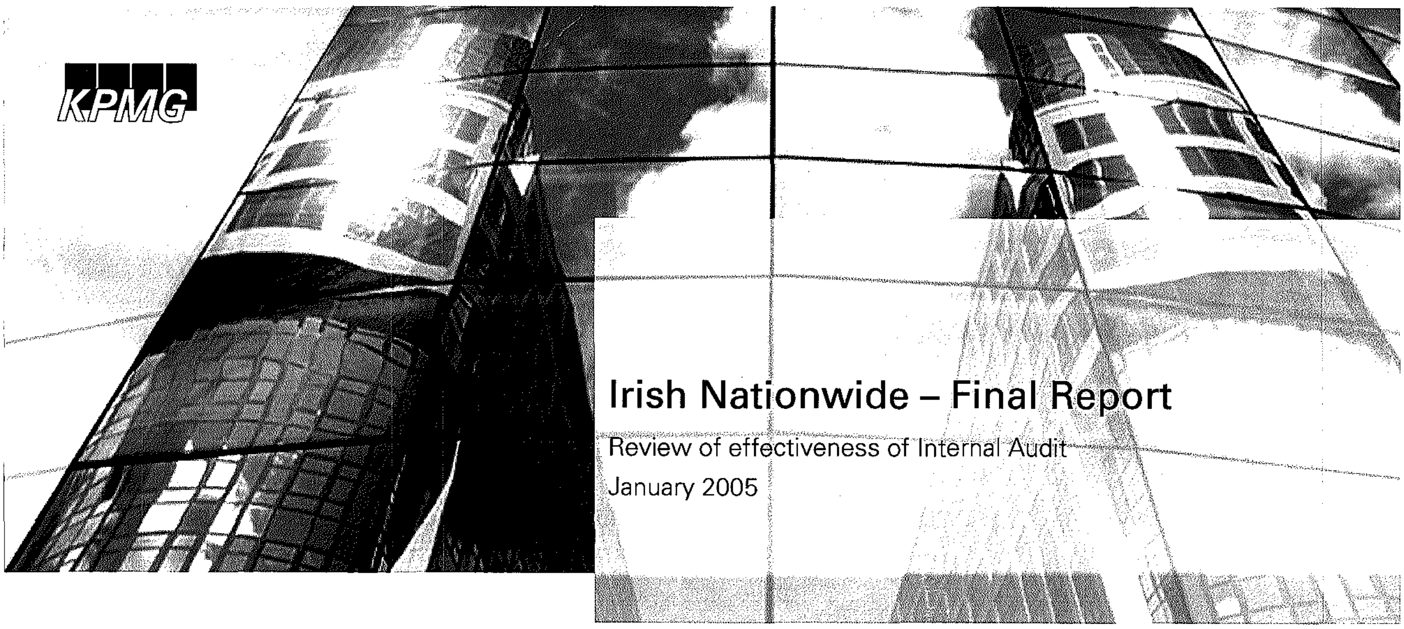
Ongoing

Management response 2008:

A stress test was not completed in 2007 due to an increase in workloads from due diligence queries. It was postponed until April 2008 and will be performed on the December 2007 year end. When completed and presented to the Board it will be forwarded to the Financial Regulator.

2009 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved.

Document ID: 0.7.2256.50491



Irish Nationwide – Final Report

Review of effectiveness of Internal Audit

January 2005

Strictly Private and Confidential

Copies of this document and or any part thereof should not be discussed, disclosed or copied to any third party without our prior written consent.

AUDIT ▪ TAX ▪ ADVISORY

2004 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved.
The KPMG logo and name are trademarks of KPMG International.

Executive summary

Internal Audit (IA) within Irish Nationwide is going through a period of significant change. The business emphasis has changed such that there is a greater focus on commercial lending and there is a vacancy for the position of Internal Auditor. Management and the Audit Committee together with the regulator IFSRA recognise that given these changes, it is an appropriate time to complete a review of IA. As a result KPMG was commissioned to complete a review of the effectiveness of the function, with a view to developing an action plan which would reposition IA in the Society to meet best practice and to meet its changing needs.

