

SELECT COMMITTEE PROCEEDINGS

EPTKSF131109

Douglas, Friday, 13th November 2009

Morning Session: 10.02 a.m. – 1.01 p.m.

Select Committee of Tynwald
on Kaupthing Singer and Friedlander
and the Depositors' Compensation Scheme

5

*The Committee sat in public at 10.02 a.m.
in the Millennium Room,
Legislative Buildings, Douglas*

10

[MR WATTERSON in the Chair]

15

Procedural

The Chairman (Mr Watterson): Good morning, everybody. Can I welcome you to this meeting of the Select Committee of Tynwald on Kaupthing Singer & Friedlander (Isle of Man) Limited.

20

The Select Committee was appointed on 16th July 2009, with the following remit:

25

'To investigate and report on the cause of the collapse of Kaupthing Singer & Friedlander (Isle of Man) Limited; the role of the Financial Supervision Commission in ensuring the proper management of Kaupthing Singer & Friedlander (Isle of Man) Limited to protect depositors' funds; the credibility of the Depositors' Compensation Scheme; and any other relevant matter, and report back to the March 2010 sitting of Tynwald.'

30

The Committee recognises this matter is complex and important and has, therefore, decided to split this inquiry in two. The first part of the inquiry will deal with the first two parts of the remit, namely the cause of the collapse of Kaupthing Singer & Friedlander (Isle of Man) Limited and the role of the Financial Supervision Commission in ensuring the proper management of Kaupthing Singer & Friedlander (Isle of Man) Limited to protect depositors' funds. Once we have reported on that part of the remit, we will turn our attention to the credibility of the Depositors' Compensation Scheme and any other matters which may need to be investigated.

35

We are this morning to take our second session of oral evidence. We have invited the directors of KSF (Isle of Man) to give evidence today. A further evidence session will take place on 4th December with Treasury Minister, Allan Bell.

I would like to introduce my fellow members of the Committee: to my immediate left, John Houghton

MHK; Mr Eddie Lowey MLC; Mr Phillips, Clerk of Tynwald, Counsel to the Speaker, is the Committee's Clerk and legal adviser; and also Phil O'Shea, who is an adviser to the Committee.

40 Mr Clive Alford is our Hansard Editor for today and he is recording this morning's proceedings. At this point, could I ask everybody, please, to put your mobile phone on to aircraft mode, rather than silent, otherwise it will interfere with the recording equipment.

45 **Q.224. The Chairman:** I would like to welcome the witnesses, and if I could just ask you, for *Hansard*, just to state your name, your role within the bank and perhaps give us a brief history of your banking expertise or experience, please.

If I could start, perhaps, with Mr Cashen.

50 **Mr Cashen:** Yes. My name is John Alfred Cashen. I am a non-executive director of Kaupthing Singer & Friedlander (Isle of Man) Limited. For the record, I am also the Deputy Chairman of the Financial Supervision Commission. I was the Chief Financial Officer in the Isle of Man Treasury for 10 years from 1991 until my retirement in 2001.

55 **Mr Gelling:** Donald James Gelling, non-executive director at the time of the problems, ex Chief Minister, ex Treasury Minister and otherwise Captain of the Parish of Santon.

Mr Doherty: Good morning. Aidan Doherty, Managing Director of Kaupthing Singer & Friedlander. My background is banking: 32 years in banking, most of them offshore since 1984, since moving to the Isle of Man.

60 **Mr Davies:** My name is Andy Davies. I was previously the Finance Director of Kaupthing Singer & Friedlander (Isle of Man). I trained as a chartered accountant with KPMG on the Isle of Man and with Kaupthing Singer's for just over 10 years.

65 **Q225. The Chairman:** Thank you very much and welcome.

I would like just to give you a rough idea as to how we are going to go through the session today. We will start off with a bit of the background and then take you quite a bit back to the time when Kaupthing took over the local branch of Singer & Friedlander and the Derbyshire; then, perhaps, move on to the events of last May; then move on to the events of last October; and then go on to a bit about what has been going on since 8th October, if that is okay.

70

Mr Gelling: Could I, Mr Chairman, ask is it possible to have an introductory statement from our side?

The Chairman: If you would like to make an introductory statement, that is fine.

75

INTRODUCTORY STATEMENT BY MR GELLING

80 **Q226. Mr Gelling:** Yes. Thank you very much, first of all, for that.

I was going to introduce my colleagues, but you have already got that information. For the record, if I may, I would like to confirm that each of us here today were the directors of Kaupthing Singer & Friedlander (Isle of Man) Limited, which is KSF (IOM), at 8th October. Whilst KSF (IOM) may now be in liquidation, the directors remain in office, save for Mr Davies, on the end, who resigned on 26th November 2008.

85 Based on the Committee's letter dated 27th August 2009, each of the directors was invited to provide written evidence, which we have already done, and oral evidence, which is why, obviously, we are here today. Whilst we have summarised our position in the written evidence already submitted, we would like to make it known, for the record here today, that... just a few bullet points:

- 90 • *At all material times leading up to 8th October 2009, KSF (Isle of Man) was a solvent and viable business. It was fully in compliance with its regulatory obligations and its licensing requirements.*
- *In April 2008, following a request, and with the approval, of the FSC, £185 million was transferred by KSF (Isle of Man) from Kaupthing (Iceland), the parent bank, to KSF (UK) in the form of a secured equity repurchase agreement.*
- *In June 2008, the FSC indicated its requirement that KSF (Isle of Man) remove all remaining potential exposure to Kaupthing (Iceland) and, as a consequence, KSF (Isle of Man) transferred the*

95 *sum of £175 million from Kaupthing Bank (Iceland) to KSF (UK). These two transfers amounted to £360 million, which removed KSF (Isle of Man)'s exposure to Kaupthing Bank (Iceland): substantially different – and I just wanted to make that point – to the sum alleged by various parties up to now. So that is the figure.*

100 *• On 8th October, without warning or having given any notice of their intentions to the FSC or, I must say, KSF (Isle of Man), the UK Treasury and the FSA combined to order the transfer of the majority of KSF (UK)'s retail deposits to ING Direct and placed KSF (UK) into administration. Therefore, Mr Chairman, deprived of access to the funds placed by it with KSF (UK), KSF (Isle of Man) called upon KF (Iceland) to provide liquidity to meet its future needs. When it was advised that Kaupthing Bank (Iceland) was unable to honour its parental guarantee to KSF (Isle of Man), the directors resolved to petition for the appointment of a liquidator provisionally and Michael Simpson of PWC was appointed on 9th October.*

105 *Against that backdrop of economic turbulence – unprecedented, I would suggest, in recent times – the collapse of KSF (Isle of Man) was precipitated by the unforeseen and unilateral action of the UK authorities.*

110 *So that is the background, basically, of where we found ourselves on 8th October.
Thank you, Mr Chairman.*

115 **EVIDENCE OF MR J A CASHEN, MR D J GELLING,
MR A DOHERTY AND MR A J DAVIES**

Q227. The Chairman: Thank you very much.

120 *Could I ask, then, taking us right the way back, were any of you directors of Singer & Friedlander (Isle of Man) Limited before the takeover?*

Mr Doherty: Which takeover are you referring to, Mr Chairman?

125 **The Chairman:** The takeover by Kaupthing of Singer & Friedlander (Isle of Man) Limited.

Mr Gelling: Yes.

Mr Cashen: Yes.

130 *Mr Davies:* Yes.

Mr Doherty: Yes, we were.

135 **Q228. The Chairman:** All of you?

Mr Doherty: Yes.

140 **Q229. The Chairman:** Can you describe at that time how the relationship with the parent company, which was at that time Kaupthing (UK)... how that relationship worked on a day-to-day basis?

Mr Gelling: Mr Doherty.

145 *Mr Doherty:* I think if I could just clarify, Kaupthing took over Kaupthing Singer, then Singer & Friedlander Limited, by taking over the UK company. We... the Isle of Man operation, was a subsidiary of the UK arm at that stage, so it was not a direct takeover by Kaupthing of us; rather, it was a takeover by Kaupthing (Iceland) of the UK operation, of which we were a subsidiary.

150 **Q230. The Chairman:** So, the weird thing is that, at that time, you were dealing with the same people in London and it was the same relationship.

Mr Doherty: Correct.

155 **Q231. The Chairman:** Was it pretty much the same members of staff, the same roles that you were dealing with, right from that time through until, with regard to the UK deposits, right the way until 8th October?

Mr Doherty: Other than through the normal attrition in staff and changing staff roles etc, but by and large, yes.

160 **Q232. The Chairman:** What characterised the day-to-day conversations, discussions, transfer of information that you would have between the local bank and, at that time, the parent in London?

Mr Doherty: On a day-to-day basis it was mainly operational.

165 In terms of dealing with senior management etc, it would have varied from *ad hoc* telephone conversations to meetings when I would be in London, dealing with the head of banking or the CEO of the UK. Also, in times when they would be up here on the Isle of Man at board meetings, be it at board meetings of the bank or at board meetings of the over-arching holding company of the Isle of Man.

170 **Q233. The Chairman:** In terms, then, of the local company, what did that rely on the parent for? Were there any services provided by the parent that the local bank relied on?

175 *Mr Doherty:* Indeed, bearing in mind that it was a subsidiary of the UK, and in terms of numbers, a small operation, we relied on the UK for guidance on accounting regulations, compliance, etc, things like that. Albeit that we had an accounting function here and Andrew was our Finance Director, nonetheless, as international markets changed in terms of financial reporting etc, we took guidance from the UK. We took guidance also, as I say, on the compliance side.

180 Equally, the Isle of Man operation was set up with a specific business model, and that business model originated as a pure deposit-taker, where deposits were placed back with the UK. Gradually, over the years, that business model changed somewhat, where we got involved with lending, largely to high-net-worth individuals on a secured basis. So as the balance sheet changed, that changed in line with policy as agreed, as then, with London, and continued thereafter with Reykjavik.

Q234. The Chairman: Who did you rely on at that time for your Treasury function?

185 *Mr Doherty:* London.

The Chairman: Right.

190 *Mr Doherty:* Just for clarification, we had a Treasury function here in name, in the sense that we had to manage the Isle of Man operation's liquidity, capital ratios, etc, so that was under my responsibility here.

In terms of actual group Treasury, that was at the time still with London. That was solely with the UK.

195 **Q235. The Chairman:** When you were taken over by Kaupthing, did you notice any big changes? Was there a big change of group strategy at that time?

200 *Mr Doherty:* No, there was not a change in group strategy at that time. In fact, the management reporting continued and, as I said earlier, continued to the same people in the UK, albeit that, latterly, there was an influence at the holding level by way of a director of the shareholder who was on the board of the holding company.

Q236. The Chairman: Then there was the restructuring and your relationship was governed directly with Iceland, rather than through the UK parent. Was it your understanding that the strategy of Kaupthing Bank hf was a prudent and well managed strategy?

205 *Mr Doherty:* Yes, and I will answer that in two ways.

210 In 2007... I think you are referring to when Kaupthing (Iceland) actually took over the shareholding of the Isle of Man. That happened from a legal perspective, and therefore, from then on, they became the sole shareholder of the Isle of Man. Nonetheless, the reporting structure remained with Kaupthing Singer & Friedlander Limited and the membership of the holdings board was still made up of members of Kaupthing Singer & Friedlander Limited, as I say, with the addition of one director from Iceland.

215 So, in terms of the business model, we remained very much aligned with the UK, rather than with Reykjavik, other than in respect of – which I am sure we will come onto later – the streaming of deposits to Reykjavik. But in terms of the *modus operandi* here, both in terms of the lending policy, credit controls, etc, the adherence to international accounting standards, the adherence to international compliance etc, that all was still a conduit with London, and in my case I reported to the head of banking in London.

Q237. The Chairman: But, in terms of the legal structure at the time, we moved to having the bank, then Kaupthing Holdings above that, and then a Kaupthing Bank hf above that in 2007, from a legal perspective.

220 **Mr Doherty:** From a legal perspective you are correct, Mr Chairman, yes.

Q238. The Chairman: But your relationships were definitely more aligned and direct with the UK.

225 **Mr Doherty:** Indeed.

Q239. The Chairman: Thank you very much.

You said that the strategy of Kaupthing Bank was prudent, was well managed. Do you consider that they had quite an aggressive approach to acquisitional growth at that stage?

230 **Mr Doherty:** Well, they were certainly in an acquisitive mode, in the sense that they had taken over Kaupthing Singer & Friedlander. My understanding is that they saw that, first, as a strategic fit and, secondly, that it was an entry into both the UK market and obviously further afield within the European markets.

In terms of the Isle of Man, the only acquisition that we ultimately completed was the one with Derbyshire.

235 **Q240. The Chairman:** So in terms of Kaupthing Banks' quite acquisitive strategy, that obviously had an impact, because you took on the Derbyshire group. Did that have any impact throughout the business in terms of its business model or its rationale, its way of thinking, its attitude to things like risk, everything like that?

240 **Mr Doherty:** In respect of the Isle of Man, certainly not. Again, where it did change the business model somewhat was, rather than passing the residual funding into the UK after we took over the Derbyshire, in agreement with the FSC those funds, in the first instance, were placed up with Reykjavik.

245 In terms of appetite for risk, as evidenced in our submission to you, the risk appetite on the Isle of Man did not change one iota. We had, of our loan book... 98 per cent of our loan book was secured and, as I also mentioned, there was only one small loan that was considered to be in default at 8th October, and that loan book continues to perform well. So here on the Isle of Man we were not in any way involved with providing leverage assistance for anything, if I could use the word, 'exotic'. It was plain vanilla residential property lending. We were not doing development lending, we were not doing any other type of lending; it was simply residential lending, largely to high-net-worth UK residents and non-domiciles for tax purposes. The strategy did not change and we did not get any more aggressive or anything like that.

250 **Q241. The Chairman:** So you would refute any allegations that you were involved in high-risk banking?

255 **Mr Doherty:** In the Isle of Man, absolutely not.

The Chairman: You refute the allegation?

Mr Doherty: Sorry, I beg your pardon. I would refute that, yes.

260 **Q242. The Chairman:** At the time of the takeover of the Kaupthing Bank in the UK, were any of you aware of Tony Shearer's evidence that he gave to the Treasury Select Committee, or any part of that?

Mr Doherty: Seeing as I am in the chair at the moment, certainly not.

265 Mr Shearer had a strong relationship with the Isle of Man, both in terms of reporting line and in terms of director responsibilities, and at no stage did Mr Shearer say to me or, of my understanding, to anybody else, that he had any concerns whatsoever.

The Chairman: Thank you very much.

270 **Mr Cashen:** Mr Chairman, if I may come in here, I joined the board of the bank in the middle of 2005 and I met Mr Shearer on a couple of occasions later in 2005. He certainly never mentioned anything to me in relation to the issues that he subsequently raised with the UK Treasury Select Committee. Whether or not he raised it with former directors, I do not know, but I joined halfway through 2005 and it was certainly never mentioned to me, and it was a big surprise when I read of his evidence to the UK Select Committee.

275

The Chairman: Mr Gelling?

Mr Gelling: I never knew Mr Shearer and never spoke to him because I came in after Mr Shearer had moved on.

280

The Chairman: Mr Davies?

Mr Davies: I was not aware, Mr Chairman, at any time of Mr Shearer's concerns, and I worked closely with the group finance people down in London and was not made aware of any concerns at that time, either.

285

Q243. The Chairman: Thank you very much.

Perhaps I could just turn to Mr Gelling at this point. You are the Chairman of the IPA, the Insurance and Pensions Authority on the Isle of Man. Do you see that there is a conflict between your role as Chairman of the IPA and a director of Kaupthing Singer & Friedlander? Do you think that the procedures in place were adequate to mitigate any risk?

290

Mr Gelling: I would agree.

Q244. The Chairman: Also, the same sort of questions to Mr Cashen. You are the Deputy Chairman of the Financial Supervision Commission. Do you think that there are any perceived conflicts of interest, or any conflicts of interest, in that role as also being director of the bank?

295

Mr Cashen: Mr Chairman, I know this is a sensitive issue, but I would refer you to page 12 of our submission to you, where I state that, after my appointment to the board of the bank in 2005, in accordance with the FSC's code on conflicts of interest, I received no FSC briefing papers relating to the company, I took no part in discussions on matters relating to the company and I excluded myself from all such discussions. I received no FSC minutes referencing decisions taken with regard to the bank, and the position has remained the same since October last year.

300

I have not taken any part in any FSC discussions or decisions in connection with the provisional liquidation of the bank or the Depositors' Compensation Scheme, the early repayment schemes, the proposed Scheme of Arrangement or the subsequent petition to wind up the bank. I would point out that the FSC has a published code of conduct on managing potential conflicts of interest and this is rigorously applied by the FSC, and it has also been rigorously applied by myself. There is no way in which I would choose to be involved in any issues where there is a conflict.

305

310

The Chairman: Mr Lowey, please.

