

SELECT COMMITTEE PROCEEDINGS

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Douglas, Wednesday, 28th October 2009

Morning Session: 10.00 a.m. – 12.53 p.m.

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

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*The Committee sat in public at 10.00 a.m.
in the Millennium Room,
Legislative Buildings, Douglas*

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[MR WATTERSON in the Chair]

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Procedural

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

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The Select Committee was appointed on 16th July 2009 with the following remit: to investigate and report on the cause of the collapse of Kaupthing Singer and Friedlander (Isle of Man) Limited; the role of the Financial Supervision Commission in ensuring the proper management of Kaupthing Singer and 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.

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The Committee recognises that this matter is complex and important, and has therefore decided to split its 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 and Friedlander (Isle of Man) Limited and the role of the Financial Supervision Commission in ensuring the proper management of Kaupthing Singer and 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.

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We are meeting this morning to take our first oral evidence. We have invited Mr John Aspden, Chief Executive of the Financial Supervision Commission, to give evidence today.

Further evidence sessions will take place on 13th November, with the Treasury Minister, Mr Allan Bell; and on 4th December, with the directors of Kaupthing Singer and Friedlander (Isle of Man) Limited.

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I would now like to introduce my fellow members of the Committee: on my left, Mr Eddie Lowey MLC; on my right, Mr John Houghton MHK; and the Clerk of the Committee is the Clerk of Tynwald and Counsel

to Mr Speaker, Mr Roger Phillips.

40 Mr Clive Alford is our *Hansard* Editor and he is recording this morning's proceedings. At this point, if I could ask everyone to kindly ensure mobile phones are switched off, because they do interfere with the recording equipment – so if it has an airline mode, please.

45 EVIDENCE OF MR J ASPDEN

Q1. The Chairman: Mr Aspden, thank you very much for joining us this morning. Do you have any opening statement?

50 **Mr Aspden:** No, I am very pleased to be here. I have submitted to you, on behalf of the Financial Supervision Commission, what I believe to be comprehensive evidence in reply to your request, and I am very happy to take questions.

55 **Q2. The Chairman:** Well, in summary then, in terms of the collapse of Singer and Friedlander, what were the bare bones of what happened?

Mr Aspden: Well, essentially, you will recall that, back in 2008, what was actually happening, as referred to in my evidence, was two things in particular. First of all, the world was in the middle of a global financial meltdown, with extreme turbulence, which was affecting, essentially, all countries, but particularly the US and Western Europe, but to some extent the Middle East and the Far East. That was causing exceptional liquidity stresses in the market and, at that time, actually it was more of liquidity stresses, rather than credit issues. So that was one thing that was going on.

60 Secondly, within that, and of particular relevance to today's session, was the condition of Iceland, which at the time, as you probably know, was a small economy with a relatively small number of people, and was widely regarded in financial circles – at that time, in 2008 – as suffering severe financial problems. Essentially, there was a major loss of confidence in Icelandic banks.

65 At the time, also, Iceland had been borrowing quite extensively, both in the money markets, as well as through some retail products, had been borrowing quite a lot of foreign currency including through the UK. As conditions tightened and as confidence tightened, clearly that impacted on the Icelandic banks.

70 Then as we went into September of last year, you will recall two other Icelandic banks, Glitnir Bank and Landsbanki, got into problems. After initial moves to be taken over by the Icelandic government, essentially they both ceased to trade in their form at that time and then subsequently, eventually, Kaupthing.

75 Kaupthing; the reason that was last, I think, to go, probably, was that Kaupthing was the largest bank in Iceland and certainly the Icelandic authorities had, at one stage, intended to fold at least one, if not two, of the other two banks into Kaupthing, as a possible solution. That did not emerge, primarily for two reasons: one, because Iceland did not really have the money to back it; but secondly, because, really, I think at that stage, the UK took over, in terms of invoking terrorist legislation and essentially freezing assets. That, in turn, created a big loss of confidence in any remaining business.

80 **Q3. The Chairman:** In terms of, then, who was responsible for the collapse of Kaupthing Singer and Friedlander, in your opinion?

Mr Aspden: Kaupthing Singer and Friedlander, of course, you are talking about, there, the London bank.

85 **Q4. The Chairman:** Sorry, the Isle of Man bank that we are focusing on in our evidence.

Mr Aspden: Right, okay, fine.

90 Essentially, rather than just attributing blame, I think it is well known... Your hearings are going to benefit from, also, the evidence that I have sent to you, but was previously supplied to the UK Treasury Select Committee. You will know, from that, that approximately half of the Isle of Man bank's – I mean Kaupthing Singer and Friedlander (Isle of Man) – half of its balance sheet was placed with the London bank. So when the London bank went into administration in the UK on 8th October, essentially with, very roughly speaking, half of its balance sheet sitting there, the directors of the bank and the FSC petitioned for a provisional liquidator, on the basis that it could not continue to trade.

So, essentially, the reason why that occurred was primarily because of the exposure of the Isle of Man

95 bank to the UK bank, which, at that stage, had then gone into administration.

Q5. The Chairman: What lessons would you consider have been learnt by the FSC as a result of this case?

100 **Mr Aspden:** Well, the lessons stem from many issues which, obviously, we have not discussed yet, or whatever. I think the key lesson really hangs under a global issue of co-operation – regulatory co-operation. I know you are very familiar with the finance sector, but regulators in particular rely a lot on co-operation, both formal co-operation and informal co-operation. Since we have a large number of UK institutions here, not just banks but UK institutions which are regulated by the FSA, we have traditionally had a very high level of co-operation and communication with the FSA and, indeed, in parallel to all these issues that obviously concern your remit was the ongoing saga of Bradford and Bingley, which was providing a very clear picture of the level of co-operation that one would normally expect.

105 Unfortunately, that did not materialise in the case of this bank. Ostensibly, the reason it did not materialise, as you will have seen from the evidence – particularly, not so much my evidence but the evidence given in the UK – is the fact that the FSA felt that it was a host supervisor of Kaupthing Singer and Friedlander in London, and it was not the parent or lead supervisor of the group.

110 **Q6. The Chairman:** Can I could come back to the relationships between the regulators perhaps later. What I suppose I was looking at is lessons learnt about the manner of regulating banks on the Island. Have there been any changes to procedure in the way that we do things and regulate banks here, as a result of the experience that we have gained from KSF (Isle of Man)?

115 **Mr Aspden:** Well, I think any changes – and I will explain what the changes are in a moment – that have taken place have not specifically arisen in relation to the Kaupthing Singer and Friedlander issue on its own, because, as you are aware, in the overall global scheme of things, the failure of Kaupthing Singer and Friedlander – and I am talking globally here, not for the Isle of Man – globally, the failure of Kaupthing was actually not a particularly financially major event when you compare it to some of the other major collapses that have happened in the US and the UK. It was a significant event, but it was not the only one.

120 So the steps that we have been taking in response to those global trends is in particular to look at issues of liquidity, in particular to strengthen liquidity, our oversight of liquidity, and to further enhance holdings by banks on the Isle of Man of independent sources of liquidity. Those have been the primary areas.

125 We have also put a renewed focus on capital adequacy, but that is not actually specifically for this event; it is more because of the introduction of the new capital ratio, Basel II.

130 The other thing that we have done, I suppose, more specifically in response to the Kaupthing event, is we have put ourselves in a mode of trusting other regulators a little less than one might have done before – trusting, in terms of co-operation – and therefore, I think it has made us more circumspect about that, and I think there is still a lot of work to be done there, not just in the Isle of Man but internationally.

135 **Q7. The Chairman:** So, are you happy that the FSC has complied with international best practice at all times during this scenario?

Mr Aspden: I am very happy that, during the Kaupthing event, we have complied with what relevant standards there were. The reason I put it that way is a lot of what happened actually was outside of what the standards might specifically apply to.

140 We were dealing with exceptional events but, as you will have seen from other issues covered by the IMF Report recently published, we are in pretty good compliance with international standards.

Q8. The Chairman: But are you happy that your remit is adequate, as the FSC?

145 **Mr Aspden:** Well, that is an interesting question. The reason I say that – and I am not flannelling this, but I think it is just important you understand it – we have a remit, which you know and I have submitted to you; we do not have a remit for consumer education on the Island. I am not fishing or suggesting that we should have one, but I think it is important to note that because, for example, the FSA in the UK and the Irish regulators do have clear remits for consumer education. We do not. So that is one issue that perhaps is not locally covered in quite the same way as elsewhere.

150 Secondly, we actually on the Island, as you of course know, we do not have a financial system. We are part of the UK. I do not mean politically, but in financial terms, our clearing system here is part of the UK

clearing system. So we are not responsible here for financial stability. We do not have a sort of macro role, so we are very much institution specific.

155 So should that be built into our remit? I think it is certainly something to be considered, in terms of wider stability. Is it something that we are fishing for or anything? No, and the reason we are not is, as I say, because of the unusual situation we are in.

160 Other than that, our present remit, as you know, focuses primarily on the supervision of individual institutions and economic crime, as well as fostering the economic situation of the Island, and we are happy with those, because the legislation for that, actually, as of course you will be aware, was only recently revised in 2008.

165 **Q9. The Chairman:** Do you feel that the Financial Supervision Commission is sufficiently resourced and sufficiently independent of Government?

Mr Aspden: Well, resources – given the constraints we have got and everything – I would not cite a lack of resources in defence of anything that you might feel or whatever.

170 The independence of Government issue is an interesting one. To be very fair, I think, I feel, at any rate, from my side of the fence that, on many issues, we have an open relationship with Treasury. The reason I cite Treasury is because that is our sponsoring Department. I think we have an open relationship with them and a regular dialogue.

175 You may have seen from the recent report published by the IMF that one of the areas that they cited which should be looked at, which was actually a repeat from what was the previous 2002-03 assessment, was that some of the remaining powers of direction which Tynwald has – Government has – over the Commission, including for the removal of the board, should that be necessary and, should it be necessary, the issue of directions, those should be removed. Now, I am not aware that either of those powers have ever been used to compromise the independence of the FSC, but you will find that those matters are referred to in the IMF Report.

180 **Q10. The Chairman:** Another large issue that has raised its head as a result of Kaupthing Singer and Friedlander (Isle of Man): will the FSC's policy be reviewed in relation to employing Commissioners who are directors of institutions subject to regulation?

185 **Mr Aspden:** This, Chairman, as you know is a very... not so much sensitive, but politically active subject, but my own views are this: as you know, at the moment we have a board of Commissioners, a number of whom – not all – are directors of existing licence holders whom we supervise. I am well aware of the cogent argument that that presents conflicts of interest.

190 Equally, having been now with the Commission for a few years, I also have been subject, in the past, to comments that it is critical that the FSC is commercially aware, has experience and awareness of current commercial constraints and issues and, whilst I fully understand the conflicts issue, I think to simply go what might be a convenient route of saying no-one on the board should be conflicted, I think that would compromise the effectiveness of the FSC from just having essentially a load of bureaucrats on the board.

195 How do you, therefore, deal with the conflict issue? We have tried to deal with that in an appropriate way, given the fact that we are an Island, we have a relatively small pool of people on whom we can call, presumably, for board appointments of this nature, and therefore what we have done is that we have on our website ensured that all Commissioners' interests as directors are published – they are all published on the website, they are all kept up to date.

200 Our conflicts of interests code is published, and we are rigorous in making sure that, if any issues arise where a member is conflicted – and there is a conflicts register in the Commission, which is reviewed by the Chairman and myself on a regular basis – if any conflicts actually arise, they are formally minuted and the person concerned absents themselves from the discussion or deliberations or whatever.

I know you can pick holes in that argument, but I would respectfully suggest, whichever way one goes, one does not have an entirely satisfactory solution, at the end of the day.

205 I would simply say, finally, that I know today we are looking at issues of financial collapse, but fortunately, as an Island, we spent many more years in a climate of economic growth and, therefore, hopefully to actually have a more commercially aware regulator is something that will benefit the Island for a longer period.

210 **Q11. The Chairman:** Your preference is for the *status quo* in that regard?

Mr Aspden: Correct.

The Chairman: Mr Lowey.

215 **Q12. Mr Lowey:** Can I, first of all, just ask and may I say – let me get it off my chest straight away – your file which you have sent us is fine. On the very first covering letter, from you, sir, you say in paragraph 1:

220 ‘The papers contain confidential material relating to information obtained in the course of our supervision of KSF (IOM). While the Commission fully respects the Select Committee process, we felt it important to put you on notice of this fact, so that any public use of the information does not compromise the Island’s position as a financial centre.’

Sir, as a longstanding Member of Tynwald, I do not need to be put on notice how to deal with financial sensitivities. That is number one.

225 Number two, would you say that the actions of the FSC have enhanced the financial reputation of the Isle of Man worldwide?

Mr Aspden: Over the last – ?

230 **Q13. Mr Lowey:** Over KSF.

Mr Aspden: Over KSF: not particularly, no.

Q14. Mr Lowey: Can I just come back, then – I have got that off my chest – to some of the questions the Chairman has asked.

235 You started with the collapse of the world meltdown. Would you not agree that storm cones had been hoisted long before 2008 over the Icelandic growth in banking?

Mr Aspden: That is correct.

240 **Q15. Mr Lowey:** So it was an open secret, even to the FSC of the Isle of Man?

Mr Aspden: Before 2008, it was known that Iceland was overheating, yes.

245 **Q16. Mr Lowey:** I come, then, to the second point the Chairman made, and you answered, that over half the balance of the local bank was placed in the UK KSF.

Is it not the role of the supervisors, in the climate that I have described so far, to have been extra careful? To put exposure of the local bank in the hands of KSF UK seems to me to be putting all your eggs in one basket. Would it not have been prudent to have said to the local bank, ‘Distribute your risk by putting it in other financial supervisions’? That is not with hindsight; that is in the climate that was appertaining at that time and which the FSC knew was appertaining at that time and should have been extra careful. Would you not think that is a reasonable...?

250 **Mr Aspden:** It is a very reasonable question. At the time, this bank had around half of its balance sheet on direct exposure to Iceland, to the Icelandic bank, and from the papers submitted, you will have seen that we required that exposure to be eliminated, and we actually use the word ‘eliminated’. I just make the comment – I know you have not said this, but others have said it – and that is the FSC never *directed* the local entity to put its money into the London bank. That was a suggestion put forward by the bank itself, that it would put the money there.

260 **Q17. The Chairman:** Sorry, could I just question that. You did say, in your evidence, that you would have issued a direction had they chosen not to do that. Is that correct?

Mr Aspden: No, what actually... Right, I think there are two very different things here.

265 First of all, it has been once or twice commented publicly that the FSC required the bank here to put the money in London. We never did that; it was management that came up with the decision.

Then, having actually discussed that proposal, having been through the dialogue with the FSA and so forth, and satisfied ourselves, subject to what I am going to explain to Mr Lowey, that that was a course of action that they were going down, what the evidence would have said is that, had they then not done it, we would have issued a direction, but not in the first instance. I think it is important to have that distinction.

