

Final Summary

**A report on an independent review of
Royal Bank of Scotland Group's
treatment of small and medium-sized
enterprise customers referred to the
Global Restructuring Group**

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A report on an independent review of Royal Bank of Scotland Group's treatment of small and medium-sized enterprise customers referred to the Global Restructuring Group

Foreword by Andrew Bailey Chief Executive, Financial Conduct Authority

Small and medium-sized enterprises (SME) are a vital contributor to the UK economy. They need fair access to credit facilities to help them trade successfully and contribute to economic growth.

The allegations made against Royal Bank of Scotland Group ('RBS' or 'the Bank') in Dr Lawrence Tomlinson's report *Banks' Lending Practices: Treatment of Businesses in Distress* (Dr Tomlinson's report) were serious and generated significant public interest. Given these serious allegations I believe it was appropriate for the FCA to look at the treatment by RBS of SME customers referred to its Global Restructuring Group (GRG).

Commercial lending activity is largely unregulated in the UK, and there are no 'conduct of business' rules against which to assess GRG's treatment of SME customers. It is also important to understand that many SME customers are not eligible to use the Financial Ombudsman Service's (Ombudsman) dispute resolution service if they are dissatisfied with their banks' handling of their complaints. Eligibility to use this scheme is limited to 'micro-enterprises' employing fewer than ten people and with a turnover or annual balance that does not exceed €2m.

The independent review commissioned by the FCA in response to the allegations in Dr Tomlinson's report (and the recommendations of Sir Andrew Large's RBS Independent Lending Review (23 November 2013)) applied a definition of SMEs which included businesses with debt levels of between £0.25m and £20m that were transferred to and managed from within GRG.

The independent review was undertaken by a 'skilled person', Promontory Financial Group (UK) Limited, together with its sub-contractor Mazars. It considered 207 individual cases, comprising a representative sample of 178 SME customers and a further 29 SME customers drawn from those who had contacted Dr Tomlinson. It was therefore a lengthy and complex exercise.

The independent review did not look at the sale of a particular product. It looked at what were often longstanding bank and SME customer relationships in an area largely unregulated by the FCA. GRG was therefore reviewed with reference to applicable laws and regulations, the standards it set itself, wider requirements set by RBS that applied to GRG, and general principles of fair and reasonable treatment which were identified by the independent review. The independent review also necessarily had regard to the fact that businesses enter freely into contracts with commercial lenders, and that a commercial lender is entitled to

enforce its legal and contractual rights against a business customer in default or at increasing risk of default, even where this may have a material financial impact on the business customer.

As the FCA reported in November 2016, the most serious allegations in Dr Tomlinson's report were not upheld by the independent review. However, the independent review identified significant concerns about SME customer treatment by RBS, and SME customers engaged with during the independent review believe very strongly that they did not receive the support they could have reasonably expected in a period of extreme financial stress for many SMEs and other businesses and for the UK and global economy more generally.

We expect high standards from the firms we regulate, but we cannot set or enforce these high standards in areas of unregulated activity carried on by these firms. RBS does not agree with many of the conclusions reached by the independent review. Nevertheless, RBS has accepted that it did not always meet the internal standards that it set itself, which impacted on the level and quality of customer service and support offered. I welcome that public acknowledgement from RBS and the voluntary steps it has taken aimed at changing culture and practice within its Restructuring function.

RBS also put forward voluntary proposals to review and refund certain complex fees and it set up a complaints scheme for eligible SME customers. I welcome these steps as an appropriate response but, given the findings of the independent review, these complainants may understandably demand assurance of fair and reasonable consideration by RBS of their grievances. To help provide that assurance, RBS included an appeal stage in its complaints scheme, engaging Sir William Blackburne, a retired High Court judge, as an independent third party to oversee the complaints scheme and consider complainants' appeals. RBS will separately consider claims for consequential loss where it has accepted it was at fault and made offers to compensate SME customers for direct losses. RBS has published consequential loss guidance on its web site.

For me, coming to this towards the end of the independent review, the work highlighted a gap in support for smaller businesses with genuine grievances about business banking conduct issues that could benefit from impartial assessment and quick resolution. The FCA does not act as adjudicator in individual disputes between customers and the firms we regulate, but the decision to commission the independent review raised expectations among SME business customers that the FCA would also be able to intervene on their behalf in their individual circumstances. We have received many requests for help and we have heard some very sad stories about the impact of the financial crisis and subsequent events on small business owners' personal lives. I mentioned that the Ombudsman is available as a dispute resolution option for some smaller businesses, and we are seeking to broaden its scope to provide more SME customers with access to it. We have also published a Consultation Paper on Industry Codes of Conduct (CP17/37).

The skilled person that conducted the independent review invited the FCA and other policymakers to consider extending the protections available to SME customers in other ways, in particular for less sophisticated SMEs and vulnerable persons, and to extend the regulations covering unfair contract terms. The FCA will make a constructive contribution if invited to do so by lawmakers but ultimately it is for Parliament to consider and approve recommendations about widening our statutory remit.

INTRODUCTION

The independent review covered treatment of SME customers referred to GRG between 1 January 2008 and 31 December 2013 (the 'review period').

We used the FCA's power to appoint a 'skilled person' under section 166 of the Financial Services and Markets Act 2000 to conduct the independent review. The FCA was concerned that the serious allegations, if substantiated by an independent review, might indicate wider concerns in relation to governance and culture within RBS.

The FCA established the independent review to have two stages. The first stage of the independent review was to consider RBS's treatment of a sample of SME customers referred to GRG in the review period, to assess the validity of the allegations of inappropriate customer treatment. The first stage of the review would also consider whether any poor practices identified were widespread and systematic. (In the skilled person's Requirement Notice, which instigated the independent review, the word systematic refers to an intentional and co-ordinated strategy; the skilled person interpreted intentional as including the situation where RBS failed to take action to address the inevitable and foreseeable consequence of a decision.) If that was found to be the case, the second stage of the review would proceed to identify the root cause of these issues, including whether inappropriate treatment of customers was known about, authorised or sanctioned by management within RBS Group, and make recommendations to address any shortcomings identified.

Context of the independent review

The context in which the independent review was undertaken posed a challenge to assessing the conduct of GRG for the following reasons:

- commercial lending activity is largely unregulated and, therefore, most of the judgements made about inappropriate customer treatment are not based on regulatory rules or principles,
- commercial lending activity was significantly affected by the financial crisis particularly in the earlier years of the review period (2008 to 2011) and SME customers and commercial lenders had to make very difficult business decisions as a result,
- commercial lenders such as RBS are likely to have legal rights through the contractual arrangements with their customers which they may exercise at their discretion when dealing with financially distressed customers in default of, or at risk of defaulting on, credit facilities,
- commercial lenders have no obligation to lend to a business customer on terms that they find unacceptable or to continue to lend on terms that are no longer being met by a business customer in default, and
- while successful turnaround may sometimes be of mutual benefit to a commercial lender and a customer, a return to financial health is not always possible and businesses will at times fail. In the case of businesses

that are clearly no longer viable, action will necessarily be taken to protect creditors and to enable the bank to minimise its losses.

Scale and conduct of the independent review

The independent review involved detailed consideration by the skilled person of voluminous bank records and interviews with individuals at affected SME businesses and with bank employees. The underlying evidence included policies and procedures, management reports/information, board and committee agendas and minutes, credit reports, staff training materials, compliance and audit reports, customer satisfaction surveys, staff appraisals, and hard and soft copy records relating to 207 individual SME customer cases (the 'review sample').

Of the 207 cases in the review sample, 178 comprised a statistically representative sample (representative sample); 29 other cases were added to the review sample, including some customers whose accounts of their treatment had informed conclusions in Dr Tomlinson's report (Tomlinson sample). The independent review therefore looked at a broader range of SME customer circumstances than the sample that informed Dr Tomlinson's report.

The evidence relating to a typical case in the review sample filled around 10 A4 binders, and in some cases filled more than 60 A4 binders. RBS noted that during the review it provided around 323 gigabytes of data (more than 1,486,500 physical pages and 270,000 emails). The written material was supplemented with meetings with RBS staff and with customers included within the review sample who wished to engage with the independent review.

The independent review considered representations from RBS, and representations and testimony from those customers in the review sample who came forward in response to the skilled person's requests for their input. For the avoidance of doubt, RBS made representations to the FCA regarding the conclusions of the independent review, including an expression of concern that it had not been able to investigate complaints regarding staff behaviour which had been made to the review. We noted those representations and took them into account when considering its remediation steps, but we decided that it was important for the review findings to be entirely independent. Those independent findings are summarised in this published account.

The FCA's oversight of the independent review was limited to the following main activities:

- setting the scope and terms of the review,
- commenting on the case review and sampling methodologies,
- checking the independent review's adherence to the case review methodology,
- overseeing the independent review's case reviews and RBS's comments on them,
- attending trilateral meetings with the independent review and RBS,

- attending bilateral meetings with the independent review, and bilateral meetings with RBS, as the need arose,
- commenting on the independent review's distress assessment methodology,
- observing some of the independent review's distress assessment panels, and
- commenting on the independent review's formal updates and draft final report.

Review outcome

The FCA published a summary of the independent review's conclusions on 8 November 2016. We reported that, while some isolated examples of poor practice were identified:

- RBS did not set out to artificially engineer a position to cause or facilitate the transfer of a customer to GRG,
- SME customers transferred to GRG were exhibiting clear signs of financial difficulty,
- there was not a widespread practice of identifying customers for transfer for inappropriate reasons, such as their potential value to GRG rather than their level of distress,
- there was not a widespread practice of requesting personal guarantees and/or cash injections when GRG had already determined that it had no intention of supporting such businesses,
- there was not a widespread practice of RBS making requests for information from customers that were unnecessarily burdensome,
- there was not a widespread practice of RBS acting as a 'Shadow Director',
- there was no evidence that an intention for West Register to purchase assets had been formed prior to the transfer of the customer to GRG, and
- there were no cases identified where the purchase of a property by West Register (as opposed to by another person) alone gave rise to a financial loss to the customer.

There were other areas in which the inappropriate treatment of SME customers by GRG was identified by the review as being widespread:

- a failure to comply with RBS's own policy in respect of communicating with customers around transfer, where the standard of much SME customer communication was poor and in some cases misleading,
- a failure to support SME businesses in a manner consistent with good turnaround practice,
- placing an undue focus on pricing increases and debt reduction without due consideration to the longer term viability of customers,
- a failure to document or explain the rationale behind decisions relating to pricing following transfer to GRG,
- a failure to ensure that appropriate and robust valuations were made by staff, and carrying out internal valuations based upon insufficient or

inadequate work, especially where significant decisions were based on such valuations,

- a failure by RBS to adopt adequate procedures concerning the relationship with customers and to ensure fair treatment of customers,
- a failure to identify customer complaints and handle those complaints fairly,
- a failure to handle the conflicts of interest inherent in the West Register model and operation, and
- a failure to exercise adequate safeguards to ensure that the terms of certain upside instruments - Equity Participation Agreements (EPA) and Property Participation Fee Agreements (PPFA) were appropriate.

Some elements of this inappropriate treatment of customers were also considered by the independent review to be systematic, resulting from a failure on the part of RBS to fully recognise and manage the conflicts of interest inherent in what were described as GRG's 'twin' commercial and turnaround objectives and to put in place the appropriate governance and oversight procedures to ensure that a reasonable balance was struck between the interests of RBS and SME customers.

The FCA has been conducting a general investigation into matters contained in the report which we announced in November 2016. We have now decided to carry out a more focussed investigation.

The report of the independent review made certain findings about GRG management's state of knowledge of the failings in GRG, a matter which, according to the Requirement Notice, was to be addressed in detail, and if appropriate, at stage 2 of the review. Given the seriousness of this issue, the FCA undertook significant further work to understand the relevant findings and, beyond that, to understand what RBS management actually knew or ought to have known. To a limited extent, these matters are also relevant to the FCA's ongoing investigations. Those who might potentially be implicated by findings as to what management knew or ought to have known have not had the opportunity to make representations in relation to those findings either during the investigation which preceded the independent review or subsequently. There are cogent legal and practical reasons why the FCA would not wish to embark upon a process of receiving and acting upon such representations before publishing an account of the findings of the independent review. For those reasons:

(a) the summary below does not include findings made by the independent review as to what GRG and wider RBS management knew or ought to have known about the failings in GRG which are identified in the report,

(b) conclusions in the summary about the failings in GRG are not, and should not be read as being, criticisms of any particular individuals who were involved in the management of GRG, and

(c) none of the conclusions should be understood as criticisms by the FCA of GRG, RBS or any of the individuals involved.

It is not our normal practice to publish skilled persons' reports. They are commissioned for the purposes of FCA investigations, investigations which, for good reasons, are generally conducted in private and subject to conditions of confidentiality. The disclosure of the contents of such reports is subject to a wide prohibition in the legislation which governs the FCA's activities. If we were to seek to publish the full report in this case, it would be likely to require heavy redaction and the process of deciding exactly what could be published would be complex and lengthy. We do not believe that this would be in the public interest, and so we have prepared this detailed summary of the findings and conclusions of the skilled person's report which has been validated by an independent legal advisor as a fair and balanced account of the report, within the parameters set out above. We published our Interim Summary on 23rd October 2017 and the Treasury Committee's Special Advisers provided comments on it the following day. This Final Summary incorporates changes which reflect the suggestions made by those Special Advisers.

We should record that Promontory would prefer to see their report as a whole published, with redactions where necessary. Nevertheless, following careful consideration, the view of the FCA remains that we do not support this approach, for the reasons we have given. The delay which would be caused by a process of 'Maxwellisation' – allowing those criticised, expressly or by necessary implication – to make representations about those criticisms, is of particular concern at this juncture.

Addressing harm caused to SME customers

As the independent review concerned poor customer treatment, as distinct from the mis-selling of a regulated product, not all of the independent review findings may equate to claims for readily identifiable direct losses suffered by SME customers. The pronounced focus on generating income for RBS from fees and the use of upside instruments which was identified by the independent review was clearly something that RBS could address. It has sought to do so, through voluntary refunds of complex fees to eligible SME customers and reviewing certain complex instruments that it used with some SME customers who did not necessarily understand their complexity.