Q245. Mr Lowey: I think my position on senior civil servants and senior politicians taking bank risks is public knowledge and has been, not just for this, but for many years previous, so my position is quite clear.

315

Gentlemen, you have both said that there is no conflict. I happen to know both gentlemen, for the public record, over a lifetime. I know them to be men of integrity. Having said that, it is public perception and we have evidence that there are allegations made that there has been too close a relationship between directors and the overseeing agencies of Government to look at it.

320

It is all fine and good to say that you do not receive minutes regarding the bank and the company that you are both directors of, but you will, in the course of your business, receive comments and papers of other competitors of the bank, which must put you in a position of knowledge that may be of benefit. Would you not agree with that?

325

Mr Cashen: Mr Lowey, can I point out that, in my days in the Treasury in the mid 1990s, it was particularly difficult to find individuals to serve on the regulatory bodies who did not have some potential conflict of interest. There is only a small pool of people on the Island on whom we can call, people with the

right professional background and professional experience. So the issue of conflicts of interest has been an issue going back several years.

330 Now, could I just point out to you – and you will remember – that in 1998 the UK launched an investigation into the Isle of Man, the Edwards Review, looking at the Crown dependencies. Mr Edwards was at great pains to point out the problems with regard to conflicts of interest, and he himself addressed this issue. If I could refer you to paragraph 5.10 of his Report, he has written about conflicts of interest as it applies to members of the legislature and also to members of the regulatory bodies. What he said was, and I quote:

335

‘The islands have tackled the problem with considerable success by developing a culture of transparency with good sense. There are rules on declaration of interest and dealing with conflicts of interest. These are included in publicly available legislation, standing orders, rules of procedure or guidance notes, which the islands make a point of keeping up to date.’

340

He went on to say:

‘Informal policing of conflicts of interest is also highly developed. Commercial and professional interests are not easily hidden. Local critics are indefatigable in attacking those who may be thought to have committed abuses.’

345

He went on:

‘My impression is that the critics may even sometimes identify conflicts that do not really exist.’

350

Since then – and that was 1998 – we have had investigations into the financial systems of the Isle of Man and the other Crown dependencies by other international bodies, including the IMF. The IMF have been here twice, in 2003 and again last year. They have looked at the Isle of Man and have made no adverse comment with regard to conflicts of interest.

355

Q246. Mr Lowey: Would you be correct in quoting all of those things... and I have not got the Edwards Report with me, but I am sure, Mr Cashen, you will have quoted correctly... that it is a bit selective, isn't it, because his recommendation was that there should not be politicians as the chairmen of these organisations?

Mr Cashen: That is correct.

360

Q247. Mr Lowey: That was maybe an observation, but the conclusion was different. Would you also not –

365

Mr Cashen: The conclusion, sir, was that there should be no politicians involved, but he did go on to say that the members of the regulatory bodies should be professional people who have got experience in the industry.

Q248. Mr Lowey: I do not want to get too involved in the detail. It is public perception, and you would agree that we have moved on in banking and in finance a lot since 1998.

370

Mr Cashen: Yes, well –

Mr Lowey: You know, and now we are an international... and therefore –

375

Mr Cashen: Since then, in fact, the codes of conduct have been tightened even further.

Q249. Mr Lowey: Well, yes, be that as it may.

Can I come to the Derbyshire?

Mr Gelling.

380

Mr Gelling: I was going to continue from your first question, actually.

I was always conscious of... You used the word three times now – ‘perceived’ – as well as real, perceived... and during my time... Well, if I come to Singer & Friedlander, I was approached three times over a period of time to see whether I would join the board, and I did not for the simple reason that I still had a connection with the Treasury and I felt that there was possibly a perception, although I am quite sure that I could have handled it.

385

390 But actually, when you think of the IPA... You said about papers. You see, Singer, Friedlander, Kaupthing was a licensed bank, licensed with the FSC. Nothing ever came through the IPA appertaining to this particular company, so there were never any papers. Obviously, if you wanted information from the IPA you might very well be calling the IPA, but as far as I was concerned as a person who had been on that regulatory body prior to, for the period up to, when Norman Radcliffe died, certainly I never found any conflict at all being part of that regulatory body.

395 Of course, it was all part, as you so rightly said, about the removal of politicians from regulatory bodies. That was the whole idea that, when I retired from Tynwald, I continued the next period as the Chairman of the IPA, which removed the political question mark, although I must admit, even going back to that, I never really saw ever that there was a conflict of a politician being on these regulatory bodies – but, again, I know your personal view, going back to the MEA etc.

But no, certainly, to your original question: no papers ever crossed my desk, because it was not a licensed entity with the IPA, because it is insurance, of course.

400 **Mr Lowey:** I have to say, I am still of the persuasion that I was over 10 years ago. Having said that, I do not want to stress that.

Can I come, Chairman, to the Derbyshire?

405 **The Chairman:** Can we just hold off on the Derbyshire. We are dealing with conflicts of interest at the moment, if that is okay. If you want to say anything more on that, please feel free, Mr Lowey.

410 **Q250. Mr Lowey:** Can I come to the relationship with the conflict when you deal with the FSC. I am sure you will be aware that there is an emphasis. I noticed you used the word ‘approved’ by the FSC – our dealings with the parent bank were *approved* by the FSC. That word comes up time after time.

We had the FSC in and they said that they did not have to approve anything, they did not advise you to do anything. Having read the minutes, it was quite clear over that period of time, before the collapse, that year... We know the world was in a financial whirl, so –

415 **The Chairman:** Conflicts of interest, please.

Mr Lowey: Oh, is that another one? Well, the conflict of interest is between the bank and the FSC. Did you see the FSC as a conflict of interest – in other words, the regulator was trying to influence the bank in any way, shape or form?

420 **Mr Gelling:** I think I would start – and I am quite sure Mr Doherty would follow on – we are a Manx company, registered in the Isle of Man under the regulations of the Isle of Man, and therefore under the regulations of the FSC. I would suggest to you that, in any move we would make, it would be acceptable, as far as I am concerned, that you get the regulator’s view on the transaction, and I think using the word ‘approved’, it would be fair to say in some cases – maybe not others – whereby it was approved that that action be taken...

Let us face it, we were looking after a licence of a bank in the Isle of Man and we wanted to make sure that we were doing everything possible to be within those regulations.

430 **Q251. Mr Lowey:** The implication, though, is that you are using that as a shield for your actions. (**Mr Gelling:** No.) The ultimate actions of the bank are of the directors, are they not?

Mr Gelling: Yes, but I would say that that is trying to give you an overview that we did not just go and do it. We actually did consult with the FSC, and there was a relationship between the FSC, I would suggest, and any licensed bank, that you keep in touch with them and they know what you are doing and so on.

435 But I would say... You started by saying about a cosiness and a too-closeness. I do not think that existed. I think we were treated in exactly the same way as any other licensed bank in the Isle of Man.

The Chairman: Mr Houghton.

440 **Q252. Mr Houghton:** Mr Cashen, how were your personal copies of the minutes published in respect of meetings at the FSC and KSF (Isle of Man)? For instance, were your personal copies of those minutes redacted in any way?

445 *Mr Cashen:* Yes.

Q253. Mr Houghton: Have you got copies? Can you let the Committee see those copies?

450 *Mr Cashen:* I have not brought copies with me, sir, but you can obtain copies of the minutes that were sent to me from the FSC.

In those minutes, it says ‘Mr Cashen left the meeting’, and then, for my personal copy, there would be a blank where there was discussion on KSF matters.

455 **Q254. Mr Houghton:** I would be grateful if you could let the Committee have some examples of those ones from your good self, if you would be good enough, Mr Cashen.

Did this limit the extent to which you could discharge your duties to KSF (Isle of Man)?

Mr Cashen: Not at all.

460 **Q255. Mr Houghton:** You mentioned earlier that regulations had tightened, which, of course, we all agree.

How do you see now the direction of those regulations? In which way have they tightened, and does that continue to keep your position in both entities still in the manner that they were when you joined?

465 *Mr Cashen:* Since 1998, which I referred to in the Edwards Report, the code of conduct on conflicts of interest has been, I think, adopted by all Statutory Boards. Basically, the revised code was based on the original FSC one. Now all the codes are published on the FSC’s website. We now have to declare what bank accounts we have as members of the FSC. That was not included before.

470 So there has been a tightening up of the situation. Where it will go in the future, I do not know. It is a very sensitive issue and I do not know if there is really any satisfactory solution to it.

Q256. Mr Houghton: How do you find, though, your position as your involvement in the FSC and KSF (Isle of Man) has changed – or has it changed, do you perceive – with the changes of the regulations tightening as time has gone along, as you mentioned earlier?

475 *Mr Cashen:* There has been no change. At the FSC I was not involved –

Q257. Mr Houghton: Sorry, Mr Cashen, you told the Committee that there was a change, that issues had changed since you were –

480 *Mr Cashen:* There was a change in the FSC’s code of conduct on conflicts of interest –

Q258. Mr Houghton: Since your joining the FSC. It is just that point of clarification.

485 *Mr Cashen:* Well, there have been changes to the code of conflict over the years, but those changes in the FSC’s code of conduct have not affected my relationship between the FSC and KSF, because I always abided by what was in the code of conduct, as published at the particular time.

Q259. The Chairman: I can see the *Hansard* editor’s brow furrowing. If we can just make sure that we give people the opportunity to finish, rather than speaking over the microphones.

490 I would like to move on now, if I may – unless anyone else has anything on conflict of interests – to the takeover of the Derbyshire Building Society, please. Just if you could give us a bit of an overview as to the public announcements that were made after the takeover of the Derbyshire in regard to, especially later on, the protection arrangements that moved.

495 *Mr Doherty:* Certainly. The Derbyshire takeover occurred in late 2007 and in November 2007 the announcement of the takeover of Derbyshire took place: that took place both by ourselves and by the Derbyshire. The takeover, in actual fact, also was proceeded with the permission of the FSC, the FSA, the FME, the boards locally and, obviously, the boards of the Derbyshire.

500 In terms of subsequent notifications after the November notification, which was... and I draw your attention, if I may, to the set of appendices, marked ‘Appendix 1’ attached to our submission. There were various communications sent to... Sorry, if I could concentrate, at the end of 2007, there were notifications

sent to customers and there were press notifications issued by the bank here, by Kaupthing Bank themselves, and by Derbyshire. So there was a mixture of press releases and direct communications with customers.

505 Subsequently, then, at the end of 2007 – in December 2007 – customers were written to again, explaining or confirming that the takeover had been completed from a legal perspective.

After that, then there was a transition period because Derbyshire at the time was managed by Close Bank here on the Isle of Man, on what is called a managed bank basis. So, from a practical perspective, we had to address the issues of migrating the customer data from Close Bank's systems, or Derbyshire's systems, onto our own, and that took planning and project management, etc.

510 Once that was completed, i.e. the practical aspect – that was completed around March 2008 – we again wrote to customers, confirming that those practical issues had changed and advising them of change of account numbers, etc. So there were three sets of communication: in November 2007, December 2007 and March 2008.

515 **Q260. The Chairman:** That takeover meant that there was a change in the home regulator, removed from the FSA to the FME. Yes, it would have done straightaway on the takeover, wouldn't it, because of the dates of your corporation restructuring, as well?

520 *Mr Doherty:* The Derbyshire was a full subsidiary – Derbyshire (Isle of Man) that is, was a full subsidiary – of Derbyshire Building Society (UK), so the actual home regulator for Derbyshire (Isle of Man) was the FSC. It was not the FSA.

525 Again, I think it is useful for clarification here today: Derbyshire (Isle of Man) was not a branch of Derbyshire (UK); it was a subsidiary. It was a subsidiary Manx company and therefore it was subject to the FSC's oversight.

Q261. The Chairman: But because it was part of a group it would make the Isle of Man a host regulator, rather than a home regulator. Do you concur with that?

530 *Mr Doherty:* Yes.

Q262. The Chairman: But the home regulator, from a group perspective, moved from the FSA to the FME. Did you, as directors of the local firm – yes, the local firm was host regulated consistently by the FSC throughout – in terms of the home regulation, did you identify any significant changes of approach between the FSA and the FME, in terms of that overall regulation?

535 *Mr Doherty:* In relation to the Derbyshire, absolutely not because, again, our relationship was with the FSC locally and, again, Kaupthing Singer & Friedlander (Isle of Man), being an Isle of Man subsidiary, was subject to both statutory and regulatory rules here. There was no interference or change from the FME.

540 **Q263. The Chairman:** During the takeover, there was no termination allowed for depositors, so they could not get out without penalty, if they had a bond with the Derbyshire prior to the takeover. Why was that?

Mr Doherty: There are a number of issues here, and thank you for clarifying that, because there has been commentary that withdrawals were not allowed, full stop. Yes, they were allowed, with penalty.

545 I think one must remember that this was a takeover. This was not a no-cost merger. There was a takeover, there was a rationale for buying the Derbyshire, and the rationale, again, as outlined, was because it gave the group additional liquidity. It gave the group an additional and wider customer base and, with that customer base, the long-term intention was then to cross sell group products, both from here or wherever that we could. It is a natural progression within a group.

550 So at the time – and again, as part of our submission – Kaupthing group was in a change situation, where it was changing its ratio of retail deposits to loans, moving it to a greater concentration of retail deposits throughout the whole group, moving it away from wholesale funding. Part of that was the acquisition of the Derbyshire, so it would not have made sense buying a business for the reason that we did, for long-term liquidity, therefore just to allow people to withdraw deposits at will, because of two things: number one, there would be a further cost in replacing that liquidity, because we would have to go out and somehow replace it; secondly, the impact that it would have had on our liquidity locally... Once we had taken all of those deposits onto our books, we had to merge that within our liquidity requirements and our liquidity ratios, as set down by the FSC. So if we had wholesale withdrawal of those fixed deposits, it would have also upset liquidity positions etc.

560 Going back to the acquisition, the acquisition was for long-term liquidity and, from a commercial perspective, would not have made sense to just allow people to withdraw, because the whole purpose of a term deposit is that it stays the life.

565 In all other respects, Mr Chairman, the legal advice that we took at the time of the takeover was that we, as the institution, had to honour all terms and conditions that the Derbyshire had offered customers up to then. So, I think, in fairness, and from a commercial point of view, it was a *quid pro quo* on both sides.

Q264. The Chairman: So you say that people could withdraw their funds, but with penalty.

570 **Mr Doherty:** Absolutely, and that continued all the way up to the moratorium that was introduced on 2nd October.

575 **Q265. The Chairman:** There seems to have been quite a lot of public speculation about this particular issue. Was this cause for complaint at the time, up to, say, the end of September, that people could not get their money out from Derbyshire accounts? Were there many complaints that reflected that?

Mr Doherty: The only complaints that I am aware of would be where people were actually suffering a penalty, but certainly at that stage we were almost 12 months after the takeover of the Derbyshire.

580 Derbyshire clients were not treated, by any manner of means, any differently to any customers that were taken on subsequent to the takeover, or what one might call the old Singer & Friedlander clients. So there was no differentiation made between any class of client.

Q266. The Chairman: But was there a large body of complaints that came in around the takeover time regarding this issue?

585 **Mr Doherty:** Not a large body, no.

The Chairman: Does anyone else want to come in at this point?

590 **Q267. Mr Lowey:** Yes.

But there were certainly some, weren't there? Is this a standard practice, industry-wise? You will appreciate I am a layman. I just go into the bank and put my money in and, hopefully, it will be there when I come back. That is my limit, so I am learning here.

595 Is there, on takeovers, the rights of the people, the clients, to take some sort of... I can understand exactly, as you have explained it, why the bank took it on, why it was to sell other things in a wider base. I understand all that, but what about the clients? Will it surprise you that a former member of the FSC did not realise, in evidence to this Committee, that it had been taken over by KSF?

Mr Doherty: Sorry, a former member... Could you just repeat that?

600 **Mr Lowey:** Yes, a former member of the Financial Supervision Commission has submitted evidence complaining, as a depositor in Derbyshire... was unaware that it was now part of... Does that surprise you?

Now, that is a man who I would have thought would have been *au fait* with the intricacies and the rights of people.

605 **Mr Doherty:** Indeed. It surprises me greatly because, as I say, we wrote to clients on three occasions – November and December 2007 and March 2008 – so if he was a client, I am very, very surprised that he is now suggesting that he was not made aware. Equally, if I might finish, as I also said, there were press releases at the time in the papers here. So, both in local and international ex-pat publications etc, there were also publications, so it does come as a surprise that he is saying he was unaware of it, that the takeover happened.

610 **Q268. Mr Lowey:** Can I come back to the other point I made: were the rules being applied here the same as in any other takeover in any other jurisdiction?

615 **Mr Doherty:** I cannot turn around and say that in any other takeover in any other jurisdiction those rules applied, but I am fairly confident in saying that those rules applied in *most* instances, to my knowledge.