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Q18. Mr Lowey: Could I then just press you a little bit further. Did the local directors of the bank have a dialogue with you at the time and say... I would not have thought it was a normal practice to put half your reserves into the UK, is it? It is a rather large sum of money is it not, £500 million?

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Mr Aspden: I would entirely agree with you, Mr Lowey, but the reality is, I regret to inform you, it is not unusual. There are a lot of banks that place a lot larger amount of money than that. Some of them have, in the past, upstreamed almost their entire balance sheet to their parent's bank, so it is not unusual. So I think it is important to look at it in that context.

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Also just to emphasise, if I may, because I think this gives a context to it, that, like it or not, this is a business model which, collectively, the Isle of Man has developed over a number of years, so this is not something that has suddenly occurred. The Isle of Man banking system here, a large part of it, (**Mr Lowey:** Subsidiaries.) is subsidiaries upstreaming money, and then it is the revenue from that that creates the profits which we then tax.

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If you are saying to me, if we were sitting in another jurisdiction, is that something which, as a regulator, I am entirely comfortable with, the answer is no; but that is not my job.

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You know, Mr Lowey, as a seasoned politician, you have heard in your time lots of remarks about how the FSC is uncommercial, uncompetitive, over-regulates, over-zealous. So this is the balance one has to strike between, on the one hand, what actually prudentially, as a regulator, one might like in theory to do versus, in practice, on the other hand, saying, 'Okay, we have to have some risk for various reasons'. The question is how do we then manage it?

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Q19. Mr Lowey: Can I just touch on consumer education: it was an interesting one that you brought up – I know you were not fishing, I recognise that – but does the FSC not allow at the moment its reputation for the banking and finance sector to advertise the fact that it is licensed by the FSC, in their advertising, and therefore there is a *quid pro quo* here?

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If you are being used as a comfort factor for investors, using the fact that 'you are licensed by us', implying that somehow it gives them security, comfort, whatever adjective you care to use, it does then put an imposition reverse on the Commission to make sure that they do what is on the can label.

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Mr Aspden: I hear exactly what you say, Mr Lowey, and I think that is a very good point. All I would say to you is this: I think the wording that is used to describe the fact that people are licensed with the FSC is intended to tell people that that organisation or whatever is licensed, to give some sort of comfort or whatever, as you have just said.

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The whole issue of consumer education – in other words, how financially sophisticated should people be, who should actually be in schools, raising financial literacy and all of this sort of thing, which is what the FSA does and everything – I would respectfully feel that that is a different issue. I see the connection you are trying to draw, but I do not think there is an automatic assumption that simply because somebody has told an entity it is licensed, for comfort reasons, that that also extends to actually mean that the FSC has got to go out and promote education.

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Q20. Mr Lowey: One final question: we were talking about... Mr Aspden knows my position regarding ex-politicians and ex-civil servants being on Commissions. I am on public record of where I particularly stand: I do not approve of it.

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Would you not agree, however, there are degrees of conflict? Would you not agree that the Chief Financial Secretary, who is now the Deputy Chairman of the Financial Supervision Commission – *was* the Chief Financial Officer, who I have known all my life, by the way, so I declare an interest there – in the public perception of things, that is too close for comfort. Do you agree or not agree?

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Mr Aspden: That issue, Mr Lowey, has been extensively discussed in the board and is, I agree with you, a very relevant question. It has been extensively discussed in the board, and we are in the position we are, but I do agree with you, it is a very sensitive issue.

The Chairman: Mr Houghton.

Q21. Mr Houghton: Thank you, Mr Chairman.

Mr Aspden, I am going to ask you a few basic questions. Some of those I will ask for documentation to be produced, if that can be, as I work my way through, taken note of and sent on, for the information of the

Committee. Some of the information may already be with us, but I just want to put it into *Hansard* that I am asking for this evidence, in particular. So whatever has not been sent in, if that can be sent in, sir.

330 On 1st August 2007, the Financial Services Act 2008 came into force. KSF (Isle of Man) Limited was an Isle of Man deposit-taker incorporated in the Isle of Man. Can you confirm, for the record, that this is correct and that it was duly licensed as a deposit-taker under the Financial Services Act 2008 by the FSC?

335 *Mr Aspden:* I certainly need to check on the dates. Yes.

Q22. Mr Houghton: Thank you.

Can you explain how KSF (Isle of Man)'s banking licence number 4, dated 9th January 2007, under section 10 of the Banking Act 1998, continued to be effective after 1st August 2008?

340 *Mr Aspden:* I would need to look at the file... I am not quite sure about your question on that.

Q23. Mr Houghton: Some of that detail, if it could be followed up, I would be grateful.

345 Now, also, would you send the Commission's regulations, codes and guidelines governing the supervision of Manx licensed banking institutions in force in the period 1st August 2007 to 9th October 2008? And will the Commission place in written evidence, before this Committee, copies of those regulations highlighting the provisions that regulate large group exposures?

Mr Aspden: Yes, sir.

350 **Q24. Mr Houghton:** Thank you.

355 KSF (Isle of Man) collapsed because of its large exposures to Kaupthing Bank HF, and Kaupthing Singer and Friedlander Limited (KSF UK) could not be repaid in time by the group debtor. Can you summarise the Commission's regulations, codes and guidelines, procedures and regulatory position with regard to large exposures of KSF (Isle of Man) to other licensed deposit takers within the group of companies of which it was a member? Was KSF (Isle of Man) compliant with all those requirements at all times in the period 1st August 2007 to 9th October 2008? Again, that can be sent in.

Would KSF (Isle of Man) still have failed if all large group exposures had been eliminated? Could you throw some light on that today, Mr Aspden?

360 *Mr Aspden:* Would KSF (IOM) still be in business, if all...?

Q25. Mr Houghton: If all large group exposures had been eliminated?

365 *Mr Aspden:* By eliminated, you mean money repatriated or...? (**Mr Houghton:** Yes.) Yes, it would.

Q26. Mr Houghton: Thank you.

370 Do you agree with the following statements: excessive exposure to a single customer or counterparty, or to a group of closely related customers or counterparties, is a significant risk incurred by banks. Would you agree with that?

Mr Aspden: I would agree with that, but just for clarification, when, certainly in regulatory parlance, one talks about customers and groups of customers, one is talking about non-bank entities. So, to the extent that we are talking about non-bank entities, I would agree with you.

375 **Q27. Mr Houghton:** Thank you.

Where excessive concentrations exist, it is fully important that a bank fully understands the resultant risks and that these are in line with the bank's strategic appetite for risk mitigated as far as possible. Do you agree with that statement?

380 *Mr Aspden:* Okay, yes.

Q28. Mr Houghton: Thank you.

385 Are all statements, returns and calculations for the period 1st August 2007 to 9th October 2008, including all those required by the Financial Services Rules Book 2008 and the Banking Guidance Note (BGN 4.2) Large Exposures, August 2007, in the three volumes of evidence provided to the Select Committee? Is that

information in the information provided?

390 **Mr Aspden:** As you will be aware, Mr Houghton, we provide a lot of figures. Whether everything is in there, perhaps I could check that and revert to you, but volume 3 of what we sent to you contains a large amount of that.

Q29. Mr Houghton: If you could check that I would be grateful, thank you.

395 Please, will the Commission place, in evidence, KSF (Isle of Man)'s statements and returns of its large exposure policy provided to the Commission, in force on 1st October 2007, and any subsequent changes, including those required by paragraphs 2.25 to 2.28, 8.35 and 8.44 of the Financial Services Rules Book 2008 and paragraph 2.6, Banking Guidance Note, Large Exposures. That is further information that I am asking for – and the 'Large Exposures' was in August 2007. If that could follow up.

400 Mr Aspden, the definitions of 'exempt exposure' set out in paragraph 5 of the Banking Guidance Note, Large Exposures, August 2007, are different from those set out in Rule 8.38 of the Financial Services Rule Book 2008. Why is that?

Mr Aspden: Well, I did not have notice of this question. I am going to have to look at the detail of that and then let you know.

405 **Q30. Mr Houghton:** I wondered whether you might have been able to comment today on that.

In particular, the rules on exposures to group companies are far more restrictive in paragraph 5.3.6, Banking Guidance Note (BGN 4.2) Large Exposures, August 2007, than Rule 8.38. Why is that?

410 **Mr Aspden:** I will get back to you on that.

Q31. Mr Houghton: Thank you. What is the particular concern behind that paragraph 5.3.6? If you could let us know that as well, please.

415 Also, would you provide copies of all notifications given by KSF (Isle of Man) to the Commission under paragraph 5.3.6, Banking Guidance Note 4.2, Large Exposures, August 2007, and all notifications or returns concerning large exposures under the Financial Rule Book 2008. Would you provide that information too, Mr Aspden?

Mr Aspden: I think you will find a lot of that is already in the material you already have.

420 **Q32. Mr Houghton:** And if you could confirm where it is in the document. Thank you.

And if you would provide copies of all agreements, confirmations by the Commission pursuant to paragraph 5.3.6 to such large exposures and all documents, records, risk assessments and minutes of meetings undertaken by the Commission concerning such large exposures and any agreements given: if you can provide that, too. Thank you.

425 Please, also, if you will send us copies of all correspondence, other documents, records and minutes of meetings concerning such large exposures to other members of the KSF (Isle of Man) group. I would be grateful for that.

430 And, also, if you can identify any credit institution in the KSF (Isle of Man) group that manage surplus liquidity across the group from 1st August 2007 and if you can identify if this changed in the period 1st August 2007 to 9th October 2008.

I do not know whether you would be able to comment on that now, but please feel free to do so.

435 **Mr Aspden:** Chairman, could I just say this is a string of questions which I am very happy to provide information to. What concerns me, Chairman, if I may, is the fact that I have provided a lot of this information in three volumes and, with every respect to your colleague, it appears that the evidence has not been read sufficiently enough to determine what, if anything, I have not supplied that is requested. I think the implication that we are just going through like this, I have had no list of questions put to me beforehand and, with respect, I do not think that is a fair way to deal with it.

440 **Q33. The Chairman:** I appreciate that, Mr Aspden, and I am certainly happy to ensure that this is followed up with a letter requesting the relevant documents that are provided – some of them are and some of them are not.

445 **Q34. Mr Houghton:** I do have to, though, and I will not take too much time to deal with these further requirements, but I am giving you the opportunity to say that they are in already within the files. There are reasons for this, Mr Aspden. So, I want to know whether they are actually already in the files that were sent to us, or reasons why they have not been sent, or they are going to be sent on.

450 So, if you will just bear with me, I have just got a few more. I have given you the opportunity of commenting in between, and I would be just grateful for your further comments, other than the ones that you have already made.

Q35. The Chairman: Just on the last point that Mr Houghton has made, would you agree that the two main Treasury functions of KSF were in Iceland and in London?

455 *Mr Aspden:* Correct.

Q36. Mr Houghton: Thank you.

460 And, further, if you can identify any credit institution in KSF (Isle of Man) that took on a treasury role on behalf of the group from 1st August 2007 and identify if this changed in the period 1st August 2007 to 9th October 2008; and that KSF (Isle of Man) did not have a treasury role on behalf of its group?

Mr Aspden: Well, I will now reply to that question. There was no other institution on the Isle of Man undertaking a treasury role between 2007 and 2008 for KSF (IOM).

465 **Q37. Mr Houghton:** Thank you.

470 Paragraph 5.3.6 of the Banking Guidance Note, Large Exposures, August 2007, provides that the Commission may agree large group exposures and defines, in paragraph 5.3.6 (a), (b) and (c), the circumstances of which it may be appropriate. Can you provide copies of correspondence and any other documents, records and minutes of meetings in the period 1st August 2007 to 9th October 2008 which considered circumstances other than paragraph 5.3.6 (a), (b) and (c), where it might be appropriate to give consent to a large group exposure?

475 *Mr Aspden:* Just for the record, Chairman and Mr Houghton, what we have actually done, with all three files, we basically just copied our file and sent it to you. So, we were not selective. Obviously, we could not be, but we were not selective. We just basically copied the files and sent them to you.

There were one or two areas in the statistical arena which I referred to in the covering letter: prudential returns and everything, which we did not send everything to you. You clearly now want them. That is fine; not a problem.

480 But, in relation to minutes, you have said on a number of occasions and so forth, they are already... we do not have any other minutes other than what, as far as I am aware, has already been sent to you.

Q38. Mr Houghton: That is fine. I just have to put it down for the record, Mr Aspden, so you have had the opportunity in order for us to follow this through. Thank you and I am very grateful for that.

485 In the period, 1st August 2007 to 9th October 2008, did any of KSF (Isle of Man)'s large exposure breach any provision or principles of the Financial Services Rule Book 2008 or Banking Guidance Note 4.2, Large Exposures, August 2007?

Mr Aspden: I will check on that and come back to you.

490 **Q39. Mr Houghton:** Did any report, statement or return to the Commission by KSF (Isle of Man) from 1st August 2009 show any exempt exposures in excess of 10 per cent or 25 per cent of its large exposure capital base?

495 *Mr Aspden:* Well, to the extent that there was the lending to London, the answer to that is, obviously, yes.

Q40. Mr Houghton: Thank you.

Can the Commission put these reports and annual reports by KSF, in the period 1st August 2007 to 9th October 2008, in its written evidence and could you check that, please?

500 *Mr Aspden:* Yes.

Q41. Mr Houghton: Thank you.

505 If any such large exempt exposures were shown in any SR-2B reports under paragraph 6.1 of the Banking Guidance Note 4.2, Large Exposures, August 2007, this would indicate that KSF (Isle of Man) had adopted a policy of the 10 per cent limit being exceeded as a matter of course. What did the Commission do about this?

510 *Mr Aspden:* There was no question of KSF exceeding large exposure limits as a matter of course. So, I will investigate further the allegation that you are making, but it certainly was not a question of exceeding large exposures as a matter of course.

Q42. The Chairman: You are talking about large exposure limits to third parties, rather than into a group with are exempt.

515 *Mr Aspden:* Exactly, third party customers, yes.

Q43. Mr Houghton: Thank you very much.

In deciding prudential regulation of deposit-takers incorporated in the Isle of Man, is the Commission influenced by potential adverse effects to the Isle of Man's revenues, or any political considerations?

520 *Mr Aspden:* I think the answer to that is no.

Q44. Mr Houghton: Thank you.

525 Why did the Commission consider possible repercussions on the Isle of Man and the political issues this will raise in its meeting on 2nd May 2008? What were the possible repercussions and what were the political issues? Can you recall that?

530 *Mr Aspden:* Well, without actually drawing the paper itself, I think you are referring to issues at the time, in particular, where we referred to the Depositors' Compensation Scheme. The reason that that was highlighted – although the word 'political' was in there – was not to highlight the politics of it, but because the DCS at that stage, as you know, had not been revised. The limit was as it had been for many years – in other words, three quarters of £20,000 – and, therefore, was plainly, at that stage, prior to its revision, insufficient to deal with the insolvency of a bank, particularly the bank type we were dealing with.