There are many instances where best practices are being complied with and these include:

- There is a strong audit committee in place
- There is a strong mandate for Internal Audit
- Funding is available to enhance the section provided there is a business case
- IA use a risk based methodology
- An audit manual is in place
- IA perform a quarterly review of large exposures
- The Acting Internal Auditor is thought very highly of throughout the business and there is an expectation that improvements will occur
- IA have a dedicated training budget
- There is a strong team culture within the IA section

We also observed compensating management controls which focus on the main business risks of the Society and these include:

- Internal Audit report to the MD and while this is consistent with best practice, it should be noted that the MD retains some responsibility for Commercial Lending
- An on-going review of the top 50 commercial loans by an independent third party
- The creation of a Compliance post and a Mortgage Administration Audit and Control post

In the course of our examination we also identified a number of areas where the effectiveness of IA could be improved and these included:

- The section lacks the experience and business knowledge to provide a real and robust challenge to some of the more complex business areas including Commercial Lending, Treasury and IT;
- IA could improve the way it co-ordinates its work with other internal assurance providers;
- IA does not use CAATs and test samples are not representative;
- Follow up procedures need to be improved;
- Certain members of the IA team lack credibility with management;
- Only one member of the IA team has a recognised IA qualification;
- Training is not targeted to individuals competency development.

We have made a comprehensive series of recommendations which will form a basis for a detailed action plan for management and IA. Where possible management have commenced addressing our recommendations, for example, management held a workshop to identify and assess the key risks being faced by the Society. The next step will be for the internal audit plan to be aligned with the key risks. On the basis that the action plan will be implemented within the prescribed timescales, we are confident that the internal audit section will form an effective, robust and integral part of the Society's control framework.

2004 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved.
The KPMG logo and name are trademarks of KPMG International.

Stakeholder questions answered

IFSRA requested the review should focus on, inter alia:	Our findings / answer
• The needs and requirements of the Society in the context of having a "best practice" IA function which has the ability to review, monitor and recommend improvement for all business activities of the Society	• The existing internal audit function is not best practice. It is in a transition period having lost its former Internal Auditor. In particular it lacks the depth of experience necessary to challenge the areas of key risk which includes Treasury and Commercial Lending. • Management are however, aware of the shortfalls of Internal Audit and have taken decisive action in order to increase their confidence regarding the accuracy and robustness of their systems. This is evident by Irish Nationwide commissioning a loans specialist to conduct on-going reviews of the top commercial loans, the appointment of a compliance manager and the appointment of a Mortgage Administration Audit and Control person. • We have made detailed recommendations which will form the basis of an action plan with management. If implemented, the internal audit section will become an effective, robust and integral part of the Society's control framework.
• The ability of the existing IA function to provide such a service;	• The internal audit section needs to be developed. In the short term it is our assessment that the section will need assistance in the specialist areas such as Treasury, IT and Commercial Lending together with training on aligning the audit plan to the key organisational risks and conducting assignments in a way which improves their credibility with managers throughout the Society. • Management responses to our recommendations together with an action plan has been included within Appendix IV.
• Adequacy of the current "risk assessment" approach adopted by IA; and	• The risk assessment performed by the Internal Audit section is quite pervasive and well considered. However, it lacks transparency and has not been developed in full and open consultation with management. As such it is very much perceived to be IA's risk assessment and not managements. • We have however facilitated a risk assessment with the Board and identified the key risks of the Society. The risks will form the basis of an audit needs assessment which re-aligns the audit plan to these key risks in accordance with best practice.
• Review the adequacy of the Society's training programmes) for IA staff.	• While the Society has made significant funds available for IA training, training is ad-hoc and is not linked to defined competencies and training plans for each member of the audit team. • Training and on-going mentoring has been targeted as a key area within the action plan and we are confident that with the right support the audit plan will be delivered in an effective and robust manner which will significantly add value to the assurance process.

2004 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved.
The KPMG logo and name are trademarks of KPMG International.