Q269. Mr Lowey: Could you tell me what the size of the penalties, broadly... I know they vary between

bigger depositors and smaller depositors. What was the penalty being imposed on anybody wishing to withdraw their money?

620

Mr Doherty: Without looking at it being account- or product-specific, it generally tended to be between 30 and 90 days of interest.

625

Mr Lowey: I have got that now. Thank you very much.

The Chairman: Mr Houghton?

Mr Houghton: No, not on that.

630

Q270. The Chairman: A few other issues surrounding the Derbyshire... Was the Derbyshire in a healthy financial position when the company acquired it?

Mr Doherty: Was the Derbyshire? Derbyshire (Isle of Man)? (*The Chairman:* Yes.) Yes.

635

Q271. The Chairman: It was; and did the book that you bought perform as expected?

Mr Doherty: By and large, yes.

640

Q272. The Chairman: It was a good buy?

Mr Doherty: We felt it was a good buy.

645

Q273. The Chairman: There was some speculation by the Financial Supervision Commission that it was bought for a rather high price. I was just wondering why you felt there was a need for this, why the premium?

Mr Doherty: I think there are two things: number one, the takeover was undertaken by the holding company, not by the bank, and the –

650

The Chairman: Kaupthing Holdings or –

Mr Doherty: Kaupthing Holdings (Isle of Man). They took over the share ownership of the company and the business itself was transferred into the bank. The funding for the takeover was provided by Reykjavik, by the parent, and therefore the negotiations in terms of price, etc, was between Reykjavik and Derbyshire (UK). We were involved more from a procedural perspective on the banking side because the business was coming in.

655

The attraction to them, in paying whatever price they chose to pay, can be looked at in numerous ways. Number one, the group was already under the publicly announced policy of moving their retail funding from something like 34 per cent to 50 per cent by 2008 and to increase it further. You must also remember that the price paid included the capital and reserves of Derbyshire, and the premium that was paid was viewed as being offset against the cost that it would have taken and the time that it would have taken the Isle of Man operation to actually build up a deposit book of £360 million or £370 million because, again, as you are probably aware, the make-up of the book was diversified, both in terms of age etc, but equally geographically.

660

So to be able to make up that number of customers with those balances would have taken a long time and a lot of cost, through marketing and business development costs, etc. So the premium is looked at over a longer life than just a point in time.

665

Mr Davies: Could I just add there, Mr Chairman, that we were actually buying a book of business: it was not an entire operation, i.e. there was not an IT department etc, because it was a managed bank. So therefore we were not bringing lots of costs in to Kaupthing Singer's, because there were only, I think, three or four staff who came across with the acquisition.

670

The Chairman: Thank you. Anything on that?

675

Q274. Mr Lowey: No.

The only other thing... You did say that the negotiations for the takeover were done by Iceland. Obviously

an input by yourselves?

680 **Mr Doherty:** Input from ourselves from the point of view of due diligence on the book itself, in terms of the type of customer it was: was it inter-bank deposits that were placed with Derbyshire or were they customer retail deposits etc.? So we did due diligence in terms of the type of book it was, that all of the FSC regulations in terms of compliance, anti-money-laundering rules, etc were all complied with. So from the business perspective, we did all the due diligence.

685 **Q275. Mr Lowey:** I am of simple country folk –

Mr Gelling: And you are asking, Mr Lowey, who made the decision.

690 **Mr Lowey:** Absolutely. Who was the driving force for expansion? I presume the local bank knows the local community and they would advise central office, i.e. Reykjavik. You have a holding company as a third element here, and I presume that holding company are yourselves.

695 **Mr Doherty:** That is correct. And you are also correct in your assumption that, yes, we are aware of our marketplace and what is happening here, and the Derbyshire came up for sale. We did not actually make a direct approach to Derbyshire. It came up for sale.

Q276. Mr Lowey: It was on offer.

700 **Mr Doherty:** It was on offer and we were not the only people that were interested in it so, consequently, going back to, Mr Chairman, your question, there were other bidders there, as well as us.

Q277. The Chairman: Thank you very much.

705 I would like to move us on now at this point to the decisions that were made around about May and June of 2008, but in build up to that, in the first quarter of 2008 there was a weakening of the Icelandic economy at this time. During the first quarter of 2008 the currency fell by just short of 30 per cent. How much monitoring was being done by the local directors into the general economic state of Iceland?

Mr Doherty: Not an awful lot, in terms of the economic state of Iceland. That was fairly much publicised and well publicised in the media.

710 I think what you must equally be aware of is that, at the time, the Kaupthing group... most of their income and most of the revenues were actually non-Icelandic generated. In actual fact, I think – and I stand to be corrected – the figure for group-wide income was approximately 70 per cent non-Icelandic.

715 So the Isle of Man operation did not actually have an exposure to the local domestic economy, and therefore we did not concern ourselves with the local economy. Most of the Kaupthing group non-Icelandic was based in Scandinavian countries, Luxembourg, the UK and here.

Q278. The Chairman: So you did not have great concerns about country risk, as far as Iceland was concerned?

720 **Mr Doherty:** Not at that point in time, because our concentration and our concerns were group and whether there was an issue with group. Therefore, that is how we managed the position.

Q279. The Chairman: Did the directors monitor information such as the credit default swap price for Kaupthing?

725 **Mr Doherty:** Again, not in detail or on a daily basis. We were fully aware of the volatility of the credit default swaps; however, during those times, Kaupthing was not in the wholesale market issuing papers, as it is called, to get funding. Its concentration was on the retail markets through its Luxembourg office, the UK and the Isle of Man principally. So the credit default swaps related mainly to the costs of insurance of people who would actually be investing in the company as direct investors, by buying corporate bonds from the company; 730 but the company was not issuing those at that time. They did some private placements, but they did not do public placements.

Q280. The Chairman: Did the company maintain a risk register?

735 **Mr Doherty:** How do you mean a risk register?

The Chairman: In terms of a formal document that identifies the risks to the business, the potential risks to the business and how it would cope with those?

740 **Mr Doherty:** Yes, we have a market risk paper on how we deal with liquidity, credit risk etc. There are quite a few volumes!

The Chairman: I can imagine.

745 **Mr Doherty:** Because it covers both market risk, liquidity, FSC ratios etc and our own internal credit risk process when going and doing lending, as I mentioned earlier.

Q281. The Chairman: At that time, what were the items on that risk register that related to your relationship with the parent?

750

Mr Doherty: The relationship with the parent was a single relationship as a subsidiary, and the business model was designed to pass the deposits up to the parent. So the information that was passing down from group to us, in terms of statutory accounts, monthly accounts, etc, was what we monitored.

755 **Q282. The Chairman:** So what information were you getting from group?

Mr Doherty: If I could refer you to the monthly... well, first of all, the statutory accounts that were published at the end of 2007 and June 2008. We had also, obviously, the accounts from Singer & Friedlander Ltd, and group also produced monthly reports which we gave you a sample of, which were quite detailed reports on appendix 31, all the way through to September 2008.

760

Q283. The Chairman: Just while you are looking up what was in those, the reason I ask, of course, is because the evidence that you have presented to us is not in the public arena, whereas this session is at the moment, and that is the reason that I –

765

Mr Doherty: I appreciate that.

So there was a wide variety of information that was made available to us but, equally, we did not have the right to go to the parent and start demanding to carry out analysis of their own books.

770 **Q284. The Chairman:** But your exposure to the parent must have been something on your risk register and the ability of the parent to get funds to you must have been an item that was considered as part of your risk-management process.

775 **Mr Doherty:** Yes, but any time that we ever... and all the way through 2008, any time there was ever a call on any of our deposits in Reykjavik, there were never any liquidity problems or anything, so none of those issues gave concern during that period.

Q285. The Chairman: That is fine, and you are talking about your experience, but I am just talking about the risk-management process – was that something that was considered and planned for?

780

Mr Doherty: Yes, in all of the internal reports there was an outline – and indeed in our reporting to the FSC there was an outline – of where all of our risk was, be it private risk, corporate risk, whether it was London, i.e. UK risk, whether it was Icelandic risk etc.

785 **Q286. The Chairman:** Thank you.

Can we, then, move on to... Unless you have anything else on risk management, I would like to just move on to the funds that you placed with the UK and the movement of them.

To what extent were the funds that you placed... We are talking about two tranches here: one of £185 million and one of £175 million. If I can take the £185 million first, to what extent was that secured?

790

Mr Doherty: By an equity purchase agreement.

Q287. The Chairman: And that was ultimately secured in London?

795 **Mr Doherty:** The way an equity purchase agreement works... It is obviously subject to stringent
documentation and the documentation that was in place was international standard GMRA agreements –
Global Master Repurchase Agreements – the standard international documentation for derivatives. What
800 happens is, in a case like that, where somebody agrees to lend, they agree to lend on the basis that that loan is
repaid at the end of the month. In our case, originally it tended to be rolled on a weekly basis. It then stretched
to one month towards the back end.

Q288. The Chairman: Which loan are you talking about?

805 **Mr Doherty:** The £185 million.

Q289. The Chairman: But which end of it?

810 **Mr Doherty:** That was backed by the repurchase agreement and what happens is that security is placed in
our account during that period. So the security –

815 **Q290. The Chairman:** There are, in fact, two elements to this, aren't there? You have got the £185
million that you have borrowed from Iceland and that you have. I know it did not actually come through
Kaupthing (Isle of Man), but it ended up in London, then, because you then lent it on to London and that
money, that £185 million, was secured by an asset –

Mr Doherty: Correct.

Q291. The Chairman: – and that asset was what?

820 **Mr Doherty:** There were various assets.

Q292. The Chairman: Right, can you give us a –

825 **Mr Doherty:** Well, some of them are already published on the Liquidator's report, others are subject to
legal confidentiality at the moment, so I would respectfully request that maybe that question on
confidentiality and what some of the other assets were is for the Liquidator. I may be –

Q293. The Chairman: Can you just give us an outline of what you cannot tell us, please?

830 **Mr Doherty:** Are you looking for the names of them or are you looking for the type?

Q294. The Chairman: No, I am looking for what was that £185 million put into in the UK, that was
secured in your name.

835 **Mr Doherty:** The security were equities, so there is a basket of equities – I beg your pardon, I
misunderstood your question – there was a basket of equities pledged as security against that £185 million.
The nominal value of that started out, it was approximately, from memory, about £210 million and because of
the volatility on the last couple of days towards 8th October, on a revaluation basis, it was about £195 million.

840 **Q295. The Chairman:** That difference between the £185 million that was the underlying amount and the
additional amount, that is the 'haircut' that was referred to by Mr Aspden?

Mr Doherty: Correct.

845 **Q296. The Chairman:** I am just making it clear so that everybody has this straight because, obviously,
equities can fluctuate in value on a daily basis.

Mr Doherty: I think you should also be aware that it was revalued on a daily basis so any fluctuation was
taken care of on a daily basis between here and London.

850

Q297. The Chairman: But that basket of equities was in high-quality equities?

Mr Doherty: I am not going to say that they were treble A-rated equities.

855

Q298. The Chairman: Can I say, were they FTSE 250- or FTSE 100-rated equities?

Mr Doherty: Some of them were inside and some of them were outside that band.

860

Q299. The Chairman: Are you able to give us a rough idea of how much was FTSE 250 and how much was other?

Mr Doherty: Not at this point in time. I would have to pass that information to you because I just need to refer to the records.

865

Q300. The Chairman: You were happy, though, that the full amount was fully secured in your name with London, the full value of the total basket of securities, the £195 million?

Mr Doherty: Absolutely, in our account.

870

Q301. The Chairman: In your account. So they were fully ring-fenced and they were in your account. The nature of the security, they were the GMRA agreements. I do not think we have seen those: I think we may need to go and get those from the Liquidator, though, that is correct?

Mr Doherty: Yes.

875

The Chairman: Right. Does anyone else want to come in at this point on the –

Q302. Mr Lowey: Yes. It is easy here, sitting with hindsight.

880

I tried to put myself in that position, it was 1978, but the world was in quite turbulent times. Even Eddie Lowey was aware that things were overheating in the Icelandic banks, for most of the year, going back to, if I can say, the spring, late spring if you like, May –

Mr Houghton: 2008!

885

Mr Lowey: – 2008. I want to ask the bank – and perhaps I am jumping this, Chairman, correct me if I... You will pull me up if I am wrong. After discussion with the FSC, it was agreed that we should not have the parent Icelandic money and that is the money that the Chairman referred to earlier in his address to us.

890

As a layman, I cannot understand why taking it from the mother company, that is Iceland – forgive me if I am shorthanding but I am sure you understand exactly where I come from – taking it from the mother bank in Iceland and placing it with the sister bank in London of the same name was any risk sharing. Did the directors not think it would have been advisable to have it in independent banks in other institutions as a safeguard, bearing in mind – this is not hindsight, this is the world that we were inhabiting at that time of turmoil and flux – why did you put it with the sister bank and not with what I would call, independent financial institutions?

895

Mr Doherty: If I may, you have raised a number of issues there, both in terms of transferring money to the UK, or having money with the UK operation, that is, or independent liquidity.

900

If I may refer you, in the first instance again, to the submission. We had a substantial amount of assets that were non-Kaupthing: they were not exposed to the Kaupthing group at all. Of the assets, there was £161 million which was actually placed with independent banks. There was approximately £416 million that was lent on a secured basis to individuals, as I mentioned earlier on in our loan book. Of that, approximately 98 per cent of it was secured on residential property. Of the money that we had with the UK, which was approximately – and this is a round number – approximately £530 million at the time of 8th October, that represented 40 per cent of our total assets.

905

In the Foot Report that was recently published, the average assets that banks here have up-streamed to group is actually around 70 per cent. So, looking at it from a prudency perspective, we had our assets, independent liquidity, some to the UK operation and others on the loan book, but if I may, I think it is also

worthwhile noting for the record here that, of the money that was with the UK, £185 million of it was already secured through the equity repurchase agreement which equated to 21 per cent of customer deposits, okay? Of the remainder that was with the UK, which was on a straightforward inter-bank basis through the methodology of up-streaming, which all offshore banks are mainly about, that equates to 39 per cent.

So we had a group exposure of only 39 per cent that was unsecured, when compared to the industry average, as affirmed by the Foot Report, of 70 per cent.

So I think it is fair to say that, yes, we were – well I do not think, I *know* – it is very fair to say that we were fully aware of the turmoil that was in the world markets, the questions about Iceland, Icelandic bank risk etc. but, in terms of our exposure, the remaining exposure to the UK was very much below industry standard.

Why were we comfortable with that in any event, you might ask, and I think it was part of your question? We did enquire and, again, it is part of our evidence, as to what would happen in terms of exposure that the UK might have with Iceland. There is no point in us taking money back, giving it to the UK and then it goes straight back up again.

When we were dealing with the FSC, we queried KSF (UK) exactly what sort of ratios and rules they were under by the FSA. The FSA confirmed to us, and again it is in evidence and I will not go through the numbers, but the numbers were very small in terms of permitted risk that the UK operation could have with any part of the group, and that included parent, under what is called connected lending exposures.

So having got that corroboration from the UK, the FSC then independently spoke to the FSA and got the same information from them. So not only were we getting comfort from a sister company, which I think, in all reality, taking comfort and taking information on face value from a sister company or a group company is not untoward, I do not believe, but the FSC here in their dialogue with the FSA got the same type of comfort.

So my answer to your question is, why were we happy in lending to the UK? It was because we were comfortable that they had the liquidity that was consistently and, again, I refer you to the report, we were consistently getting messages all the way through to 7th October that the UK had sufficient liquidity to honour all of its obligations. We were getting confirmation from Kaupthing group that they were still in observance of all of their liquidity ratios and that they had long-term liquidity cover etc. etc.

So, all things considered, we were given enough comfort that the 39 per cent of customer deposits that was exposed to the UK would be repaid in the event that we called for repayment of any of our deposits with them.

Q303. The Chairman: Can I just clarify: did the connected lending limits you are talking about, now I have got a figure in my mind for between £147 million and £160 million, does that sound familiar to you?

Mr Doherty: That is correct. Sorry it is a long-winded way about answering your question, but there were a couple of points that you made.

Q304. Mr Lowey: No, not at all. It is interesting but it is easy with hindsight.

I am in the scenario as it was then. I then have to say to myself, if I was sitting as a banker and I was saying, ‘Well hang on, I’ve taken it from the parent company, now then it’s a lower albeit...’ you know. It is a substantial sum of money, however we dress that up. I mean, for laymen, it is just so many noughts at the end of a piece of paper. Big, large sums of money!

Can you say, had you ever placed that sort of money up-stream to the sister bank before or was that abnormally high?

Mr Doherty: That was not in any way abnormally high.

If you look at the... We collectively tried during our submission to give you a history of the operation here back to inception and all spare cash flow outside of that which we lent to private individuals used to go back to parent. Then, some years ago, the FSC changed their policy, where we had an independent liquidity requirement to fulfil, but outside of that, in proportion to the book, this was not in any way abnormal.