The extent of any adverse impact from poor treatment of customers (where RBS did not meet its own standards) will depend on SME customers' individual circumstances. It is not for the FCA to make judgements about these individual circumstances. However, having considered those documents and cases which were highlighted by the independent review, we agreed that RBS's proposal to establish a complaints scheme was an appropriate step. RBS's complaints scheme gives eligible SME customers the opportunity to put their grievances to the Bank and to state their own case about their direct losses (and indirect or consequential losses if their complaints about direct losses are upheld by RBS).

RBS's complaints scheme, which includes an appeal function, is intended to provide a relatively quick and efficient way for eligible SME customers to settle their grievances. As a result, consequential loss claims are excluded from the appeal function. Such claims, which may involve complex legal arguments about contractual rights and causation, could create long delays and backlogs, affecting all complainants regardless of whether they have consequential loss claims, and are therefore more appropriately addressed through the courts.

Sir William Blackburne, the independent third party, was asked to report to RBS and the FCA on his assurance of RBS's complaints scheme and his consideration of SME customers' appeals, on a quarterly basis. In the interest of transparency, his reports will be published.

SUMMARY OF THE INDEPENDENT REVIEW FINDINGS AND CONCLUSIONS

1 Key review findings

- 1.1 The independent review found that there had been widespread inappropriate treatment of SME customers by RBS which arose from:
- a. a failure to comply with RBS's own policy in respect of communicating with customers around transfer, where the standard of much SME customer communication was poor and in some cases misleading (see section 2(d) below),
 - b. a failure to support SME businesses in a manner consistent with good turnaround practice (see section 2(e)),
 - c. placing an undue focus on pricing increases and debt reduction without due consideration to the longer term viability of customers (see section 2(g)),
 - d. a failure to document or explain the rationale behind decisions relating to pricing following transfer to GRG (see section 2(g)),
 - e. a failure to ensure that appropriate and robust valuations were made by staff, and carrying out internal valuations based upon insufficient or inadequate work, especially where significant decisions were based on such valuations (see section 2(h)),
 - f. a failure by RBS to adopt adequate procedures concerning the relationship with customers and to ensure fair treatment of customers (see section 2(a)),
 - g. a failure to identify customer complaints and handle those complaints fairly (see section 2(i)),
 - h. a failure to handle the conflicts of interest inherent in the structure and operation of West Register, GRG's property arm (see section 2(m)), and
 - i. a failure to exercise adequate safeguards to ensure that the terms of certain upside instruments, in particular EPAs, were appropriate (see section 2(m)).
- 1.2 The independent review found that some elements of this inappropriate treatment of customers should also be considered systematic as they resulted from a failure on the part of GRG and RBS to fully recognise and manage the conflicts of interest inherent in GRG's twin objectives (turnaround of businesses in distress and financial contribution to RBS) and to put in place the appropriate governance and oversight procedures

to ensure that a reasonable balance was struck between the interests of RBS and SME customers. Those elements were:

- a. failings in GRG to place appropriate weight on turnaround options in its handling of SME customers,
- b. failings in GRG to manage the conflicts of interest inherent in its design and operation of West Register,
- c. failings to handle complaints fairly,
- d. undue focus on pricing increases without due consideration of the longer term viability of customers, and
- e. undue focus on EPAs.

1.3 In a number of other areas, whilst the independent review identified isolated examples of poor practice, the conclusion was that there was no widespread or systematic inappropriate treatment of customers:

- a. RBS did not set out to artificially engineer a position to cause or facilitate the transfer of a customer to GRG (see section 2(d)),
- b. SME customers transferred to GRG were exhibiting clear signs of financial difficulty (see section 2(d)),
- c. there was not a widespread practice of identifying customers for transfer for inappropriate reasons, such as their potential value to GRG rather than their level of distress (see sections 2(d) and 2(h)),
- d. there was not a widespread practice of requesting personal guarantees and/or cash injections when GRG had already determined that it had no intention of supporting such businesses (see section 2(f)),
- e. there was not a widespread practice of RBS making requests for information from customers that were unnecessarily burdensome (see section 2(i)),
- f. there was not a widespread practice of RBS acting as a 'Shadow Director' (see section 2(m)),
- g. there was no evidence that an intention for West Register to purchase assets had been formed prior to the transfer of the customer to GRG (see section 2(m)), and
- h. there were no cases identified where the purchase of a property by West Register (as opposed to by another person) alone gave rise to a financial loss to the customer (see section 2(m)).

1.4 The independent review identified what it regarded as instances of inappropriate treatment on the part of RBS and GRG in 86% of the 207

cases reviewed. The independent review estimated that over a third of the 5900 SME customers transferred to GRG during the review period were not viable at or around the time of transfer and could be expected to face insolvency or administration regardless of RBS's actions. Of the potentially viable SME customers transferred to GRG, the independent review found that a minority of the representative sample (16%) had experienced inappropriate action by RBS which appeared likely to have caused material financial distress. However, due to the wider economic circumstances of the time, there were seldom clear-cut causal links between Bank actions and particular consequences.

- 1.5 The independent review noted that, in forming its views, it had taken a pragmatic approach, adopting criteria that were intended to reflect what it considered most people would regard as being fair and reasonable, and that it had avoided the use of any legalistic considerations. This was because the Requirement Notice did not require a legal analysis of the matters at hand, but also because the matters raised by customers related to their general treatment and the Requirement Notice only required it to form a view (that is, to set out what it had found) rather than determine its conclusions by reference to the legal position.

2 Independent review's thematic findings

2.1 We have indicated in section 1 above where in this summary to find more detailed information about the independent review's findings. Based upon its consideration of individual cases, the independent review set out its conclusions with reference to the following themes:

- a. GRG objectives and strategy,
- b. governance and oversight,
- c. staff objectives,
- d. transfers to GRG,
- e. turnaround,
- f. facilities,
- g. pricing,
- h. valuations,
- i. customer experience,
- j. complaints,
- k. third parties,
- l. customers exiting GRG, and
- m. Strategic Investment Group (SIG) and West Register.

a: GRG objectives and strategy

2.2 GRG had twin objectives:

- a. to be a major contributor to RBS's financial objectives (often expressed as a contribution to RBS's bottom line) which initially focussed on revenue generation but later in the review period evolved to focus on the protection of capital (the 'commercial objective'), and
- b. to be at the leading edge of a wider rescue culture – focussed on turnaround, rehabilitating customers in distress and working with the aim of returning customers to the frontline wherever possible (the 'turnaround objective').

2.3 The independent review did not criticise the Bank for giving GRG a commercial objective and in particular for taking steps to protect the Bank's capital. However, whilst GRG's objectives were not inherently inappropriate, they created at a minimum a need for the careful balance of focus in the management and day-to-day operation of GRG to secure

both the commercial objective and fair customer outcomes. In practice, the commercial objective had been the strategic focus of management during the review period. There was accordingly a risk that in pursuit of its commercial objective GRG would pay insufficient regard to the interests of its customers and that customers would be treated unfairly as a result. The key risk was that by pursuing its commercial objective GRG would take action that was unfair and inconsistent with genuine efforts to turn a distressed SME around. That might in turn lead to the risk of material financial distress for the business or potentially to placing an otherwise viable business on a journey towards administration, receivership and liquidation.¹

b: Governance and oversight

2.4 As the activities of GRG largely fell outside UK regulation, the normal requirements on regulated businesses in respect of systems and controls did not fully apply. Nevertheless the independent review was guided by the general approach taken by the FCA in its rules and principles, regarding these as a reasonable general statement of good practice. It also bore in mind the arrangements that it would expect to see in equivalent regulated entities.

2.5 In assessing the systems and controls framework that GRG put in place across the review period the independent review made the following observations:

- a. GRG took decisions in relation to SME customers who were already manifesting some signs of financial distress. These decisions (eg to increase pricing or to withdraw overdraft facilities) clearly had the potential to exacerbate the already difficult circumstances in which SME customers found themselves. They also had the potential to have a significant bearing on lives and livelihoods.
- b. The decisions that relationship managers and other relevant Bank staff made were often complex, and required the assimilation and assessment of complex information about the specific circumstances of each customer.
- c. GRG experienced significant growth in the number of distressed customers it was required to deal with in the period from 2008 onwards, which led to a significant increase in the number of staff employed by GRG.
- d. Many of the SME customers transferred to GRG were not financially sophisticated and their financial distress may have added to their vulnerability. In addition, being inside such a unit would have been

¹ See paragraph 7(a) of the Specialist Adviser's report to the Treasury Committee

a new experience for many, and some of the concepts and terms used would not have been well understood.

- e. In many cases the future of the SME customer and the personal financial circumstances of an owner/manager were closely intertwined.

2.6 The potential for harm to customers from inappropriate actions by GRG was therefore significant and GRG should have been aware of these heightened risks. GRG needed a framework of systems and controls to ensure that key risks to customers were identified, managed and appropriately mitigated. The independent review identified a number of particular shortcomings in this regard:

- a. the procedures in place for frontline oversight of relationship managers were inappropriate and unlikely to have been sufficient to ensure risks were mitigated appropriately,
- b. there was limited second or third line oversight of the activities of GRG across the review period, in particular in relation to customer issues,
- c. key risks to customers were not articulated or identified and were not subject to ongoing monitoring or management,
- d. management information was not sufficient or appropriate to enable senior management to have clear oversight of the risks to customers,
- e. assurance work in relation to key risks was not undertaken (aside from some work on complaints),
- f. Treating Customers Fairly (TCF), an FCA initiative, was not implemented in an appropriate fashion in GRG, and
- g. while there was insufficient bespoke training of GRG relationship managers on viability and turnaround issues, more important factors were a failure to follow the processes set out in GRG policy and inadequate Bank oversight which allowed this to continue throughout the review period.

2.7 As for the potential harm to customers caused by these shortcomings, the independent review concluded that there was very limited focus on risks to customers during the review period. Further, the absence of appropriate governance and oversight, including a failure to properly implement TCF, resulted in a significantly increased risk that any

inappropriate treatment of customers would be left unidentified and allowed to continue unchecked.²

c: Staff objectives

- 2.8 The independent review considered the performance measures which operated for GRG staff, including the objectives that were set for customer-facing staff and senior managers and the manner in which they were appraised.
- 2.9 The independent review noted a tone and emphasis in the appraisals of senior managers which placed financial objectives first and emphasised the need for continuing financial performance.
- 2.10 Although assessment of GRG relationship managers' performance used a 'balanced scorecard', the measurable outcome that took precedence over any other aspect was the generation of 'incremental income' from customers (ie immediate income in the form of margin enhancements and fees and future income from upside instruments).
- 2.11 Considering the full range of material evidencing how management objectives were communicated to staff, the independent review found that the dominant message to staff concerned GRG's own commercial objectives, not least the levying of fees to achieve incremental income targets and related objectives on the number of upside instruments agreed. This was at the expense of objectives that might have mitigated adverse impacts for customers, such as the importance of TCF, the need to explore opportunities for turnaround and successful return of customers to mainstream banking.
- 2.12 As a result, there was a failure to establish and oversee objectives for staff which were appropriate for delivering GRG's twin objectives. This failure was reflected in a culture of deal making within GRG, which focused upon the financial interests of GRG and placed little weight on the stated turnaround objective of GRG, and less still on the fair treatment of customers.³

d: Transfers to GRG

- 2.13 The criteria for transfer of a customer to GRG were widely-drawn and gave significant discretion to RBS staff, and in particular to GRG itself, when determining whether SME customers should be transferred to GRG.
- 2.14 The independent review concluded that the transfer criteria could have been simplified but were not in themselves inappropriate. The retention of

² See paragraph 7(a) of the Specialist Adviser's report to the Treasury Committee

³ See paragraph 7(a) of the Specialist Adviser's report to the Treasury Committee

discretion in their application was appropriate but brought with it a need for checks and balances to ensure that it was being exercised fairly and consistently.

- 2.15 In the first instance, it was the task of the mainstream Bank to identify potential cases for problem credit management (which may have meant inclusion on a watch list and potential transfer to GRG). From 2009, RBS operated a Watch Forum framework where individual cases were monitored prior to transfer to GRG. GRG attended this forum, although generally the mainstream Bank decided which cases were to be discussed. Decisions to transfer customers to GRG were taken jointly by representatives from Specialised Relationship Management, Business & Commercial Banking Credit, and GRG, with GRG as the final decision-maker in the event of disagreement.
- 2.16 The independent review found no evidence that there was a general practice of targeting businesses for transfer based on their value to GRG rather than on the level of their distress.
- 2.17 Almost all of the customers whose cases were reviewed had, prior to their transfer to GRG, exhibited clear signs of financial difficulties and required either turnaround action or collection of the debt. In a small number of cases, there was evidence that GRG had considered, during the transfer process, its own perception of the advantage to GRG of particular customers but even in those cases transfer could have been justified by reference to appropriate considerations.
- 2.18 There were instances identified (11 in total) of delay in the process of transfer to GRG, which meant that a customer was not able to access a turnaround solution in a timely way.⁴
- 2.19 The independent review also identified that RBS failed to recognise the potential conflict of interests arising from GRG's twin objectives, and its input into the transfer of individual SME customers.
- 2.20 As for the transparency of the transfer process, RBS's policy recognised that the transfer process was important and that the changes for the customer inherent in the transfer meant that clear information should be provided in a timely way. However, there were frequent failings to comply with the policy, resulting in poor communications to customers about the reasons for transfer. From the records of contemporaneous customer communications examined by the independent review the quality was often found to be poor and/or not sent when required under policy and procedure, and was in some cases misleading. Taken together, these failings resulted in inappropriate treatment of customers on a scale which was widespread.