Assessment of specialist areas

As part of our review specialists from KPMG performed sample file reviews of commercial loans and Treasury and we have extracted the following points on an exception basis:

Commercial Lending

We found significant scope for improvement in the audit process, our findings include:

- Report had not been signed off at time of review although work commenced in February
- Recommendations do not state the risk to the business or assess the potential impact of the risks
- Testing of authority levels was not readily apparent
- Reports were very long and key messages were not clearly evident or prioritised
- The file covered Ireland loans only and not loans advanced by the Belfast office which is a significant proportion of the loan book
- There was no evidence to support follow up on previous year's recommendations
- The audit file does not document how internal audit effort was expended only on the major business risks
- Only new advances were tested – there was no evidence of testing additional drawdowns, amendments, updates to interest rates on existing facilities etc.
- The staffing workshop considered numbers only and not the qualifications or current training
- Testing should cover all types of loans e.g. development, land and acquisitions and this was not evident from the file
- Additional areas which should have been tested include: linked exposures, accounting for joint ventures and risk sharing, arrangement fees (income recognition), review of fees and charges levied by account, review of moratorium arrangements
- There was no evidence to support testing of IT controls, analytical review, management sign up to the scope of the review or segregation of duties and compliance with guidelines.

Treasury

We found significant scope for improvement in the audit process, our findings include:

- There was no evidence of specific tests in respect of funding requirements and counterparty concentrations
- Testing of the Society's liquidity ratio focused on month end as opposed to intra day or inter day testing and consideration should also have been given to the independence of the preparer.
- There was no evidence of testing the source information used in the calculation of the prudential liquidity ratio
- No tests were evident in respect of fixed issue transactions being authorised by ALCO or the Board
- Testing of sterling deposits focused on ensuring interest swap arrangements were used to hedge foreign exchange risk. We would also have expected an analysis of the instruments such as FX forwards, FX futures, FX options and a gap analysis of: 1) total sterling assets and liabilities, 2) the re-pricing of these assets and liabilities, in order to establish the sterling interest rate risk to which the society was exposed and 3) the maturity profile of the sterling assets and liabilities in order to determine any funding gap.

KPMG

2004 KPMG, the Irish member firm of KPMG International, a Swiss cooperative. All rights reserved.
The KPMG logo and name are trademarks of KPMG International.

IRISH NATIONWIDE
BUILDING SOCIETY
www.irish-nationwide.com

Nationwide House
Grand Parade
Dublin 6
Tel: 01 6096000
Fax: 01 6096696

Yvonne Madden,
Banking Supervision Department,
Financial Regulator,
PO Box No 9138,
College Green,
Dublin 2.

21 April 2008

Dear Yvonne,

I refer to your letter dated 14 December 2007. At the request of the audit committee, I have addressed below a number of issues raised in your letter.

1. <u>Positively rated audits completed by the Internal Audit Department</u>

In light of your comments on the 100% level of positively rated audits completed by the Internal Audit Department, the rating system used by the Department has been changed from 1 January 2008.

The new system will ensure that, as the assessment of each area of an audit declines from excellent to unsatisfactory, greater weighting is assigned to the lower risk ratings. This will result in lower overall ratings for areas audited, where control weaknesses are identified.

The new rating system was discussed with the audit committee on 28 March 2008.

2. <u>The assessment of the board's performance</u>

Your letter dated 20 November 2006 stated that:
"The board does not formally review its own performance annually".

The Society responded in a letter dated 31 January 2007 that:
"The board will review its own performance and that of its sub committees annually. The first review will take place at the first board meeting following the 2007 AGM."

At a board meeting held on 24 May 2007, the board carried out its first annual review of its performance and also that of the sub committees of the board.

I am not ware of any assessment of the performance of the board carried out by KPMG three years ago.

3. <u>Treasury audit - ineffective hedges</u>

The three hedges, which had been identified as ineffective as of December 2006, were as follows:

Chief Office: Nationwide House, Grand Parade, Dublin 6. REGISTERED NO. 14B DUBLIN
DIRECTORS: Michael P. Walsh, B.Comm., M.B.S., M.B.A., PhD., *Chairman.* Terence J. Cooney, B.Comm., M.Econ.Sc., F.C.A., F.C.C.A., F.I.T.I.
David M. J. Brophy, B.A. (Mod) Law. John S. Purcell, B.Comm., F.C.A.
Michael P. Fingleton, B.Comm., F.C.I.S., F.C.C.A., Barrister-at-law, *Managing Director.*
Irish Nationwide Building Society is regulated by the Financial Regulator

Document ID: 0.7.2321.39652

Hedge no. 29 £25m
Hedge no. 30 £30m
Hedge no. 31 £5m

These hedges were ineffective as there had been no loans available to hedge against.