Mr Lowey: That is fine.

Mr Doherty: In fact, up till then, up till we went into the repurchase agreement which was secured, all placements back to group, and I think I say that for most of the up-streaming that other banks do here and internationally, are actually unsecured. So the profile was slightly different, come 8th October, in that some of it was secured.

Q305. The Chairman: With regard to the repo agreement, then, were you happy with the repo agreement

at the time?

Mr Doherty: In what regard?

970 **Q306. The Chairman:** Well, let me put it this way, looking back at it, is there anything that you wish you had done differently?

975 *Mr Doherty:* I think hindsight is a marvellous thing. In terms of the repo itself, the repo was a condition that was set down by the FSC and we complied with it.

Q307. The Chairman: But in terms of the structure of the document and the security that it gave you, you were content with that and if you were doing another one for another bank a few years from now, you would be doing it exactly the same way?

980 *Mr Doherty:* The GMRA is an internationally accepted document that is used by all banks who trade derivatives, so we were relying on an internationally accepted document so, yes, we would contract the same way.

985 **Q308. The Chairman:** Okay, and in terms of the recoverability of that repo, what is your opinion of that, do you think you will get the full £195 million back?

990 *Mr Doherty:* I think it is public knowledge, both in terms of the Statement of Affairs that we, as a board of directors, supplied to the courts that there is a question over the recoverability of some of it. That has been put in the public domain by the Liquidator because part of the securities that were backing the repo were removed without the Isle of Man's knowledge or approval and that is currently subject to legal challenge.

Q309. The Chairman: Okay. So, in terms of your estimate of recoverability in terms of pence in the pound, would you be able to give us an estimate?

995 *Mr Doherty:* In our Statement of Affairs I believe we put, I think, about 140.

The Chairman: Right, okay. Thank you very much.

1000 *Mr Doherty:* But that, again, is subject to the liquidators and the lawyers in dispute with the UK. That is not an issue that the directors had any control over. That was removed and I just want it on the record because there is a bit of a discrepancy between the two figures. They were assets that were removed out of our account.

1005 Going back to your question earlier: how was the security put forward? It was put into our account in escrow through a custody agent in London, part of the group: they removed that without our knowledge, without our agreement. I just want that on record.

Q310. Mr Lowey: Is that not an insurance job?

1010 *Mr Doherty:* Pardon?

Mr Lowey: Does the industry not have insurance for –

1015 *Mr Doherty:* Well, I think the first part of it is, it has to go through the legal process. I am not part of that, that is the liquidators and their lawyers dealing with Ernst & Young because we only became aware of it after 8th October –

Mr Gelling: After the event.

1020 **Q311. Mr Houghton:** When did that happen?

Mr Doherty: To my understanding, it was around 6th and 7th October.

Q312. Mr Houghton: Right, just before the death.

1025 *Mr Doherty:* Literally days before the event and it was only at the end of that week, when we actually went back and got a confirmation of our portfolio that we became aware that those assets had been removed.

Q313. Mr Houghton: Are those in your submission? Have you enclosed details of that?

1030 *Mr Doherty:* No, because of the nature of the litigation that is going on between the provisional Liquidator – PW’s and Ernst & Young –

Q314. Mr Houghton: And when did that take place?

1035 *Mr Doherty:* That is ongoing.

Q315. Mr Houghton: But when did it begin?

1040 *Mr Doherty:* As soon as they became aware, they appointed... So that will have been going on since October.

Q316. Mr Houghton: Do you not think we should have been made aware, just vaguely aware? It is a very serious issue, this.

1045 *Mr Doherty:* It is a very serious issue but it is actually included in the Statement of Affairs that we published to the court.

Q317. Mr Houghton: To the court, but not to us?

1050 *Mr Doherty:* Not to here, but we have already put it in the public domain.

Q318. Mr Houghton: So why was it not included in the information here, because I was not aware of that?

1055 *Mr Doherty:* Well, my apologies for not making you aware of it, but it is already a public domain issue. The Liquidator has already published it.

Q319. The Chairman: Who initiated the whole repo process? Who kicked the ball off with regard to even floating the idea of wanting this arrangement?

1060 *Mr Doherty:* Well, if you revert back to when the FSC wanted us to remove assets from Iceland –

Q320. Mr Lowey: That was March some time, was it not?

1065 *Mr Doherty:* That is when it commenced, you are correct. The whole point of an Isle of Man operation is having unfettered liquidity passing from a subsidiary up to its parent or its sister company. On removing the risk from Kaupthing Bank hf, the group still wanted to retain the liquidity. We were in unprecedented times. Banks, let alone lending to private individuals, they were not lending to each other, so Kaupthing wanted to retain its own liquidity.

1070 In order to retain that liquidity, the FSC insisted that, in some shape or fashion, it be ring-fenced, secured, whatever terminology you want to use, and during the period of March up to the beginning of April, we discussed throughout the group, between UK and with Reykjavik, ways that the Isle of Man’s provisional liquidity would still be beneficial to the group, whilst at the same time adhering to the desires of the FSC which, ultimately, would have culminated in a direction from the FSC to do something. That, again, is part of our submission.

1075

Q321. The Chairman: So this was the FSC’s idea?

1080 *Mr Doherty:* No. The idea was the FSC’s to have it secured and what I am saying is that we then discussed within group – and, let us be clear – with Reykjavik and with the UK, as to how we may best achieve that and, achieving that, we recommended to the FSC, as part of the correspondence that you already

have, that one of the things that we will do, amongst the other things that they wanted us to do, was the £185 million would be secured in this form.

1085 That was then agreed and we liaised with them right up until the basket of equities was put in place and we copied the FSC with all of that at the time. So it was caused – if I use the word very loosely – it was caused by the FSC, in that they wanted something secured. We came up with various ideas, one of which was the repo, which they approved.

1090 **Q322. The Chairman:** And you were under pressure from the group to ensure that was all held internally or with London?

Mr Doherty: The liquidity or the security?

1095 **Q323. The Chairman:** The security.

Mr Doherty: The security was part and parcel of the way the group managed repo agreements, and because we were a sister company, the bank here on the Isle of Man did not have... we did not do any proprietary trading or anything like that. So we ourselves did not have any security accounts, therefore we used group to hold the assets in an account in our name.

1100 **Q324. The Chairman:** And that liquidity was better in London than it was anywhere else?

1105 *Mr Doherty:* Well, the liquidity was... We were being forced to take the liquidity away from Reykjavik so at least transferring it into the UK kept the liquidity within group so it was utilised by the Treasury operation in the UK, rather than the Treasury operation in Reykjavik.

Q325. The Chairman: So it was a group decision that it would go into London rather than to Berlin or any other centres that Kaupthing was offering –

1110 *Mr Doherty:* Yes.

Q326. Mr Lowey: Mr Chairman, if I may say so, it was like a sword of Damocles, was it not?

1115 If I remember, from reading the minutes of the FSC, it was either you come up with an idea or we would give you a direction. So you were working under that scenario and, between Reykjavik, London and yourselves, you decided this was something that met all the requirements.

1120 *Mr Doherty:* Absolutely, because we were caught in the middle, in that we, as a business model, were providing a service, if you want to call it that, i.e. liquidity, into the group. The FSC then wanted that business model partly changed and, with dialogue with Reykjavik and with London, we subsequently made a proposal to the FSC which met their requirements and met ours.

Q327. Mr Houghton: Mr Doherty, in the period 19th March to 2nd May 2008, did you understand the FSC's concerns to be about the liquidity position of KSF (Isle of Man) or about its solvency, or both?

1125 *Mr Doherty:* I am not aware that they had any concerns of solvency of the Isle of Man, none whatsoever, at the time.

Q328. Mr Houghton: So it was only about liquidity.

1130 *Mr Doherty:* It was only about liquidity.

Q329. Mr Houghton: Okay, thank you.

1135 In reference to the FSC letter of 28th March 2008, which is in appendix 5, if you want to review it, it talks about 'immediate steps being taken to reduce your exposure to the parent bank'. It goes on to say – and I quote –

'We would stress that covering off the inter-group exposure, at least on a temporary basis, is the immediate priority'

and, of course, later it states,

1140

'We envisage questions that inter-group exposure should not increase as a back stop.'

1145 So my question is, in the period 19th March to 2nd May, were the Financial Supervision Commission's concerns about the risk posed to KSF (Isle of Man) by the parent bank, Kaupthing Bank hf, or by the Kaupthing group or both?

Mr Doherty: Sorry, could I ask you to –

1150

Mr Houghton: Do you want me to read it to you –

Mr Doherty: Would you mind, please.

1155

Mr Houghton: With pleasure. In the period 19th March to 2nd May 2008, were the FSC's concerns about the risk posed to you – KSF (Isle of Man) – by the parent bank, Kaupthing Bank hf, or by Kaupthing group or both?

1160

Mr Doherty: In the correspondence you will see that the concern we were led to believe was with the Kaupthing parent, not with the group and I think you will see in all the correspondence that I have provided for you that the emphasis, as far as we were concerned from the FSC, was to remove risk from *parent* and *not* from the group.

Q330. Mr Houghton: On 24th April 2008, the board of the FSC resolved,

1165

'In view of the earlier discussion on liquidity, the Commission agreed that the executive should discuss arrangements with the licence-holder to cover group indebtedness to Isle of Man by 100 per cent by independent assets. This will be reviewed after six months.'

Then, on 2nd May 2008 the board of the FSC resolved,

1170

'The Commission unanimously resolved to retain its requirement that the licence-holder should remove all of the group's indebtedness to the Isle of Man by appropriate means.'

1175

Were these decisions of the FSC, that there would be no group exposure, as opposed to Icelandic exposure, conveyed to you by the executive, that is the Board?

Mr Doherty: No.

1180

Q331. Mr Houghton: No. And if the group exposure had been eliminated, would KSF (Isle of Man) have become insolvent?

Mr Doherty: If we removed the exposure at that time, we would probably have been under directive to put it with a third party bank or whatever so, no, it would not have caused insolvency because, at no stage – other than because of the administration in the UK – was the Isle of Man operation insolvent.

1185

Q332. Mr Houghton: Can I ask, Mr Doherty, when did you become concerned about the risk of insolvency within the group? What did you do about the concerns and where were they recorded?

The Chairman: You are talking, then, about October because I would like to come onto the end of things.

1190

Mr Houghton: Yes, it is just a general risk about the insolvency situation.

Mr Doherty: No, that is fine: on Wednesday 8th October.

1195

Q333. Mr Houghton: And no sooner than that?

Mr Doherty: No sooner than that.

Q334. Mr Houghton: Thank you.

1200 Mr Doherty, can you confirm that the arrangements ultimately put in place by 19th June 2008, as a result of the Commission's decision of 22nd May, were as follows – it is just to confirm these matters – put in order: KSF (Isle of Man)'s exposure to Kaupthing Bank hf was capped at £185 million, payable on demand, and that this exposure was matched by a loan from Kaupthing Bank hf of £185 million, payable on two months' notice? Can you confirm that?

1205 *Mr Doherty:* Can you just – I am struggling with that, a bit.

Mr Houghton: KSF's exposure to Kaupthing Bank hf was capped at £185 million, payable on demand, and that this exposure was matched by a loan from Kaupthing Bank hf of £185 million, payable on two months' notice. Can you confirm that?

1210 *Mr Doherty:* We had a borrowing from Reykjavik for £185 million that was repayable on two months' notice. The £185 million, which is the repo that we talked about earlier, originally, at that time, was actually rolling over on a weekly basis. It was not on demand, it was rolling on a weekly basis.

1215 **Q335. Mr Houghton:** Okay, so you can confirm that, thank you.
KSF (Isle of Man) placed the £185 million received from Kaupthing Bank hf with KSF London, secured by an Equity Purchase Agreement, known as a repo, as we have already stated – I am sorry if I am going back over some of this –

1220 *Mr Doherty:* No, no, no, I am jotting down the question. It is a long question and I just want to –

Mr Houghton: It is coming from a different angle. I will read it again, without... KSF (Isle of Man) placed the £185 received from Kaupthing Bank hf with KSF London, secured by an Equity Purchase Agreement, repurchase agreement, known as a repo, ultimately with a 20 per cent haircut. Can this be confirmed?

1225 *Mr Doherty:* Yes.

Q336. Mr Houghton: The benefit of the haircut on the equity repo was compromised by a netting arrangement between KSF (Isle of Man) and KSF London. Can you confirm that?

Mr Doherty: I do not know why it was compromised. I am sorry, I do not believe it to be compromised. The haircut was the haircut under FSA regulations.

1235 **Q337. Mr Lowey:** Was the percentage right, 20 per cent, or five per cent?

Mr Doherty: What happened at the –

1240 *Mr Houghton:* It was a 20 per cent haircut.

Mr Doherty: Yes, it was 20 per cent.

1245 So, let me clarify that. In general, there was a 20 per cent haircut but, under regulations, if there was cash in a repurchase agreement it was zero per cent weighting. If it was a certain type of equity, it could have been 10 per cent or 15 per cent. So, I think it is probably fair to say, without having records here, it was up to 20 per cent, but the five per cent, which it was across the board, originally, was amended by the FSC.

Q338. The Chairman: You are talking about risk-weighted assets there, though, are you not?

1250 *Mr Doherty:* No, I am talking about the haircut.

Q339. The Chairman: Okay, the margin on that, the haircut on that, does appear to have dropped from 20 per cent to five per cent. I am just not quite clear why.

1255 *Mr Doherty:* When?

The Chairman: Between the FSA's initial direction and by the end of it, by 8th October.

1260 **Mr Doherty:** Yes, but if – I am just looking for a part of our report to you because, following the meeting – in our meeting following the 30th April, the FSC subsequently wrote to us, removing that five per cent treatment and amending it such that the treatment would be in accordance with FSA regulations which, as I say, could have been as high as 20 per cent.

So after the five per cent, the reduction to five per cent, they subsequently changed it in their letter of 7th May, where they confirm that:

1265 ‘While the portfolio subsequently allocated was outside of this definition...’

– which was the FTSE definition –

1270 ‘... the board resolved that a haircut should be applied using the Financial Services Authority’s approach in determining the amount of margin required.’

1275 So it did go down for a short time to 5 per cent, in agreement with the FSC, but they subsequently amended that, such that everything was margined according with the FSA and, as I say, as a consequence of that, some of the securities were margined back up again, as high as 20 per cent.

Q340. The Chairman: Was the reduction to 5 per cent at the directors’ insistence?

Mr Doherty: I beg your pardon?

1280 **The Chairman:** Was the reduction of the margin to 5 per cent on your insistence as directors?

1285 **Mr Doherty:** No, we requested it. We requested it simply because... Again, I do not want to get too bogged down here on technical issues, but because of the margin that London would have to place with us, they accounted for that excess margin as an exposure to the Isle of Man, i.e. an exposure to a connected company. Therefore, under connected lending, it was a serious amount of money that they were having to put aside and was, in effect, dead money – they could not do anything with it. They made representations to us to see could we speak with the FSC to have that reduced. They did at the time – they reduced it to 5 per cent – but, subsequently, in the May letter that I have referred to, they altered the situation again, and it had to be margined in accordance with FSA regulations. That is appendix 16. It is their letter of 7th May.

1290 **The Chairman:** Mr Houghton.

Q341. Mr Houghton: Mr Doherty, is all that correspondence in that...

1295 **Mr Doherty:** It is, yes.

Q342. Mr Houghton: It is all in?

1300 **Mr Doherty:** It is all here.

Mr Houghton: I know we have got a lot, and I thank you for that.

Mr Doherty: I am sorry. I had difficulty in locating it because there is so much we gave you.

1305 **Mr Houghton:** Not at all. It is just for clarification. That is all I am asking for.

Mr Doherty: That is fine.

1310 **Q343. Mr Houghton:** If I can move on, 10 per cent of KSF (Isle of Man)’s deposits were kept with third parties in the Isle of Man. Would you concur with that?

Mr Doherty: We had in excess of that. We had approximately 15 per cent of what is called ‘independent liquidity’.

1315 **Q344. Mr Houghton:** Finally, on this particular section, the balance of KSF (Isle of Man)’s deposits were

lent unsecured to KSF (London) on an unsecured roll-over basis up to one month, and subject to certain confirmations from the United Kingdom's Financial Services Authority. You have alluded to that a little earlier.

1320 **Mr Doherty:** No, I think there are two separate issues there.

As I have mentioned to you before, upstreaming is where group companies lend to their sister companies. They are lent on what is called a straightforward simple inter-bank basis, and that is on an unsecured basis. The clarification that you refer to, in terms of the FSA, actually related to a discussion we had earlier in terms of the repo and connected lending exposures up to Reykjavik. So, two separate issues.

1325

Q345. The Chairman: But, if I could just stay on the repo a second, there appeared to be... Could we just discuss, firstly, what other options were you considering, instead of the repo, at the time?