⁴ See paragraph 7(a) of the Specialist Adviser's report to the Treasury Committee

2.21 Particular conclusions were reached about transfer procedures operated by Ulster Bank in Northern Ireland, which were different from those in the rest of the UK:

- a. while the situation in relation to Ulster Bank and its customers at the time gave rise to significant challenges for RBS, the practices adopted were in several respects inappropriate and failed to pay sufficient regard to the needs of the customers involved,
- b. a 'bulk transfer' to GRG of 300 'problem cases' in 2011 was a pragmatic solution in the circumstances in which Ulster Bank found itself, but it meant that customers were not adequately informed about an important change in their status; and
- c. cases with lower priority (typically, but not only, smaller accounts) could be left for a considerable time before receiving adequate attention, potentially damaging opportunities for turnaround or adding to uncertainty for the customer.⁵

2.22 The independent review found that the Bank's failings with regard to the transfer process did not generally give rise to clear financial distress for the customers involved, but it could not rule out that possibility in individual cases. The poor standard of the Bank's communication certainly gave rise to inconvenience and annoyance for many customers. More generally, the failings contributed to an environment where many customers did not know where to turn for assistance or how to respond to the demands the Bank was now making of them. Failings in the Bank's communications also led to the customers' expectations not being appropriately managed. They were led to believe that entry to GRG would help to restore an ailing business that was otherwise viable to health and that they would receive a level of service and assistance that, in the end, many feel they did not receive.⁶

e: Turnaround

2.23 The independent review found that GRG placed little emphasis on turnaround of SME customers other than wanting these customers to meet credit policy requirements, and that there was inadequate focus on returning SME customers to financial health and mainstream banking through genuine business restructuring.

2.24 GRG recognised that the early identification of a workable strategy for handling SME customers was critical to its success. The earlier the position of the customer was analysed, and a strategy determined and agreed, the

⁵ See paragraph 7(b) of the Specialist Adviser's report to the Treasury Committee

⁶ See paragraph 7(a) of the Specialist Adviser's report to the Treasury Committee

greater the chances of a successful turnaround. Similarly, if the outlook was less positive, the sooner resources could be re-deployed and recovery action (if appropriate) could be commenced.

- 2.25 Review of GRG's training and guidance material showed that it intended to adopt a strategy containing the following stages. First, a careful assessment of whether or not a business was viable, or could be made viable. That assessment was supposed to be based on a wide review of the business, not simply immediate technical solvency issues. Next, GRG was to ensure that the business, if clearly not viable, was transferred for recovery action without delay. Where the business was potentially viable, GRG was to ensure that a turnaround plan was considered, documented and, if practicable, that it addressed the underlying business issues that the SME customer was facing.
- 2.26 GRG recognised that turnaround plans might not be practicable in all cases. Sometimes the SME customer's management team was unwilling or unable to make the necessary changes, or the changes could not be made in time. Turnaround might in some circumstances also depend on RBS's willingness to provide funds and the terms on which funds would be offered. If a turnaround plan was not practicable, GRG policy was to support the customer exiting RBS.
- 2.27 The independent review noted that RBS's documented policies and procedures were appropriate and broadly reflective of normal turnaround practice. However, in a number of important respects, the stated policy was not widely followed in practice during the review period.
- 2.28 In some of the cases reviewed, the transfer of the customer to GRG came too late for it to be able to provide any turnaround assistance. Over one in ten of the cases in the review sample were transferred directly to the Recoveries unit within GRG, or were transferred to it soon after their arrival into GRG. Some of these late transfers may not have been capable of turnaround even if they had been referred earlier, but there was at least a risk that delayed attention by RBS endangered the future of otherwise viable businesses capable of being turned around. However, the independent review could reach no firm view on the causes of these delays.
- 2.29 The independent review identified frequent failures to pay appropriate attention to turnaround considerations, including as a result of failures to:
- a. carry out adequate viability assessments,
 - b. consider and implement viable turnaround options including medium and longer term sustainable turnaround solutions (instead of focusing on short-term measures such as rescheduling or renewing an existing credit facility on revised terms),

- c. document clear turnaround plans with appropriate objectives and milestones and monitor progress against those plans,
- d. make adequate use of a broad range of turnaround tools, including forbearance where appropriate, and
- e. consider the impact of RBS's actions (eg re-pricing facilities, pressing for debt repayment, and withdrawing working capital facilities) on the ability of the SME customers to continue to trade.

2.30 The independent review found that the inappropriate treatment of customers resulting from GRG's failings to place appropriate weight on turnaround options in its handling of SME customers during the review period was widespread. It was also systematic because:

- a. GRG prioritised its commercial objectives at the expense of turnaround objectives,
- b. GRG's overall management and oversight of risks to customers was inadequate and did not treat turnaround as a priority,
- c. GRG did not place appropriate emphasis on turnaround in its staff objectives, instead focusing on pricing,
- d. GRG placed an undue focus on pricing and debt reduction without due consideration of the longer term viability of SME customers,
- e. GRG did not adequately manage the conflicts of interest in its relationship with West Register, thereby leading to an environment where case strategy was influenced by the perceived or actual interests of West Register with a reduced focus on customer-led recovery and turnaround, and
- f. GRG did not put in place adequate or appropriate processes to ensure that turnaround was given due weight in its day-to-day interactions with SME customers.

2.31 In terms of potential harm to customers arising out of failings in relation to turnaround strategy, the independent review concluded that:

- a. delays in transfer restricted the ability of GRG to make meaningful contributions in some cases and reduced the possibility of turning around otherwise viable businesses,
- b. an impact of lack of documented consideration of viability was that businesses which were clearly not viable remained under GRG management for considerable periods, rather than being identified for recovery action at an early stage. For those customers who were potentially viable, RBS remained unclear about their prospects and the extent to which (if at all) it should support the business. In turn, this led to a lack of clarity about the options for turnaround

and gave rise to the possibility that practical and mutually advantageous turnaround opportunities were missed,

- c. an absence of rigorous assessment of turnaround options also led to these options being missed or overlooked or becoming impractical due to delay. GRG staff instead focused on short term measures such as rescheduling or renewing an existing credit facility on revised terms, creating the risk of failing to grasp fundamental issues facing the customer and the Bank,
- d. there was a reluctance to engage with customers' counter proposals, some of which were potentially credible, and
- e. there was confusion on the part of GRG staff about the way in which IRHP products worked and a lack of appreciation of the cash flow impact of selling income-producing assets to reduce indebtedness.⁷

f: Facilities

2.32 In the independent review 'facilities' referred to any contractual arrangement under the terms of which customers were lent money by RBS. That might include loans that are repayable after a fixed period, perhaps three or five years, overdrafts, or short-term loans or an invoice discounting facility available through RBS Invoice Financing.

2.33 The contracts governing facilities were likely to be on terms that conferred wide discretions upon RBS. These terms would have included the contractual right to increase margin as well as the discretion to use breaches of the terms of the loan as the basis to renegotiate the overall financial position. The independent review recognised that such reassessment is not inappropriate. It enables the Bank to exercise forbearance as well as to address the increased risk that it assumes when a loan no longer meets the criteria against which it was originally underwritten.

2.34 The independent review was required to look at whether the removal of or changes to banking facilities and asset-based finance was one of the potential causes of distress to otherwise viable businesses. It included asset-based finance as an integral part of its work on facilities.

2.35 Almost all customers who entered GRG were already exhibiting clear signs of financial difficulty. In many cases, this also meant that the customers had already defaulted on at least one of their facilities, or were in breach of one of the covenants that had been written into the original credit agreements. The fact that a customer was in breach of the terms of the

⁷ See paragraph 7(a) of the Specialist Adviser's report to the Treasury Committee

facility (or that the facility had expired) gave GRG the wide discretions referred to above.

- 2.36 It was a major feature of the cases reviewed that RBS had taken steps to reduce the level of facilities offered to the customer by, for example:
- a. requiring asset sales to enable some repayment of the outstanding debt,
 - b. encouraging customers to refinance with third parties,
 - c. withdrawing or reducing working capital facilities (including overdrafts), and
 - d. replacement of on-demand facilities with term-loan facilities.

The Bank sometimes also sought additional personal guarantees to provide additional security against the customer's credit facility. This strategy was not, in principle, inappropriate given the Bank's risk appetite and customers' financial difficulties. However, the Bank's failure to conduct viability assessments, or to seek to properly understand the business in many cases, increased the risk that decisions taken around the size and types of facilities would lead to material adverse consequences for the business.

- 2.37 There were a large number of cases that involved some form of property development (be it residential or commercial) where the property loan was short-term in nature and was designed to be paid back once the development had been completed and sold. In cases where developments had not been completed to time and original budget the existing facilities simply expired with no prospect of immediate repayment. Some cases were sent to Recoveries at an early stage, while in others the facilities were extended, often for short periods, with agreements to sell assets gradually to repay outstanding debt and/or to rent out the properties to cover at least interest on the loans. Many customers wanted RBS to continue to provide funding in the hope that the property market would recover. However, the independent review concluded that it was not reasonable to expect RBS to continue to finance assets that had little realistic prospect of recovering value within a reasonable period of time.
- 2.38 The independent review therefore concluded in principle that it was not inappropriate for RBS to seek to sell assets or put the business into Recoveries in cases where there was little prospect of the asset appreciating sufficiently within a reasonable period to secure the repayment of debt, especially where the customer was unable to service the interest costs and have funds in hand to maintain the property. However, the position in individual cases was not always so clear. Property assets often turned from straightforward developments into letting businesses, with at least some potential to fund interest if not

capital repayments against term loans. The independent review considered whether it was fair and reasonable in individual cases not to renew facilities, or whether it was more appropriate to renew facilities for a limited period so that assets could be sold in an orderly manner.

- 2.39 The independent review noted that trading cases were much more likely to include a range of credit facilities. Typically, these would have included long-term credit facilities with a regular interest and capital repayment schedule; as well as working capital facilities, usually an overdraft, that were invariably short-term in nature because an overdraft (unless it provides to the contrary) is usually repayable on demand.
- 2.40 Changes in the credit facilities made available to trading businesses, in particular overdrafts, came with increased risk that they could have potentially significant impacts on the ability of the businesses to operate. The independent review sought to decide whether the Bank had given due consideration to alternative courses of action, the impact of changes to facilities on the business concerned and whether, overall, it had behaved in a way that was reasonable. In some cases it was clear that the Bank had acted appropriately; it had provided adequate time to the customer to meet changes to facilities and appropriate consideration had been given to the impact on the underlying business. In other cases, a change to facilities resulted in adverse outcomes but it was often difficult to pinpoint the extent to which any one single action by the Bank led to an unfair outcome for the customer.
- 2.41 The independent review noted that GRG had no specific policy on the exercise of forbearance until after the end of the review period, although it introduced reporting mechanisms in June 2013 to capture the amount of forbearance extended. This enabled RBS to produce statistics for 2013 on the amount of forbearance recorded across the Business Restructuring Group, a division of GRG, and the figures reflect that forbearance had taken place.
- 2.42 The independent review found that forbearance was exercised by RBS in some cases. However, many of the cases where RBS had not undertaken a meaningful appraisal of the turnaround options would have benefited from some degree of (additional) forbearance. Similarly, other cases would have benefited from a modest injection of additional funds, for example to allow a development to be completed where the evidence indicated that this was the best way forward. The main focus, however, in many of the cases was on debt reduction and re-pricing and so opportunities to aid businesses by either some kind of forbearance or new monies were missed. In those cases where new money was injected, the price was usually substantially greater than the existing arrangements and very little account was given to the comparative weakness of the customer in seeking to negotiate the terms on which new money would be made available.

- 2.43 In considering ways of reducing its exposure to customers, GRG routinely offered customers the option of making cash injections and in some cases considered personal guarantees from the owners of the SME business or a combination of both. In cases where RBS withdrew support quite some time after the initial restructure of the credit facility, the independent review found that it was not evident that RBS had a pre-determined strategy to withdraw support at the time the personal guarantee or cash injection occurred. This typically occurred where the passage of time proved insufficient to solve the financial problems that the customer was experiencing.
- 2.44 In other cases, where RBS asked for personal guarantees or cash injections to extend the customers' credit facility, and where these customers did not wish to inject further funds or provide additional personal guarantees, RBS sometimes decided that it would no longer support the customer. While the customer might have perceived that RBS had requested additional cash or personal guarantees when it had no intention of supporting the business, this change of approach by RBS was not necessarily inappropriate in the individual circumstances of these cases. The independent review found no widespread or systematic practice under which RBS misrepresented its true intentions to the customer with the object of obtaining further funds or guarantees.
- 2.45 In summary, the independent review found that RBS did not act unreasonably in seeking to reduce facility levels in most cases it dealt with, and that many of the cases transferred to GRG were in breach of their facilities that had been granted in the years leading up to 2008 on terms which appeared in hindsight to have been generous. However, having determined that it no longer wished to lend to categories of customers, RBS should have been mindful of good turnaround practice and its TCF objectives and would need to consider carefully how to execute that objective in a manner that was appropriate and which minimised as far as practicable the adverse impacts of its decision on the customer.
- 2.46 The independent review found that GRG had in fact pursued its objective of reducing facility levels with insufficient regard for the impact its decisions had on its customers, and as such GRG's decision-making relating to existing facilities was inappropriate. The overriding objective in respect of facilities was to reduce the Bank's exposure, and extensions were typically short-term and on terms that secured additional income for GRG.
- 2.47 The independent review found cases where RBS had exercised forbearance, but its findings of inappropriate customer treatment in this area arose from failings by RBS to exercise forbearance when it would have been fair and reasonable to do so. This was often linked to a failure to undertake any meaningful assessment of viability or turnaround options

coupled with an overriding objective to reduce the debt and re-price where possible. The independent review concluded that the failure to exercise forbearance, in circumstances where it would have been appropriate, occurred on a scale that was widespread.

g: Pricing

2.48 The independent review considered the way in which GRG sought to apply contractual increases to the price payable (increases to the margin that RBS charged on the facilities it provided and to fees), and to renegotiate other financial terms. Pricing could be revisited if certain terms of the original contract between RBS and the customer were breached.