535 So, the reason that concerned me is because – I highlighted it – I think it was another reason that one wanted to make sure that one took as much defensive action as one could, rather than actually allowing the bank to go into liquidation.

The Chairman: Last one, Mr Houghton.

Q45. Mr Houghton: Thank you.

540 Why was the prudent policy adopted by the Commission on 2nd May 2008 – despite possible repercussions for the Isle of Man and political issues – to remove group indebtedness not followed through at the meeting of the Commission on 22nd May 2008? That is a part question.

545 *Mr Aspden:* Well, by group indebtedness you are talking about the whole of the Kaupthing exposure and, as you will know from the papers we have already sent to you, it was never intended that the entire group exposure would be eliminated because, obviously, KSF in London was part of the group. So we never said that there should not be any exposure to London.

So, I am afraid that is... I have a different view of that to yourself.

550 **Q46. Mr Houghton:** Thank you.

And the second part of that question: did the presence of Mr John Cashen or representations made by him prior to 22nd May 2008 have any influence on the change of direction? If not, what caused the Commission to change its decision and accept continuing group indebtedness?

555 *Mr Aspden:* Well, I am not aware that Mr Cashen was present at any of the Commission... or, indeed, the meetings with KSF, in a way that would have influenced, or had any effect, on the Commission's views on that. So, I just mention that, because you refer to him at the outset of your question.

Mr Houghton: Thank you.

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Q47. The Chairman: Can I just change tack slightly at this point and talk about the takeover of the Derbyshire, which is, obviously, part of the Kaupthing Singer and Friedlander loan book by the time it went into liquidation. What are the FSC's criteria for takeovers and mergers of other banks and financial institutions, other than simply looking for letters of comfort from other regulators?

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Mr Aspden: Well, critically, when one bank is taken over by another bank, we look to establish who the incoming controller is; what level of support the incoming controller can provide; what level of supervision is exercised over the new controller; the amount of consolidated supervision that would be exercised over the new combined group; obviously, what sort of business plan is going to be adopted for the enlarged entity; as well as looking for the other normal sort of prudential requirements. But those are the key ones.

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Q48. The Chairman: When did you firstly become aware of the evidence of Mr Shearer on the... moving on to KSF? Perhaps I will just keep that one for later: it is relevant but that was to do with KSF takeover, rather than the Derbyshire.

575

One of the concerns that was noted with the takeover of the Derbyshire was the high price that was paid for it. What concerns did that give you as a regulator?

Mr Aspden: Well, at that particular stage, you will be aware that, for many years now, actually, the raising of retail deposits has been an attractive strategy for many banks where they are seeking to diversify their sources of funding and so forth. The fact that the Derbyshire in the Isle of Man actually had, basically in the Isle of Man, a fairly clean balance sheet, in terms of raising deposits and on lending, that was obviously attractive to any particular purchaser.

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In fact, the Derbyshire is not, as you know, and has not been the only deposit-taking company or bank on the Island that has been up for sale and there have been other mergers for precisely that reason. So, the fact there was a fairly – it may have been in some people's view – high price paid for it, I think, reflects that, reflects the need of banks wanting to diversify their funding and, also, reflects the fact, at the same time, that the Kaupthing group was obviously an active purchaser, because they were keen to diversify their sources of funding.

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There is one final point and, of course, I do not think it should be forgotten that the Derbyshire has often been put across as a safe, middle-market building society and that sort of thing. Of course, you will be aware it was not. It had actually suffered substantial losses in the US sub-prime market. It had suffered substantial losses the previous year on IT, and had actually then had to be merged with the Nationwide, because it was actually a basket case in its own right.

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So, again, whilst I do not know the full detail of the Derbyshire in the UK, I imagine that in their sale of the Isle of Man operation, they were keen to extract a high price, because of the difficulties they were suffering elsewhere in the group.

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Q49. The Chairman: To the best of your knowledge, was the Derbyshire (Isle of Man) managed, in the Isle of Man specifically, on consistent grounds in the build-up to the sale to Kaupthing?

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Mr Aspden: As far as I am aware.

Q50. The Chairman: You are not aware of any sort of ramping or sales push that was unusual about that?

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Mr Aspden: Yes.

Q51. The Chairman: Okay. Then, overall, when did the FME become the home regulator of that book? Was that in January 2007?

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Mr Aspden: Yes. In theory, they would have become... and in practice, they would have actually become the home regulator, the home supervisor, of the Derbyshire subsidiary when the transaction was legally completed by the acquisition of KSF taking over the Derbyshire.

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Q52. The Chairman: Yes. And then in terms of the depositor security, for those people with the Derbyshire Building Society, did you see that there was a significant change in the security offered to them – instead of it being the Derbyshire and the Nationwide, to move to Kaupthing and that regulatory structure? Moving it from the FSA to the FME, did that regulatory difference cause you any concerns?

620 **Mr Aspden:** Moving from the FSA to the FME was, obviously, a change of regulator. The FME actually came over to the Isle of Man. They came over; they met with us; they signed a Memorandum of Understanding. We had discussions with them, in terms of how they supervised, consolidated supervision and all of that sort of thing.

625 So, yes, it is a matter of public record, because we allowed the acquisition to go through. We were, therefore, happy that the FME had taken... indeed, also had the FSA as well, and the file that we have sent to you will show that we had also had a dialogue with the FSA on that, at the same time.

630 **Q53. The Chairman:** Under what circumstances would it be appropriate for a break clause to be allowed by depositors whose funds have been moving from one company to another or one regulator to another? If they had concerns, how would they get their money out?

Mr Aspden: Typically, the answer to your question is, first of all, in my view, anybody who actively wants to get out of deposits should have that right and, almost invariably, including in the case of the Derbyshire, can have that right.

635 Now, the issue is whether they can get out with or without a penalty, so it is not actually whether they get out; it is whether they get out without a penalty. In some acquisitions, people have been allowed to get out without a penalty; on other acquisitions, the matter of the penalty has been silent.

640 **Q54. The Chairman:** But you are happy that anybody who was unhappy with going to either Kaupthing or to the FME could have got their money out between that time: between the time of the takeover and possibly even up to 1st October 2008? With or without penalties?

645 **Mr Aspden:** Right. I have been advised that, had a depositor wanted to exit during that period, they could have done and the bank would have allowed them to do that, but I cannot comment on the interest penalty that might have been incurred.

Q55. The Chairman: As long as there was the option there. We can discuss the –

Mr Aspden: So I am advised.

650 **The Chairman:** Okay. Does anyone else want to come in at this stage on matters relating to the Derbyshire?

655 **Q56. Mr Lowey:** On the Derbyshire, is Mr Aspden saying to us that...? The criticism that I seem to get from the Derbyshire acquisition is that people were content to put their money into a... I use the word, 'British' building society, but they were then used, to sell, and they were not informed that they had been transferred either to the Nationwide or to KSF. You are saying that is normal practice, that the depositors do not get information of the changes?

660 **Mr Aspden:** Mr Lowey, I am certainly not saying that, but, perhaps... I am sorry if I did not explain it clearly, but let me just explain.

Perhaps we can use the Derbyshire as an example, because that is obviously one that interests you most. In the case of the Derbyshire, up until – I forget the precise date – I think it was the 19th November, but, again, all the papers are in your file, those depositors who were on the books of the Derbyshire were actually written to and told about the impending sale to, and transfer to, Kaupthing.

665 Now, to cut through the issues, there is an issue which has been raised with me about those depositors who placed money between that date and the date of completion. I think we have to assume that, after the date of completion, people would have known who they were banking with then, so there is that intervening period.

670 Now, from my investigation, either those depositors would have been aware from previous material, but let us take a worse case. Either they would have been aware from a copy of the same letter that would have been given to them, but let us say someone says to you, 'Well, that did not happen to me.' Let us say they say, 'That did not happen to me.' All depositors were then written to, after the legal acquisition of the Derbyshire was done, at the end of December, by Kaupthing Singer and Friedlander (Isle of Man), to tell them that they were now with the new group. Then there was a further letter that went out either in February or March to all depositors, including those who came in in that intervening period, telling them that computer systems had changed, but their account details were the same, etc.

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Plus, thirdly, which ties in to the question that the Chairman was asking, between that time and 9th October, when the bank went into provisional liquidation, those people also will have received new statements, or whatever it is about the thing, with ‘Kaupthing Singer and Friedlander (Isle of Man)’ at the top.

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So, whilst I agree with you that there will be some people there who are upset about what happened, who possibly did not look as closely as they might have done and who found themselves, on 9th October 2008, in the situation they were, in terms of communications that were sent to them and everything, that is how the story unfolded.

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So, those people, anyone who came on board or in that period over that year, as the position in Iceland deteriorated, all had the opportunity to exit if they wanted to and those people – and I do not know if they are the same ones that have come to you – the ones that have come to me, I have actually said to them, ‘Please could you send me copies of any correspondence which you might have had with the bank during that period, where the bank refused to repay your deposit’, and I have been sent nothing.

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Q57. The Chairman: Did the letters that were sent out to customers after the takeover outline the change in protection offered to their deposits?

Mr Aspden: What change in protection?

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Q58. The Chairman: Well, the fact that they would no longer be covered by a parental guarantee from the Derbyshire in the UK, but they would be covered by a parental guarantee from Kaupthing in Reykjavik.

Mr Aspden: It did refer to the guarantee from Kaupthing Bank HF in Reykjavik, yes.

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Q59. The Chairman: If I can then move on to the takeover of Singer and Friedlander (Isle of Man) at this stage. Are we happy with that? Can I bring you on to when were you first aware of the Shearer evidence that was given to the UK Treasury Select Committee, and has also come to us?

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Mr Aspden: Well, the first I was aware of that was actually, I represented... I was one of the three people representing the Isle of Man on the panel on the UK Treasury Select Committee, and Mr Shearer actually gave evidence in the two hours before me. So I actually sat in the same room as him, listening to him give his evidence in front of the Treasury Select Committee. That was the first time... not the first time I had met him, but it was the first time I had actually seen his evidence and heard his evidence.

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Q60. The Chairman: So, it must have come as quite a surprise to you?

Mr Aspden: Yes. He basically, as you know, had a number of things to say about what he allegedly had said to the FSA and they had done nothing about, allegedly.

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Q61. The Chairman: Did your opinions about the senior management at the bank that was taking over Singer and Friedlander (Isle of Man) correlate with his?

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Mr Aspden: Well, no. One of the things that astounded me about this was the fact that Mr Shearer, if he had all those concerns, first of all had never, ever come to us and, in fact, I have met Mr Shearer before, not on this matter, but in a regulatory sense. I have met him, so he knew me. He had never come to us and expressed those concerns.

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Secondly, if, as he seems to feel, obviously, he said all those things to the FSA, given the dialogue that we had with the FSA at the time over the acquisition – because we did, and everything – the FSA never mentioned any of his evidence to them to us. Now, it may be that they discounted it or whatever, I do not know.

So, that is why I say to you the whole thing came as a complete surprise to me.

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Q62. The Chairman: But you certainly had a realistic expectation that the FSA would have shared any relevant information like that to you?

Mr Aspden: Given what he said, yes.

Q63. The Chairman: And do you believe it was extremely pertinent to that takeover?

735 **Mr Aspden:** It was very pertinent to the takeover. What I do not know is what the reasons were that the FSA decided to discount his submission.

Q64. The Chairman: But other than the letter that you received from the FSA, what other sort of due diligence did you do on the firm that was taking over Singer and Friedlander (Isle of Man)?

740 **Mr Aspden:** Kaupthing Singer and Friedlander (Isle of Man) Limited at the time was actually owned by the London entity, so there was no formal change of ownership at that time of our entity directly, but of course there was indirectly. We did – this was back in 2005...

745 Kaupthing, as you will be aware, was the largest bank in Iceland, and we did a review of their financials. We talked with the regulator there; met with the regulator; set up the usual supervisory apparatus with the regulator, as I have already described; talked with the FSA; satisfied about the consolidated supervision and everything.

So those were the steps we took.

750 **Q65. The Chairman:** Did you do any review of the experience and competency of the directors and senior management of the parent, in the same way that you would do for local senior management and directors?

755 **Mr Aspden:** Yes, we had to, in fact, actually approve one or two of them, because one or two of them... we actually had Icelandic representatives on the board here.

Q66. The Chairman: So you did do that, and they met appropriate benchmarks that you had?

760 **Mr Aspden:** Yes, they were... In fact, I think there were only two Icelandic representatives on the board here – two or so. So as, of course, you know, on many bank boards, you will have some people who are hands-on locals, some are non-executives and then you might have parental representatives as well. So within that capacity, yes.

765 **Q67. The Chairman:** So in terms of vetting that you would do for those particular directors coming from the parent, what sort of experience, competency, would you be looking for, as a sort of standard or bare minimum, maybe?

770 **Mr Aspden:** In that sort of board structure, the first thing one would look for, which applies to anybody coming on to any board of a bank, and that is the usual vetting that is done in terms of probity, integrity, criminal checks, all that sort of thing. So that is number one.

775 Number two, then, when you look at the board of a bank, as I have just mentioned clearly, what you are doing is you are looking for a breadth of the right expertise. In relation to the Icelandic representatives on the board here, their role was not to be hands-on, because there were local people doing that. Their role was to provide the parental connection, the parental oversight, and also to provide the right sort of degree of channel of communication from the Isle of Man back through London to Reykjavik, should that be needed. That they fulfilled and we were satisfied that they fulfilled that... In fact, I think one of the people on the board was the regional head, or whatever you like to call it, for Kaupthing, which embraced the Isle of Man. So that is a fairly typical type of appointment that we would expect to see on a local board.

780 **Q68. The Chairman:** Were you aware of the level of experience that those people had, in terms of number of years' service within the banking industry, and all that sort of thing you would have done as background checks?

Mr Aspden: Yes.

785 **The Chairman:** At this point, we have come to a natural recess. Would anyone like a five-minute comfort break at this time? I am happy to do a short adjournment, if people would feel happy; otherwise I can launch straight into the next barrage! Would anyone...? *[It was agreed to continue.]*

790 Okay. The next area I think I would like to cover is the issue surrounding the parental guarantee, the Icelandic exposure, the repo arrangement and the unsecured funds that were then left with KSF (UK).

Q69. Mr Lowey: Can I... from my point of view, the world has changed since the UK introduced new

legislation in 2008. Is that correct? The banking –

795 **Mr Aspden:** Which legislation are you...?

Q70. Mr Lowey: The immediate cause of KSF (IOM)'s collapse was the UK Treasury making a transfer order under the Banking Special Provision Act 2008, transferring the KSF (UK) retail deposits to ING and, as a consequence of the transfer, KSF (UK) became insolvent and had to be placed into administration. Would you agree with that?

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Mr Aspden: No, it would not be correct to say that the passing of the legislation of itself was the cause of the collapse. The reason the bank collapsed was because, basically, it dried up of liquidity. That is why the bank collapsed as a whole, not just because of the passing of legislation.