1330 **Mr Doherty:** The other options... Again, it is in one of the board papers which I think you have.

We looked at options of removing the risk altogether out of group, securing it and... I cannot remember what the third option was without referring to the board paper.

1335 **Mr Davies:** I think, Mr Chairman, it was actually, potentially, increasing our external lending, our private property lending etc.

1335

Mr Doherty: So, we would be utilising... in terms of loans to private customers rather than inter-group.

1340 **Q346. The Chairman:** But you would be under pressure from the group, given the business model, to put that money to group rather than third parties.

1340

Mr Doherty: Again, it clearly demonstrates that we were under pressure from the FSC to do something. Equally, we were under pressure to maintain the business model here, taking account of what was good for the company etc – and we went back to the FSC with a suggestion which satisfied their requirement.

1345 **Q347. The Chairman:** The board did not particularly want the repo – it did interfere with the business model and created a burden, if you like, on the overall group – but, in hindsight, do you think that the FSC made the right call?

1350 **Mr Doherty:** Specifically in the repo?

The Chairman: In allowing it to happen, in making this insistence?

1355 **Mr Doherty:** I think the repo speaks for itself, in that it is secured outside of the legal issues that are going on at the moment. So in respect of the repo, was it a right call? Yes, it was, because the £185 million was secured.

The Chairman: Thank you.
Mr Lowey.

1360 **Q348. Mr Lowey:** I have got here your memo from Aidan Doherty to Michael Weldon – I presume that is the FSC officer you were dealing with?

Mr Doherty: Yes, it is.

1365 **Q349. Mr Lowey:** It is dated 11th April, and it is the second paragraph, which says:

'Following further discussion with you, and at your direction, it has been agreed that the repurchase agreement be renewed for a further week with a revised haircut of 5 per cent.'

1370 **Mr Doherty:** Yes.

Q350. Mr Lowey: That fits in exactly with what you have said, that it was on a reviewable basis, but it is the words 'at your direction' that I find strange, when you say that you were told that you had to do something and here you are saying, in your memo to the FSC, 'you are directing us to do this.' Or was that just directing

1375 us to do *something*?

Mr Doherty: To do something, in that, right up until then, without a formal written directive from the Commission, they had already given us instruction –

1380 **Q351. Mr Lowey:** Yes, verbal.

Mr Doherty: – so it is a verbal direction that we need to do something, and that was to remove risk from the parent. Again, that 5 per cent is the 5 per cent we talked about earlier, where we looked for it to be reduced.

1385 **Q352. Mr Lowey:** It confirms things were –

Mr Doherty: The direction related to the removal of risk from the parent.

1390 **Q353. The Chairman:** With regard to the repo, who undertook negotiations on behalf of the bank and the FSC on this subject?

Mr Doherty: Officially, you will see the correspondence is largely between John Aspden and myself.

1395 In terms of the repo and how we came to make the final proposal to the FSC, that was done internally here and also involving discussions with KSF (UK) and Reykjavik.

Q354. The Chairman: But was the whole board party to the final agreement?

1400 **Mr Doherty:** They were all kept advised, and you will see that there is actually a paper that was sent around to all parties, including Reykjavik and the UK, that we had agreed in principle with the FSC.

Q355. The Chairman: So the ultimate agreement was signed off in accordance with the four-eyes principle?

1405 **Mr Doherty:** Well, the four-eyes were Andrew and myself.

Mr Davies: Mr Chairman, I was present at these discussion, as well, with the FSC.

1410 **Q356. The Chairman:** Doesn't one of the four need to be a non executive?

Mr Doherty: Absolutely not. The four-eyes of the FSC... It is in their regulations, which do not actually state that a non-executive director has to be a four-eyes.

1415 **The Chairman:** Just happy to clear that up for the moment.

Mr Doherty: No problem.

1420 **Q357. The Chairman:** In terms of the security that you got, with regard to the £160 million that was placed unsecured with London –

Mr Doherty: £175 million.

1425 **The Chairman:** £175 million, sorry. What did you have in terms of that? Was that just money placed in an account, unsecured, no guarantees or specific guarantees relating to that money?

Mr Doherty: No, as I have mentioned to Mr Lowey, it was a straightforward inter-bank placement with KSF (UK) and was tendered at the early part to be rolled on a weekly basis.

1430 **The Chairman:** Right.

Mr Doherty: It was a money-market loan to London.

Q358. The Chairman: Was that then covered by the parental guarantee?

1435 **Mr Doherty:** No, the parental guarantee involved the parent guaranteeing that it would cover any shortfall of liabilities for the Isle of Man, so placing money with KSF (UK) was directly with them and not with the parent. The parent was a separate undertaking.

1440 **Q359. The Chairman:** But that £175 million could not then be upstreamed twice because of the large exposure limits?

Mr Doherty: Correct.

1445 **Q360. The Chairman:** And, as far as you know, that did not happen either?

Mr Doherty: Not to my knowledge, and those rules, again for the record, were independently confirmed by the FSA to the FSC during all of this.

1450 **Q361. The Chairman:** So by the time this whole process had stabilised – so by, say, June or July, 2008 – what did you consider your exposure to Iceland to be?

1455 **Mr Doherty:** Nil on a net basis. The reason for that is when the money – the £185 million – was borrowed and then placed into the UK, to ensure that the Isle of Man had no net exposure to Reykjavik, we – i.e. the Isle of Man – undertook that the loan documentation included specific right of set-off – not just your normal banker's right of set-off, but specific right of set off – so that, in the event that anything happened, the borrowing and the deposit that we still had with Reykjavik were, on a net basis, zero. So there was no net exposure, both in balance-sheet terms and contractually.

1460 **The Chairman:** Could I move on, then, to the nature of the guarantee that you had with your parent. Does anyone else have any questions about the repo or the unsecured money at this stage?

Mr Lowey: Not at this stage.

1465 **Mr Houghton:** Not at this stage.

Q362. The Chairman: We have seen the corporate structure of the group and we have discussed that earlier. Does the guarantee, then, bypass Kaupthing Holdings, that parental guarantee? It was straight between Kaupthing Bank hf and Kaupthing (Isle of Man)? It did not go through the legal structure of the group?

1470 **Mr Doherty:** Again, I do refer you to page 13 of our submission, 'Guarantees to discharge the liabilities of its subsidiary, Kaupthing Singer & Friedlander (Isle of Man) Ltd.'

Q363. The Chairman: Specific to that?

1475 **Mr Doherty:** Straight through to the bank.

Q364. The Chairman: The other companies within the group continued to operate, as well.

1480 **Mr Doherty:** Sorry, are we talking about other Isle of Man companies or external –

The Chairman: The Isle of Man companies under Kaupthing Holdings Ltd. Can you just outline what has happened with those as well, please?

1485 **Mr Doherty:** Under the holding company, you have the bank. You have a sister company called Singer & Friedlander Investment Management (Isle of Man) Ltd, which was an investment management company, and most of the business of that has been transferred to Thomas Miller here on the Island. There was another sister company, which is a trust company – Singer & Friedlander Trust Company – which, since 2004 or so, has been in wind-down, anyway. We pulled out of the trust business and that is still there, but will very shortly go into liquidation. And we had what is called Knockdara Ltd. Knockdara is the shell, I guess you could call it, for what was the Derbyshire.

1490

Q365. The Chairman: So where did the funds from the sale of Singer & Friedlander (Isle of Man) Investments go? The sale to Thomas Miller, where did the funds from that go?

1495 **Mr Doherty:** In my understanding, there was a very small amount and it is still within the company.

The Chairman: It is...?

1500 **Mr Doherty:** It is still within Singer & Friedlander Investment Management, because that company still exists and it is still solvent itself.

Q366. The Chairman: And it is beneficially owned by Holdings?

1505 **Mr Doherty:** Yes, correct.

Q367. Mr Lowey: And the directors are the same directors?

Mr Doherty: No.

1510 **Mr Gelling:** No, Mr Doherty is not a director of SFIM, and neither is Mr Davies. It is only John and myself, because we are the only ones left of SFIM, but that is still –

Mr Doherty: Neither Andrew nor I were ever directors of SFIM at any stage, just for the record.

1515 **Mr Gelling:** And there is a role for accounts that are still outstanding that were not transferred to Thomas Miller, which obviously still have to be serviced etc.

1520 **Q368. The Chairman:** We have all seen the very brief document, the guarantee from Kaupthing hf. Was it your understanding that this was an on-call and unlimited facility?

Mr Doherty: Yes.

1525 **Q369. The Chairman:** What risk did you undertake, or what records were kept, regarding discussions in relation to Kaupthing Bank group regarding asset quality and things like the Moody's rating, things like that?

Mr Doherty: Well, at the time – and I stand to be corrected – I think the group was AA rated at that stage, so it had a significant rating back in 2007.

1530 As I commented earlier, a group company taking information from its parent would be taken on face value, so having had Moody's or Standard & Poor's, or anybody doing a rating quantification on the group, we would have accepted that at face value. Therefore, what we were looking at here is our own parent providing a parental guarantee for its subsidiary.

1535 **Q370. The Chairman:** But right until the end you did not actually feel that the parental guarantee was going to be needed because of the good situation that existed both in the Isle of Man and in London?

Mr Doherty: I repeat: until Wednesday, 8th October, we had no reason to believe that London, which is where this started, was in any way, shape or fashion, insolvent. Therefore, consequently, we did not even contemplate that we would be calling on the parental guarantee.

1540 **Q371. The Chairman:** Were you more worried about money having to move the other way, having to move money back to Iceland?

Mr Doherty: No. We were not asked to move any money back to Iceland.

1545 **Q372. The Chairman:** I was wondering if that was something that you were starting to plan and prepare for?

Mr Doherty: No, and again, just for clarification, we were not asked to place any further funds up to

1550 Reykjavik.

The Chairman: I am going to move now to the final few days, unless anyone has any more questions so far?

1555 **Mr Houghton:** I have got a few more in-between ones.

The Chairman: Please carry on, Mr Houghton.

Q373. Mr Houghton: Thank you very much indeed.
1560 Mr Doherty, I am just referring to paragraph 5 of your letter dated 9th May 2008 – in appendix 17, if it is any help.

Mr Doherty: Which paragraph, sir?

1565 **Mr Houghton:** It states, and I am just quoting now where it states, in appendix 17:

‘You will seek written confirmation to be provided from KSF (London) to the FSC in relation to the large exposure policy applying to KSF (London).’

1570 I do not recall having seen that letter on the FSC’s files. Was such a letter written and, if so, may we have a copy of it?

Mr Doherty: The answer is no, and the reason for the letter not being written was that the FSC chose to independently ratify with the FSA what we were saying.

1575 **Q374. Mr Houghton:** Thank you.
You set out at length the FSA’s large exposure policy. May I ask what protection did your board believe that this would provide to KSF (Isle of Man)?

1580 **Mr Doherty:** The protection was that – again, something we touched upon earlier – we were adhering to the FSC’s desire to remove risk from the parent. What we were trying to ensure, and to give the FSC comfort, was that this just was not round-tripping, and we made investigations of London as to what their counterparty risk limits were with other group members, and they provided us with that.

1585 As I say, that was subsequently ratified by the FSA, so it gave comfort that the money that we were passing through, and as their own balance sheet increased, they were not simply just placing deposits back up with the parent, or as we were led to believe through this correspondence.

Q375. Mr Houghton: Thank you.
On 23rd June 2008, KSF (Isle of Man) wrote to the FSC, stating:

1590 ‘By close of business on Thursday, 19th June 2008...’

Mr Doherty: Sorry for interrupting. Could you give me that date again?

1595 **Mr Houghton:** I am sorry, not at all. On 23rd June 2008, you wrote to the FSC, stating:

‘By close of business on Thursday, 19th June 2008, we had acceded to the Commission’s request to remove our net Icelandic risk from our balance sheet.’

1600 This can only be true if KSF (London), which at the time held about £380 million of KSF (Isle of Man) money, had no net exposure to Iceland, can it not?

Mr Doherty: No, that is totally incorrect, simply because we are a stand-alone Isle of Man company here and, as I have discussed with the Chairman a few moments ago, our balance sheet had no net exposure to Iceland.

1605 **Q376. Mr Houghton:** Did you have such confirmation from KSF London on this?

1610 *Mr Doherty:* Well, we did not require it because, again, our balance sheet – our financial position – was that the Isle of Man operation did not have a risk to Reykjavik.

Q377. Mr Houghton: Did KSF London provide you with its balance sheet so you could confirm this position?

1615 *Mr Doherty:* No, they did not but, as I say, the additional comfort that we derived indirectly was... well, firstly, directly from them, was the large exposure limit but, equally, after the FSC had spoken with the FSA, they also confirmed that the large exposure limits were in place.

1620 **Q378. The Chairman:** So you would not be able to tell from the regular information that you were getting from group that this was the case?

Mr Doherty: No, but we were in ongoing dialogue with group and with group finance on a whole wide range of issues and, quite honestly, this large exposure limit never came up for discussion again, because the FSA did not adjust KSF (UK)'s connected lending exposure limits.

1625 **Q379. Mr Houghton:** So how, then, Mr Doherty, did you establish there was no net Icelandic risk on your balance sheet?

Mr Doherty: I have just answered the question, sir: because –

1630 **Q380. Mr Houghton:** But I would like to know more, because you said there was, and now you are saying there were a lot of discussions between all those supervision authorities. That is not an answer for me.

You made this point very clear. It has to be backed up by some evidence, so what evidence did you request from London so that you could continue to monitor that there was no Icelandic risk on your balance sheet?

1635 *Mr Doherty:* If I go back to the money that was unsecured with London, that is UK risk. The £185 million that was still left on account in Reykjavik was contractually set off against the loan that Reykjavik provided to the Isle of Man. So that eliminates our risk with Reykjavik.

1640 The other risk that was subsequently taken on was with KSF (UK), which was a separate UK-licensed entity. It was not a branch of Reykjavik; it was a wholly-owned subsidiary, a UK-registered and UK-licensed bank. So our risk there was to a UK company, and therefore, in sovereign terms, it was UK risk.

Q381. Mr Houghton: So the way I see it, there was Icelandic risk.

1645 *Mr Doherty:* No, because... Can you explain to me where, because if we are lending to a UK company, we are lending to a UK entity. If we are lending to a UK company who is registered in the UK and licensed in the UK, the sovereign risk there is UK: a standard banking practice how one quantifies that.

I just do not understand where you are –

1650 **Q382. Mr Houghton:** Can I perhaps ask Mr Davies, then? You were the accountant at the time: what advice did you give to the directors at that time, Mr Davies, can you recall, as far as this issue? Was it not an issue on this matter and whether it was appropriate to put on the balance sheet that there was no Icelandic risk?

1655 *Mr Davies:* We were relying there that the UK company was FSA regulated and, because of the large exposure limits – the connected lending limits that were in place under FSA guidelines – there could not be any Icelandic risk.

1660 **Q383. Mr Houghton:** And you advised the board of directors on that?

Mr Davies: Yes, that would be part of our discussions.

1665 **Q384. The Chairman:** Perhaps it would help Mr Houghton if you gave an idea of how big the UK bank was, to put into context the large exposure capital limits. Can you give a ballpark figure as to the size of the balance sheet of the UK operation, so that we can put the £160 million into context?

Mr Doherty: Probably about £5½ billion, £6 billion.

1670 **Q385. The Chairman:** So that really does put the £147 million, £160 million, large exposure capital limits into some form of context, doesn't it?

Mr Davies: It is a very small percentage.

1675 *Mr Doherty:* Yes, but I think one has to be careful here, because I think what is trying to be clarified here is that the FSC was insisting that we removed Icelandic risk, and yet we were left with Icelandic risk...

Well, in actual fact, as I have already explained, we netted out the risk contractually on the £185 million and the exposure that we then had was a UK exposure.

1680 **Q386. The Chairman:** But even the residual UK exposure through to Iceland – that is what I am just saying – was negligible.

1685 *Mr Doherty:* But I think what one must remember is that was their upper limit, so one needs to be careful. We, at no stage, said that that is what their exposure to Iceland was. All we were saying all along is that that is their upper limit under the FSC regulations.

Q387. Mr Houghton: If I could just say that, with Mr Watterson, the Chairman's, helpful question about the ballpark figure and the large capital holdings etc by the big parent bank, as it were, in London –

1690 **The Chairman:** Sister bank.

1695 **Mr Houghton:** Sister bank. But taking that into account, your job was to look after the Isle of Man situation and the finance in the Isle of Man. Never mind about big figures and, 'Oh, it's all locked up in big figures,' and all the rest; it was your job and you were charged and you were running at that time, under pressure from the FSC, to keep your eye on the ball.

Just one final comment on that: did you keep your eye on the ball, rather than get overtaken with large amounts and large deposits? It is your job to look after the Isle of Man's funds, which is one of the reasons why the bank failed, isn't it?

1700 *Mr Doherty:* No. You have asked me two questions there.

Am I the cause of the bank failing – absolutely not!