Each of these hedges had inception dates of 28/12/2006. It was subsequently noted that the loans that these hedges had been required for were already covered by hedges 27 (£25m) and 28 (£50m). Therefore, the loans were designated as ineffective as there were no loans to hedge against.

The maturity dates for these hedges were extended, effectively cancelling the original hedges, with each of the hedges being designated against a number of specific loans. There was no resulting financial gain / loss to the Society. The only cost to the Society was a 0.03% increase in the interest rate payable by the Society under the hedging instrument.

4. Treasury - FX Deals

This FX deal was done for the account of Confidential on 06/09/2006 for GBP 5,000 (EUR 7,369.19). There was an email on file from Marie Louise Colgan (Treasury Back Office) requesting the transfer which required the FX deal, which states that the request had come from Confidential.

There is no documented policy in relation to staff transactions. For FX deal purposes, all staff are treated as normal customers and do not receive any preferential treatment.

5. Matters raised by Internal Audit at the meeting in relation to prudential issues

I did not advise you of the situation concerning Emlpoyee Confidentiality at our meeting on 5 October 2007 as the Society was still conducting the investigation into Emlpoyee Confidentiality practices and enquiries were not sufficiently advanced to come to a conclusion. I felt at the time that in order to comply with the principle of natural justice and fair process, I could not divulge the details of the investigation prior to the conclusion of the process.

If there is anything else you require, please do not hesitate to contact me on the number below.

Yours sincerely,

Killian McMahon
Internal Auditor
01-609 6633

IRISH NATIONWIDE
www.irish-nationwide.com
Nationwide House, Grand Parade, Dublin 6. Telephone: (01) 6096000 Fax: (01) 6096200

Mr. Con Horan
Head of Banking Supervision
Irish Financial Services Regulatory Authority
PO Box No 9138
College Green
Dublin 2.

13 October 2004

Dear Con,

I refer to your letter dated 16 July 2004 and would respond to the matters raised as follows.

1. General Matters

Corporate Governance

The Head of Function for the Commercial Lending area is Tom McMenamin. From 1 October 2004 Brian Fitzgibbon has commenced managing commercial lending administration in order to strengthen reporting and management information systems in this area.

Internal Audit Function

There are currently six full time staff working in internal audit. In relation to the 2003 audit plan, the treasury audit extended into 2004 otherwise the 2003 audit plan was completed.

The level of expertise in internal audit has been and continues to be enhanced by means of attendance at training courses as set out in the training plan for 2004 (see attached). Full scope reviews of commercial lending were conducted in 2003 and 2004, of treasury in 2003/4 and IT in 2003.

KPMG will be carrying out a comprehensive review of the internal audit function in November 2004 as recommended in your letter.

ESTABLISHED IN 1873. Chief Office: 1 LOWER O'CONNELL STREET, DUBLIN 1. REGISTERED NO. 14B DUBLIN
DIRECTORS: Michael P.Walsh, B. Comm., M.B.S., M.B.A., PhD., *Chairman.* Cornelius P. Power, B. Comm., F.C.I.S., F.C.M.A., F.C.C.A., M.Econ.Sc., D.B.A., Comp.I.E.I., PhD.
Terence J. Cooney, B.Comm., M.Econ.Sc., F.C.A., F.C.C.A., F.I.T.I. John S. Purcell, B.Comm., F.C.A.
Michael P. Fingleton, B. Comm., F.C.I.S., F.C.C.A., Barrister-at-law, *Managing Director.*

Commercial Lending

Commercial Lending Review

- An independent review of the Society's commercial book was undertaken by KPMG and was submitted to the FSR on Monday last.

Reclassifications

- The Society's computer system was upgraded to incorporate new developments in 2003 which facilitated additional coding for reporting purposes. Following this upgrade sectoral code data was reviewed by the commercial lenders to ensure that loans had appropriate and up-to-date sectoral codes. This process resulted in the re-classification of a number of loans.

Desired mix for the Loan Book

- As stated before the Society's policy is to prioritised its home loan business. However, even though our rates are on a par with most of the other lenders we find it difficult to generate the volumes we would like. This is due to the intense competition for market share by our bigger competitors chasing a finite number of lending opportunities in any given year. There are eleven lenders aggressively chasing the business and there is not enough for everybody to fulfil their needs in this regard i.e. building up their home loan book and increasing market share.

