



# IS IT LEGAL? DIRECTORS' LOANS IN A BANK

Aidan Clifford considers the topical question of whether loans to directors in a bank are permitted

**Section 31 of the 1990 Companies Act prohibits a company from making a loan to a director: '...a company shall not ...make a loan or a quasi-loan to a director of the company'. Section 32 then states that 'Section 31 shall not prohibit a company from entering into an arrangement with a director or a person connected with a director if:**

- (a) the value of the arrangement; and,
- (b) the total amount outstanding under any other arrangements entered into by the company with any director of the company, or any person connected with a director, together, is less than 10% of the company's relevant assets.'

This would allow a bank to lend up to 10% of its assets to the directors in aggregate, and directors include the directors' families. Section 37 goes further and allows:

- '(a) ... the company enters into the

- transaction concerned in the ordinary course of its business; and,
- (b) the value of the transaction is not greater, and the terms on which it is entered into are no more favourable, in respect of the person for whom the transaction is made, than that or those which
  - (i) the company ordinarily offers, or,
  - (ii) it is reasonable to expect the company to have offered, to or in respect of a person of the same financial standing as that person but unconnected with the company.'

So, in summary, loans to company directors and connected persons of less than 10% in aggregate or loans in the ordinary course of business are not illegal. One might argue about what 'in the ordinary course of business' means in the context where the loan is drawn down and repaid every year, but the 10% limit is absolute.

**What are the disclosure requirements?**

There are different requirements and a number of different sets of rules depending on whether the bank uses UK GAAP or IFRS. If the bank is quoted then it must use IFRS. The 1963 Companies Act requires 'The directors of every company shall ... once at least in every calendar year prepare accounts for the company for each financial ... in accordance with international financial reporting standards' and the Act defines this as "'international financial reporting standards" means the international financial reporting standards, within the meaning of the IAS Regulation, adopted from time to time by the European Commission in accordance with the IAS Regulation'. So the Act specifically requires that you comply with IFRS. Interestingly, the Act does not require compliance with UK GAAP for those entities that apply UK GAAP. The section specifies that 'Where



financial statements.'

The standard then goes on to require specific detail:

- '(a) the amount of the transactions;
- (b) the amount of outstanding balances and;
- (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and,
- (ii) details of any guarantees given or received.'

Quite an amount of detail then is required in addition to disclosure of pay, pension and other benefits of key employees. IAS 24 states that: 'In ... this Standard, the following are not necessarily related parties: ...providers of finance, ... simply by virtue of their normal dealings with an entity'. The UK GAAP standard, FRS 8, has a different exemption for bankers: 'The FRS does not require disclosure of the relationship and transaction between the reporting entity and (related) parties simply as a result of their role... as providers of finance in the course of their business in that regard'.

The difference between 'not necessarily related parties' and the use of the term 'normal' and the complete blanket out-scoping under UK GAAP is interesting. A dictionary definition of 'not necessarily' is 'what has been said or suggested may not be true'. So what the standard is saying is lenders are not automatically related parties of a client, quite the opposite of UK GAAP. In my opinion, it would appear that IFRS GAAP requires disclosure of directors' loans, even when not outstanding at the year end and UK GAAP does not. In our previously much applauded principal approach to accounting, deciding definitively if something is required to be disclosed is much more difficult than, say, under the American rule-based system. In addition, non compliance with IFRS is an offence under The Companies Act 1963, but not a criminal offence. It is not automatically reportable by auditors to the Office of the Director of Corporate Enforcement should they discover a breach.

Another interesting aspect is the substance-over-form argument. UK GAAP has a very strong standard on this topic, FRS 5, which would look at a series of transactions as a whole and require the reporting of the substance of the arrangement which, if some of the transaction is artificial or temporary, would see through this and report the substance. IFRS GAAP does not have a similar standard.

any... director of a company fails to take all reasonable steps to comply with this section, the person is, in respect of each offence, liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding €635 or to both', although the Act also allows a defence: '...it shall be a defence to prove that the person had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that this section was complied with...'

#### Related parties

So, if the act requires compliance with IFRS, what then does IFRS have to say about directors' loans? IAS 24, on related parties, gives the answer when it defines a related party in the following way: 'a party is related to an entity if: ...the party is a member of the key management personnel of the entity or its parent'. IAS 24 requires disclosure: 'If there have been transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the

#### The Companies Act, 1990

The disclosure requirements of S41 of the 1990 Act are as follows: '...shall contain the particulars ... (of) any transaction or arrangement of a kind described in section 31 (Loans to Directors) entered into by the company ... for a person who ... was a director of the company'. Section 42 lists some specific requirements including 'particulars of the principal terms of the transaction, arrangement or agreement' and 'in the case of a loan:

- (i) the amount of the liability of the person to whom the loan was or was agreed to be made, in respect of principal and interest, at the beginning and at the end of that period;
- (ii) the maximum amount of that liability during that period;
- (iii) the amount of any interest which, having fallen due, has not been paid'.

However, for some reason the Act then goes on to exempt licensed banks from this requirement. The disclosure requirements above do not apply 'for the purposes of any accounts prepared by any company which is ... a licensed bank'. There are separate provisions in relation to licensed banks: 'A licensed bank prepared in accordance ... in respect of the relevant period shall contain a statement in relation to transactions, arrangements or agreements made by the company for persons who at any time during the relevant period were directors of the company, of the aggregate amounts outstanding at the end of the relevant period under transactions...'. So it is clearly not a requirement of the 1990 Act to disclose a loan to a director if it had been repaid at the year end.

#### Redrafting

This article concentrated wholly on the company law aspects of directors loans in banks. It has been suggesting that these loans were illegal in one recent Irish case, however, there is no evidence yet presented that this is the case. I have made a tenuous enough link to a requirement in an accounting standard requiring disclosure, but for which non-compliance is prosecuted only on a summary basis and for which there are not one but two mitigation factors allowed in the law. What the article does do is identify that Section 41 *et seq.* of the 1990 Companies Act needs some redrafting. I can see no reason for exempting banks from the disclosure requirements for other companies.

**Aidan Clifford FCCA is advisory services manager with ACCA Ireland. E-mail: [aidan.clifford@ie.accaglobal.com](mailto:aidan.clifford@ie.accaglobal.com)**