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There were other issues in connection with legislation, yes; but I think, overall, the main reason this bank got into difficulty – I am talking about the group as a whole – was because of the total collapse of confidence in Iceland, and then the steps the UK took, with Alistair Darling's remarks, if you remember, in connection with terrorist legislation and all that sort of thing, yes, and the seizure of assets of other banks, not of Kaupthing. So it was a –

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Q71. Mr Lowey: Combination, yes. Right, forgetting the history, then, you would agree that the Banking (Special Provisions) Act 2008 came into force on 20th February and was designed, in particular, to protect UK retail depositors, following the collapse of Northern Rock.

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Mr Aspden: You are telling me the particular date; I do not have the date.

Q72. Mr Lowey: No, I am not going to tie you to the date. That is the information I have got, and I am reciting it to you, sir; the point being that is looking after the interest of UK depositors.

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I want to focus on the fact that that is the world we are living in now. What has the Isle of Man FSC done to make itself aware of that, and how does that impact on depositors in the Isle of Man?

We have got to learn some lessons, and that is the point that I am trying to come to, Chairman: what lessons are we learning and what steps have we taken since then to deal with the world that we are living in now, with the legislation that is in force in the UK?

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Mr Aspden: So far as the UK is concerned, they have put through different legislation. Some of the legislation you have talked about and then also other legislation which I referred to in my evidence, which was legislation designed specifically to deal with the KSF event.

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In relation to the Isle of Man, we have already had some initial thoughts, mentions or whatever to Treasury about when we are looking at the banking sector here, what steps do we need to take in the Isle of Man to avail ourselves either of that type of power, but also other prioritisation – for example, issues that could help depositors in the event of insolvency – instead of just falling back on the Depositors' Compensation Scheme? As we all know, the Depositors' Compensation Scheme costs money, and it costs money from the banks, as well as from the Government. Therefore, there are other measures that one can take, including the ability to intervene in transfer deposits and including the ability to give prioritisation to depositors over particular assets, in the event of an insolvency.

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We can consider all of that, and I think it would be very useful if we did do that, but I think one thing that we have to remember, and I respectfully say, is that we do not have the clout here that they have in London.

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Let me explain: if you are with the FSA and you have got a bank that is failing and that sort of thing, that is the time when you go into overdrive, you go into action, phoning up other banks, twisting their arm to take over the deposits and so on, so that you provide a seamless or effortless, or whatever you like to call it, transition. That is exactly what happened with the transfer of the deposits to ING bank, and it is what has happened in dealing with a number of other UK bank insolvencies. We do not have that ability to do that. So, for example, if a bank goes down here, we could make a few phone calls to a few banks here, but as you know, we are all subsidiaries here, so they are not movers and shakers in banking groups here.

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So some of what goes on in the UK is not going to be practically possible here, because we do not have the power or authority, and we do not have the breadth of banking system to be able to do that.

But I do take your point that I think these measures, including the Isle of Man's insolvency legislation, insofar as it relates to banks, could usefully be looked at, as part of a package for dealing with distressed banks in that situation.

850 **Q73. Mr Lowey:** Do I take it that we have not put anything into operation since 2008, and here we are nearly in 2010?

I come back to the question I asked: what has the FSC learned? The UK legislation is not designed to help 'Manx' depositors; it is to protect British depositors. Notwithstanding that, are you really saying – and you have already said that most of our banks are subsidiaries of external banks – therefore we are in a weaker position?

860 **Mr Aspden:** Just going back to your point on this, we are now one year and one month after the collapse of Kaupthing. We have certainly not sat and done nothing since then, in relation to increasing the protection for Isle of Man depositors. I have already mentioned, in reply to another question, measures we have taken in relation to liquidity, capital adequacy, significantly on independent assets, enhanced communication with our regulators and all of those things, so we have done a lot of measures. Now, by definition, those are non-statutory. We have been able to do that.

865 We have also significantly assisted in the operation of the Depositors' Compensation Scheme, in conjunction also with the current consultation, of course, which you are aware of. So there has been a lot going on. Legislation has not come to fruition yet, but there has been a lot going on.

870 Your other point is an interesting one, and you finished by saying that we are in a weaker position. I have to be honest with you, I think we are in a weaker position. Yes, it would be wrong for me to try and duck that. That arises because we have subsidiaries here. We are not in the driving seat. We have subsidiaries of foreign banks here. We do not have a central bank; we do not have a lender of last resort; we are not the parent supervisor. So, yes, we do rely quite a lot on that.

Let me be quite candid with you that Bradford and Bingley... we would have had another insolvency on our hands here, in the case of Bradford and Bingley, were it not for the extensive co-operation we had with the FSA, and the fact that Bradford and Bingley was essentially bailed out.

875 So this weaker position and everything works both ways. So it is quite interesting on the table: we have got, for example, Bradford and Bingley and we have got the Icelandic situation. Bradford and Bingley was neatly tidied up, so far as we are concerned: no loss; everyone paid off; that was it. Kaupthing: the situation is different.

So, yes, we are in a weaker position potentially, but I would ask you to consider the wider picture, that we are always in a weaker position.

880 Also, my final point on this is that I think that is why the FSC, despite what happened with the Icelandic bank, has always stuck closely to a fairly tough admissions policy – in other words, who we are going to license here. That is why we do not have banks from Timbuktu here, and we primarily are UK-bank focused. (**Mr Lowey:** Blue-chip.) Yes.

885 **Q74. Mr Lowey:** You gave us a catalogue of some of the things that you have done administratively to strengthen our position. Do you think we could have a list of those? (**Mr Aspden:** Yes.) I always find it handy to have a list in front of me: I would appreciate that if you can do that, as you have time.

That is fine, thank you.

890 **Q75. The Chairman:** Do you consider that moving funds from Iceland to the UK firm represented an error of judgement?

895 **Mr Aspden:** It certainly was not an error of judgement. Of course, the files will have shown you the steps that we took to discuss all this with the FSA, the safeguards that we established would be put in place, and I think we did everything that we could have done.

900 Now, let me just make a couple of points. One person questioned earlier – I think it was Mr Lowey – as to would it not have been better if, for example, all the money was placed with third party banks? Or £700 million, £600 million, could have gone... which I think is very reasonable. The answer to that is, yes, clearly; but there are some interesting issues on this. First of all, bear in mind we were in a scenario, at that time – and this was May 2008 – after which banks all around the world were collapsing. So who is to say that actually the banks that that money might have been diversified to would have gone to any better hands? Even RBS went bust, essentially, before it was bailed out. So who is to say that that money would have gone...?

905 So from a regulator's viewpoint, it is a very fine dividing line to be able to actually almost move into the minds of management and say 'thou shalt do that', and then find the potential liability on the regulator for having made the wrong call, in terms of where the money goes. So, I am just saying that is a decision...

But I think we made a very good decision, when we actually told the bank that the Icelandic exposure must be eliminated. We, of course, now, will get no credit for that, but I would actually say to you, at the

time, that actually, for a regulator, was quite a brave decision, to be able to say to the parent bank, 'we do not want any direct exposure.'

910 The question is, then, the money then went to London. You could quite rightly say to me that London was a subsidiary of Iceland. The reputation of London hung on Iceland. It might have been separately, and I agree with you.

915 So did it represent a compromise? Yes. How did we risk-mitigate the compromise? The way we did that was through the exchange with the FSA to what we believed, on the basis of that communication, which was also confirmed by the FSA, was that the net exposure to Iceland was pretty much eliminated – not entirely, but pretty much eliminated.

920 **Q76. The Chairman:** So how did you and the board of the FSC perceive the risks associated with KSF (UK) were different to that of KSF (Iceland)?

925 *Mr Aspden:* That hung primarily on the exchange of correspondence, which is in the file, which we had with the FSA, in relation to the limits and protections which they put on the UK bank. You will recall the letter that dealt with liquidity, large exposures and that sort of thing. We wrote to them – there was a critical element – and they wrote back to us.

930 **Q77. The Chairman:** The evidence that we have suggests that, near the end, there was about a billion pounds' worth of exposure from KSF (UK) to KSF HF. Does that fit with what the FSA were telling you, in terms of their limits?

935 *Mr Aspden:* No, it does not, and one of the most unsatisfactory things about this whole episode is that no-one has ever been called to account, to explain why the UK bank got into the trouble it did, when the limits, which are referred to in the papers that you have got, were clearly set by them. It does not take a rocket scientist to work out that had those limits been... I am not saying there would have been no trouble, but the situation would have been a lot better.

940 **Q78. The Chairman:** So you were surprised that there was such a large exposure from the UK to Iceland, given the assurances that you had received from the FSA. What did you think the maximum exposure to Iceland from London was?

945 *Mr Aspden:* We, on the basis... and this is set out in our letter in May 2008, our understanding at the time was there would be a net nil exposure, but there would be a large exposures limit of 25 per cent of capital to group-related entities in the UK and there was also a liquidity drawdown facility, but that did not incur an exposure from here, there.

950 **Q79. The Chairman:** So if the UK large exposure capital base was in the region of £140 to £156 million, does that sound familiar?

Mr Aspden: Yes, I do not have the exact figures, but –

955 **Q80. The Chairman:** About right, though. If that was available to lend to the group, did the unsecured £160 million that the Isle of Man had with London not count against that figure, in forming the net position?

Mr Aspden: Did the £160 million, the money that we had placed – ?

960 **Q81. The Chairman:** Would the money that was with the Isle of Man, had been placed in London unsecured, count against that large exposure capital base limits for London?

965 *Mr Aspden:* I am not sure how the FSA would have calculated their capital base, but a placement by the Isle of Man – in other words, a deposit by the Isle of Man to the London bank – would not... I do not see it would have automatically resulted in a deduction from the capital base.

Q82. The Chairman: Okay. Not as a deduction, but in terms of the percentage exposure that they would allow to be with the intragroup?

970 *Mr Aspden:* Our deposit with London would have been on the liability side of their balance sheets. What

we are talking about, then, is the exposure of the London bank to other group entities, which would have been on the asset side of the balance sheet. So an inward deposit from us would not have necessarily counted against that.

970 **Q83. The Chairman:** Could you not have obtained, through your MoU with the FSA, the actual exposure that London had to Iceland on any point up to the collapse?

975 **Mr Aspden:** No, the MoU that we signed with the FSA does not automatically give us the right to pry into the detailed figures of that, no. But what we did do, in this particular case, because of the concerns we had, we had that exchange of correspondence with them.

Q84. The Chairman: So what information did you seek from either the company or from the FSA to verify the assurance that they gave you?

980 **Mr Aspden:** Let us just refer to the letters, because these are important, and I think it is –

Q85. The Chairman: These are the letters that the FSA wrote to you, giving the assurance?

985 **Mr Aspden:** This is the letter we wrote to the FSA and then the FSA wrote back to us. So, we wrote to the FSA on 21st May, and the FSA wrote back to us, also on 21st May.

Q86. The Chairman: But there was no follow-up after that?

990 **Mr Aspden:** There did not need to be, because the FSA... What had happened was we had had a dialogue with the FSA, we then established what their positions were, and everything. We had then written our understanding to them; they had written back and basically said... they did not say 'you're correct', but they regurgitated what we had said to them, essentially, and that was on 21st May. So, we had a common understanding on both sides.

995 Then it was our expectation – and this gets back to the whole co-operation issue, it is our expectation – that because of that understanding, obviously if there had been any variance, then they would have come back to us.

Q87. The Chairman: That correspondence outlines limits of acceptable behaviour that the company will abide by, because it is regulated to do so.

1000 What I am saying is that between May and October there was no follow-up to say 'is this still the case?' or seeking evidence of what the actual exposure was. As tensions or concerns heightened, there was no follow-up to that letter to say 'is this still the case?' or 'what is the exact status at this point?'

1005 **Mr Aspden:** This is one thing that we find. I have mentioned before about the co-operation thing and dialogue with the FSA, because, actually, during that period, we were in intensive discussions with the FSA on the Bradford and Bingley issue.

1010 So although you have not got much in this file, were you to be looking at our Bradford and Bingley file, you would find the FSA even came over here, a senior person from the FSA, to negotiate on Bradford and Bingley. So there was a lot of dialogue going on, which made us even more surprised, after the event, that actually having had a common agreement as to how things were to be left and this is exactly how we would play it, then they did not come back to us and say, actually the situation is not what it is or it has deteriorated or whatever.

1015 **Q88. The Chairman:** What support did KSF (UK) give to the Isle of Man in the way of any guarantees? I know that the money was relatively short-placed, in terms of sight to eight days, but was there any other sort of liquidity call or guarantee from the sister company that this money would be made available, should it be needed?

1020 **Mr Aspden:** I am not sure they gave any guarantees, because actually to have a guarantee from London backing a claim that you have actually got on them does not of itself give you, as you know, any additional security.

But part of the exposure was guaranteed, as you will see from the file we had – not guaranteed; secured – and you will see from the file that we had discussions with the bank on the level of haircut to apply to the

1025 security provided to that. There was not a guarantee, but there was... well, that was essentially it: the shares.

Q89. The Chairman: But did you see evidence that the... Well, let us move on to the repo then. Are you satisfied that that was held on a bare trust? Did you actually see evidence to confirm that?

1030 **Mr Aspden:** I am not sure that we saw the legal documentation for that, no, but we were satisfied. Even to this day, I do not think there has been any evidence that the terms of the repo were not as we thought at the time.

1035 **Q90. The Chairman:** How are you satisfied that that is the case, if you did not see evidence of how it was constituted?

1040 **Mr Aspden:** We do not, on every single sort of structure or whatever that is put in place with the Commission, seek the full documentation and crawl through it... On particular issues we might but, at the end of the day, that was not creating any additional exposure. That particular repo has not... I have not discussed it with the liquidator, but I am not aware that it has caused any... been unwound in a different way than which we originally thought.

Q91. The Chairman: And what was the justification for the level of haircut that was ultimately determined for that repo? It fluctuated between 5 and 25 per cent in the discussions.

1045 **Mr Aspden:** It was a haircut on the securities and the reason was because originally – and I am talking from memory here – the basket of securities was to be either FTSE 100 or 250, and in the end they were not. So, what we did is we reverted to the FSA and we applied a stronger haircut or a larger haircut, because the shares were not to the same perceived quality.

1050 **The Chairman:** Does anyone else want to come in?

Q92. Mr Lowey: I am trying to get the position of our regulator regarding the regulations that apply elsewhere, bearing in mind that most of our banks are UK banks. Do we have any dialogue with the UK authorities regarding rescues of banks?

1055 **Mr Aspden:** We have started to have some, not just with the UK, but internationally as a result of all of this. Beforehand, I cannot recall any, no.

1060 **Q93. Mr Lowey:** So, before the collapse of this one, we had none; since then, we are building... That is fine.

It is very easy for me to go off on a tangent and say, ‘if we had done this and if that’; but, anyway, the reality is we did not and, since then, it is part of the learning curve. We are beginning to do that. That is fine. That is all I have to say on this one.

1065 **Q94. Mr Houghton:** I have a series of questions now, Mr Aspden, that cover the area between the period with the Commission’s dealings between 26th March 2008 and July 2008.