1705 Did I keep my eye on the ball – of course, I did! Right up until 8th October, as is repeated and substantiated all through our submission to the Committee, all of the information that was at hand to all of the directors, including me as the managing director... At no stage did that information give any indication that there was any question of trouble, any factual trouble, coming from any authority, let alone the institutions involved, i.e. KSF (UK), from any authority whatsoever.

You have also got to bear in mind, sir, that we were also regulated by the FSA here on the Isle of Man for mortgage lending.

1710 **Mr Houghton:** I appreciate that.

1715 *Mr Doherty:* So the information that we were being provided with – financial information under appendix 31, I think it is, monthly reports coming out of group... every piece of information that we were being given, substantiated our belief that the group was on a sound financial footing, both in terms of capital and in terms of liquidity.

Q388. Mr Houghton: But do you, as a counter to that, read the financial press and the financial press of the day... and the talk of the day was there was real concern about Icelandic investments since probably a year before – anything up to a year before – the bank went insolvent?

1720 *Mr Doherty:* That is right, and we were lending to a UK bank, not to an Icelandic bank.

Mr Gelling: That is why the Icelandic risk was eliminated.

1725 **Mr Doherty:** Remember, KSF (UK) was a UK-registered bank.

Q389. Mr Houghton: I accept your explanation of this.

What I do not accept, and I cannot come to accept on this, is the fact that you were just looking to the UK as if that is where the money stopped. You know the money was being upstreamed to Iceland, and –

1730 **Mr Doherty:** Mr Chairman, I object to that statement.

Mr Cashen: No.

1735 **Mr Gelling:** No, that is not –

Mr Houghton: I still have to say it and put it to you, so I get an answer from you, Mr Doherty. That is what I am here to do, to test the situation – and test the situation I will.

1740 **Mr Doherty:** No problem.

Q390. Mr Houghton: That is the issue here, and I am grateful for your comments. This is a very serious matter. Everybody else, it appears... and I will make this other... and I would be grateful for your comments. Everybody else appeared to be aware, in the wider world, of major trouble... only the directors, or the Chief Executive and the directors of KSF (Isle of Man) –

1745 **Mr Gelling:** Incorrect.

Mr Doherty: I refute that completely, because there was a lot of speculation internationally and not all speculation has the facts as to an operation.

1750 There was speculation – and long before it happened – about Barclays in 2007. There was speculation about Alliance and Leicester. There was speculation about a host of institutions, not least Icelandic-associated institutions, but we had to deal with the information that we were being provided – provided through the group –

1755 **Q391. Mr Houghton:** That is the danger –

Mr Doherty: Excuse me. We also were in liaison with our regulator, who was in liaison with the Central Bank of Iceland, the FME in Iceland, the FSC in the United Kingdom, and at no stage... and you will see, in actual fact, in one of my meeting notes where I specifically asked, from a regulatory perspective, were there any concerns with group, and the specific response that came back – it was not ambiguous in any shape or fashion – was that, no, there were no specific problems registered by the FSA or the FSC, and that was shortly before the October issue.

1760 But, if I may, the directors are tasked with looking after the company; it does not matter what company it is. The directors do it with all of the information that is readily available to them. The information that we had readily available to us, right up to and including the accounts that were released by group as at 30th September, a week before everything went down, was that the group was in a very, very stable position.

1765 If you also refer to some of the communications that were coming out of KSF (UK) all the way up to 7th October from the CEO of KSF (UK), and if I may, Mr Chairman, read out... I will not repeat this, because it is on record in the submission, the e-mail of 6th October from the CEO of KSF (UK). In this update, Mr Thorvaldsson stated that:

1770 ‘although it should be clear that we are an independent subsidiary, without reliance or exposure to Iceland...’

1775 Based on that, again going back to the discussions we have just had, where I was trying to make everybody aware as to how we decreed that there was no net Icelandic risk, there is another affirmation from the head of the group company. Previous notifications that he gave – which are all in your papers there – refer to the substantial amount of liquidity that the UK operation had, mentioning sums of up to £1½ billion placed with the Bank of England etc, in Treasury bills. That information, coupled with the group information, right up to 30th September, and the information that was coming through the chief communications officer from Reykjavik, all indicated that the group and KSF (UK) were all financially sound.

1780 At no stage did we get any direct information that we, as directors, could actually act upon that gave us evidence – if that is what you are looking for – that there was a problem in Reykjavik or there was a problem

in the UK. Everything was to the contrary.

1785 **Q392. Mr Houghton:** So why was there a run on the bank?

Mr Doherty: It is called confidence.

1790 Crikey, if you look at – again, talking to peers around town – during this whole issue, leave Iceland out of this for a moment, there were people switching from – I am not going to start naming banks here – but from clearers, switching money in between clearers, because they were nervous. This was not just happening on the Isle of Man. The whole world was in meltdown and the reason people were nervous was because of confidence.

1795 We had already seen Lehman’s go on 15th September. We had already seen two Icelandic banks go. Yes, I do not deny that for one second but, equally, the converse of that is, on the Monday the Icelandic Central Bank came out and said it was supporting Kaupthing. So, not only is the company getting information from Reykjavik, bearing in mind the chief treasurer was on our holdings board from Reykjavik, we were getting information from KSF (UK) and we were getting the Central Bank of Iceland saying that they were going to stand by Kaupthing. All of those led the directors to believe that the information that we were receiving was correct.

1800 **The Chairman:** We have strayed into the October –

Mr Houghton: Yes, and I do not wish to do that.

1805 **The Chairman:** Well, I would like –

Mr Houghton: I have got a few more questions –

1810 **Q393. The Chairman:** Well, actually, I think if we are going to keep to time, I think we are going to have to start that loop. If we have got time at the end, perhaps we can come back to a few of the outstanding issues.

Building on the comments that you have just made, then, Mr Doherty, you would describe working relations between KSF (Isle of Man) and senior management in the UK and Iceland as cordial and normal and you were still having regular discussions with both UK and Iceland throughout the week, as you would do normally?

1815 *Mr Doherty:* Absolutely, and the people we were talking to... this was not lower ranked personnel; we are talking about, as I say, the chief treasurer of the group. We are talking about the head of banking. We are talking about e-mails from the CEO. We are talking about head of treasury etc., so the communication was at very senior level.

1820 **Q394. The Chairman:** And it was full, honest and free?

Mr Doherty: As far as we were led to believe.

1825 **Q395. The Chairman:** And do you doubt that in hindsight?

Mr Doherty: Put it this way, I do not know the reasons for the action that was taken in the UK, so I do not know what to think in respect of the cause of that, so I really cannot answer the question.

1830 **Q396. The Chairman:** Are you still in regular communication with colleagues in the UK? (*Mr Doherty:* No.) They are no longer involved?

Mr Doherty: They are no longer involved. In terms of the day to day, I am working for the Liquidator.

1835 **Q397. The Chairman:** Okay. What advice or instructions did Kaupthing Bank give you in the days leading up to the collapse, in relation to the financial position of the company and of KSF (UK)? Was it all just business as normal? You had the management accounts up to the end of the quarter –

1840 *Mr Doherty:* It was business... We had the monthly accounts from group to the end of September. We had all of this communication that was coming from KSF (UK) up to and including 7th October, when it was

categorically stated by KSF (UK) that liquidity was sound.

It was *only* – and, again, this is in your packs, gentlemen – in an e-mail on 8th October that Thorvaldsson actually turned around and, in the e-mail, stated that they had been in discussions with the FSA prior to then. Up till that, all of the information that we were acting upon indicated that the bank was totally sound.

1845

Q398. The Chairman: So, when did you first learn of the supervisory notice that was made by the FSA on the UK bank on 3rd October?

1850

Mr Doherty: Probably... Is this to do with the trust account? (**The Chairman:** Yes.) Probably around January or February of this year by the Liquidators.

Mr Gelling: Not at the time.

1855

Mr Doherty: I think, just to follow on from that, we were not even aware until probably mid-morning on Wednesday, 8th October, that there was a problem within the clearing system for settling payments of ours. So we were not made aware at any stage, by anybody in group, that the FSA, the Treasury, were involved with KSF (UK) at all.

So, we could not have known about it. Nobody told us!

1860

Q399. The Chairman: So your awareness of the problems with the clearing system was only on the morning of the final day?

Mr Doherty: Probably mid-morning on 8th October.

1865

Q400. The Chairman: Am I right in thinking that all of your clearing had to be pre-funded?

Mr Doherty: No, it did not all have to be pre-funded. Some of the BACS payments had to be pre-funded but an awful lot of our payments were actually made out of KSF (UK).

1870

Q401. The Chairman: Right, okay.
When did you stop accepting deposits?

Mr Doherty: Well, we did not officially stop accepting deposits because we did not know the... There were difficulties, there is no doubt about it. Again, I go back to the question of confidence etc. but we did not stop taking deposits.

1875

Q402. The Chairman: So, close of business on the 8th is –

Mr Doherty: Well, we actually probably ceased business around, if memory serves me right, about half past 12 to one o'clock, when we started –

1880

Mr Davies: We started the board meeting at the time.

Mr Doherty: Yes, just before we started the board meeting, because everything had come to a stop. We could not accept deposits, because the UK was put into administration, so we could not physically take money electronically.

1885

Q403. The Chairman: Right, so when the UK stopped is when you stopped taking deposits: at that moment.

1890

Mr Doherty: Yes.

The Chairman: Okay.
Mr Houghton.

1895

Q404. Mr Houghton: Thank you.

In the period of 2nd October 2008, you stopped breaking bonds on accounts; as many depositors as possible were encouraged to maintain their money with KSF (Isle of Man); and only paid were those that

1900 insisted on repayment of maturing deposits. You did this to keep KSF (Isle of Man) afloat.
You must have been aware there was a serious situation. So, in retrospect, do you consider that this was fair to depositors?

Mr Doherty: Well, first of all, again I refute your comment that we knew that something was happening. We did not know because we did not know until 8th October.

1905 There was a confidence issue, where people were looking to withdraw their accounts. People were doing the same in every other bank. I had, and the board, and indeed the finance director, we had a collective responsibility to the FSC, who have set down different ratios etc. We must adhere to all of those ratios. We must keep the company stable. We are directors of the company. If we were to allow – and, again, it goes back to a question that was asked in relation to the Derbyshire, at the beginning of this session – if we were to continue to allow people to break their deposits, we would be giving them preference over people, in terms of liquidity and cash flow, if we...

1910 Sorry, let me back-track a second. Our liquidity was managed very well, very prudently. However, if we allowed people to break contracts, it would have put liquidity under strain. If, then, liquidity came under strain to such a degree that we were not able to allow people to withdraw their deposits from ‘on demand’ accounts, we would have then been giving preference to people who were contractually tied in for a certain period of time.

1915 Therefore, it came to a situation where we, looking at it from a treasury perspective in the Isle of Man, from a liquidity perspective, from a regulatory perspective – could we allow this to continue? – it would have been negligent for me to have done that. I would have been abrogating responsibility in what I was there to do: to try and keep the company stable.

1920 **Q405. Mr Houghton:** Would it not have boosted confidence in the Isle of Man, though? ‘Oh, there’s no problem if you break your bond.’ I know people who, when there were runs on other banks earlier in the year, who broke their bonds at the bank, lost the interest – obviously when you break a bond, as you understand – there was no problem at all. The bond was broken, the capital repaid. But you were not doing that.

Mr Doherty: Up until 2nd October we were doing it and I would also like to add to that – and I cannot give you *evidence* because it is from talking to my peers around the time – no less than five other institutions on the Isle of Man took exactly the same action.

1930 Now, to single out Kaupthing Singer & Friedlander for taking action and, therefore, saying that we knew something was going down, is totally inappropriate, because other banks were managing their liquidity and their cash flows in the same prudent fashion that we were doing. We were looking at it from a prudential perspective, nothing else.

1935 **Q406. The Chairman:** Could you confirm that you stopped making payments to life companies at 11 o’clock on 1st October?

1940 **Mr Doherty:** The moratorium went out on 2nd October, so anything that was agreed up to the 2nd and, from memory, the e-mails that went round specifically to do with the life companies, the e-mails went around on the evening of the 2nd, so we honoured anything that we were aware of up to 2nd October, even though those payments may have been made on the 3rd or 6th or 7th, or whenever.

1945 **Q407. Mr Houghton:** You have confirmed, of course, Mr Doherty, that, on 7th October, you refused earlier breakages; and a note in your submission that applied also to all depositors, retail customers and staff alike. Did this apply to directors?

1950 **Mr Doherty:** It applied to... The breakage of deposits and, again, I go back to the answer to a question I made earlier on, or I gave earlier on, everybody was treated in the same way. So if people were, under the terms of their contract – i.e. the deposit contract – they were freely allowed to withdraw, that goes for staff and for customers alike.

Q408. Mr Houghton: Up until 2nd October, how many of you, the directors, or connected parties to you, had accounts with KSF (Isle of Man), in the period March to October 2008.

1955 **Mr Cashen:** I did.

- Mr Gelling:* I didn't.
- 1960 *Mr Doherty:* I had a minor account that took in some expenses, that was all. I did not bank with the company.
- Q409. Mr Houghton:** There have been allegations that directors, or their connected parties –
- 1965 *Mr Cashen:* I did have an account.
- Q410. Mr Houghton:** There have been allegations that directors, or their connected parties, withdrew moneys from KSF (Isle of Man) in the period to 9th October 2008. It is in the public interest that these allegations are shown to be false. So, for the record, did any of you, or parties connected with you, reduce the balances on these accounts in the period March to October 2008.
- 1970 *Mr Doherty:* Are we talking about ordinary bank accounts or are we talking about breaking deposits or something here?
- 1975 **Q411. Mr Houghton:** Whatsoever. Mr Cashen?
- Mr Cashen:* My money is still locked in.
- Q412. Mr Houghton:** Mr Gelling?
- 1980 *Mr Gelling:* I had nothing.
- Mr Doherty:* I had nothing, I had no withdrawals.
If you are talking about connected parties, my mother-in-law was returning from Cyprus and she took her money out to buy a house and she is subsequently back here.
- 1985 **Q413. Mr Houghton:** Okay, Mr Davies?
- Mr Davies:* I made a withdrawal, Mr Houghton, on Monday 6th October. That money was on a call account and I made that withdrawal in the normal mechanism, placed the withdrawal instruction with the banking department and no preference was given to that withdrawal. It was basically placed in the system and the reason for me making that withdrawal is I was restructuring my personal finances at the time and looking to repay part of my mortgage.
- 1990 **Q414. Mr Houghton:** And did you receive the money?
- 1995 *Mr Davies:* I did receive my money.
- Mr Houghton:** Okay, thank you very much. I do hope that that helps to clear the air, as far as public rumour is concerned, and I thank you for that.
- 2000 **The Chairman:** Mr Lowey, are you –
- Mr Lowey:** I am happy. The only thing that I was... No, no, I will leave it at that, I am happy.
- 2005 **Q415. The Chairman:** When did you start getting behind with payments outwards? Obviously, there is a fair bit of correspondence within your submission that says you realised that there was a problem: you ring-fenced staff so that they could get on with the job because of the high volumes. When did that start? When did that start going up?
- 2010 *Mr Doherty:* Probably around the Thursday or Friday, which would have been the 2nd or 3rd.
- Q416. The Chairman:** Okay. And you, presumably, were expecting a short confidence dip and then, once the thing settled down with Glitnir and Landsbanki and everyone knew where they stood, this would come out in, say, a week or so, or whatever?

2015

Mr Doherty: Well that is what we hoped.

Q417. The Chairman: That is what you anticipated?

2020

Mr Gelling and others: Yes.

Q418. The Chairman: But, right the way up until the final day, you were receiving, as you have referred to, strong evidence from within the group, from sister company and parent company, that things were strong. That presumably was the basis on which you passed information on to customers who phoned up and were concerned about their deposits?

2025

Mr Doherty: Yes, and again referring to my submission, Mr Chairman, if you look at pages 24 and 25 – page 24, section 15, communications with customers and KSF communication.

2030

I have also provided for you here, in the packs, a selection of correspondence that was being issued to customers. All of that information – and I have verified it and I have substantiated it in the submission to you – was substantiated by group, be it KSF (UK), or KB Reykjavik.

2035

Q419. The Chairman: That was, basically, the information you were receiving, which you were entirely happy was accurate at that time and that was also done as fact sheets to your staff, as well, who were answering the phones – and that was happening right the way up until lunchtime on the final day?

2040

Mr Doherty: Yes, and you will see where, on a number of occasions, I sought clarification directly from Reykjavik on some of the points, such as the ratings, such as the liquidity provision etc. So we were not just sitting here and answering questions off our own bat, so to speak, we were seeking clarification from group and/or KSF (UK) as to the status.

Q420. The Chairman: The telephone lines were pretty busy during those –

2045

Mr Doherty: Well, quite frankly, the telephone system actually collapsed at one stage!

Q421. The Chairman: When was that?