2.49 The term 'pricing' means any one, or a combination of any, of the following:

- a. increases to the margin paid on the loan,
- b. administration fees charged by GRG to reflect the increased costs to the Bank in employing additional staff to deal with cases in financial difficulty ('management' fees),
- c. upfront fees charged on granting 'new' money (often called arrangement fees),
- d. fees that are deferred until the loan is repaid (usually described as an "exit" fee),
- e. sums payable when an upside instrument matures,
- f. risk fee following default – a risk fee is an additional fee charged to reflect RBS's increased risk profile in continuing to support the customer for a period of time following the event of default. The rationale for charging this fee was that the lending had fallen outside of the contract terms originally agreed with RBS, and RBS needed to ensure that it was appropriately rewarded for continuing to offer support at a risk level that would not normally be accepted,
- g. waiver fees – waiver fees are fees payable to RBS for agreeing to waive a default by the customer. The rationale was that RBS had provided the customer with a benefit by waiving its legal rights,
- h. 'payment in kind' fees – if a customer is unable to service interest on its debt, the customer may ask for interest to be rolled up/capitalised. If RBS agreed to vary the loan terms in this way, it also charged fees for doing so,
- i. non-utilisation/commitment fees – fees payable to RBS to compensate it for holding funds available for drawdown but which are not actually drawn, and

- j. excess fees/unauthorised overdraft fees – an excess occurs when the balance on a customer’s current account is either (a) overdrawn, with no formal facility in place, or (b) in excess of any agreed overdraft facility limits.
- 2.50 In March 2011 written guidance was issued by RBS to GRG on the procedures to be followed when considering charging customers fees and when it was appropriate for fees to be charged. The 2011 guidance provided for a wide variety of fees and emphasised the need to avoid double-charging and to evidence the rationale for pricing decisions. This guidance reflected prudent practice which ought to have been adopted throughout the review period.
- 2.51 An email to all GRG staff noted that care needed to be taken to ensure that the customer’s cash flow position was ‘properly taken into account in all cases’.
- 2.52 The independent review concluded that it was not unreasonable for the Bank to be mindful of the desirability of matching its risk with the reward it sought. But in the context of a turnaround division the application of that approach needed particular care. A focus on matching risk and reward in the short term inevitably implied significant additional charges for GRG’s customers but simply demanding more money from already financially stressed businesses was often unrealistic. The Bank’s wider turnaround policies and its turnaround objective meant that it needed to be thoughtful about how to observe risk/reward principles whilst actively seeking opportunities to support potentially viable businesses achieve a successful turnaround and ‘return to satisfactory’.
- 2.53 GRG relationship managers were vested with considerable discretion as to the application of pricing arrangements and this was not inappropriate. A degree of flexibility is an inherent requirement of a turnaround unit. There was, however, a failure to provide more detailed guidance on how to exercise that discretion in the context of a turnaround division. There was evidence that the focus of staff was simply on how to increase prices, and leverage opportunities.
- 2.54 The 2013 revisions to pricing policy were intended to put an end to some of the more contentious elements of GRG charging. Those revisions came too late in the review period for their effect to be tested but in any event the independent review did not view those revisions as sufficient to address the shortcomings in policy it had identified.
- 2.55 The independent review was required to form a view about the appropriateness of costs imposed on businesses once in GRG. In assessing whether there was inappropriate treatment of customers by RBS in relation to pricing, it focussed on four key areas:

- a. whether there was evidence on the file to justify GRG's pricing decisions,
- b. whether pricing changes were properly explained to the customer,
- c. whether the quantum of pricing was fair and reasonable in the individual circumstances of each customer, the extent to which increases would affect such issues as cash flow, and
- d. whether the pricing complied with RBS guidance.

2.56 Findings of inappropriate treatment of customers in relation to pricing were made on 118 of the review sample cases (57%), primarily in relation to the failure to record the rationale for the pricing increases and/or a failure to properly inform customers of the rationale for the pricing increases.

2.57 The following conclusions were reached in relation to pricing:

- a. GRG sought to impose on customers a wide range of pricing increases and charges,
- b. there were wide discretions available to GRG relationship managers, but the failure to provide proper oversight about how that discretion was exercised was inappropriate and gave rise to an environment where there were inadequate controls over pricing practice,
- c. there was an undue and inappropriate focus on the generation of income in the form of pricing increases from SME customers,
- d. there was an attempt to remedy the situation in June 2013, with a revised policy approach, but that came too late to affect almost all of the sample cases and was in any event too generic in nature,
- e. there was legal guidance from March 2011 on the need for GRG to set out a clear rationale on pricing decisions to justify them if called upon to do so, advice that was not followed in most of the cases in the review sample,
- f. the absence of adequate records of the rationale for decisions rendered it difficult, and often impossible, for the review to consider how a decision on price had been arrived at,
- g. there were common failures to communicate pricing decisions to customers; this was a known issue having been apparent in both customer complaints and customer surveys,
- h. some of the pricing observed was inappropriate when assessed against normal risk return principles or was otherwise excessive. There was a significant group of cases where pricing appeared to be at best questionable and sometimes opportunistic. But the most

important and immediate consideration for customers was not so much the notional quantum of the increases that GRG imposed as the short-term manageability of those charges given other financial pressures on the business,

- i. pricing was used on occasion as a mechanism to encourage the customer toward taking a course proposed by RBS,
- j. there was evidence that RBS used its pricing discretion as leverage to achieve its objectives, and
- k. in a number of cases it was evident that, while exposure was being reduced (either debt was being paid down and/or security cover was increased), pricing was still increased.

2.58 Overall, there was an undue focus on pricing increases without due consideration to the longer term viability of customers. That pricing focus resulted in the inappropriate treatment of customers on a widespread scale.

2.59 The independent review also found that these failures amounted to systematic inappropriate customer treatment because:

- a. GRG prioritised its commercial objective at the expense of its turnaround objective,
- b. GRG's overall management and oversight of risks to customers in GRG was inadequate and did not treat turnaround or risks to customers as a priority to balance against the focus on income generation,
- c. the focus of GRG's management information was on pricing related metrics, not risks to customers,
- d. GRG, in operating its staff objectives, focussed on pricing, and it placed less emphasis on other objectives such as treating customers fairly,
- e. the GRG staff objectives in practice, material on case files and in some local staff communications suggested a culture in at least some quarters of GRG of deal making that set little store by the interests of customers but which had as its paramount focus the generation of income and creation of 'upsides',
- f. there were material deficiencies in the policy framework in respect of pricing practice prior to March 2011, and subsequently the legal guidance was not widely followed in practice, and
- g. GRG failed to put in place adequate or appropriate processes in its day-to-day interactions with SME customers to ensure that pricing

changes were appropriate, bearing in mind its objectives as a turnaround unit. In particular:

- i. there was a failure to provide more detailed guidance to GRG staff about how to exercise the significant discretion available to them under GRG's pricing policy,
- ii. there was little evidence of GRG engaging with the need to balance pricing increases with other considerations in connection with the handling of SME customers (for example in Strategy and Credit Reviews) – indeed the evidence suggests otherwise – that the focus was on income generation, and
- iii. there were inadequate controls over pricing practice generally.

h: Valuations

2.60 The primary purpose of valuations was to assess whether lending was still within policy and risk appetite and how this impacted upon the Bank's capital reporting. But valuations were used in relation to a range of other issues which were potentially important for customer outcomes, including:

- a. the decision to transfer to GRG,
- b. the initial viability assessment,
- c. the assessment and formation of restructuring or renewal proposals for expired facilities,
- d. determining pricing,
- e. testing the customer's compliance with financial covenants in its lending agreements and determining if additional security was required.

Dr Tomlinson's report identified valuations as a common ground of complaint, by customers who felt that the Bank had significantly undervalued assets and so put them in breach of their covenants.

2.61 Notwithstanding the Bank's policy framework, the independent review found that there were frequent failures in respect of valuations, including a failure to oversee and ensure that robust valuations were made by frontline staff in a manner consistent with the objectives of a turnaround unit and a failure to carry out adequate work in making those valuations and in documenting the basis for them, in particular those that had a material impact on the approach taken to customers. The independent review found little evidence of oversight and validation of valuations. It concluded that RBS should have taken better steps to ensure the appropriateness of its internal and external valuations, given that they

were used to drive decisions about strategy, pricing (fees and margin), and the calculation of upside instruments.

- 2.62 The independent review did not find any evidence that the valuation practice or methodology used by GRG systematically under-valued assets or that values were manipulated to achieve a transfer to GRG or for any other purpose. It did not conclude that any particular valuation was necessarily incorrect (although in some cases subsequent sale prices certainly indicated that that may have been so). However, the internal valuations that were used were often not accompanied by evidence that supported how they had been arrived at, which increased the likelihood that they may have been wrong. RBS should have taken more care to ensure that this risk was minimised. In order to provide assurance to customers that the internal valuation process was independent of GRG's preferred strategy or other commercial objectives, there should have been stronger 'Chinese walls' between the functions.
- 2.63 The independent review viewed the use of internal valuations based on insufficient and/or inadequate work as an inappropriate treatment of customers on a widespread basis.

i: Customer experience

- 2.64 The independent review considered RBS's approach to handling customers, including how it implemented the TCF initiative, and with particular reference to requests to customers for information and allegations that it had restricted customers from taking action.
- 2.65 The independent review found no evidence of widespread inappropriate treatment of customers in respect of requests for information by RBS or preventing customers from taking action. It was not uncommon for RBS to seek information from a customer in GRG that would not routinely have been collected when the customer was handled by the mainstream Bank. It was understandable that a bank would wish to monitor such a customer more closely, through more frequent and more detailed reporting than would normally be the case. The independent review identified only two cases in the review sample in which it considered that the extent of information requested in the timescales provided was inappropriate in the circumstances and unduly burdensome on the customers.
- 2.66 Given the enhanced risk to RBS represented by customers in GRG, closer scrutiny of financial and related information was a prudent course and was not, of itself, inappropriate. The independent review identified eight cases in the review sample where GRG's observations risked being understood by the customer as an instruction to take specific action, such as to delay payments to Her Majesty's Customs and Revenue, to suppliers or other creditors, to cancel existing orders or make specific staff or other appointments. These practices were not widespread but where they occurred were not always appropriate.

- 2.67 GRG's approach to the implementation of TCF for most of the review period focussed on a narrow range of process measures that failed to address the key risks to customers in the GRG model. GRG failed to identify key risks to customers arising from its activities, to develop management information against which those key risks could be monitored on a timely basis and to implement systems and controls (including governance) to ensure that risks were mitigated and controlled appropriately.
- 2.68 The independent review found that RBS's relations with its customers were often insensitive, dismissive and sometimes unduly aggressive. These failings added to an already inherently stressful situation, making the environment both more antagonistic than was necessary and more error-prone. The GRG policy and procedures concerning the relationship between relationship managers and SME customers were inadequate. This failure to adopt adequate procedures and to ensure fair treatment of customers gave rise to widespread inappropriate treatment of SME customers throughout the review period.

j: Complaints

- 2.69 Complaint-handling was a regulatory requirement in respect of some customers (micro-enterprises) but RBS recognised that it was a necessary part of its TCF approach to all its customers in GRG. However, the independent review found expressions of dissatisfaction in 125 of the cases in the review sample that it considered and failings in complaints handling in 52 of those cases. In 22 cases the expressions of dissatisfaction had not been identified as a complaint. In 31 cases, complaint handling procedures were not followed. In 11 cases, no response was made to the complainant.
- 2.70 The independent review found that RBS's complaint handling policy included elements that limited its practical effectiveness and lacked, for much of the review period, sufficient escalation safeguards and consideration of root cause analysis. In these respects, RBS's approach was considered to be inadequate and inappropriate. The independent review also identified failings in the way the policy was implemented, including in the way staff were trained and because of the adverse impact on recognising and reporting complaints which resulted from setting an objective of 'zero justifiable complaints'. The situation improved somewhat once the handling of complaints was transitioned to a specialist complaint handling unit within the Bank, but remained unsatisfactory.
- 2.71 The Bank's failures to handle complaints fairly resulted in the widespread inappropriate treatment of customers. This inappropriate treatment was systematic because:
- a. the focus on "zero justifiable complaints" and the way this was interpreted in practice meant that the policy of fair treatment of

complaints was not followed in practice (ie it incentivised a lack of recording and reporting of complaints),

- b. RBS did not put in place adequate safeguards to ensure that it applied its policy in practice and there was no meaningful process to check compliance with the requirements of the Handbook Dispute Resolution rules relating to complaint handling (DISP) for those cases that fell within the scope of DISP,
- c. the evidence from cases suggested that GRG took a dismissive approach to complaints,
- d. management information on complaints was unreliable, and
- e. GRG did not undertake adequate root cause analysis and so was unable to learn the lessons of the complaints that were received.

k: Third parties

- 2.72 Third-party firms were widely used by GRG to provide support for their work, for example on valuations and independent business reviews. Customers had expressed concern that the action of third-party firms had affected the viability of businesses and that RBS was 'too close' to some third-party firms, in particular where the GRG staff member they were dealing with was on secondment from a third-party firm.
- 2.73 The independent review did not see any cases where third-party firms directed customers to take specific actions that were detrimental to them or where the use of third-party firms to conduct specific pieces of work was inappropriate.
- 2.74 GRG should have been aware of the potential conflict presented by the use of individuals who had been seconded from third-party firms that were often used by RBS. It does not appear that monitoring was sufficient to prevent potential conflicts from arising or that conflicts which did arise were managed appropriately. But the potential conflicts identified were more likely to impact other third-party firms than the customer, because they typically arose when a seconded staff member looked to favour their own firm during, for instance, a tender process for a specific piece of work.

l: Customers exiting GRG

- 2.75 The independent review considered the appropriateness of relevant policies and practices relating to the exit of customers from GRG and their return to the mainstream Bank.
- 2.76 In general, customers who should have been transferred back to the mainstream Bank were transferred. There was only limited evidence of customers being kept in GRG for reasons that were inappropriate and of

customers who should have returned to the mainstream Bank earlier than they did. However, the process for transfer which was adopted by GRG and communicated to customers had the potential to lead to confusion amongst customers about the steps which were required to exit GRG.

m: West Register

- 2.77 West Register consisted of various legal entities, all of which were limited companies but operationally were closely related to and managed by GRG. West Register companies acquired assets, usually real estate, either directly from customers or from insolvency practitioners. Other West Register companies held the benefit of the legal agreements that were entered into by customers who agreed to a PPFA or an EPA (ie upside instruments). SIG was responsible for managing the upside instrument strategies and collecting income including dividends and fees when due.
- 2.78 These were very distinct functions but to many customers it was simply West Register: either their property was bought by West Register; or West Register held a charge over their property (in the case of a PPFA); or West Register owned the shares in their company (in the case of an EPA).
- 2.79 RBS applied the term upside instrument to refer to an arrangement under which it sought an 'appropriate return' for its calculation of the increased risk in continuing to support businesses that fell outside the current lending criteria or which were exhibiting signs of financial distress. Such instruments were seen by RBS as being an appropriate return for the increased risk it faced by continuing to support the customer, either within the existing facilities or with additional borrowing. Payment of the anticipated return was deferred and was linked either to the value of a property in the case of a PPFA, or to the increased value of shareholdings in a limited company in the case of an EPA.
- 2.80 The independent review considered the role of West Register in property acquisitions and, separately, its role as owner of the interests secured from customers through upside instruments and the role of SIG in negotiating those instruments.