May I ask, first, did the meeting between the Commission and KSF (IOM) on 26th March represent the first moment that the Commission expressed to KSF (IOM) its concern about group exposure?

1070 **Mr Aspden:** Your question, Mr Houghton, is whether this represented the first time that we had – ?

Q95. Mr Houghton: Yes, the very first moment that you expressed a concern to KSF (IOM) in regard to group exposure.

1075 **Mr Aspden:** No, we were discussing that at officer level before then.

Q96. Mr Houghton: Have you any notes of those, Mr Aspden? Have you got copies of any attachments that are not with the file, which refer to any action points taken of those concerns?

1080 **Mr Aspden:** I will recheck but, as far as I know, you have had a copy of our entire file.

Q97. The Chairman: Is this not something that was mentioned in your initial assessment for the takeover document, about the concern over Iceland? In the paper that would be –

1085 **Mr Aspden:** You mean the takeover of the Derbyshire or the – ?

Q98. The Chairman: The takeover of Singer and Friedlander by Kaupthing.

1090 **Mr Aspden:** Back in 2005? (**The Chairman:** Yes.) It could be, I have not looked at the paper.

Q99. The Chairman: I think that is where I may have seen it.

Mr Aspden: Okay, we will check that, yes.

1095 **Q100. Mr Houghton:** Could you let the Committee have a copy of the agenda for 28th March 2008 between the Commission and KSF (Isle of Man)?

1100 **Mr Aspden:** I will certainly look at it, but very often we do not have an agenda for meetings in terms of a formal piece of paper. We obviously do for formal meetings, like board meetings and so forth, but if we are visiting a bank, we would not necessarily – we do sometimes, but we would not necessarily – have an exchange or prior agenda before where we are talking about just one subject.

Q101. Mr Houghton: I may ask on that... Is it usual for your good self to attend such meetings?

1105 **Mr Aspden:** I attend some. It depends, really, on how the matter has been escalated and what issues are to be discussed.

1110 **Q102. Mr Houghton:** If I can just clarify, the relevant minutes, then, if you can send those, if you do not have an agenda, any notes of the meetings or anything in support of that meeting.

Mr Aspden: The one that we have sent you is the minutes of that meeting held on the 28th and –

Q103. Mr Houghton: And there is no other further documentation?

1115 **Mr Aspden:** Not that I am aware of.

Q104. Mr Houghton: Thank you very much.

1120 The proposals by the Commission, which was planning for a crisis scenario, must have come as a bombshell at that particular time to KSF (Isle of Man). Was the meeting as matter of fact as the minutes suggest?

Mr Aspden: The minutes are a minutes of record.

1125 **Q105. Mr Houghton:** The minutes are minutes, but was it as matter of fact as it suggests? Because it was quite a bombshell, as I have just said.

Mr Aspden: That is a loaded question, Mr Houghton, so my answer is –

1130 **Q106. Mr Houghton:** The purpose of asking you is that particular point.

Mr Aspden: Well, I am giving you the answer, which is you have got the minutes.

1135 **Q107. Mr Houghton:** Presumably, Mr Aspden, the Commission was very concerned that £404 million, which is 55 per cent of total customer deposits, was lent intra group? Any comments on that?

Mr Aspden: Not really, because we had been keeping track of the amount lent intra group from KSF (Isle of Man) elsewhere on the statistical and prudential returns that we had been receiving.

Q108. Mr Houghton: Thank you.

1140 Your letter dated 28th March 2008, enclosing a copy of the signed minutes, emphasises the importance of the meeting. From 28th March 2008, were all new and maturing deposits held at KSF (Isle of Man) level outside intra-group lines with correspondent banks; and if not, why did the Commission back off from its proposal?

1145 **Mr Aspden:** We did not back off from the proposal. As you know, the proposal... Essentially, at the end of the day, we wanted the Icelandic exposure eliminated, which is eventually what happened.

Q109. Mr Houghton: Thank you.

1150 Following the 28th March 2009 meeting, what meetings and correspondence took place between members of the Commission, members of the Commission's executive and the non-executive directors of KSF (Isle of Man)?

Mr Aspden: All the correspondence is in the file that you have had.

1155 **Q110. Mr Houghton:** There is no other correspondence?

Mr Aspden: Not that I am aware of.

1160 **Q111. Mr Houghton:** Thank you, and if you have none of those... As I say, if you can just check just in case there may be some. We would be grateful to receive them.

In paragraph 27 of your submission, Mr Aspden, to us, you state, in relation to the end of March 2008, the priority was to eliminate KSF (Isle of Man)'s direct exposure to Iceland. That does not appear to be the whole situation, as the evidence submitted by you suggests that, by the end of March 2008, your priority was to eliminate KSF (Isle of Man)'s direct exposure to the group and that this desire intensified during April and May 2008. Is that not more like the true case? Is that an accurate account?

Mr Aspden: No.

1170 **Q112. Mr Houghton:** What are your comments on that?

Mr Aspden: My comments are that, essentially, at the end of the day, we wanted, as I have said in my evidence, to eliminate the direct Icelandic exposure and what we did was open discussions with the bank on how that can be achieved.

1175 As I have already mentioned, we actually did not direct a specific course that the bank should take; rather, what we did was ask them to come up with proposals, and that is why, in fact, at the end of the day, the course of action that was eventually taken differed from what the initial discussions were about.

1180 **Q113. Mr Houghton:** Can I ask why did you not make representations to the Committee about what took place during April and May 2008 in this particular regard?

Mr Aspden: To which Committee?

Q114. Mr Houghton: To this Committee.

1185 **Mr Aspden:** To you?

Q115. Mr Houghton: Yes, in your submission.

1190 **Mr Aspden:** I am sorry, I misunderstood. Why did we not make representations to you about what?

Q116. Mr Houghton: About the issue that I am asking you about, about the group's intensified desire during April and May 2008.

1195 **Mr Aspden:** I am very sorry, I misunderstand the question. Could you just start the question again for me?

Q117. Mr Houghton: I will go through question 19 again for you. In paragraph 27 of your submission to us you state, in relation to the end of March 2008, the priority was to eliminate KSF (Isle of Man)'s direct

1200 exposure to Iceland. That does not appear to be the whole situation, as you suggest, by the end of March 2008. You have answered that. Your priority was to eliminate KSF (Isle of Man)'s direct exposure to the group and this desire intensified during April and May 2008. What I am asking is why was this not firmed up more in your submission to this Committee, about those actions that were going on between April and May 2008, because there were an awful lot of them, weren't there?

1205 **Mr Aspden:** Yes, but simply, Mr Houghton, because my submission is necessarily a summary document and it does not include all the detail. I included what I thought were the salient points, but I have given you a copy of everything, so there can be no question – I know you are not alleging it, but there can be no question – that I have not said what is right, because it is all in the papers.

1210 The reason it is not in there is because, at the particular time, I did not think it was significant enough to put in what was a summary document, but nonetheless you have had all the papers.

Q118. Mr Houghton: Thank you.

Did the Commission see a copy of the minutes of KSF (Isle of Man)'s board meeting on 31st March 2008?

1215 **Mr Aspden:** I do not know. I would have to check that.

1220 **Q119. Mr Houghton:** Why, in the course of two telephone calls on 31st March 2008, did the Commission move from new and maturing deposits being held outside the group, as this was not in the best interest to the group, to security over Kaupthing Bank assets for 50 per cent of the site, one month intra-group exposure? Did this show a lack of conviction on the Commission's part?

1225 **Mr Aspden:** No, it did not show a lack of conviction, I would suggest, but what it did do... As I mentioned a moment ago, in all of these situations one has to work out, or one has to decide, on a course of action that achieves one's prudential objectives but at the same time is pragmatically effective, and what we did was, at the end, came to a compromise that we felt was appropriate. The fact that it was different to what we initially set out to do I think is a reflection of an entirely reasonable course of discussion.

Q120. Mr Houghton: Thank you.

1230 What was the Commission's response on the suggestion that, if the new internet product was highly successful... what would be the position re group placements in that particular regard?

1235 **Mr Aspden:** Essentially, at that stage, we had made sure that if there were any new deposits coming in they would not be redirected to Iceland, and that if any more deposits came in they were either held locally or held under the terms of what we had agreed in relation to the placement with the UK bank.

Q121. Mr Houghton: Thank you.

1240 The Commission knew, from the 26th March 2008 meeting, the scale of success of Kaupthing Edge in the United Kingdom. If the Commission had, at this point, insisted that such deposits be held outside the group, then Kaupthing Edge would have remained a UK product. In the event, did not the scale of Kaupthing Edge in the Isle of Man only make the subsequent failure worse?

Mr Aspden: No. I have not got specific figures here, but my recollection, by volume of money, is that the Edge product in the Isle of Man was not as successful as in the UK.

1245 **Q122. Mr Houghton:** Thank you.

Can you locate the letter from Kaupthing Singer and Friedlander (Isle of Man) dated 8th April 2008, and could you talk us through that letter, Mr Aspden, with particular regard as to why it reassured the Commission that no immediate action was needed?

1250 **Mr Aspden:** 8th April 2008? (**Mr Houghton:** Yes.) You would like me to go through the letter of 8th April, which I have got here?

Q123. Mr Houghton: Yes. Thanks very much indeed.

1255 **Mr Aspden:** Page 1, you will see, is basically – subject to any points you might want to raise – a

descriptive text from the bank, in particular relating to, at the bottom, how the parent bank manages their liquidity and what their liquidity position is.

1260 The letter of 8th April is actually replying to mine of 28th March, and there were various headings in there so these headings are repeated in their letter here. So going through the headings, if I may, the first one relates to intra-group lending, and you will see here this relates to actually the repo and the margining requirements that the Chairman was talking about earlier, and that sets that out, and also refers, in the second part of that response, to a committed standby line from the parent bank for £184 million as additional liquidity.

The second heading, 'Third-party liquidity', says:

1265 'We continue to observe the existing 10-per-cent liquidity requirement, as previously set by the FSC. Accordingly, we currently have other independent liquidity of approximately £90 million. We have been advised by the FSC that considerations be given to increasing this percentage.'

So I think, subject to your view, that stands for its own.

1270 The third heading relates to new deposits, and here they talk about the... In fact, they use the words 'fantastic success' but, as I say, certainly in volume of figures and so forth, it was much more of a success in London than it was in the Isle of Man, and that one ends up, essentially, with a comment from them that says:

1275 'We propose that if our deposit marketing initiatives prove successful in the immediate term and the amount of net new deposits become a significant figure we could revisit this, but in the meantime we keep the position under review with the FSC.'

The fourth heading in there was 'Intra-group lines', and they said:

1280 'We note your wish to discuss liquidity mismatch positions going forward.'

And then the letter ends.

Q124. Mr Houghton: Thanks very much indeed.

1285 **Mr Aspden:** Thank you.

Q125. Mr Houghton: Can you make any comment now as to why it reassured the Commission that no immediate action was needed?

1290 **Mr Aspden:** Well, it did not, which was why, in fact, we eventually went back to them – well, not eventually, we further went back to them – and actually said that the Icelandic exposure then had to be eliminated. So in fact what we did was escalate our response in the light of what we were not achieving, as it were, in the context of that reply of 8th April.

1295 **Q126. Mr Houghton:** Thank you.

Why did the equity repurchase proposal provide any additional comfort, as all it relied on was an intra-group indebtedness and round-tripping?

1300 **Mr Aspden:** It was not so much a round-tripping, but it was there purely as an additional liquidity facility, should it be needed, and in fact the repurchase agreement was not something which we put an enormous amount of regulatory reliance on.

Q127. Mr Houghton: Thank you.

1305 Why did the Commission just not say no to Kaupthing Edge coming to the Isle of Man?

Mr Aspden: You mean Kaupthing Edge as a product or Kaupthing –

Q128. Mr Houghton: As a product.

1310 **Mr Aspden:** As a product to the Isle of Man? Well, because at that stage we were not in the mode of closing the bank down. It is a difficult business.

This gets back to what I was talking about earlier in response to Mr Lowey and the balancing act between actually intervening effectively to manage an institution, and not, and at that stage there was no reason why... For example, they could have continued with the Kaupthing product, the Edge product, and they might have,

1315 at that stage, come back with a proposal that was entirely suitable.

In fact, we dealt with it in a different way in the end, but I think, at that stage, to have actually said, 'Don't bring the Kaupthing Edge product to the Isle of Man,' was not on the immediate list.

1320 **Q129. Mr Houghton:** There is some mention of e-mails in that letter. Can we be sent some of the attachments to those e-mails?

Mr Aspden: If there is anything that we have not copied to you on those, we will make sure we do, yes.

1325 **Q130. Mr Houghton:** Thank you very much indeed.

The Commission's letter dated 25th April went beyond the minute contained in the Commission's minute on liquidity at its 24th April 2008 meeting. Although Mr Cashen was not present at the discussion of this at the meeting, would he have received a copy of the minute and so be aware of the discrepancy?

1330 **Mr Aspden:** I think it highly unlikely, but I will check that. I see no reason why he would have received a copy of that.

Q131. Mr Houghton: Thank you.

1335 Was the direction, in the 25th April 2008 letter, that there is no exposure by KSF (Isle of Man) to Kaupthing Bank, ever implemented; and, if not, why not?

Mr Aspden: Not only was it implemented, but that was why, when the bank went down, it actually had no exposure to the parent bank, because it refers here to direct exposure to Kaupthing Bank HF.

1340 **Q132. Mr Houghton:** Thank you.

Can you now locate Michael Weldon's note, dated 29th April 2008, of his conversation on 25th April with Aidan Doherty.

Mr Aspden: Yes, I have got it.

1345 **Q133. Mr Houghton:** Thank you. Would you read that out to the Select Committee, please?

Mr Aspden: Yes.

1350 **The Chairman:** Is there anything you specifically want to ask on it, rather than... Obviously, the evidence there is a matter of record.

Q134. Mr Houghton: Yes, I appreciate that, but if you can just read the points out, if you would, Mr Aspden.

1355 **Mr Aspden:** Fine.

'Note of telephone conversation, Kaupthing Singer and Friedlander (Isle of Man) Limited.

1360 I telephoned Aidan Doherty on Friday, 25th April and informed him that I was sending him a letter, following a board meeting of the FSC that had taken place yesterday. I read Aidan the contents of the draft letter. He expressed astonishment and asked if we understood the implications of what we were requiring. It could mean that Kaupthing close their Isle of Man operations with the loss of 70 jobs. Aidan asked if the FSC board understood this. I explained that the board had taken the relevant matters into account and had made its decision on prudential regulatory grounds. I explained to Aidan that if the bank did not agree with what we were seeking, matters could be firmed up into the form of a direction. This would give the bank the opportunity to challenge what the FSC was requesting. I explained that anything the FSC requires is always open to challenge if a firm does not agree with what is being required and requested. Aidan asked for the reasons for the request. I thought this was an entirely reasonable request from him and therefore I said we would revert back to him on this. (I considered that, bearing in mind the importance of 'reasons' it was appropriate to take time to put these down on paper). Aidan asked if JRA was around to speak to and I said he was and I would ask him to phone Aidan.