  Added to this, there is no loyalty in the market and the intermediaries are continuing to increase their market share which is invariably channelled to the bigger lenders. The Society must utilise the funds available to it in other areas of the lending market i.e. commercial and this we have done very successfully in recent years.

  However, notwithstanding the difficulties with generating home loans, the Society would see loan balances of approx. 70% commercial and 30% residential as a desirable mix going forward.

Review of Loans

- The review process is not restricted to a selected number of loan files. At the outset the priority was to review high value exposures and the review process commenced with the top 30 exposures. It has since progressed to the top 50 and onwards to the top 100. The review process is ongoing and has been amended to address the shortcomings identified in the 2002 management letter.

Treasury Function

The segregation of the treasury back office was completed in January 2004. A review of the success of the segregation will be carried out in November 2004.

Controls have been implemented to monitor counterparty limits and these were noted by KPMG in their 2003 Management Letter.

The monthly reconciliations are independently reviewed outside the treasury function by the accounts department.

Treasury Policy

- Treasury policies are being reviewed and redrafted at present and will take account of the comments in your letter as well as comments and exceptions noted in the Central Bank – "Controls Report". The redrafted policies will be discussed and revised where necessary by the ALCO before submission to the Board. When the re-drafted policies are approved by the Board a copy will be sent to the FSR. We expect this will be around the end of November 2004.

Activities and Minutes of the ALCO

- The activities and recording of work done by the ALCO is also being examined at present with a view to improvement in line with the comments in your letter.

Treasury Procedures Manuals

- The procedures manual for treasury back office has been updated in a detailed format. A detailed procedures manual for the front and middle office treasury operations is being prepared.

2. Society's Action Plans to deal with various outstanding issues.

All issues raised in the Action Plans have been addressed. A number of the issues (ex Treasury policies) will be revisited and enhanced in the latter part of 2004.

3. Central Bank – 'Controls Report'

We note you will be writing separately to us in this regard.

4. Other Matters

Sectoral Exposure Limits

The Society will reply separately to the FSR's letter dated 28 June last on sectoral limits.

Large Exposure Breach

We note that the FSR will be writing in relation to the internal audit report submitted to the FSR. Recommendations made in the internal audit report have been implemented and, as requested in a letter from the FSR dated 13 July 2004, the Society's internal audit department will conduct a further audit of the new procedures for the December 2004 Large Exposures Report.

Redeemed accounts with balances

As requested by the FSR, prior to the completion of the exercise by the Society an independent review of our processes for identifying and reimbursing any affected customers will be carried out to ensure that all matters affecting customers are resolved. We expect that this review will be completed by this year end.

Document ID: 0.7.2256.15152

Movements in the level of provisions

As stated in your letter the Society's commercial loan book increased by almost €700 million in 2003 and at present accounts for 63% of total loans. The increase in the proportion of the general provision allocated to the commercial loan book was made to reflect the greater risk associated with commercial lending compared with residential lending.

Up to September 2003 the general provision was divided between residential and commercial lending based on the total amount of loans in each category. In September 2003 the allocation was changed to a general provision against residential lending of a half of one percent of the residential loan book with the remainder allocated to commercial lending. In January 2004 following review the general provision was allocated as 1% of residential balances as a general provision for residential loans losses with the balance of the general provision allocated to commercial lending (see schedule attached).

Provisioning Policy

Provisions are made to reduce the value of loans and advances to the amount, which the Directors consider likely to be ultimately received, based on a detailed appraisal of loans and advances. In addition, general provisions are made to cover risks, which, although not specifically identified, are known from experience to be present in any portfolio of loans and advances. Provisions made during the year, less existing provisions no longer required, and recoveries of bad debts previously written off are charged against the excess of income over expenditure. Loans and advances are written off when there is no longer any likelihood of further recovery of the balance outstanding.

Non-performing assets

The Society continues to report non performing assets in the manner set out by the FSR pending any further review of this reporting matter. As mentioned at our meeting on 26 February and in our letter dated 16 May 2004 the Society is of the view that the present method of reporting non performing loans overstates the non performing assets of the Society.

Yours sincerely,

Stan Purcell, Director and Secretary