West Register property acquisitions

- 2.81 RBS told the independent review that during the period covered by the review:
- a. West Register (GB) purchased 382 properties from a total of 166 SME customers, for a total purchase price of ca. £218.75m,
 - b. of the properties purchased by West Register (GB) from SME customers, 87% were purchased through an administration, liquidation or receivership process, and

- c. with one exception, none of the property assets acquired from customers had realised proceeds in excess of the underlying customer's liabilities to the Bank.
- 2.82 For the majority of the review period, West Register was pursuing a dual purpose. One purpose was to maximise recovery for the Bank by avoiding forced sales. The other was to hold assets and realise them at a later date when the Bank would benefit from any uplift in value.
- 2.83 West Register was involved in some way in 60 of the cases in the review sample and that involvement resulted in a purchase of assets by West Register in 15 of them. In 13 of the 15 cases, purchases were made through an insolvency process (ie RBS did not determine who would purchase the asset). In each of the 15 cases:
- a. there was no evidence that the intent to purchase those assets had been formed prior to the transfer of the customer to GRG,
 - b. the purchase price was significantly less than the value of the debt held by RBS at that point; so the purchase crystallised a loss for RBS (and there was no case in which the purchase price paid by West Register alone gave rise to a financial loss to the customer), and
 - c. there was no evidence that a successful bid by West Register was clearly below market prices for the asset at that time.
- 2.84 In at least 6 of these 15 cases, West Register was actively involved in the development of GRG strategy prior to a purchase, discussing issues such as whether or not property should be let.
- 2.85 In 30 of the cases in the review sample the independent review found that information had been inappropriately shared by GRG with West Register. The nature of the information shared was extensive and/or the sharing of it took place at a time when West Register was able to and in some cases did influence GRG's strategy toward the customer.
- 2.86 The independent review found that, on balance, the existence of a mechanism to acquire assets in this way is not of itself inappropriate or unfair to customers. But in setting it up, and in the design of its governance and its policies and procedures, the greatest care was needed to protect all parties, not least RBS itself, against such conflicts of interest (and the foreseeable perceptions that inevitably arise from them) inherent in such an arrangement.
- 2.87 The independent review concluded that the overall relationship between GRG and West Register was inappropriate. The relationship gave rise to a series of conflicts of interest that initial guidance failed to address and that were still only partially addressed in the guidance produced in November 2013. The governance structure that should have identified

those underlying conflicts was inadequate and inappropriate and concentrated in the same hands that were looking to the future profitability of the Bank in general and of GRG in particular. In common with the twin goals of GRG itself, the tension between two competing objectives in the West Register model (maximising immediate recoveries; future profit to the Bank) was never identified and therefore never managed.

- 2.88 The inappropriate relationship was compounded by the closeness between West Register and GRG at every level. There was inadequate separation of operational functions relating to West Register and the mechanisms that ought to have acted as a balance to them. People who had responsibility for operational matters relating to West Register also assessed their risk from a compliance and regulatory perspective. There was confusion amongst GRG relationship managers as to the role of West Register in the development of their case strategy. At the operational level, relationship managers freely shared information with West Register and were encouraged to do so, leading to an environment where many saw West Register as the easy solution to challenging turnaround cases. In some offices the physical proximity of the two teams was a significant factor. And there were occasions where West Register employees also considered themselves to represent GRG's Property Advisory Unit and were thus compromised in giving independent advice on individual cases.
- 2.89 The failings identified by the independent review resulted in the inappropriate treatment of customers by providing an environment where conflicts of interest were inadequately managed, insufficient regard was paid to turnaround options, and where case strategy was influenced by the interests of West Register. Those failings were widespread and resulted in the inappropriate treatment of customers by reducing the focus on customer-led recovery and turnaround, regardless of whether West Register ended up acquiring the property.
- 2.90 This inappropriate treatment of customers was also systematic for the following reasons.
- a. The establishment of GRG with a 'profit motive' required careful oversight, but GRG did not appear to recognise the conflicts of interest (whether real or perceived) inherent in the structure it developed, and it did not put in place adequate or appropriate controls to manage those conflicts during the period covered by the review.
 - b. GRG actively encouraged the sharing of information between GRG staff handling SME cases and West Register. This gave rise to an environment where, prior to an Appointment being made, West Register could and on occasion did become involved in the strategy for the handling of SME cases prior to administration/insolvency.

- c. There was a failure to establish an arm's length relationship between GRG and West Register, illustrated by the 'double hatting' of various roles and a lack of segregation of teams that added to the risks of inappropriate information sharing or influence over strategy.
- d. Overall there was a weak governance framework for West Register in respect of its customer-facing actions and, in particular, inadequate controls over information sharing between GRG and West Register.
- e. The focus on West Register as a potential and profitable solution to cases for RBS gave rise to an environment where West Register could become the easy alternative to more considered options for GRG staff, further weakening the focus on genuine turnaround.

SIG

2.91 The key roles and responsibilities of SIG, as described in its policies and procedures manual were:

- a. "To assist GRG Relationship Managers in the taking of equity and other upsides (including [PPFAs]) including negotiation of terms, structuring and documentation when these are required to secure a level of return commensurate with the level of risk.
- b. Management of the portfolio of all equity and other upside instruments negotiated by GRG globally in the course of debt restructuring; SIG will seek to maximise return through periodic review of strategy and performance, identification of optimal exit times and timely collection of any income due i.e. dividends. This includes listed and private positions.
- c. Investment of new capital using SIG's hybrid mezzanine/equity product; the team will review and diligence proposals, negotiate and structure the investment and undertake the management of the resultant position through to exit..."

2.92 The independent review noted that such an approach can have benefits to both the customer and the bank. The customer benefits from the continued support with no immediate impact on cash flow and may therefore be better able to trade out of its current difficulties. The bank has been able to offer the support in the knowledge that its reward, which is not guaranteed, has at least been addressed and may prove of value at some future date.

2.93 However, the independent review criticised GRG's overarching attitude towards Upside Instruments. They were important parts of the GRG strategy which were emphasised in objectives for staff at all levels. Whilst

they had a valid role in the toolkit of a turnaround unit, the focus given to them by GRG was disproportionate and inappropriate.⁸

2.94 PPFAs were typically used in the following circumstances:

- a. where the property was the business (eg a hotel, nursing home, or a pub),
- b. when a company did not have distributable reserves and these were unlikely to be created,
- c. where future survival was marginal but the company was asset rich,
- d. sole traders and partnerships (where equity was not available),
- e. where equity would be inappropriate for any other reason, and
- f. where the Bank saw redevelopment potential in the property that could enhance the value of the upside instrument over time.

2.95 There were 20 cases in the review sample where a PPFA was entered into. The main concern identified was that the rationale behind how RBS calculated the return it was proposing as compensation for its perception of the increased risk was not explained to the customers. Also, in some cases customers were given a comparatively short time in which to decide whether to accept a PPFA and the explanation given to the customers about how the agreement operated in practice could have been fuller. The independent review recognised, however, that the customer was always given the opportunity to take independent legal advice prior to entering into such an arrangement.

2.96 PPFAs provided a useful option where otherwise viable property ventures were unable to meet interest costs in the short term, but where the prospect of capital appreciation provided a way in which facilities could be funded for the benefit of both the Bank and its customer. In that sense PPFAs provided for forbearance that might not otherwise have been possible. The independent review did not find that the use of a PPFA alone had been the cause of inappropriate treatment of customers on a widespread or systematic basis.

2.97 Customers entered into an EPA in 15 cases in the review sample, and in 4 of those cases the customers also entered into a PPFA. Under the terms of an EPA, the Bank would take a percentage of the equity of the company in the form of shares. It was a common feature of these arrangements that the Bank would be entitled to a return on its investment by the payment

⁸ See paragraph 7(c) of the Specialist Adviser's report to the Treasury Committee

of a preference dividend prior to the repurchase of the equity by the customer in any year when the rules for dividend distribution were met.

- 2.98 RBS often used EPAs when it had classified the debt or a proportion of the debt as 'mezzanine risk' level or 'equity risk' level lending which required a higher level of return. These were internal categorisations of the debt according to the risk level which it was thought to pose to the Bank: 'Senior Debt' posed the lowest risk, then mezzanine risk then equity risk.
- 2.99 The pricing of these mezzanine and equity elements was achieved using approved Internal Rate of Return (IRR) models which calculated the rate of return on loans. The IRR tool used by SIG was intended to evidence the balance between the risk and reward strategy that RBS considered it was putting in place; but in most of the cases reviewed RBS was unable to provide the final model to evidence the basis of the calculation.
- 2.100 The independent review made general observations about the impact upon customers of EPAs:
- a. The effect of the arrangements was significant and provided RBS with wide-ranging rights in respect of the business. They were perceived by some SME customers in the review sample as the Bank having a considerable say in how the business was run.
 - b. The pricing associated with these arrangements was opportunistic, assessed on the basis of the best deal SIG could negotiate, and not necessarily on the basis of the prices that it would be reasonable for RBS to charge. Some of the pricing appeared excessive.
 - c. EPAs made the relationship between RBS and its customer more difficult. Through its new shareholding, RBS could (and did) intervene in issues including senior staffing, replacement of Directors, and business strategy. Although the Bank sought to avoid acting as a Shadow Director, this created risks and conflicts which were inappropriate for smaller SMEs.
 - d. There were examples of GRG relationship managers contacting SIG to discuss potential opportunities, particularly in the early part of the review period.
- 2.101 The independent review concluded that EPAs are inherently more complex financial instruments than PPFAs. An EPA typically required changes to a company's structure and complex legal documentation, was open-ended, and had no clear mechanism for determining value when terminated. The independent review concluded that GRG and SIG failed to exercise adequate safeguards to ensure that the terms of EPAs were appropriate.
- 2.102 The close association between SIG and the GRG relationship managers gave rise to conflicts of interest that were not managed effectively or appropriately. By sharing equity 'prospects' at an early stage in

consideration of the strategy for handling distressed cases (as GRG did at least in the early part of the review period) there was a risk that strategy would be unduly influenced by SIG's commercial priorities and the encouragement to relationship managers to deliver 'upsides' for RBS. This could and did result in customers entering EPAs that were not appropriate for their needs as well as options for more traditional turnaround being overlooked.

2.103 The independent review concluded that the use of EPAs gave rise to inappropriate customer treatment which was widespread, although the number of SME customers actually subject to EPAs was relatively small. EPAs should have been seen as the exception for the largest customers within GRG; they were an inappropriate solution for the overwhelming majority of SMEs.

2.104 The independent review also viewed the inappropriate treatment of customers resulting from the focus on EPAs as systematic because:

- a. GRG placed considerable emphasis on obtaining upsides – this was reflected in staff objectives, management information and training and in its pricing policies,
- b. GRG did not put in place adequate controls over the circumstances in which EPAs would be applied and the terms associated with them, and
- c. GRG did not recognise the conflicts of interest inherent in the SIG/EPA approach, and given the limited restrictions on the sharing of information between GRG and SIG there was a risk that SME case strategy would be influenced by the interests of SIG (and the expectations of future 'upside').

3 Customer outcomes

- 3.1 The independent review concluded that, contrary to statements in Sir Andrew Large's lending review, the number of cases entering GRG during the review period that had returned to mainstream banking within RBS by the end of that period was no more than one in ten of all cases, and in reality may well have been a significantly lower proportion. Most cases remained in GRG at the end of the review period; a minority (around 15%) had repaid their facilities or exited the Bank altogether. Around a third of customers entering GRG during the review period were destined to face insolvency, albeit in many cases after the end of the review period, and due in large to the financial challenges which they were already experiencing when they transferred to GRG.
- 3.2 The independent review analysed whether inappropriate actions by RBS had distressed otherwise viable businesses, using a methodology which was agreed with the FCA. It considered the representative sample of 178 cases and 29 further cases drawn from customers who had contacted Dr Tomlinson.
- 3.3 Once the initial review of individual cases was completed, each case was considered as of part of an assessment of financial distress and was placed into one of four groups:
- Group 1 – Business clearly not viable.
 - Group 2 – No inappropriate actions identified.
 - Group 3 – Inappropriate actions not likely to result in material financial distress.
 - Group 4 – Inappropriate actions likely resulted in material financial distress. The independent review defined distress as meaning a financial strain on a business, outside the extant pressures on a business arising from its inherent financial positions, the prevailing economic environment etc.
- 3.4 The independent review took a conservative view as to whether a customer (including connected entities) was 'potentially viable', and so outside Group 1, at or around the time of transfer to GRG, based on the available contemporaneous information, which was sometimes limited. If the evidence was not clear that a customer was 'clearly not viable', for example there was some element of viability, then it classified the customer as being potentially viable. In some cases, the actions of RBS were considered relevant to the assessment of viability such as where RBS had entered into a long-term financial arrangement with the customer which suggested that it considered the customer to be potentially viable.