1370 Updated JRA. We and AK worked on setting the reasons down with a draft. JRA subsequently spoke on Friday p.m. with Aidan. JRA agreed to hold over sending the letter until next week. (The FSC board had not said it had to go out by the end of this week). This would give us an opportunity to reflect on matters over the weekend.'

That was signed by Michael Weldon, Head of Supervision, on 29th April 2008.

1375 **Q135. Mr Houghton:** Thank you.

Did Mr Weldon discuss this conversation with you before writing the letter dated 25th April 2008?

1380 *Mr Aspden:* I imagine he did, yes, because it also says at the bottom, ‘Updated...’ He actually says here that he updated JRA, and that is me.

Q136. Mr Houghton: What was your reaction at that time, Mr Aspden? Can you recall?

1385 *Mr Aspden:* I cannot recall precisely, but I am sure he would have... Normally, that type of discussion would have been to discuss the terms of the letter with me.

Q137. Mr Houghton: Did you keep any notes of that particular discussion?

1390 *Mr Aspden:* If it is not in here, I did not, no.

Q138. Mr Houghton: Thank you.

Did you speak to Mr Doherty at any time thereabouts? If so, what was discussed, and did you do a note of that conversation between yourself and Mr Doherty?

1395 *Mr Aspden:* I am afraid that the notes of all the telephone conversations – and you will see there are one, two, three here in the file – are all here, so if it is not here, then I did not do a note of the conversation.

Q139. Mr Houghton; Can you explain why it took four days for Michael Weldon’s note to be written? Would it not have been best practice to write that note immediately after the conversation?

1400 *Mr Aspden:* Not necessarily. There are –

Q140. Mr Houghton: At such a critical time?

1405 *Mr Aspden:* Not necessarily. There are conflicting priorities, and four days is not an unreasonable time to get something done and out, depending on what the other priorities are.

Q141. Mr Houghton: Thank you.

1410 There was a second letter, sent by the Commission on 25th April 2008, of two pages, outlining their reasons for the decision, following a telephone conversation between Mr Doherty and Mr Weldon, and possibly a second conversation between Mr Doherty and yourself. Do you recall that, Mr Aspden?

Mr Aspden: Sorry, which letter is this?

1415 **Q142. Mr Houghton:** On 25th April, the second letter sent by the Commission. (*Mr Aspden:* Yes.) It refers to telephone conversations between Mr Doherty and Mr Weldon.

Mr Aspden: Just for the sake of clarity and other people here, there are two letters sent by the Commission dated 25th April, and they are both sent by the same person. So your question is what, in relation to –

1420 **Q143. Mr Houghton:** Do you agree that this letter really showed a prescience bordering on the prophetic and underlined the careful consideration and analysis the Commission had applied to the problems facing KSF (Isle of Man)? Can you make reference to that letter, to this Committee, and comment on the various points raised?

1425 *Mr Aspden:* There are two letters dated 25th April, both addressed to Mr Doherty: which one would you like me to go through?

1430 **Q144. Mr Houghton:** If you would like to cover both of them, that is quite alright, because one will follow on with the other.

Mr Aspden: There are two letters. One is two pages and one is one page, so –

The Chairman: I am not going to have you read these out, Mr Aspden. I am conscious of the fact that we

1435 have other issues to go on to.
Do you have any particular questions that you want to close off on this, because then I am going to bring Mr Lowey in.

1440 **Q145. Mr Houghton:** Mr Aspden, I feel, needs to be given the opportunity to understand the letters, rather than putting cold questions, as I call it, and that is the purpose of asking these questions to you, Mr Aspden, of course, and reading the contents of the letter so that it is fully understood.

I would really feel that it is unfair to ask Mr Aspden questions to do with the letter when he has not had time to read it and study it himself like he had in the earlier letter.

Would you agree with that, Mr Aspden. Is that fair?

1445 **Mr Aspden:** No, because, I mean –

Q146. Mr Houghton: I can ask you some questions on it, and I have got some questions prepared to ask you on it, but again it is time that you will need to answer and this is the information that we need to find out.

1450 **Mr Aspden:** Chairman, my time is yours. I am happy to crawl through these letters, if you would like to, but these are letters that are in the file, and –

1455 **Q147. Mr Houghton:** Well, then, we can perhaps make a start, Mr Aspden. It refers ultimately to a statement. Did the Commission ultimately follow through with the statement that the letter mentions?

The Chairman: Which statement?

Mr Houghton: There is a statement mentioned in the letter.

1460 **Mr Aspden:** As you will be aware, Mr Houghton, there are two letters and a lot of statements in here, but at any rate, the answer to your question is all of these letters actually led up to the culmination of the elimination of the exposure and the transfer to the London operation of all balances, so these were lead-up letters to that final action. So what these letters actually reflect is the course of the discussions that we were having with the bank leading up to the eventual elimination of the exposure.

1465 **Q148. Mr Houghton:** I do appreciate that the Chairman is putting pressure on time here. What I will do is I will halt these questions now, Mr Aspden, and if we have got time afterwards then I will do them, but I will require to ask these questions either now or at some later date.

1470 **The Chairman:** That is fine.
Mr Lowey.

1475 **Q149. Mr Lowey:** Mr Aspden, I know, as Chief Executive, you are responsible for everything that goes on in the Department. That is the way the pyramid works: you are the Department. The day job is multi-faceted, like most chief executives' jobs are, and it is impossible for you to be in charge of everything that is going on, obviously, but can you tell me were you in charge of KSF, or was it delegated to another senior officer in the Department to be doing the...? Because this was a developing scenario, and for clarity's sake, were you in charge personally, or was it delegated to another officer, which is not unreasonable in the whole scheme of things?

1480 **Mr Aspden:** This was an evolving situation, Mr Lowey, which I was extensively involved in, but actually not just myself, either. As the record will show, so was the board as well, so this was not even an issue that was just being dealt with by the executive. So, in terms of the whole Icelandic exposure issue – redirection of the money, how we dealt with the bank on this and everything – this was something that I was discussing regularly with the board as well. But, yes, I was in –

Q150. Mr Lowey: The board being the Chairman?

1490 **Mr Aspden:** The board being the Chairman and other members, other than Mr Cashen.

Q151. Mr Lowey: That is fine. That is really the point that I was trying to get at, because it is not

unreasonable, in developing... Because the rest of the world goes on just the same and you have got other responsibilities. I just wanted that clear.

1495 Again, getting down to some basics, can you tell me what is the total shortfall of funds owed to depositors of KSF (Isle of Man) as of today? Do we know?

The Chairman: Certainly, as at 8th October we do.

1500 **Q152. Mr Lowey:** Well, from 8th October.

Mr Aspden: I am not being evasive, but the trouble with your question, Mr Lowey, is you said the 'shortfall of funds'. I do not know what the shortfall of funds is or is going to be, because it will depend on the liquidation.

1505 As you know, the figures that Government has put out say that there will be a recovery rate of between 70p and 75p in the pound – that is what has been said, I think, in the House of Keys or Tynwald – and I know of no reason at the moment to change that figure.

1510 **Q153. Mr Lowey:** The exposure that the Isle of Man Government is at risk, that again is another matter of public record.

Mr Aspden: Yes. The exposure on which the Treasury Minister went to Tynwald and got authority from Tynwald – as, of course, you will know – for Government funding of the DCS, was a total of £193 million, of which the FSC has currently drawn down £130 million and repaid £70 million.

1515 **Q154. Mr Lowey:** Can you give us a rough idea how many depositors and what proportion of the total will receive 100-per-cent refunds of their money?

1520 **Mr Aspden:** Okay, if you do not mind receiving from me very broad figures, the sort of figures I understand from the liquidator are that, in terms of the total number of depositors, we are probably looking in terms of somewhere around 10,000, give or take. The total amount of individual ledger accounts probably is larger than that, going up to say 14,000 or 15,000, I understand; but do not forget that represents multiple accounts from a single depositor.

1525 The total number of claims on the DCS looks... Of course, it is still open so we do not know a final figure, but it looks as though we are in a figure of about 5,300 to 5,500, of which we have currently paid, or authorised to be paid, 4,300.

1530 As I said, we have drawn down £130 million from Government and repaid £70 million, so there is a net borrowing at the moment from Government of £60 million. That is excluding the EPS, so it is just the DCS; but we have also, of course, just received the first dividend from the liquidator of I think it was 24½p in the pound, which has helped our cashflow, because we stand in the place of the depositors. (*Interjection by Mr Lowey*) Exactly.

Mr Lowey: Okay, that is fine. Those were just housekeeping... that I wanted to find out.

1535 **Q155. The Chairman:** The last area I would like to touch on in the last hour, if I may, is surrounding the death of the company. When did you and the FSC realise that the end was nigh?

1540 **Mr Aspden:** You will recall, Chairman, that through the summer there were very... Ever since Northern Rock the previous year, but particularly during the summer, market conditions were tightening enormously, and during that period also we were dealing with the collapse of Bradford and Bingley, so that illustrates to you the enormity of what was going on.

1545 As regards Iceland, you will recall the three Icelandic banks of Glitnir Bank, Landsbanki and Kaupthing. Basically, at the end of September, Glitnir Bank and then Landsbanki collapsed. Of course, we do not have those two banks here, but they were obviously very high-profile events and, indeed, right until the last minute, you may also recall that as Kaupthing Bank was the largest bank in Iceland, it was actually intended to be the saviour bank for the other two. In the event, that did not materialise. Why did it not materialise? Because the government did not have the money – essentially, the Iceland Government did not have the money.

So during September, it was clear that we were very much looking at a deteriorating situation. Bear in mind, at the time, also... Many of these are conversations recorded in the files, some are not, but we were also having not only close discussions with the bank here, I was in direct contact with the group treasury in

1550 Reykjavik, and we also had direct dialogue with the FME, the Icelandic regulator. This intensified towards the end of September.

You might take the view, with hindsight, 'Okay, when Glitnir Bank went and Landsbanki went, surely it was a foregone conclusion that Kaupthing would go as well.' The answer to that at the time was no, because: (a) Kaupthing was the largest bank; and (b) the Icelandic Government were, right up until the last moment, saying that they would stand behind it. In fact, really what pulled the plug, at the end of the day, was the tension between the UK and Iceland at the political level in relation to the invoking of the terrorist legislation and that sort of thing, and that is when it all fell apart.

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1560 In fact, we will never know, even today, whether the sort of intent that they had could, would or would not, have been... if they had tried to fulfil it because, at the end of the day, the whole thing became so political, because of the accusations, that any goodwill in the matter just fell apart.

I seem to recall that 6th October was a Monday, and at that time Landsbanki and Glitnir Bank were... I think Glitnir Bank went on 30th September, but my dates may not be exact. On 6th and 7th, which was the Monday and Tuesday, clearly at that stage our concern was at maximum level. We were in intensive discussions with both the management here, as well as the regulator, but unfortunately the regulator basically stonewalled us for most of the time, and with no disrespect to him and with no disrespect to the bank in Iceland, they did take calls, but they just had a straight party line that 'Liquidity is okay, we'll manage.' That was their party line.

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1570 Then, what happened was that, on the 8th, the UK bank went into administration. You will have seen from the file that before the 8th, on either the 6th or the 7th, there were calls going backwards and forwards, including from Freshfields in London, who evidently were acting for, I think, the FSA. There were calls about the Isle of Man structure, ownership and all of that sort of thing. Unbeknown to us, but it is referred to in my evidence, at that time, the UK pushed through emergency legislation for the winding up of Kaupthing, and also completely unknown to us, they had actually set up a trust account at the Bank of England, in order to ring fence and segregate some of the moneys coming in to Kaupthing London.

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Q156. The Chairman: When did you first become aware of that Bank of England trust account?

Mr Aspden: I became aware of it, I think, in January or February this year. In fact, it was even after I went to the UK Treasury Select Committee. I am pretty certain it was even after that. I was aware of the emergency legislation when I went to the UK, but not the trust account.

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So there were the two pieces of legislation. The UK went into administration on the 8th, and then we went into provisional liquidation around lunchtime on the 9th. So that was really the chronology.

Q157. The Chairman: But do you think it was far from certain that Kaupthing Bank was definitely going to go, right up until the 11th hour on the night of the 8th?

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1590 **Mr Aspden:** I have been involved in... This sounds dreadful to say it, but I have had to manage, as a regulator, other bank difficulties in the past, so this is not a new event. I do not need to tell you this, but a collapse of a bank is a very serious thing, so what one is trying to do is look at every measure possible to save the situation.

Many of the solutions which Mr Lowey mentioned happened in the UK would be very helpful here, but unfortunately, as I had to, in response to his points, point out, we do not very often have the wherewithal to do that, because we are a small situation.

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So it was very serious, but we were obviously looking for whatever solution possible. If you remember, even after we went into provisional liquidation, there was criticism at the time, which was one of the reasons why the Government, as I understand it, spent quite a long while trying to pursue the Scheme of Arrangement, actually to elicit as much goodwill from the Icelandic people as one could.

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So, yes, it is very easy to say in these situations, 'Deal with it as any other company – bang it into liquidation straight off,' and everything but, actually, when you are talking about potential solutions, potential goodwill, as of course you will know, there are much wider factors to take into account.

But within that period, I think that is how we dealt with it, yes.

Q158. The Chairman: Looking at it from a regulatory perspective, were the actions of the FSA in issuing the first supervisory notice, on I think it was 3rd October, reasonable?

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Mr Aspden: I am not quite sure which notice.

1610 **Q159. The Chairman:** The first supervisory notice, which was the one that set up the Bank of England trust.

Mr Aspden: For Kaupthing?

Q160. The Chairman: Yes. Do you think that those actions by the FSA were reasonable?

1615 **Mr Aspden:** I have a fundamental question about that, which is: how can you set up a trust account to segregate moneys, and why would you set up a trust account to segregate moneys, if you actually did not think the bank was insolvent? Therefore, by definition, if one was in such a frame of mind that requires you to set up a trust account to safeguard deposits, why was the whole bank not in liquidation at that stage? You cannot allow a bank to continue to operate whilst having a special arrangement to protect incoming money.

1620 **Q161. The Chairman:** Do you think this was just an opportunity to hold for time while the relevant bits were cherry-picked?

1625 **Mr Aspden:** I would agree with the first part of your statement, but I have no grounds for agreeing with the second part. In other words, I would agree that I think it was very convenient in buying time and gave an important opportunity to work out a solution; but I have no evidence to suggest cherry-picking.

1630 **Q162. The Chairman:** Again, under the MoU that you had with the FSA, you would have expected to have been told about supervisory notices. You would have had a lively expectation to have been told about that.

Mr Aspden: Precisely, and not only that, even to this day we have never been sent a copy of the winding-up order.

1635 **Q163. The Chairman:** And you have asked retrospectively for all the relevant documents at that time?