2050

Mr Doherty: Oh, gosh, I would have to come back to you on that, but we had to get the engineers in for the phone system.

Q422. The Chairman: Okay, accepting that these were exceptional circumstances, how far behind did you get with your payments to people out? When did the last ones go through?

2055

Mr Doherty: Well, there were still outstanding payments come the lunchtime on 8th October, because –

Q423. The Chairman: Based on requests from when?

Mr Doherty: Oh, I beg your pardon. Probably a day, day and a half, behind, as a guess.

2060

Q424. The Chairman: So anything on the 7th probably did not happen; mostly on the 6th did?

Mr Doherty: Mostly on the 6th did. Payments that were issued on the 6th and actually left the bank on the 6th, the vast majority of them reached their destination.

2065

The problem on payments actually reaching customers was largely experienced for those payments on the 7th and on the 8th but, in terms of actual physical processing, in entering it into payment systems and checking balances etc., we were probably still a day behind, or a day and a half behind.

2070

Q425. The Chairman: So what we are saying is that anybody who... as long as they asked for their payment by 4 o'clock on the 6th, probably would have had that payment made?

Mr Doherty: Well, if you are asking me a specific question, I would prefer to do some digging because, sometimes, there are delays because signatures may have matched, or there was a query on the payment, or

2075 the destination of the payment, so it would be wrong of me to sit here and say that all payments that were received by the bank up to a certain time went through because, at the end of the day, it is a matter of logistics.

Q426. Mr Lowey: That would be normal in normal banking circumstances, would it not? There may be queries on individual –

2080 **Mr Doherty:** Absolutely. In normal banking circumstances we would attempt to clear the day's work on the day and not have any hangover: there would be no hangover work to the following day – but that was normal.

2085 **Q427. Mr Houghton:** Prior to 9th October, did the directors take any legal/insolvency advice on their duties in a liquidity or solvency crisis?

Mr Doherty: On 9th October?

2090 **Q428. Mr Houghton:** No, prior. Any time prior.

Mr Doherty: No. We invited our advisers in on the 8th, after we heard that KSF had gone into administration.

2095 **Q429. Mr Houghton:** And did you formalise any policy at that time?

Mr Doherty: Well, it was an ongoing board meeting that started about 1.30 p.m. and finished about nine o'clock. Well, the decision was made about 9 o'clock. So there was no policy *per se*, it was a decision based on the facts that were then available to us.

2100 **Q430. The Chairman:** Colloquially, was there an 'ah, ha' moment that, 'actually, this is it, boys, there doesn't appear to be the safety net: this is the end'? When was that moment?

Mr Cashen: Quarter to eight.

2105 **Mr Doherty:** About quarter to eight, ten to eight, on the night of 8th October.

Q431. The Chairman: And that was on the basis of a phone call from Iceland?

2110 **Mr Doherty:** Well, if I could bring you back to the middle of the day, when we called the non-executive directors in. We called them in after the ING announcement. Between the phone call to the two non-executive directors and them actually arriving at the building, the announcement had come that KSF (UK) had been put into administration.

2115 At that stage we convened as a board and our advisers and, from then on, there was open dialogue between us, the FSC and Reykjavik, culminating ultimately with a demand, under the guarantee, for... well, a demand for cover from the parent, on the basis that they were the ultimate lender of last resort in our case. They initially agreed – and without the benefit of opening up the timeline here – they initially agreed to provide liquidity and then, when push came to shove, at about ten to eight that evening, they turned around and said, 'We can't provide it to you'.

2120 At that stage, it was obvious that, from a solvency perspective, the bank was not going to be able to meet its commitments and we had no alternative. Up till then, again from a solvency perspective, all avenues were open, between funding from Reykjavik or parental guarantee from Reykjavik etc. It was not until ten to eight that they said, 'No, we're not going to support you', and then we had no alternative.

2125 **Q432. The Chairman:** But, in the run up to that, when you had your run on the bank, to use the expression, and you were losing about £25 million a day, did you go back – and I know the answer to this, it is the wider benefit – did you go back to London and ask if they could release some of the funds that you had down there?

2130 **Mr Doherty:** Yes, I think I know what you are asking. Firstly, the liquidity position of the bank was totally oversubscribed, in terms of the ratios that were set

2135 down by the FSC. However, looking forward, based on a gradual build up, I contacted the head of treasury, a chap called Pablo Vergara, in relation to the £175 million deposit and the repo deposit that we had with London. One was maturing – and again I stand to be corrected – in about six or seven days time, another was maturing about another week after that. We enquired of London, if push came to shove, if we needed, would they allow us to break those deposits? For the same reasons that we had taken the decision here in the Isle of Man the previous week, in relation to retail deposits, they turned around with an emphatic ‘No’.

2140 So it was not that we actually needed it. Our liquidity profile was such that, *contractually* – and, again, I go back to your question in terms of breaking deposits – our profile was absolutely matched. We had plenty of liquidity but, looking forward, purely from a prudency perspective, we begged the question and London refused to entertain it. Again, that is evidenced in the packs that we have given you.

2145 **Q433. The Chairman:** It turns out there was a bit of a case of bad luck, in terms of when the dates fell for the maturing of your deposits, for one part, but you were content, overall, that your time matching was reasonable. It was – did you say it was two week intervals that this money was held over for?

2150 **Mr Doherty:** For those two big sums, yes. But bear in mind that we had other deposits that were placed with London which were in differing periods etc. and they were, again as the days went on, there was a gradual increase in our ‘on demand’ amount of cash that we had sitting with London, again for cash flow purposes, but unfortunately that ended up being tied up in the administration, as well.

Q434. The Chairman: When it all closed.
But whilst you were able to recall the money from London in two weeks or less, shall we say, your liability onto Iceland was over a far longer period?

2155 **Mr Doherty:** That was purposely structured, in that it was two months.

Q435. The Chairman: That was two months? Thanks very much.
So, when did you first contact the FSC on the 8th? Roughly what time was it?

2160 **Mr Cashen:** Throughout the day?

Mr Doherty: Quarter past or half past two. Shortly after we convened (**Mr Gelling:** Constant.) and then it was just an open dialogue with the FSC.

2165 **Q436. The Chairman:** But there was no need for extraordinary communication with the FSC prior to the final day, even though you were experiencing a bit of a run?

2170 **Mr Doherty:** We had a meeting with them – and, again, it is documented in the evidence we have submitted – on the 6th. Andrew Davies and I met with the FSC on the 6th and gave them an updated position on cash flow, liquidities, deposit withdrawals etc. and that is in your evidence pack.

Q437. The Chairman: And they were content with that?

2175 **Mr Doherty:** Yes. Other than – (*Interjection by Mr Lowey*) The culmination of that meeting actually was just to keep in contact. There were no other issues brought up at that meeting.

The Chairman: Mr Lowey.

2180 **Q438. Mr Lowey:** Other banks would be experiencing the same because of the flux and the change?
Again, I am back to the position we are in. We are sitting here coldly examining, as if it was normal.

2185 In that fevered period, I think the main question most people cannot understand is – and I have taken note of what steps you have taken to make yourself comfortable through reserves and you were aware of what was going on around you – how it was that the Bank of England could have demanded your sister bank to place money with them and they chose not to tell you. Have you any explanation, or guesstimate or whatever, why they chose not to tell you?

Mr Doherty: I have absolutely no idea why anybody chose not to tell us. And that is a whole list of people, not just the Bank of England. Nobody in Reykjavik told us anything. Nobody in KSF (UK) told us

2190 anything. None of our other board members at the holdings level told us anything.
The FSA told us nothing, even though we were also regulated with them as part of our mortgage business, so we did actually have a link with them. Some banks here do not because they do not do mortgage lending. We actually did have a link with them. They chose not to tell us. They also, I understand, chose not to tell the FSC, so the FSC here had nothing to tell us.

2195 So, in all cases – and, again, it is evidenced by the fact that we did not even know there was a clearing problem until the middle of the morning on 8th October, i.e. banks not processing Icelandic payments. So there was a cloud of secrecy. I do not know whether you want to call it secrecy, confidentiality, or whatever. There was nothing being passed to anybody within Kaupthing (Isle of Man) that these dangers were upon us.

2200 **Q439. The Chairman:** Mr Gelling?

Mr Gelling: Yes, I was just going to say, there was actually a gag – I am quite certain of it – in the UK, that we were not to be told by anybody, anything. You can imagine it was like being on a pedestrian crossing and being hit with a wagon.

2205 We were still content and thinking, ‘We’re still okay, we can still get the liquidity, we can still stop a run on the bank because we can bring down money from Reykjavik’ and, all of a sudden, the whole thing was just taken from under us.

2210 **Q440. The Chairman:** Is that something you have been able to confirm with anybody, for example the Administrator in the UK?

Mr Gelling: No.

2215 *Mr Doherty:* No, because all the papers are still under seal. So we actually do not know, other than – and again I refer to it in our submission – on 8th October Armann Thorvaldsson, – and again, for the record, up until then he was continually telling us that liquidity in the UK was fine. Mr Thorvaldsson... (*Interjection*) I beg your pardon, this is on page 27 of our submission – the e-mail of 8th October 2008... It was only in this e-mail that Mr Thorvaldsson refers to difficulties surrounding the UK which, hitherto, neither the management nor the board of directors of KSF (IOM) had been made aware of.

2220 Mr Thorvaldsson conceded that they had worked with a number of investment banks, KB hf – i.e. the parent – and the FSA

‘over the last two weeks, to explore a large number of possible options to ensure the future of KSF (UK)’

2225 That came out on the morning of 8th October. In all other respects, every bit of information, and again going back to your question, every bit of information was in a positive mode. Nobody ever gave us the warning signs.

2230 *Mr Cashen:* Mr Chairman, if I could add that, if Mr Thorvaldsson’s statement is to be believed, then the FSA were in discussions with KSF (UK) for *two weeks* prior to 8th October 2008 and this further questions why the FSA never contacted the FSC to voice its concerns about KSF (UK).

Q441. The Chairman: So, do you believe that your colleagues in the UK were responsible for, basically, meaning that you were giving misleading information to customers, because you were being misled yourself?

2235 *Mr Doherty:* Again, for the record, the information that we were being given was being given as it was made known to us and in good faith. We did not –

Q442. The Chairman: Made in good faith by you?

2240 *Mr Doherty:* Made in good faith by us and, again, the evidence is substantiated there in the presentation that we have given to you. You can see that what we were telling customers was the information that was passed on to us by a range of Reykjavik, UK, etc.

2245 **Q443. The Chairman:** But, in hindsight, you know that you have been misled.

Mr Doherty: In hindsight, totally, absolutely! Mr Thorvaldsson’s e-mail of 8th October specifically states

– and I want to repeat the quote – that they were ‘in discussions for two weeks.’

2250 **Mr Gelling:** I think, Mr Chairman, previously we said about off-Island directors of the holding in the Island. When you think that one was from the London office and the other was from Iceland, they must have, in some way, known there was something going on and yet I have not heard one single word, then or since. Not a word! And they are still, or they were, on our holdings company in the Isle of Man.

2255 **Mr Doherty:** I think if you also look under ‘Group Communication Press Releases’, again, which is on page 27 and 28, these are press releases that are coming out of Reykjavik – again, giving the positive spin on how the group sat at that stage.

2260 Equally, you will also see, again in the evidence that we have presented to you, correspondence that I sent up to Reykjavik, again, with a sort of template response to customer enquiries, asking Reykjavik to fill the blanks. Those blanks related to liquidity; they related to capital strength; it related to a whole host of things. So, we, at all stages, were passing on information that was provided from the group.

Q444. The Chairman: Kaupthing Holdings still exists?

2265 **Mr Doherty:** Indeed.

Q445. The Chairman: Has it met since the 8th?

Mr Doherty: It has had to meet on a number of occasions, yes.

2270 **Q446. The Chairman:** And the directors from the UK and from Iceland are still directors?

Mr Doherty: No.

2275 **Q447. The Chairman:** They are not?

Mr Doherty: The only directors that are currently on the holding company are the three of us. There is a recommendation in from the shareholder that a replacement for Mr Adalsteinsson, who was the Icelandic director, come on board – excuse the pun – next week but that representative will be somebody from the Resolution Committee in Reykjavik.

2280 The board has met for a number of reasons: Scheme of Arrangement; considerations; etc. all to do with the liquidation or largely to do with the liquidation.

Q448. The Chairman: Would you know when those two people resigned from the board?

2285 **Mr Doherty:** I do not now, but we can provide it for you, if you let us know.

Q449. The Chairman: Okay, thank you very much.

2290 Turning to a slightly more positive note, what proportion of the depositors of KSF are going to get all their money back?

Mr Cashen: That is a matter for the Liquidator.

The Chairman: Pardon?

2295 **Mr Cashen:** That is a matter for the Liquidator, I would think.

Mr Doherty: It depends on what the ultimate payout is going to be, but there have been – I think if I could answer it in a different way, if I may.

2300 The Liquidator has said publicly that they expect the payout will be somewhere up to around 84p in the pound. Now, that, equally, is based on two things: one, the ultimate payout from KSF (UK), and Ernst & Young’s original estimate of that payout was circa 50 per cent. Assuming... and that was made some four, five months ago, that, I hope, was a very conservative estimate at that time because they were not in office that long in terms of liquidations, as they go. Hopefully, that figure will be greater.

Equally, the amount claimable under the guarantee is another question because, again, as put in the report,

2305 the Liquidator has already put Reykjavik on notice that there will be a claim coming. Now, I have had this clarified that, whilst we are not privy to the legal advice that the Liquidator has received, the Liquidator is making that claim on the basis that he believes the guarantee is a valid instrument. Again, I would like that on record because there have been various comments about the guarantee etc., but the Liquidator has confirmed that he is making, or will make, that claim on the basis that he believes it is a valid instrument.

2310

Q450. The Chairman: And the reason that he cannot make that claim at the moment is because there is a moratorium on all claims on KSF hf?

2315 **Mr Doherty:** There is a moratorium at the moment but, equally, when one makes a claim under a guarantee, it has to be a quantifiable amount and what – and I am not trying to speak for the Liquidator – I think they are trying to do is to get their second dividend payment out of the way, which is coming up in December, I believe, the next dividend payment out of Ernst & Young and a more up to date estimate from Ernst & Young as to how much is going to come from the administration in the UK, which will then, at best estimate, give them an amount on which they can make a claim.

2320

So, it is two things: the moratorium prohibits it at the moment and unknown amount, just yet.

2325 **Q451. The Chairman:** You have been through a rather turbulent experience with all this. Would you care to draw any comments out about what lessons you think might be drawn from the system of regulation on the Island, and whether you think that has worked satisfactorily, as far as you, as directors of the bank, are concerned?

Mr Doherty: I think you have just made an understatement there, in the ‘turmoil’ that we have gone through. It has been phenomenal!

2330 There are, I think, things that could be learned. I think one of the things that is quite evident from our submission is the lack of communication. Communication breeds confidence; it breeds understanding and, above all, it breeds truth on what is happening or what is not happening. At all stages – and I know I am repeating myself, sir – but at all stages, we have relied on the information that we have been given. We have sought information from our parent; we have sought information from various authorities, including the FSC. I am quite sure that, based on my own track record with the FSC, both with Singers and my previous employer here on the Island, that the FSC would not have sat back and ignored information that they might have received from the UK, be it from the bank or be it from the FSA, warning that there would be an issue relating to our liquidity. Quite simply, our liquidity was what caused the bank to collapse. We were wholly unaware.

2335

2340 So, what do I learn from this? Perhaps greater communication between the regulatory authorities, for one.

Now, I know there is the Memorandum of Understanding. Again, that is in our submission. It failed, but we, again, in our report, allude to why we believe it failed: it failed on the lack of communication from the UK, not on the part of the FSC, and I am not here to defend any third party. We are here to defend ourselves. The communication was lacking. I think, going forward, the regulators need to look at that, revisit it.

2340

2345 The business model, in itself, on the Isle of Man and the one that we adopted right up until 8th October, I actually believe still holds. It is supported by the Foot Report and, indeed, the IMF. The IMF have confirmed that the Isle of Man is as good as... there are small improvements that they have asked and that they have recommended. But the Isle of Man is band 2 compliant, as well. So, the business model works.

2345

2350 Where it failed here was a lack of truth coming from KSF (UK) and a lack of anything coming from the FSA, bearing in mind that, only a week previously, they did everything that they could possibly do to ensure that Bradford & Bingley was protected, not just in the UK, but also here. And they did the same thing with Royal Bank of Scotland. They did the same thing with an awful lot of other banks.

2350

Q452. Mr Houghton: Were you expecting that to happen to your organisation at that time; just at that window of time?

2355

Mr Doherty: Expecting what: support?

Mr Houghton: Support.

2360

Mr Doherty: Yes, because, again, I go back to our dialogue on the exposure to Iceland, etc. and I tried to emphasise the point. KSF (UK) was an English registered bank. Full stop. It does not matter where its origins come from.