- 3.5 In cases of trading entities, the independent review considered the medium-term prospects and performance across the business cycle, whether the market for the product had changed, whether key purchasers had not renewed contracts, and the length of time the business had been successful previously. For property companies, medium-term viability at the time under review largely depended on the actions RBS might itself choose to take and the independent review considered whether or not these cases represented a “viable proposition” for RBS, recognising that RBS might not always wish to decide to advance facilities even if the likely outcome was viability. The independent review made no assumption about the inevitability of the property market improving; it was more likely to classify essentially speculative property developments as being clearly not viable rather than assume that the property market would recover within a reasonable time period. In all cases, the independent review recognised that the viability of a business will change, sometimes markedly, over time and for businesses that were considered potentially viable around the time of transfer, any subsequent change of viability was noted in the context of considering the impact of any inappropriate actions by RBS.
- 3.6 Cases which were ‘clearly not viable’ were placed in Group 1 and were removed from further consideration in the distress assessment process, given the focus in the Requirement Notice on distress to otherwise viable businesses. In the balance of “potentially viable” cases, the independent review went on to consider (a) whether there were inappropriate actions by RBS, and (b) if there were inappropriate actions, whether they were reasonably likely to have led to material financial distress. In assessing whether inappropriate actions of RBS were likely to have caused material financial distress, the independent review applied the following test on the balance of probabilities: (a) there would need to be some element of financial distress, (b) that financial distress, given the circumstances of the case, would need to be material for that customer, (c) there would need to be a causal link between the inappropriate action(s) of RBS and the material financial distress experienced by the customer. The threshold of reasonable likelihood of causing material financial distress was adopted because the assessment of whether inappropriate actions had caused financial distress was challenging due to a number of contextual factors, including that customers were invariably suffering from pre-existing financial difficulties and the wider economic circumstances of the time.⁹
- 3.7 The conclusions of the independent review were as follows:
- a. 34% of cases in the representative sample were clearly not viable.
 - b. 92% of the remaining, potentially viable, cases in the representative sample had experienced some inappropriate actions in the handling of their case by RBS.

⁹ See the transcript of the Treasury Committee hearing of 31 October 2017

- c. 16% of the potentially viable cases in the representative sample (amounting to 11% of all cases) did experience inappropriate actions by RBS that, in all the circumstances of the case, were likely to have resulted in material financial distress (beyond that which the business would have experienced in any event). It was noted, however, that there were seldom clear-cut causal links between Bank actions and particular consequences. Adverse outcomes were more likely in the case of trading businesses and less likely in property-related cases.
 - d. All but one of the potentially viable cases in the Tomlinson sample had experienced some inappropriate action. Of the potentially viable group in the Tomlinson sample, inappropriate actions were likely to have resulted in material financial distress in 28% of these cases (beyond that which the business would have experienced in any event).
- 3.8 In terms of potential harm to customers the independent review concluded that causes of material financial distress identified by the independent review included:
- a. sudden (or at least unduly rapid) requirements to reduce credit facility levels,
 - b. pricing increases that paid insufficient regard to the customer's circumstances and cash flow,
 - c. upside instruments that appeared to be unreasonable in all of the circumstances, and
 - d. a general failure to consider wider turnaround options and identify and implement appropriate alternatives when they existed.
- 3.9 Across the case review sample of 207 cases, the independent review identified actions that appeared to be inappropriate in the following thematic areas¹⁰:

¹⁰ See paragraph 7(a) of the Specialist Adviser's report to the Treasury Committee

Thematic Area	Total number of cases with a finding	Finding Rate
Identification for transfer	39	19%
Transparency of the referral process	113	55%
Viability/Turnaround/Distress	77	37%
Independent Business Reviews	4	2%
Shadow Directorships	8	4%
Valuations	56	27%
Pricing	118	57%
Information requests	2	1%
Personal guarantees and/or cash	3	1%
Conflicts of interest - West Register	37	18%
Conflicts of interest - Third Parties	23	11%
Complaint handling	52	25%
Interest Rate Derivatives	4	2%
Debt Purchase	0	0%

APPENDIX 1

SKILLED PERSON'S RECOMMENDATIONS

The following section substantially reproduces the formal recommendations made by the independent review. Certain passages of accompanying commentary which are present in the original have been omitted.¹¹

Recommendations for RBS

We recommend that a review is carried out to ensure that our conclusions and recommendations that remain relevant to RBS have been implemented and in particular, to provide assurance to RBS, customers and the FCA that adequate governance and oversight arrangements are now in place to ensure that similar poor treatment of distressed SME customers could not happen in future.

Specifically we recommend that in carrying out that review RBS should, in the light of the observations and conclusions in this report:

- **Improve its governance arrangements and in particular:**
 - i. Review the objectives set for its turnaround division – the revised objectives should be agreed by the RBS Group Board;
 - ii. Review the governance of its turnaround division to ensure that it is subject to effective scrutiny, and establishes effective second and third lines of defence;
 - iii. Review the content and form of management information to ensure that customer outcomes and experience are accurately reported;
 - iv. Review the staff objectives set for, and culture of, those in its turnaround unit dealing with SME customers to ensure that these more closely align with the revised objectives the RBS Board has agreed;
- **Improve the arrangements around transfer into and out of the turnaround unit:**
 - v. Revise the criteria for the consideration of referral to the turnaround unit in respect of SME customers;
 - vi. Review the governance of the transfer process for SME customers to ensure that it is acting both efficiently and fairly: specifically we recommend that the chair of the group considering transfers should be independent of both B&C and the turnaround division;
 - vii. Ensure that its arrangements for returning customers to mainstream banking are clearly signposted to SME customers and that where RTS is appropriate this can be expedited promptly;

¹¹ See paragraph 7(d) of the Specialist Adviser's report to the Treasury Committee

- **Provide a greater focus on turnaround options where these are viable:**
 - viii. Review and improve its training and guidance for staff handling turnaround issues and ensure that staff have the necessary support and training to deliver good turnaround practice;
 - ix. Ensure in future that viability assessments are carried out on all cases following transfer and that where customers are potentially viable, a clear turnaround plan with milestones and targets should be produced and wherever possible shared and agreed with the SME customer;
 - x. Review the role and purpose of the Strategy and Credit Committee (or its successors) to ensure the terms of reference contain a requirement that turnaround options and the fair treatment of customers are reviewed in addition to credit considerations;
- **Rethink its approach to pricing in respect of distressed SME customers:**
 - xi. Review the policy and practice of the turnaround unit on pricing to ensure that relationship manager pricing decisions and reasoning are fully documented and validated and that turnaround considerations are taken into account;
 - xii. Review the range and form of fees and other charges for SME customers and set out for customers a clear and simple guide to when fees will be applied;
 - xiii. Review the rationale for an additional administrative/management fee being routinely levied on distressed customers;
- **Ensure any internal valuations are handled more carefully:**
 - xiv. Ensure that internal valuations and the reasoning behind them are fully documented and that this information is shared with the customer if the valuation is to be used in the development of strategy, or in decisions around the level of facilities or pricing;
 - xv. Where in-house resources are used to provide valuations upon which significant decisions are made in the context of a turnaround unit, RBS should ensure that there is a clear separation of functions and adequate safeguards to prevent conflicts of interest;
- **Review its policies and practices on dealing with customers and on complaints:**
 - xvi. Review its policy and procedures for relationship managers' engagement with SME customers – in particular RBS should consider how its engagement with SME customers takes appropriate account of the different circumstances of the diverse group of SMEs with which it deals;
 - xvii. Review and revise its communications with customers to ensure that it is transparent, clear and informative;

- xviii. Revise its approach to complaint handling and provide SME customers with clearly signposted routes to escalate their complaint if necessary;
- **Review its use of third-party firms and in particular the use of secondees:**

xix. RBS should ensure that appropriate guidelines and mechanisms are in place to guard against conflicts of interest in these areas;
 - **Fundamentally review its approach to the purchase of distressed assets:**

xx. Amend the governance, policies and practices and other arrangements relating to circumstances where it (West Register) acquires or considers the acquisition of assets owned by its distressed SME customers to address the shortcomings in arrangements that we have identified and ensure effective separation of the function from any turnaround unit;
 - **Review the use of Upside Instruments in the context of SME customers:**

xxi. Review the information provided to SME customers in relation to PPFAs to ensure that the agreements and the associated costs are transparent; and

xxii. Review the role of EPAs in relation to SME customers. In so far as RBS judges their continued use is justified and helpful to some customers it should further consider customer communication, minimum timescales and notification of buy-back terms, the governance around the arrangements and more widely the interaction between SIG, the turnaround unit and SME customers.
 - **To address specific unfairness observed during the course of the review:**

xxiii. Revisit the cases identified in the review where it is clear that GRG failed to respond to a complaint or where its response was inadequate; and

xxiv. Review the position of those SME customers who entered into an EPA during the Relevant Period with a view to ensuring that where a West Register minority holding in their business remains in place that they have a fair means of resolving disputes about the value of that holding.

We recommend that RBS should consider the practicalities of providing redress to GRG customers who are likely to have experienced financial distress as a result of its actions.

We recommend that RBS reviews the relevance of these findings more widely to its handling of SME customers.

Lessons for the wider market

We consider that the FCA should work with the government and other relevant parties to extend the protections available to SME customers.

We encourage the FCA to work with the government to ensure that there are adequate protections for the less sophisticated SMEs. This could include the extension of the unfair contract terms protections to SMEs and greater access to the FOS.

We encourage the industry and customer groups to develop a code on how banks can best support customers in need of business support. Such a code should be subject to independent oversight and monitoring.

We suggest that banks should review how they interact with third-party providers, especially in relation to secondees.

More generally we suggest that banks should review their own turnaround units with a view to ensuring that the lessons from this report in so far as they are relevant to other institutions are applied more widely.

APPENDIX 2

FINAL REQUIREMENT NOTICE

SKILLED PERSONS REPORT

To: The Royal Bank of Scotland Plc of 36 St Andrew Square, Edinburgh, EH2 2YB; National Westminster Bank Plc of 135 Bishopsgate, London, EC2M 3UR; Real Estate Asset Management (comprising the companies listed at Annex A of this Requirement Notice, whose registered addresses are also listed therein), and Strategic Investment Group/West Register companies (comprising the companies listed at Annex B, whose registered addresses are also listed therein) (collectively "**RBS Group**").

Date: 20 May 2014

This notice, in writing, in accordance with section 166 of the Financial Services and Markets Act 2000 ("**FSMA**") notifies RBS Group of the FCA's appointment of a Skilled Person to provide it with a report (or reports, if appropriate). The scope of the report(s) is as set out in the attached annex to this notice.

Section 166 of FSMA gives the FCA the power to require a report on any matter about which the FCA has required or could require the provision of information or production of documents under section 165 of FSMA. Section 165 of FSMA gives the FCA the power to require information and documents reasonably required in connection with the exercise by the FCA of functions conferred on it by or under FSMA.

The appointment of a Skilled Person to produce a report under section 166 of FSMA is one of the FCA's regulatory tools to supervise and monitor firms. The FCA may use the report and associated materials in connection with the exercise of its functions under FSMA, including relying on the report, or any part of it, in any subsequent enforcement action that the FCA decides is appropriate to take.

Purpose of the review

The FCA has decided to appoint an independent Skilled Person in accordance with the FCA's power under section 166 of FSMA to undertake a review consisting of Phase 1 and, in the event certain conditions set out below are satisfied, Phase 2.

Phase 1

The purpose of Phase 1 is to form a view of RBS Group's treatment of small and medium size enterprises ("**SME**") customers¹² referred to Global Restructuring Group¹³ ("**GRG**") through a review of policies, procedures, other relevant documentation, a representative sample of customer cases, interviews and, where available and appropriate, using market comparators, and:

- 1) to assess the validity of the allegations of customer treatment in the report published in November 2013 by Dr Lawrence Tomlinson ("**the Tomlinson report**") and, where relevant, points raised by Sir Andrew Large ("**the Large report**");
- 2) if inappropriate treatment of customers is identified, to form a view on whether it was widespread and/or systematic¹⁴; and
- 3) to enter into dialogue with the FCA in relation to the FCA's decision as to whether to proceed to Phase 2. Phase 2 will only take place if, following review of the Phase 1 findings and dialogue with the Skilled Person and RBS Group, the FCA believes that there is evidence that indicates inappropriate treatment of customers was widespread and/or systematic and which justifies proceeding to Phase 2.

Phase 2

In Phase 2 (which will only take place if the conditions set out above are satisfied), the Skilled Person shall assess and provide a view on whether:

- 1) the evidence validates the allegations relating to root causes of inappropriate behaviour made in the Tomlinson report and points raised in the Large report (in relation to which see Annex D);
- 2) the widespread and/or systematic inappropriate treatment of customers was caused by reasons other than those identified in the Tomlinson and Large reports, in which case such additional reasons should be identified; and
- 3) the inappropriate treatment of customers and the cause of such treatment were known about, authorised by and/or sanctioned by management within RBS Group.

¹² In this Requirement Notice, "**SME customers**" is given the meaning provided at Annex F.

¹³ In this Requirement Notice, save where otherwise described, "**Global Restructuring Group**" means the units/business areas described at paragraph 1 of Annex F.

¹⁴ In this Requirement Notice, the use of the word "**systematic**" refers to an intentional and co-ordinated strategy.

Once Phase 1 has been completed, if a decision is taken, in accordance with this Requirement Notice, to proceed to Phase 2, the FCA may provide further details to the Skilled Person as to the scope and methodology for Phase 2.

Recommendations

The Skilled Person should provide recommendations to address any shortcomings identified.

Period of review

In conducting Phase 1 and Phase 2 of the review, the relevant period to be considered by the Skilled Person is 1 January 2008 to 31 December 2013 ("**the Relevant Period**").

Methodology and Procedures

Specific procedures must be carried out as set out in Annexes C and E.

Engaging the Skilled Person

Details of the FCA's Skilled Person Panel can be found on our website. The Lot appropriate to this Skilled Person Report is Lot 4 – Governance, Controls & Risk Frameworks.

The FCA has, under section 166 of FSMA, directly appointed Promontory Financial Group (UK) Limited ("**Promontory**") as the Skilled Person. Promontory will be supported by its sub-contractors, Mazars LLP and Mazars Ireland.