1640 **Mr Aspden:** We have asked for the documents. We asked for the documents in about October/November. I received a letter from the FSA one day before we appeared before the UK Treasury Select Committee, giving a summary of the information we requested, but I have never received the documents.

Q164. The Chairman: Have you pursued that, or is it – ? (**Mr Aspden:** No.) The door was pretty well firmly shut, was it?

1645 **Mr Aspden:** Yes, after that letter, and then we had the UK Treasury Select Committee and that is... Yes, I have not pursued it since.

The Chairman: Okay. Eddie?

1650 **Q165. Mr Lowey:** Yes, the only point following on from that... I had those down there: the memorandums of understanding. It seems these are reassurances to the public. We have memorandums of understanding with Iceland, for example, 100-per-cent guarantees from the government, which in the end turned out to be... if I use the word 'worthless', would I be exaggerating?

1655 Can I come back to the Bank of England, with whom the special arrangement was made. Would it not be reasonable to think that the Bank of England itself would have asked, 'Why are you making these special arrangements with us for new deposits?'

1660 **Mr Aspden:** In relation to your first point about memoranda of understanding, yes, the importance of a memorandum of understanding is that, between supervisors, it sets out a basis of understanding and co-operation. However, it is not a legal document, it cannot be legally enforced, and there is a danger that their value can be overstated. I would agree with you.

1665 Secondly, in relation to the guarantee that came from Kaupthing Bank HF, if that was the guarantee you are referring to... Is that the one? (**Mr Lowey:** Yes, indeed.) Much has been made about that guarantee in the past. There is the fact that it was short, inadequate etc. It may have been, but the point was the guarantee was not required by the Commission, it was not a regulatory requirement and it was essentially a top-up. So, I know there are deficiencies in it, but the view, I suppose, the bank here took was that it is better to have

something than nothing.

So that was the question on the guarantee, but I think the important point just to mention on that is that it was not, and never has been, a regulatory requirement.

The third –

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Q166. Mr Lowey: Sorry, just to follow that particular point: I have here, ‘Iceland agrees failed bank payouts,’ and it says, in the press:

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‘But it would reinstate an Icelandic government guarantee to pay any debts outstanding at the end of the scheduled repayment plan in 2024 – the key demand of the British and Dutch.’

This is for the funding from the IMF, which has been given to Iceland to refloat its economy. It seems that everybody is covered, bar the Isle of Man. Would that be a fair comment?

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Mr Aspden: I think your question, Mr Lowey, is very relevant; but I am afraid I am not in a position to say.

Q167. Mr Lowey: That is fine. I cannot ask you to...

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Mr Aspden: No, I am sorry.

Your third point related... and I think you basically said to me: would it not have been reasonable for the Bank of England to have asked why the account was being set up? All I would say to you is I am assuming at the time that there was legal advice taken by the people concerned down there in setting up the trust account. I do not know.

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All I would say is I would think it unusual for the Bank of England to have opened such an account without it at least taking a number of steps to satisfy itself that it was the correct thing to do; but I have no evidence of that.

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Q168. Mr Lowey: You would say unusual times ask for unusual solutions?

Mr Aspden: I think that is an interesting comment, Mr Lowey, yes.

The Chairman: Mr Houghton.

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Q169. Mr Houghton: Thanks very much.

Returning to my question in regard to the 25th April letter, Mr Aspden –

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The Chairman: Is this to do with the demise of the bank, rather than following the paper trail of April and May?

Mr Houghton: Yes, and that is what I am looking into. Why? Have you got some further questions of this particular – ?

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The Chairman: I am trying to focus on trying to keep it within the theme of looking at the end of the bank.

Mr Houghton: I will wait for you to finish that and then I will come back onto this.

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The Chairman: Alright, but you do not have anything about this particular period?

Mr Houghton: No.

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Q170. The Chairman: Okay.

Were you aware of any other additional controls put on KSF (UK) by the FSA at the time?

Mr Aspden: Not beyond what is in the file, no.

Q171. The Chairman: So, basically, it was almost business as usual as far as the FSA’s communication with you was concerned, in terms that there was nothing that they sent you that would cause alarm bells?

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Mr Aspden: It evidently was not business as usual between the FSA and Kaupthing and all of that, but in terms of... As I say, in that period after that, we were having a lot of contact with the FSA but it was mostly all on Bradford and Bingley.

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Q172. The Chairman: Just with regard to the MoU then, the MoU has not changed since 8th October, has it?

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Mr Aspden: No... This is with the FSA? (**The Chairman:** Yes.) No. What we are doing with that... As I am sure you know, this whole area about co-operation between regulators – although you are interested in it from a Kaupthing viewpoint – actually is an international issue, because of all the other problems. So what is actually happening at the moment is this whole basis, the whole issue of communication between regulators, and in particular communication between regulators who host banks... So, in other words, we host banks here and, in the Kaupthing case, the FSA was not actually a parent regulator, but it was hosting there. So communication between host regulators, which is something that has never actually really been properly addressed before and is certainly not set down in memoranda of understanding, is all being reviewed internationally, including in the Basel Supervisors' Committee and so forth.

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So we have not yet revised it, not least because it takes two parties to revise an MoU and the FSA will not sign up on a different document until these wider discussions have been completed. So that is where we are at the moment.

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Q173. The Chairman: But do you consider the MoU at the time was inadequate?

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Mr Aspden: Not inadequate, in the sense that, as I explained earlier, they are a non-legal document in any event – they are expressions of goodwill and co-operation.

I think it is very likely that MoUs going forward will probably need to be more explicit in terms of, for example, dealing with bank failures and all that sort of thing, but actually bear in mind, as I am sure you know, many regulators refuse to sign MoUs, so an MoU is by no means a foregone conclusion. If you try to go to, say, Germany, for example, the Germans will not sign one of that type with you.

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Q174. The Chairman: Bank failures are not an area that were actually covered in the MoU, are they?

Mr Aspden: No.

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Q175. The Chairman: Is that something that you would be looking to clarify going forward?

Mr Aspden: Yes, I think, definitely.

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Q176. Mr Lowey: Can I just stop you there, because you introduced about world banking. It is not a new phenomenon, is it? In the last decade, banking has become more global, and that is part of the problem, where the domino effect swept the world, not just Britain. I find it strange that our regulations have not kept up with the changing market that has unfolded, technology and all the rest of it.

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Mr Aspden: I think your point is a fair point, but just to say, I am not sure whether you mean that you are surprised that Isle of Man regulations have not kept up with it, or regulations generally –

Q177. Mr Lowey: Generally and then specifically to the Isle of Man.

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Mr Aspden: Generally, I think, subject to your view, one has to recognise that, actually, what we have gone through – or, arguably, are still going through – is something we have never been through before in terms of a banking crisis of the nature we have had. So, my own view, at any rate, is that it is entirely reasonable that there will be legislative and MoU and other lessons to be learnt coming out of this, and I agree with you.

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Let us take, for example, the capital of banks. There is an international consensus now that banks do not hold enough capital. Would that argument have run two-and-a-half years ago? No. So there are lots of things to come out of it.

In relation to the Isle of Man, all I would say to you is this: our regulation here, whether it is capital adequacy, liquidity or whatever... You have, at any rate, the assurance of knowing that we have recently been

fully gone over by the IMF in detail – so this is not a cursory audit, this is in detail – and we, on the supervision side have come out of that very well.

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Q178. The Chairman: Could I just ask: do you feel that the FSC was actively misled at any time by the FSA in relation to its conversations about KSF (UK)?

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Mr Aspden: I do not think I could point to any case where we have been misled.

Q179. The Chairman: Has there been an apology over the lack of communication?

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Mr Aspden: There was an apology that came... You remember I mentioned to you that I received something from the FSA a day before we attended the UK Treasury Select Committee and they apologised for the lateness of that, that four-month or three-month delay. They apologised for that. There has been no apology for what happened over the lack of co-operation, although you will have seen from my evidence that the UK Treasury Select Committee had clear views on what the FSA did and did not do, in that regard.

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Q180. The Chairman: I have been through your evidence, I would think quite thoroughly, but I do not recall having seen that letter from the FSA in the UK to you that you say you received the day before the Treasury Select Committee. Was that part of your evidence?

Mr Aspden: Probably not, because that came in in January this year, but I –

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Q181. The Chairman: For completion purposes, would you mind if we had a copy of that?

Mr Aspden: Yes. I think it was an e-mail rather than a letter, but I will get you a copy.

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Q182. The Chairman: Are you satisfied that, at all times, as a regulator, and to the best of your knowledge, the directors exercised good judgement at the time? This is specifically from 1st to 8th October, and I am talking about the Isle of Man directors.

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Mr Aspden: That is something on which I cannot comment at the moment. Let me just explain why, and that is because immediately KSF (IOM) went down, or fairly soon thereafter, or whatever, I contacted the provisional liquidator and said to him that we wanted to be able to assess and examine everything that had happened in the lead-up to this at the bank. However, I was conscious that we did not want to frustrate the process by taking out books and records ourselves, when the liquidator was trying to do the Scheme of Arrangement and all that sort of thing.

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In fact, the liquidator has since told me that what he is going to be doing is – and this is where we stand at the moment – he is going to be conducting an internal review himself, first of all – in other words, a liquidator's review – of what went on in the bank in the lead-up and everything, and he will then give us a copy of that as part of our investigations. So that is where the matter currently stands.

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Q183. The Chairman: But there is not going to be an inspector's report under the Companies Act, which is one of the – ?

Mr Aspden: No, there is not. No, we are not looking at the moment, but I cannot rule anything out because we have not actually completed our supervisory investigation.

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Q184. The Chairman: With significant criminal investigations happening in Iceland, regarding the actions of senior executives at the parent company, are you aware of any concerns within the Isle of Man?

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Mr Aspden: I am not but, with respect, I think the person probably you want to talk to on that, because they have been much more involved on that, if there were any, and that would be the liquidator.

Q185. The Chairman: One of the clear issues that was certainly straining KSF in its last few days were the problems with clearing payments. Are there any FSC guidelines on ensuring completion of payments to customers?

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Mr Aspden: No, there are not, and I am not sure, subject to your view, that would necessarily be

appropriate because, as you know, essentially clearing of payments is subject... All our payments are cleared through the UK.

1845 What actually happened in this case is that in the few days – particularly the 6th to the 8th, Monday, Tuesday, Wednesday of the week – there were a number of requests for payments out and also some, but a much lesser amount, I think, of payments in. Those are typically referred to as payments in flight, and I know that the liquidator has been grappling with issues as to where those payments lie: are they his property, or have they already gone?

1850 I think, again, you would need to ask him about the legal advice he has received, but my understanding is that if you make a payment out to somebody – say I give you a cheque and you cash the cheque – actually the money remains the property of the person who is sending it to you until it reaches the new recipient, until it is actually fully cleared; but if it is in the process of clearing it actually remains the property of the person who is remitting it. I know they have taken legal advice on that and you would probably want to check that.

1855 **Q186. The Chairman:** I will pick that up with the liquidator, then.

When did you become aware of the problems due to payments out, because presumably you received complaints about this subject?

1860 **Mr Aspden:** We did. We did receive some complaints between the 6th and the 8th, and my colleagues in the Commission, one or two of them, actually went round to the bank to see... not just on that subject, but basically for an on-site view of how they were actually coping with handling of queries and all that sort of thing and, basically, to ensure in those three days that the bank was, as a bank, still operating. But, really, the real issue behind that did not become apparent until afterwards, when obviously a number of complaints then arose.

1865 **Q187. The Chairman:** It was in one of the files of evidence that all the BACS payments, which were done through NatWest in London, actually required pre-funding from KSF London. Do you know when this funding actually stopped?

1870 **Mr Aspden:** I do not, and there were a number of allegations about what was going on in London in terms of clearing the payments. One was the one you have just mentioned. There were other alleged comments made about people being told not to clear payments and everything. As I understand it – but it is no more than anecdotal evidence – the authorities have looked into that, or many aspects of that, and have drawn a blank.

1875 **Q188. The Chairman:** But do you consider that this ceased to be a regulatory problem, once the licence was suspended on the 8th?

1880 **Mr Aspden:** Not so much ceased, but it was not... As I said earlier, these payments were all cleared through the UK, and therefore actually we have a very limited role in that, anyway, so I think... One of you asked a moment ago, should we be introducing regulations or whatever on the clearing of payments, and I do not really see how we can, frankly, because we do not have our own payment system here. That is the problem.

1885 **Q189. The Chairman:** I just want to draw you back to something that was in chapter 7 of the submission. It appears that it was known on 6th October that there was going to be no co-operation from the FSA, and that they were having quite a clear deflecting attitude. That was in conversations with Michael Weldon, I believe. Why was there no attempt at that point to close ranks and start drawing in funds from London?

1890 **Mr Aspden:** I think there was a lot of contact at that stage with the bank here, the Kaupthing Bank HF in Reykjavik. There were not actually discussions between us and the London bank. We did not have... We basically short-circuited that straight to Reykjavik, because, actually, at that stage the Isle of Man operation, as you know, was owned by Reykjavik, not by London. So really our line of communication was directly with Reykjavik, and at that stage the group was in severe liquidity difficulties and they just did not have available liquidity to be able to downstream money to the Isle of Man.

1895 So, in terms of your question, why we did not start repatriating money, to be very candid with you, given the state that Kaupthing was in then – you will remember Glitnir had gone, Landsbanki had gone – to be actually saying, ‘Right, I want all the money back...’, at that stage, we were dealing with a situation that was really upon us. There was still a glimmer of hope from Reykjavik that the parent bank in Reykjavik could come good, so I think there was little to be gained by pulling the plug at that stage.

1900 **Q190. The Chairman:** It appears at this point that there was still a belief held by the directors – and I am using other evidence, and I appreciate you will not have seen that – that the company was still solvent on the night it went down, because it would be able to get funds from either London or, more likely, Iceland. However, I have not yet seen any evidence that would suggest that the FSC informed the directors that it was getting an unco-operative stance from London, which would have, maybe, set alarm bells going for the directors. Is that a fair assessment: that you did not tell the directors that London was being unco-operative and stonewalling, which might have assisted them in their decision making?

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1910 **Mr Aspden:** But as I have just said to you, we actually did not have that much communication with the London bank.

Q191. The Chairman: I was talking about the FSA, sorry.

Mr Aspden: Oh, the FSA. They –

1915 **Q192. The Chairman:** You had a conversation on the 6th.

Mr Aspden: We did. Yes, I am not sure that we would have...

1920 Basically, you have got the record of those conversations that were noted down. I am not sure that we would fully brief the directors of what we had been told on a regulator-to-regulator basis. In fact, had there been a lot of sensitive information coming from the FSA. That is not something we would have passed on to the directors, anyway.

1925 **Q193. The Chairman:** But the fact that you had got absolutely nothing out of them would have set alarm bells going, and maybe that is something that you could –

Mr Aspden: Well, it was not quite nothing, was it? The files show that we had the Freshfields thing, which actually... and that was something we were concerned about.

1930 I think my recollection is that – and the directors were fully aware of this – we were in a crisis situation at that stage and the directors knew that full well.