2365 The fact is that the UK only looked after themselves. They took a decision and, again, in answer to Mr Lowey's earlier question, 'Why?', nobody knows. They took a decision to take the action that they did and not tell us. But they protected themselves and gave no advance warning.

2370 **Mr Gelling:** What I would like to add: what were the reasons? We have no idea why they chose not to do with Kaupthing what they have done with others. I think that is where it is unprecedented, that they should use the legislation that was put in place to virtually steal the money and, of course, that is what caused our problem.

The Chairman: If I can just pick up on a – Mr Lowey, please.

2375 **Q453. Mr Lowey:** Again, it is really reiterating. World banking fractured in 2008, did it not? There was not a continent where banks did not come under pressure for a variety of reasons but it was all interconnected. I use the word, Lehmans, the USA, Northern Rock, RBS. As I say, we have got to try and learn lessons and I do not see how you can, putting us in that sort of position of a world system collapsing around us, to see if there is anything specific.

2380 The only thing that I have heard that is specific to the Isle of Man is the lack of communication, where they were taken from the 1st – and I have got the dates wrong – 1st October to the day you had to call 'close'. There was no communication whatsoever and, therefore, you were flying blind, or in a – and I use the word, not derogatory – fool's paradise. I would have been the same if I had have been there. Everything was dark and there is a wall coming towards you and, you do not know. Is that a true reflection, as you see it?

2385 **Mr Doherty:** I believe so.

The Chairman: Mr Houghton.

2390 **Q454. Mr Houghton:** Thank you.

Just a few odds and sods, because we have had the rounded picture. I just want to get a few answers on one or two things that we have skipped over during the submission this morning.

Your submission does seem to blame the insolvency, of course, as you have discussed, on the financial crisis; the FSA; the UK Treasury and others, of course, as we have heard.

2395 On 28th March, the FSC offered to formalise directions to, (1) seek repayments of all inter-group liquidity, as it fell due; (2) increase third party liquidity to 25 per cent, and (3) place all new deposits, as well as maturing deposits, into independent assets. Is it not the case that, if you had agreed to those directions, KSF (Isle of Man) would still be solvent? Why did you not agree to such a direction at the time?

2400 **Mr Doherty:** If I may say, they were not a direction.

Q455. Mr Houghton: It was just advice, or what –

Mr Doherty: End of story. They were not a direction.

2405 We did not refuse. We cannot refuse a direction from the FSC or we would sacrifice our licence and, as the board of directors, we could not allow that to happen for the company. So what we did was, as you are fully aware from what we have provided to you, we entered into dialogue with them and, subsequently, ended with an agreement to find a solution that all parties could work with. It was not ideal, by any manner of means, because it was something that the business model was not built on, but, at the end of the day, that was not a direction.

2410 **Q456. Mr Houghton:** Right, okay.

2415 Was there any influence from your sister bank in the United Kingdom on you to come up with this agreement? Did you consult with them and they said, 'Oh, it is alright that the Isle of Man operation do this, this and this, and go away.'

Mr Doherty: Absolutely not.

2420 We, and as I said earlier and, again, to properly answer the question, once we ended up in dialogue with the FSC, we ended up also in dialogue with both Reykjavik and KSF (UK) and the reason that KSF (UK) and KSF Reykjavik were involved is that that is where the two main treasury operations sat within the group. So, between us, so to speak – and I mean that collectively – we came up with something that the FSC were happy

to accept.

Q457. Mr Houghton: So, it was an agreement with influence from outside the Isle of Man?

2425 **Mr Doherty:** It was...?

Mr Houghton: An agreement. This agreement was reached by influence from outside the Isle of Man?

2430 **Mr Doherty:** Well, I am not sure that I would use, 'by influence'. The influence came from the FSC, in their direction to us to remove the parental risk, not group risk and, again, you use the word, 'removal of inter-group risk'.

At the end of the day, and in the communications that we ultimately agreed with the FSC was the removal of *parental* risk. So, that is where the influence came from originally, the FSC, *not* off Island.

2435 **Q458. Mr Houghton:** Okay.

On page 17 of your submission, you state that, in advice received from KSF London, it was confirmed that the FSA did not expect lending to connected counterparties to form a significant portion of the bank's assets without the written authority of the FSA. Have you got a copy of such advice, or could you look into that and let the Committee have that following advice from KSF London as evidence for us, please?

2440

Mr Doherty: Yes. I think ... Is that not... because it was actually an e-mail that came from KSF (UK) which gave us the –

2445 **Q459. Mr Houghton:** Could you tell us precisely what that advice said?

Mr Doherty: Well, it was not advice. It was a statement regarding the large exposure capital base that we discussed previously: the 25 per cent limit that KSF (UK) had up to parent in Reykjavik. So, that paragraph there that you are referring to, refers to the large exposure, the LECB limit. That is, if you remember, we chatted earlier, where we sought comfort that the money that came down from Iceland, that went to London, was not going straight back up again and we sought comfort as to what limits London were under.

2450

London confirmed those limits to us in the way of an e-mail, which I am more than happy to provide to the Committee, absolutely. But those limits were then, subsequently, independently, verified by the FSC with the FSA. So, that is part of –

2455 **Q460. Mr Houghton:** So, if you could let us have any further background documentation on that, I would be very grateful.

Mr Doherty: It is a simple e-mail. I have been sitting here, if I may, without taking notes. Will you be following up with a request for these items?

2460

The Chairman: Yes. We will follow it up and there will also be the publication from the *Hansard* that we can all just check ourselves, because that will be published on the internet as a result.

2465 **Mr Doherty:** Absolutely. It is just that you have asked for certain things today, that is all.

The Chairman: We will certainly follow that up and we will let you know.

Q461. Mr Houghton: Final question, if I may.

2470 You will have seen the exchanges between the FSC and the FSA dated 13th May and 21st May 2008. In your opinion, did these safeguards provide an adequate protection for KSF (Isle of Man) depositors? And, if not, why? I am asking you to turn to your memory now. You can come back to the Committee with that, if you want.

2475 **Mr Doherty:** I am speaking from memory and I think there are two questions in that single question. One is with the benefit of hindsight and one is at the time.

Mr Houghton: At the time.

2480 *Mr Doherty:* At the time, yes. I believed that that was giving independent corroboration for what London was saying and that was a part – it was not the only part – it was a part of the reasons and the rationale why we were comfortable in passing money to our sister company in the UK.

2485 **Q462. Mr Houghton:** If I can clarify, just for the record, if each director can let us have the banking qualifications that they hold: banking qualifications, if any.
Mr Cashen?

2490 *Mr Cashen:* Well, I am a chartered public finance accountant, through you, Mr Chairman, and as such, I am required to have knowledge of accountancy; banking; statistics; economics; financial management and a range of issues like that.

Q463. The Chairman: That is the Chartered Institute of Public Financiers and Accountants?

Mr Cashen: Yes.

2495 **Q464. Mr Gelling:** No qualifications, banking.

Q465. Mr Houghton: Thank you.
Mr Doherty?

2500 *Mr Doherty:* No professional qualifications, but I have been working in the banking industry since I was 16 years of age. So, I have 32 years of experience all through the ranks.

2505 **Q466. Mr Davies:** I am a qualified chartered accountant and I trained with KPMG, where I had a lot of audit exposure to banks prior to joining KSF.

Mr Houghton: Thanks very much. Just for the record.

2510 **Q467. The Chairman:** I have got a few more questions that I might just dart around the place to sweep up a few clarifications, if that is alright?
Firstly, Mr Davies, you resigned in November 2008. Can you explain the reasons for that, please?

2515 *Mr Davies:* I did, Mr Chairman. My main reason for resigning at that stage was that I was in discussions to take up a number of other positions external to KSF because, obviously, I have no long-term future there. I was potentially taking up alternative employment at that stage.

Q468. The Chairman: Okay.

2520 And would you care to either make now, or make available to the Committee, a personal statement outlining... You said that you made a request to remove money from the bank on the 1st and I think... I would be amazed if that did not attract some sort of speculation from outside. If you would like to make a personal statement about that, or provide the Committee, if you would wish to, as to why and what you felt you knew at the time, justified that.

Mr Davies: Yes. I am quite happy to do that, Mr Chairman.

2525 **Q469. The Chairman:** Just an opportunity for you, as much as anything. Okay.
Did any of the directors actually purchase credit default swaps in Kaupthing?

Witnesses: No.

2530 **Q470. The Chairman:** Do you feel that the position of the Isle of Man company was weakened by becoming a direct subsidiary of Iceland, rather than staying as a direct subsidiary of the United Kingdom branch, looking back as it all shakes out?

2535 *Mr Doherty:* Well, again, looking back, at the time rather than with hindsight, the benefits that it gave to us, which we did not have with Singer & Friedlander was a wider opportunity, in the Isle of Man, to attract deposits, because it was a much bigger group than Singer & Friedlander was. So, once Kaupthing took over

the Singer & Friedlander group, we were then part of a much bigger group, which gave us greater marketing opportunities etc.

2540 **Q471. The Chairman:** I suppose I can really only talk about deposit protection, that you felt...?

Mr Doherty: In terms of deposit protection, well, it waits to be seen. We, obviously, were part of the Isle of Man Depositors Compensation Scheme itself. Whether it adds any more through the parental guarantee, I do not know, because the actions of the UK, they chose to ignore the Isle of Man's balance sheet. Who is to say that they would not have done it even if we were Singer & Friedlander?

2545 **Q472. The Chairman:** Right, but what was your expectation? Would your expectations have been, given the UK's state, that had you been a direct subsidiary of the UK company, you might have been caught up in a rescue package from the UK?

2550 *Mr Doherty:* No. I am not sure about that, because I think they actually, through various comments etc., have declared that they were looking after themselves.

2555 **Q473. The Chairman:** Okay. Could I just ask what your present duties are in terms of being directors of the various bodies, specifically the bank, but others as well. Just what your...

Mr Doherty: In general, the tree that you have in the submission is unchanged, so we are still directors of the holding company and of the bank. In terms of the bank, I am working with the Liquidator in retrieving the assets and the loan book.

2560 **Q474. The Chairman:** So, in terms of your director's responsibilities, how do they split out between you and the administrator?

2565 *Mr Doherty:* Once the bank went into liquidation, then my director's duties actually ceased. Sorry, all of the directors' duties actually ceased.

Mr Cashen: We are still directors but our powers are suspended, Mr Chairman. We have no responsibilities.

2570 *Mr Doherty:* We are directors in name because the company still exists and the Liquidator has not, at this point, asked us to resign, but we are not carrying out any executive duties as directors or anything. That is all vested with the Liquidator.

2575 **Q475. The Chairman:** Could I just ask also, of the three of you who are still directors, are you still being paid for your role as being a director and, if so, what?

Mr Gelling: I think, if I may answer, Chairman.

2580 You have been told how many companies are in there from the Holdings and, of course, it is paid in an amount which the Treasury Minister answered a question to, I think it was, yourself. Because, of course, SFIM – Singer & Friedlander Investment Management – of which John and myself are still, but not Mr Doherty.

2585 We are meeting probably once a week, do you know what I mean? It is not executive whatsoever. Then, of course, there is Knockdara, the trust company and the holdings company. So, it is still split around and I cannot just remember. We could give you the percentages, but I think I remember Mr Bell gave an answer of what those percentages were –

Q476. The Chairman: I suppose, yes, I did ask the question some time ago and I am really looking for an update as to whether any of this is –

2590 *Mr Cashen:* It has not changed, Mr Chairman, from the answer you were given by the Treasury Minister.

Q477. The Chairman: And that accounts for all three of you?

Mr Doherty: Well, I am working with the Liquidator now. So, if you are looking for my annual salary, I

2595 am prepared to –

Q478. The Chairman: So, it is still the same as the answer that was put in, I think it was either Keys or Tynwald at that time? The amounts will have, obviously –

2600 **Mr Doherty:** Well, the amounts will have changed, but again, I am on a salary with the Liquidator.

Q479. The Chairman: And the salary has not changed?

2605 **Mr Doherty:** My base salary has not changed.

The Chairman: Okay, that is what I was asking for: what changes were there.

Mr Doherty: That is fine.

2610 **Q480. The Chairman:** Do we feel that the expectations that depositors have had over this point have been reasonable, or do we think that, perhaps, there could have been a better job, not just by directors, but by all parties about education there?

2615 **Mr Doherty:** In terms of the Compensation Scheme, or in terms of...?

The Chairman: In terms of providing depositors with the information they have expected over the time.

2620 **Mr Cashen:** Do you mean consumer protection, Mr Chairman, or do you mean information from the Liquidator?

Q481. The Chairman: No. Consumer protection, certainly around 8th October time: that you felt that you were happy at all times that you were able to give consumers everything that they needed at those times, items of communications.

2625 **Mr Cashen:** As far as we were able to, we gave the best information that we could.

Mr Doherty: Any time there was a question asked by a customer, we answered it.

2630 Hindsight is a wondrous thing, but the veracity of some of those answers, information that we were provided by group: in answer to your question – ‘Could it have been improved?’ – obviously it could have, but how one gets to that needs an awful lot of dialogue, externally.

2635 **Q482. The Chairman:** There were talks late in the day on the 8th about the potential for a takeover of the book from Kaupthing Singer & Friedlander (Isle of Man). Can you tell us what you can about those discussions?

2640 **Mr Doherty:** The discussions on the evening of the 8th, that you refer to: we were led to believe that there were two parties out there who would consider looking at the bank. However, the immediate stumbling block was, if they were to pay for the depositors, how can we actually transfer the assets, bearing in mind that £500 million of the assets were stuck under the administration. So, it fell at the first hurdle.

Q483. The Chairman: So, it literally did not last very long at all?

2645 **Mr Doherty:** No. Subsequent to that, the Liquidator then, obviously, looked to find a buyer etc. So, I am only commenting on the events of the evening of the 8th.

The Chairman: Okay.

Mr Lowey, do you have any further questions?

2650 **Q484. Mr Lowey:** No.

I just would ask the directors, the comfort factor to the depositors of any bank – this applies generally, but you are the directors I have before me – guarantees mean very little, even when it is backed by a sovereign government?

2655 **Mr Doherty:** Well, this guarantee was not backed by the sovereign government. This was a guarantee that was provided by a commercial entity, which was Kaupthing Bank hf.

Q485. Mr Lowey: Yes, which is now owned by?

2660 **Mr Doherty:** Well, since it is partly owned, there is a new bank, which is 'Kaupthing new bank' that they have split, like they have done with all banks. Good and bad, they call them!

Q486. Mr Lowey: Had they got international funding from the World Bank on the understanding that they pay compensation to their owners.?

2665 **Mr Doherty:** If I could clarify that, they did indeed, but their meaning of 'compensating depositors' related to depositors which were under their responsibility.

2670 What I mean by that is, where Kaupthing Bank hf had branches in any other country, or Landsbanki, who had a branch in the UK and a branch in the Channel Islands, they, under EEA rules, were obliged to compensate for €20,000 each. The difference with Kaupthing was that Kaupthing (UK) and Kaupthing (Isle of Man) were subsidiaries. So, that is where the difference is.

So, that funding they received, it does not, unfortunately, compensate any of our clients.

Q487. Mr Lowey: It comes back to the thing, buyer beware.

2675 **Mr Doherty:** Well, a guarantee is only as good as when it is called, unfortunately.

The Chairman: Mr Houghton.

2680 **Mr Houghton:** No, thank you.

The Chairman: Thank you very much for spending the morning with us. Do you have a closing statement or any key issues that you want to reaffirm or get across, make a closing statement?

2685 **Q488. Mr Gelling:** I would only leave the Committee with the thought that there is no-one more in sympathy with those depositors that were with Kaupthing and there is no shadow about that. We, certainly, have worked extremely hard to try and get what we could for the Isle of Man entity. I know, with Kaupthing – there is no shadow about that – we, certainly, have worked extremely hard to try and get what we could for the Isle of Man entity.

2690 I know directors', non-executive directors', first liability is to the company but, certainly, we were considering all the other areas of reputational deposits and so on. It came as a great shock to us and one that we have really had a turmoil in the Isle of Man, never mind the rest of the world, but it does not come easy. As I say, depositors have had this long, long time to wait and we just hope we can get things sorted out as soon as possible.

2695 **Q489. Mr Doherty:** Well, as managing director, I just echo what Mr Gelling has said and we, so far, have done everything, right up to 8th October, to protect the business: subsequently, to retrieve the assets. Hence, I am still working with Pricewaterhouse Coopers. I am doing that and, so far, it has all been successful. So, hopefully, as I mentioned earlier, the actual payment back to customers will be far in excess of what has originally been estimated and we will use every endeavour to try and ensure that.

2700 **The Chairman:** Gentlemen, thank you very much for your evidence. Thank you very much for your time this morning.

The Committee will now sit in private. Thank you.

2705 *The Committee sat in private at 1.01 p.m.*