Contractual arrangements

RBS Group is responsible for paying the fees and related expenses of the Skilled Person in accordance with the requirements described in FEES 3.2.7(R)(zp).

Reporting arrangements - Phase 1

Once the final sample for the review has been agreed between the FCA and the Skilled Person, the FCA will notify the Skilled Person and RBS Group of dates for the delivery of the draft and final reports for Phase 1 and Phase 2 of the review.

A draft of the final report for Phase 1 must be completed. The Skilled Person must send the FCA six copies of the draft report in paper form to The Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London, E14 5HS. An electronic copy of the report should also be sent to the RBS Group Supervision Team mailbox:

conduct_RoyalBankofScotland@fca.org.uk

The Skilled Person must send the FCA six copies of the final report in paper form to The Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London, E14 5HS. An electronic copy of the report should also be sent to the RBS Supervision Team mailbox:

conduct_RoyalBankofScotland@fca.org.uk

Reporting Arrangements - Phase 2

A draft of the final report for Phase 2 must be completed. The Skilled Person must send the FCA six copies of the draft report in paper form to The Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London, E14 5HS. An electronic copy of the report should also be sent to the RBS Supervision Team mailbox:

conduct_RoyalBankofScotland@fca.org.uk

The Skilled Person must send the FCA six copies of the final report in paper form to The Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London, E14 5HS. An electronic copy of the report should also be sent to the RBS Supervision Team mailbox:

conduct_RoyalBankofScotland@fca.org.uk

Reporting Arrangements - General

The reports may, subject to sections 348–349 FSMA, be made public. The Skilled Person should draft reports in such a way that the contents can be published without the disclosure of confidential information to third parties, for example by including all confidential information within an Annex to the report which can be withheld from publication (as to confidentiality constraints in respect of disclosing confidential information to RBS Group, also see section 7 at Annex C).

The Skilled Person should provide RBS Group with copies of any draft and/or final reports issued to the FCA.

The Skilled Person should provide the FCA with first sight of any such reports so that the FCA can confirm, before they are issued to RBS Group, that they do not contain confidential information.

The FCA may provide copies of the final reports for both Phase 1 and Phase 2 to other third parties pursuant to its public functions.

Annex A – Real Estate Asset Management Companies

Company Name	Registered Office
GRG Real Estate Asset Management (Great Britain) Limited	280 Bishopsgate, London EC2M 4RB
GRG Real Estate Asset Management (Northern Ireland) Limited	11-16 Donegall Square East, Belfast, Antrim BT1 5UB
West Register (Property Investments) Limited	24/25 St Andrew Square, Edinburgh EH2 1AF
West Register (Residential Property Investments) Limited	135 Bishopsgate, London EC2M 3UR
West Register (Realisations) Limited	24/25 St Andrew Square, Edinburgh EH2 1AF
West Register (Land) Limited	24/25 St Andrew Square, Edinburgh EH2 1AF
West Register Hotels (Holdings) Limited	24/25 St Andrew Square, Edinburgh EH2 1AF
West Register (Hotels Number 1) Limited	24/25 St Andrew Square, Edinburgh EH2 1AF
West Register (Hotels Number 2) Limited	24/25 St Andrew Square, Edinburgh EH2 1AF
West Register (Hotels Number 3) Limited	24/25 St Andrew Square, Edinburgh EH2 1AF
West Register (Northern Ireland) Property Limited	11-16 Donegall Square East, Belfast, Antrim BT1 5UB
WR (NI) Property Realisations Limited	11-16 Donegall Square East, Belfast, Antrim BT1 5UB
WR (NI) Property Investments Limited	11-16 Donegall Square East, Belfast, Antrim BT1 5UB

Annex B – Strategic Investment Group/West Register companies

Company Name	Registered Office
West Register (Investments) Limited	24/25 St Andrew Square, Edinburgh EH2 1AF
West Register Number 2 Limited	24/25 St Andrew Square, Edinburgh EH2 1AF
UB SIG (NI) Limited	11-16 Donegall Square East, Belfast BT1 5UB

Annex C

RBS Group

FSMA 2000 Section 166

Scope of Skilled Person Services

1. Background

1.1. The FCA has commissioned this Skilled Person Review having considered the Tomlinson and the Large reports on RBS Group. Whilst commercial lending is not a regulated activity under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, the allegations in the reports gave the FCA concerns as to whether RBS Group has treated SME customers appropriately, in particular those in financial difficulties. If substantiated, such allegations may also indicate wider concerns in relation to governance and culture within RBS Group.

1.2. The Skilled Person has been commissioned to undertake a forensic examination of RBS Group's business practices during the Relevant Period in order to provide evidence and a view on the validity of the allegations in the Tomlinson and the Large reports.

2. RBS Group

2.1. If the Skilled Person needs to expand the scope of its enquiries to entities other than Royal Bank of Scotland Plc, National Westminster Bank Plc, Real Estate Asset Management Companies ("**REAM**") (and REAM's predecessors) and Strategic Investment Group/West Register companies in order to complete this review, the Skilled Person should inform the FCA immediately.

3. Key requirements of the review

3.1. The work undertaken by the Skilled Person is to:

Phase 1

Form a view on RBS Group's treatment of SME customers referred to GRG, through a review of policies, procedures, other relevant documentation, a representative sample of customer cases, interviews and, where available and appropriate, using market comparators, and to:

- (1) assess the validity of the allegations of customer treatment in the Tomlinson report and, where relevant, points raised by the Large report;
- (2) if inappropriate treatment of customers is identified, form a view on whether it was widespread and/or systematic; and
- (3) enter into dialogue with the FCA in relation to the FCA's decision as to whether to proceed to Phase 2 (with Phase 2 occurring only if, following review of the Phase 1 findings and dialogue with the Skilled Person and RBS Group, the FCA believes there is evidence that indicates inappropriate treatment of customers was widespread and/or systematic and which justifies proceeding to Phase 2).

Phase 2

Assess and provide a view on whether:

- (1) the evidence validates the allegations relating to root causes of inappropriate behaviour made in the Tomlinson report and points raised in the Large report (in relation to which see Annex D);
- (2) the widespread and/or systematic inappropriate treatment of customers was caused by reasons other than those identified in the Tomlinson and the Large reports, in which case such additional reasons should be identified; and
- (3) the inappropriate treatment of customers and the cause of such treatment was known about, authorised by and/or sanctioned by management within RBS Group.

Once Phase 1 has been completed, if a decision is taken, in accordance with this Requirement Notice, to proceed to Phase 2, the FCA may provide further details to the Skilled Person as to the scope and methodology for Phase 2.

4. Approach to Phase 1

4.1. Policy and procedure review

4.1.1. This includes a review of relevant documented policies and controls to form a view on:

- (1) Appropriateness of governance and oversight procedures implemented in GRG and how GRG interacts with the rest of the RBS Group in relation to financially distressed SME customers.
- (2) Reasonableness of criteria for moving customers to GRG, including the policies for inclusion on relevant watchlists and policies relating to transition to GRG. This includes the policies and procedures relating to triggers such

as covenant breaches, changes to banking facilities and relating to the revaluation of assets.

- (3) Appropriateness of relevant policies and practices relating to the criteria for SME customers exiting GRG, including those being classified as “Return to Satisfactory” and returned to local management.
- (4) Appropriateness of policies and procedures governing the relationship between relationship managers and SME customers in GRG.
- (5) Appropriateness of costs imposed on businesses once in GRG, including appropriateness of RBS Group’s decision making process with regard to increases in margins and fees, to include adequacy of credit risk profiling of customers as an input to decision making.
- (6) Appropriateness of processes (transparency, openness etc.) for referrals to GRG and within the GRG business, including decision making on existing facilities and related matters such as further lending requests and requests for personal guarantees and/or cash injections.
- (7) Appropriateness of complaints procedures relating to SME customers referred to GRG, including, where applicable, compliance with the FCA’s Dispute Resolution: Complaints (DISP) sourcebook of rules and guidance.
- (8) Appropriateness of conflicts of interest policies and procedures, including management of conflicts with REAM and its predecessors, Independent Business Reviewers, valuers, insolvency practitioners and receivers.
- (9) Appropriateness of strategic targets, revenue targets and incentive schemes in place for relationship managers and credit officers who manage SME customers, to the extent these may influence the incidence of referrals to GRG and the behaviour of GRG management and staff.

4.1.2. The Skilled Person should ensure it identifies and takes into account changes in policies and procedures over the Relevant Period and gives due regard to relevant internal audit reports and regulators’ reviews into GRG.

4.2. Customer outcomes

4.2.1. The Skilled Person will conduct a review of a representative sample of customer cases using the methodology outlined in Annex E. This review will help inform a view of the delivery of policies and procedures in practice at RBS Group.

4.2.2. The Skilled Person will use evidence from the review of policies and procedures, review of customer cases and interviews to form a view on the following (paying

due regard to the allegations made in the Tomlinson Report and to relevant points raised in the Large report (key points are set out in Annex D)).

- (1) Whether RBS Group appropriately identified customers for transfer to GRG.
- (2) The transparency of the referral process (both into and out of GRG) to customers and other parts of the RBS business (such as the Business & Commercial team) who may have owned the original customer relationship.
- (3) Whether the actions of RBS Group distressed otherwise viable businesses, including by: increased margins, excessive fees, reassessment of loan to value, breaches of covenants, removal of/changes to banking facilities and asset based finance.
- (4) Whether the practices of relevant third parties (such as the Independent Bank Reviewer) affected the viability of businesses transferred to GRG and/or the bankruptcy of its owners, including by adversely affecting the directors' ability to operate the business effectively.
- (5) Whether the property valuation methodologies employed by GRG, deliberately or otherwise, undervalued properties.
- (6) Whether increases in fees/loan interest charged for businesses in GRG or requests for information were appropriate and contributed to the subsequent failure of businesses, for the benefit of GRG or otherwise.
- (7) Whether GRG requested personal guarantees and/or cash injections when it had already determined that it had no intention of supporting such businesses.
- (8) Whether GRG failed to manage conflicts of interest appropriately (to include consideration of Independent Bank Reviewers, REAM and REAM's predecessors, insolvency practitioners and valuations).
- (9) The appropriateness of the complaint handling process for GRG customers, including, where applicable, compliance with the FCA's Dispute Resolution: Complaints (DISP) sourcebook of rules and guidance.

4.3. Sampling

4.3.1. The approach to sampling is set out in Annex E. The Skilled Person is expected to undertake a detailed review of a representative sample of customer experiences to form a view on the validity of the allegations.

4.4. Interviews

4.4.1. The Skilled Person should consider as part of its evidence gathering for Phase 1 interviews with relevant GRG staff, customers from the case sample; and third parties that conduct work for/on behalf of GRG (e.g. valuers, insolvency practitioners). Phase 2 may require further interviews.

5. Approach to Phase 2

5.1. In order to make the assessments and provide its views for the purpose of Phase 2, the Skilled Person will need to consider the root causes of inappropriate customer treatment identified in Phase 1. This may include, but is not limited to, considering the following issues in relation to RBS Group:

- (1) Leadership of the business;
- (2) Governance and oversight of the business;
- (3) Strategy of relevant parts of the business, including the impact of a drive to deliver profit;
- (4) Influence from external stakeholders;
- (5) Culture in GRG and/or referring parts of the business;
- (6) Conflicts of interest of various parties involved; and
- (7) Reward and incentive structures for staff in GRG and/or parts of the business involved in referrals to GRG.

5.2. The Skilled Person should establish whether the issues identified were known about, authorised by and/or sanctioned by management within RBS Group. This may include, but is not limited to, whether there is/was an intent or strategy to:

- (1) distress viable businesses to create revenue;
- (2) assess businesses for their potential value to GRG, not their level of distress; and
- (3) not fully disclose information to customers.

6. Recommendations

6.1. The Skilled Person should make recommendations to address any shortcomings identified. The Skilled Person should consider the relevance of recommendations in the Large report to address shortcomings.

7. Confidentiality Constraints

7.1. The Skilled Person shall endeavour to obtain the consent of customers included in the sample to disclose to RBS Group the detail of (a) any asserted facts, (b) allegations, and (c) complaints by the customer. Save where the Skilled Person has obtained such consent, the Skilled Person shall take appropriate measures to avoid such information becoming identifiable by RBS Group.

7.2. There may also be other information received by the Skilled Person for the purposes of this review that will be provided on a confidential basis. The Skilled Person should also take appropriate measures to avoid this information becoming identifiable to RBS Group and/or to third parties¹⁵.

7.3. In the event that it is not possible for the Skilled Person to obtain an informed response from RBS Group in respect of a specific allegation(s) without disclosing confidential information, the Skilled Person should be aware that it is unlikely to be appropriate to reflect that allegation(s) in the report. The Skilled Person should still consider whether it is appropriate to reflect that allegation(s) in the report in light of what is fair in all the circumstances. If the Skilled Person considers it appropriate to reflect that allegation(s) in the report, then, without prejudice to the Skilled Person's independence, the Skilled Person should:

- (1) discuss with RBS Group the nature of the confidential information in broad terms, taking into account the need to respect confidentiality;
- (2) explain to RBS Group why the allegation(s) should be included in the report; and consider RBS Group's response; and
- (3) ensure that if the allegation(s) is/are included in the report an appropriate mechanism is adopted to reflect the allegation(s) in the report in light of what is fair in all the circumstances which will include confirming in the report that RBS Group has not had a chance to make an informed response to the relevant allegations.

7.4. Prior to reflecting an allegation in the report in relation to which, due to confidentiality constraints, the Skilled Person has not been able to obtain an

¹⁵ For the avoidance of doubt, the FCA is not a third party.

informed response from RBS Group but which the Skilled Person considers appropriate to so reflect, the Skilled Person should consult the FCA in relation to the decision to and the method of incorporating that allegation in the report.

7.5. Where a case in the sample is or has been subject to litigation¹⁶ the case may be included in the sample but due consideration shall be given to legal privilege and issues of confidentiality.