Q194. The Chairman: This is on the Monday?

Mr Aspden: Not on the Monday, but –

1935 **Q195. The Chairman:** That is when the conversation was, though, between the FSA and the Isle of Man, where you got this largely stone-wall response. Given how little you got out of that, was it not only reasonable that you could have let the directors know that you were not getting the co-operation that you would have expected out of the FSA, so that it would have informed them more fully about the broader picture?

1940 **Mr Aspden:** Yes, a valid point, but I would certainly challenge any comment from the directors, or whatever, that that would have been a pivotal point on whether or not they viewed their bank as in trouble or in difficulty. They knew full well, because they were actually being stonewalled by the group treasurer.

1945 **Q196. The Chairman:** For the record, it is not an allegation made by the directors. It is something I have just picked up and wanted to quiz you on.

Section 12 of the Banking Act 1988 on the Isle of Man permits the FSC to seek information on other companies in the group. Were these powers used, and are they used in this way; and if not, why not?

1950 **Mr Aspden:** I think we would not use those powers in relation to obtaining information about an entity being regulated and supervised in another jurisdiction, because that would be extra-territorial and they could just turn round and say, ‘We’re not providing it.’

1955 **Q197. The Chairman:** You have that and you have the MoU, both of which say ‘if we ask questions, we get answers.’ What was the theory, then, behind section 12 of the Banking Act 1988, if that was not it?

Mr Aspden: I would have to look at it further, but an obvious response would be in relation to any other

non-regulated group companies on the Island, for example.

1960 **Q198. The Chairman:** But you do not think that this would be a crucial possibility, to use that provision within the Banking Act in order to get key information out of other companies within the group?

Mr Aspden: No, because they would just turn round and say, 'We're in a different jurisdiction, we're not providing it.'

1965 **Q199. The Chairman:** When did you, as regulator, first inform the Isle of Man Government that there was a problem?

1970 *Mr Aspden:* I have a number of regular meetings with the Chief Financial Officer, which are not minuted, as part of our regular dialogue with Treasury and so forth, and I had, in the months before, on an escalating basis, made sure that they were aware of the deteriorating position in Iceland.

As regards the collapse of this bank itself, you will no doubt... Well, you have already said you are going to be interviewing Treasury and the Minister and everything, so you will no doubt be able to ask them this, as well. You will, of course, recall that in parallel to all of this we are going through the changes to the Depositors' Compensation Scheme, and it was actually at that time – in fact –

1975 **Q200. The Chairman:** It was that week?

1980 *Mr Aspden:* It was those days. It was literally in parallel, and so that is why it was very important for me to make sure that they were fully aware of the situation.

Q201. The Chairman: One more, before I bring anyone else who wants to follow up on anything that has been said: what is your involvement now with Kaupthing Singer and Friedlander?

1985 *Mr Aspden:* The joint liquidators are actually a licensed bank. They have got a bank licence in order to carry on their present business of winding the bank down. We receive some basic end-year data from them and so forth, but the main business at the moment is being, as you know, wound down by the liquidator. I probably meet with the liquidator every few months and have been doing so, really, on a communication basis.

1990 We do not have a statutory role with the liquidation, as you know, and we also have had depositors' rights assigned to us in relation to DCS claimants, so we are now actually a creditor of the bank, in terms of payments made out.

1995 So our relationship is really as creditor, or the DCS's creditor; as regulator, in terms of the bank licence they have got; also I have mentioned to you the work they are doing in relation to... they are coming back to us in relation to directors; and then I have also mentioned to you the regular communication I have, the meetings with the liquidator.

The Chairman: Do you want to follow up on anything there?

2000 **Mr Houghton:** Not in that particular area.

The Chairman: Did you want to follow up on anything there?

2005 **Q202. Mr Lowey:** I do not know whether this does, but, Mr Aspden, forgive me, anyway. The amount of money, the lump sum of money that was transferred – the 50 per cent of the assets of the local bank transferred to London: for clarity, for me, anyway, they were excessive in international banking, in percentage terms – correct me if I am wrong – under Basel II – have I read that right? Basel, is it, or Basle? Anyway, I call it Basle – and the BIPRU guidelines. The amount that we sent, although small, as you said in your evidence to us, was not unusual in the total amount of money that is transferred from subsidiaries to mother banks elsewhere. Under those regulations it was, in percentage terms, out of the ordinary. Did you monitor that, the way in which it was then dispensed when it got there? Did you do all of those things?

2010 *Mr Aspden:* First of all, in relation to the Basel limits and so forth, none of the limits were outside of... The Basel regime allows interbank exposures, which this was, to take place of this size, so I think it is important for the record to state that. You are quite right that 50 per cent of the balance sheet figure, £600

2015 million, whatever you want to call it, is a big figure. There is no question about that. It is a big figure, although I have to say not as large as some banks here, but it is a big figure.

Were we monitoring what was happening to the money? We knew – we had actually gone to a lot of trouble, as evidenced in the submission to you – about establishing with the regulator what limits and what prudential norms the bank in London was operating under, and the evidence of that was on the file. We also knew, from informal discussions, not from any formal returns or anything, because we do not have the authority to get those, but we did know – we had some idea – from informal discussions about the general nature of what business was being done in the London bank.

2020 Did we know the detail of the loans? No, but in fact the London bank was a participant in a number of the loans that had actually been made out of the Isle of Man. Therefore, we were aware of those because they had actually put their money in here as a sub-participation. But in relation to... We, I think not unreasonably, as we do in other cases as well, relied on the dialogue we had had with the FSA. For example, if you take another bank here – any other banks here – we are not legally in a position to go into the parent banks and say, ‘Right, we’d like details of this and details of that, and who are your customers?’ We cannot do that. We legally do not have the powers to do it.

2025 What we can do is we can liaise through the parent regulator and get that qualified information from them, and I think if you are going to say to me ‘Will you be doing more of that in the future?’, most definitely yes, and I think all regulators will be. This is the type of... another thing that is coming out of the current event.

2030 But despite the power that the Chairman referred to earlier, we do not have the ability to go cross border, and just go in and get information.

The Chairman: Mr Houghton.

2040 **Q203. Mr Houghton:** Mr Aspden, the Commission met on 2nd May 2008 and it decided that the Commission unanimously resolved to retain its requirement that the licenceholder should remove all group indebtedness to the Isle of Man by appropriate means. The core problem is that your letter dated 7th May 2008 said something wholly different, and placed the whole process on the road to disaster. You varied the Commission’s decision by, and I would quote:

2045 ‘... not communicating with the Commission... wanted all group indebtedness to KSF (Isle of Man) removed...’

and you merely referred to the bank in question.

You compounded this by suggesting that the Commission would permit further funds being placed with KSF (UK), subject to assurances being received from the FSA, and then you appear to have conceded the 5-per-cent haircut on the securities in place that we dealt with a little earlier.

2050 Given the careful minutes of the 2nd May 2008 meeting, how can you justify writing as you did to KSF (Isle of Man) on 7th May, when your letter appears to be wholly unauthorised by the minutes of the Commission? What had happened between 2nd and 7th May for you to take such a breathtaking risk?

2055 **Mr Aspden:** Thank you for your comments on that, and I appreciate that you are quoting from the file before you, but in view of the insinuations of your remarks, I would like to make it very clear, for the record, that everything that was agreed in relation to Kaupthing Singer and Friedlander and, in particular, the final agreement that was agreed in relation to the no exposure to Iceland and putting it to London – all of that, including that final letter to them – was agreed with the board. I would suggest, if you have any doubts about that, that you get my board in here and ask them directly.

2060 So all of those – your idea about ‘breathtaking this’ and all that rubbish – at the end of the day, I appreciate entirely that you are quoting from the file, but I am afraid at this stage, pending you getting my board members in, you will have to take my assurance that what was agreed was not, as you imply, an act of an individual to amend decisions reached in minutes or anything, but was actually the result of detailed discussion with the Commission and was agreed with the board, but as –

2065 **Q204. Mr Houghton:** So why the discrepancy, then, between the content of your letter and the Commission minute made only a few days earlier?

2070 **Mr Aspden:** Because, Mr Houghton, with every respect, we live in a real world and we do not spend all our time writing voluminous minutes about every single discussion that takes place. We are strapped for staff, we are tight, we do not have the luxury of that.

2075 As I say, what I think you need to do, if you have any doubts – which clearly you do – about what I am saying, I would suggest that you call in my board and they will be able to confirm the position to you directly.

Q205. Mr Houghton: I am afraid that, Mr Aspden, it will have to be followed up, and when you made that comment just before, that you were strapped for staff, you did tell us earlier that you had sufficient staff, and especially on a most important issue here, when the minutes are quite different from the actions you took in that letter. I would ask you to note that.

2080 The period from 9th May 2008 and the KSF (IOM) reply to the Commission's letter, to 1st July 2008, the Commission's minute of the KSF (IOM) problem solved, until early 2008, represents the death throes of your supervision of KSF (Isle of Man). KSF (Isle of Man) state – in charming language at the time – that they do not like your proposal, they had not been informed of the Commission's much stricter and, in light of the events, much more prudent requirements which, subject to a small dance with the FSA, you agreed to. The result was that the Commission's decision of 2nd May 2008 was never enforced, and the compromise was that KSF (Isle of Man) got what it proposed. Is that supervision Isle of Man style, or does it meet the highest regulatory standards, Mr Aspden?

2085
2090 **Mr Aspden:** I think it meets the highest regulatory standards that we could achieve at the time, given the particular issues we were confronting – not just us, but also the bank concerned.

Q206. Mr Houghton: Does it meet the Commission's stated mission objective 'to protect the public interest by providing effective regulation and supervision within the Isle of Man's financial services sector'? Perhaps you could comment on that?

2095 **Mr Aspden:** Yes, I think it does.

Q207. Mr Houghton: Was your letter dated 7th May 2008 produced to the 22nd May meeting of the Commission?

2100 **Mr Aspden:** I do not know; I would have to check that.

Q208. Mr Houghton: I would be grateful if you could look into that and let us know why, because if so, my question is why was this not minuted as being tabled, following?

2105 Mr Aspden, the solution appears to have been slid through as a provisional proposal. That is my way of viewing this. Is this just simply a fig leaf, as it seems to be the final solution before the insolvency supervenes? Again, to do with that letter.

2110 **Mr Aspden:** That is a statement, not a question.

Q209. Mr Houghton: Any comments to it?

Mr Aspden: No, thank you.

2115 **Q210. Mr Houghton:** Okay. How did the Commission move from threatening to issue a direction – and that was in a letter from Mr Weldon to Aidan Doherty on 25th April 2008 – and the robust resolution of 2nd May 2008, impervious to repercussions and political issues, when the Commission determined to end KSF (Isle of Man)'s group exposure to largely leaving the intergroup exposure in place, subject to another fig-leaf, courtesy of the FSA? Have you any comments to that?

2120 **Mr Aspden:** I have. You will recall that I have already replied to a previous question from yourself and your colleagues that the reason we did not issue the direction was because, actually, we reached the solution that we did, with the agreement of the bank, and therefore a direction was not needed.

2125 **Q211. Mr Houghton:** Can you say who was it who resolved this entirely in Kaupthing Group's favour, and how was it done?

Mr Aspden: Resolved what?

2130 **Q212. Mr Houghton:** Resolved the situation of Kaupthing's problem, the bank's problems, with the

directions it got from the FSC in that earlier letter. It was resolved. Who resolved it and how was it done?

2135 **Mr Aspden:** This was taking place during an intensive period of discussion between ourselves and the bank, and the way it was actually resolved was, following the executive actually reaching what it felt was the most appropriate solution, given the circumstances. That was then agreed with the board and then communicated to the bank. So that was how it was actually done.

2140 **Q213. Mr Houghton:** Would we have been here today, Mr Aspden, if the Commission's resolution of 2nd May 2008 had actually been fully implemented?

Mr Aspden: I do not know.

2145 **Q214. Mr Houghton:** On 22nd May 2008, did the Commission fully understand the excessive concentrations that might come to exist and the resultant risks?

Mr Aspden: Excessive concentrations of what?

Q215. Mr Houghton: That might come to exist and the resultant risks.

2150 **Mr Aspden:** Yes, but what concentrations?

Q216. Mr Houghton: In respect of the correspondence of that date.

2155 **Mr Aspden:** Could you just develop that for me?

Q217. Mr Houghton: Perhaps I could ask further, then, on 22nd May 2008, did the Commission fully understand – and this is at the Commission's meeting now – that these risks were in line with the Commission's strategic lack of appetite for the risks in the interest of protecting creditors?

2160 **Mr Aspden:** Yes, the board of the Commission is fully aware of its remit and responsibilities to protect depositors and was doing its best throughout this period to do that.

Q218. Mr Houghton: Thank you, Mr Aspden.

2165 My final supplementary on this particular point, sir: would the answers to those two previous questions that have been made have been more palatable, if the Commission's resolution dated 2nd May 2008 had been more fully and properly implemented?

2170 **Mr Aspden:** I think that is a subjective question. This is looking back with the benefit of hindsight. We did the best we could at the time.

2175 **Q219. Mr Houghton:** Would you provide us with a statement, Mr Aspden? We would be very grateful if you would provide this Committee with a statement of the actual meaningful activity that took place between those dates – the date of the Commission... the actual date of the Commission's meeting on 2nd May, leading up to and around about the time of your letter of 7th May.

Mr Aspden: Sure.

Mr Houghton: Thank you.

2180 **The Chairman:** Mr Lowey.

2185 **Q220. Mr Lowey:** Mr Aspden, you said you were operating... We know that you operated on behalf of the FSC in these negotiations. Who was actually operating on behalf of the agent that you were dealing with? The bank is generic. There must have been specific individuals. Who were the individuals you were talking to about their problems?

Mr Aspden: Aidan Doherty, who was the managing director here.

2190 **Q221. Mr Lowey:** At all times it was him?

Mr Aspden: Probably not at all times, but –

Mr Lowey: Maybe you have answered my point. That is fine.

2195 **The Chairman:** Mr Phillips, are you happy?

The Clerk: I have no questions.

2200 **Q222. The Chairman:** Is there anything you would like to clarify or add at this stage, or any final words?

Mr Aspden: No, thank you.

2205 **Q223. The Chairman:** Today has been something of a canter through some of the key issues and themes that surrounded the downfall of KSF. I am sure that you can appreciate that we have 23 lever arch files of evidence to sift and more oral evidence to take. There is a lot of work yet to do on this, so it is only fair, I suppose, at this state, to let you know that it is likely that we may well be inviting you back to address a few further issues, as they develop.

2210 But with that, can I thank you now for your time this morning and your contribution, and with that, that concludes the public session and the Committee will now sit in private.

Mr Houghton: Can I just say, Chairman, can we place the three volumes of the files that the FSC have provided to the Committee on record to form part of these proceedings?

2215 **The Clerk:** That should be done in private. This is a matter for private deliberation.

The Chairman: Thank you very much. At this stage we will meet in private.

The Committee sat in private at 12.53 p.m.