8. Report Structure

8.1. The report (a report being required for Phase 1, and a separate report for Phase 2, if the decision is taken to proceed to Phase 2) should be structured as follows:

- (1) An executive summary of the report findings and recommendations, including the Skilled Person's view on the key issues to be addressed in Phase 1/2.
- (2) An outline of the work that was undertaken to fulfil the requirements of the scope of the report, including where appropriate:
 - (a) the nature and extent of documentation examined;
 - (b) the nature and extent of reliance on customers', RBS Group's and third parties' staff;
 - (c) the people interviewed; and
 - (d) whether the Skilled Person found it necessary to conduct further work not originally planned in order to meet the report requirements and, if so, the nature and extent of such further work.
- (3) A section providing details of each of the matters examined under the terms of the report's scope, providing summary results of testing, expressing an opinion on the outcomes of such testing, and providing detail and recommendations in any areas where weaknesses were identified.
- (4) An annex documenting detailed testing carried out by the Skilled Person.
- (5) Any other of the matters detailed in SUP 5.5.1 R(1)(b) of the FCA Handbook.
- (6) A breakdown of the total cost of the report.

¹⁶ "Subject to litigation" includes cases where a formal notification of an intention to sue RBS Group or a pre-action letter of claim has been served by or on RBS Group

9. Communication between the Skilled Person and the FCA

- 9.1. The Skilled Person will be required to meet and hold discussions with the FCA prior to the review in order to discuss its scope and to obtain a full briefing of the background and objectives of the review.
- 9.2. Once the scope and sample methodology of the review has been agreed between the FCA and the Skilled Person, the Skilled Person should provide the FCA and RBS Group with a breakdown of estimated costs for Phase 1 and Phase 2 of the review.
- 9.3. The Skilled Person will be required to meet and hold discussions with the FCA during the review to discuss the progress of the report and any emerging findings. A timetable for ongoing progress meetings/calls will be agreed at the outset of the review.
- 9.4. The FCA expects to maintain an open line of communication with the Skilled Person throughout the review. In addition, the FCA must be kept informed by the Skilled Person of any significant developments as and when they occur. This should include notification of any material changes (greater than 10%) in the estimated cost of commissioning the report.

Annex D – Allegations arising from the Tomlinson report, supplemented by additional points from the Large Report

Tomlinson report

Strategic Aims/Performance of GRG

- 1) GRG is a profit centre for RBS, as opposed to a turnaround division aimed at improving business performance to recovery.
- 2) There are very few examples of businesses entering GRG and moving back out into local management.

Customer Mistreatment Allegation

The process/criteria for moving businesses to GRG

- 3) The criteria/process for deciding on whether a business should be moved to GRG inappropriately considers the value of such a move for RBS.
- 4) Businesses are assessed for transfer to GRG on the basis of the potential value to GRG and not their level of distress.
- 5) Businesses which are demonstrating similar levels of performance are treated differently in an inappropriate way, with the treatment depending upon whether there is more value to be made by RBS through a transfer to GRG.
- 6) Technical breaches of covenants with no bearing on the performance or viability of the business are used to transfer a business to GRG.
- 7) The actions of RBS, through the removal or change to facilities and/or the move to asset based finance, triggers the move to GRG in an inappropriate/unfair manner.
- 8) The decisions taken by RBS to change lending criteria for businesses whose performance and growth potential has not changed are unfair and/or inappropriate.
- 9) Banks manipulate the financial position of businesses that are profitable but not generating any additional fees or profit for the bank.
- 10) If there was more transparency businesses would be better protected from the banks' opportunistic behaviour.
- 11) Customers with an interest rate derivative product with a maturity date that is longer than their other banking facilities are unable to move banks as their assets are all secured against the swap and there is no security available for the new lender so they cannot meet the risk profile of the potential new bank. RBS unfairly uses this lack of ability to move facilities as part of the renegotiation process.

- 12) The process of the default that triggers the move to GRG is inadequately explained to the customer.
- 13) Relationship Managers are disciplined if they contact customers transferred to GRG.

Treatment of customers in GRG

- 14) GRG artificially distresses otherwise viable businesses. Through such actions GRG places businesses on a journey towards administration, receivership and liquidation.
- 15) Businesses within GRG are not supported in a manner that is consistent with good turnaround practice. Such an approach has a catalytic effect on the journey of businesses towards insolvency.

Property Valuation

- 16) Property valuation methodologies unquestionably undervalue properties.
- 17) GRG significantly undervalues the assets of businesses, with the consequence that this puts such businesses in breach of their covenants.
- 18) GRG deliberately engineers defaults of otherwise viable businesses through the removal of, or change to, facilities, reassessment of loan to value and the move to asset based finance.
- 19) There is an inherent conflict of interest with regard to the relationship between valuers employed by GRG and GRG's aims and objectives.
- 20) The valuers employed by GRG inappropriately act in the interest of the bank in their valuation of properties.
- 21) GRG's property valuation methodology is based upon a fire sale of property, which is unfair.
- 22) GRG inappropriately revalues properties, undertaking insufficient work.
- 23) GRG is incentivised to undervalue properties, which triggers insolvency. West Register is then able to cheaply acquire such properties.

Increase in Margins and Fees

- 24) Otherwise viable businesses become increasingly distressed by the level of fees, bureaucracy and restrictions on trading capabilities.
- 25) Businesses are fined on entry into GRG for breaching their covenants.
- 26) Upon transfer to GRG interest on loans will be inappropriately/unfairly increased and the term of loan may be shortened dramatically.
- 27) Such changes are unjustified based upon the performance of the business.

Independent Business Reviews

- 28) Businesses are not allowed to read Independent Bank Reviews which is unfair.
- 29) Businesses are not allowed to challenge Independent Bank Reviewers' conclusions, which is unfair.
- 30) The company which conducts the Independent Bank Review gets much of its high value work from RBS Group and may also later become the business' administrator. This process presents a conflict of interest which GRG does not manage appropriately.

Requests for Information

- 31) The process whereby businesses receive requests for information is so laborious that it means that the Directors of such businesses are unable to run their business effectively.

Shadow Directors

- 32) Decisions made by the bank and Independent Business Reviewer whilst the business is in GRG can have detrimental impacts on the business' ability to operate effectively as a business.
- 33) The bank has actively prevented some businesses from taking action that would prevent the business from going into default or would pay off the debt e.g. a direction for businesses to delay or stop paying their suppliers.

Personal Guarantees

- 34) GRG asks for cash injections and/or security over loans through personal guarantees when it has no intention of supporting or helping the business in question.

- 35) GRG misrepresents its intentions to businesses, stating its willingness to support businesses and then quickly placing businesses into administration, leaving the business owner bankrupt as a result.

Selling the debt

- 36) The fact that a business is in support is used as a validation for the sale of the debt and transfer of personal guarantees to a different financial institution with whom they have close connections enabling those colleagues to buy the debt, put the business into administration to dissolve the equity of the owner and then call on the personal guarantees.

The Insolvency Process

- 37) There are no Chinese walls in place to prevent conflicts occurring when the Independent Bank Reviewer who works with the business whilst in business support is also the business' administrator.
- 38) Administrators of businesses in GRG do not act in an independent manner and as such they do take appropriate action against other parties involved in the insolvency when these parties are acting unjustly/illegally.
- 39) GRG does not appropriately manage the potential conflict of interest presented by West Register's activities.

Complaints

- 40) The complaints handling process for GRG customers is not working effectively.

Large Report

Governance

- 41) RBS's governance structures do not do enough to address the potential conflict of interest raised by the fact GRG retains the ultimate authority over which customer relationships are transferred to it and there are no procedural checks and balances in place.
- 42) Due to different reporting lines B&C has limited ability to see or influence what happens to customers in GRG when they may be appropriate for future return to B&C.
- 43) B&C has limited visibility over the actions taken and decisions made by GRG and the governance process for the critical decision of whether a business has reached the point of non-viability is therefore opaque both to B&C and to the SME itself.

Annex E – Phase 1: Sampling methodology

Glossary of terms

- **Starting Population:** SME customers (as defined in Annex F)
- **Review Period:** Cases referred in to GRG from 1 January 2008 to 31 December 2013 inclusive.
- **Outcome Pools:**
 - Cases that resulted in winding-up, administration, liquidation or receivership;
 - Cases that returned to the **main bank**;
 - Cases that **exited** RBS borrowings; and
 - Cases that remain **in GRG as at 01/01/2014**.

Methodology / Approach

In order to answer the questions posed in the Requirement Notice and to assess the validity of the allegations as set out in Annex D, the Skilled Person should consider the following (although some elements will only be relevant to Phase 2 – to be determined by the Skilled Person):

- A representative sample of cases (see below for more detail);
- Policies/procedures¹⁷ used in GRG, including, where relevant, related internal communications;
- Interviews with:
 - GRG staff;
 - Customers from the case sample; and
 - Relevant third parties that conduct work for/on behalf of GRG (e.g. valuers, insolvency practitioners).
- Any other information the Skilled Person may determine as relevant to enable them to answer the questions in the Requirement Notice.

¹⁷ From the 'review period' – with particular regard to current versions in operation (where relevant).

Phase 1: Selection of cases for initial sample

In order for the Skilled Person to determine a representative sample size for the initial case review in Phase 1, RBS Group should provide numbers of the Starting Population (by number of customers) for each 12 month period from 1 January to 31 December in the Review Period, broken down by the number of cases in each Outcome Pool. RBS Group should also identify the number of customers in each pool (in the Review Period) that lodged a complaint with RBS Group.

RBS Group should provide the figure for the Starting Population as a percentage of the total population of all GRG customers.

Once this data has been provided, the Skilled Person will determine a representative sample of cases for review. The sample size will be agreed with the FCA.

Where a case is selected for the sample, and it is subsequently found that it is inappropriate to include that case in the sample, the Skilled Person shall replace that case by an appropriate alternative.

Before agreeing the sample size with the FCA, the Skilled Person will determine an appropriate timeframe for this part of Phase 1 with consideration of the potential impact on serving existing customers.

Phase 1: Case review

Case review parameters

- **Start point:** First signs of customer financial distress (i.e. when still managed by the main bank).
- **End point:**
 - Appointment of insolvency practitioner; or
 - Customer returned to main bank; or
 - Customer exited from RBS borrowings; or
 - If none of the above, conduct the review of the case up to 1 January 2014.

Case review to include, but not be limited to, consideration of the following (from within the review period and within the review parameters):

- customer correspondence;
- call recordings (including any internal calls if relevant);

- notes, minutes of meetings (internal and external) and internal correspondence that relates to the case (including correspondence to/from other parts of the RBS Group);
- where relevant, to include the above in relation to any customer complaint; and
- where appropriate (to be determined by the Skilled Person) meetings with: staff (including, but not limited to, relationship managers and credit officers), customers and/or third parties.

Annex F – Definition of GRG and SME Customers

1. The Global Structuring Group (“**GRG**”) means the following units/business areas within RBS Group:
 - a. Business Restructuring Group (“**BRG**”);
 - b. Strategic Relationship Management Unit (“**SRM**”);
 - c. Strategic Management Unit (“**SMU**”);
 - d. GRG Recoveries Unit (“**GRGr**”) (but only where cases originated from SMU, SRM GRG, or BRG);
 - e. REAM (which comprises the companies listed in Annex A)(but only where cases originated from SMU, SRM, GRG, BRG or GRGr (as defined above));
 - f. Northern Ireland Business Restructuring Group and Strategic Relationship Management Units;
 - g. the predecessors of the above business units/business areas as appropriate.
2. For the purposes of the review “**SME customers**” is defined as all customers who were directly or indirectly transferred to and/or managed by GRG during the Relevant Period with debt levels of between £1million and £20million, and where that transfer and/or management was carried on from an establishment in the United Kingdom.
3. If the Skilled Person considers it necessary to amend the definition of SME customers in order to complete the review, the Skilled Person should inform the FCA immediately. The Skilled Person should consult with RBS Group and the FCA. Any change to the definition of SME customers shall require the prior approval of the FCA.

ADDENDUM TO THE FINAL REQUIREMENT NOTICE

SKILLED PERSON'S REVIEW

In respect of:

The Royal Bank of Scotland plc of 36 St Andrew Square, Edinburgh, EH2 2YB; National Westminster Bank Plc of 135 Bishopsgate, London, EC2M 3UR; Real Estate Asset Management (comprising the companies listed at Annex A of the 20 May 2014 Requirement Notice, whose registered addresses are also listed therein), and Strategic Investment Group/West Register companies (comprising the companies listed at Annex B, whose registered addresses are also listed therein) (collectively "**RBS Group**").

Date: 26 January 2016

1. Background

- 1.1. This addendum is to supplement the previous Requirement Notice to RBS Group dated 20 May 2014 (the "**Requirement Notice**"). The Requirement Notice notified RBS Group of the FCA's appointment of a Skilled Person to provide it with a report (or reports, if appropriate) relating to the treatment of SME customers referred to Royal Bank of Scotland's Global Restructuring Group ("**RBS GRG**").
- 1.2. This addendum sets out an amendment to the definition of "GRG" and "SME customer" as defined in Annex F of the Requirement Notice. Paragraph 3 of Annex F provides that if the Skilled Person considers it necessary to amend the definition of SME customer in order to complete the review, the Skilled Person should inform the FCA immediately, should consult with RBS Group and the FCA, and that any change to the definition of SME customer shall require the prior approval of the FCA.
- 1.3. Following discussions with RBS Group the Skilled Person has determined that it is necessary to amend the definition of "GRG" and "SME customer" in order to capture some customers who were directly or indirectly transferred to and/or managed by the Strategic Management Unit ("**SMU**") but whose debt levels were below £1 million. The FCA has approved this change and is amending the Requirement Notice accordingly.

2. Amendment to the definition of SME customer

- 2.1. Paragraphs 1 and 2 of Annex F to the Requirement Notice are replaced with the following text:

"1. The Global Restructuring Group ("**GRG**") means the following units/business areas within RBS Group:

- a. Business Restructuring Group ("**BRG**");
- b. Specialised Relationship Management Unit ("**SRM**");
- c. GRG Recoveries Unit ("**GRGr**") (but only where cases originated from SMU, SRM GRG, or BRG);
- d. REAM (which comprises the companies listed in Annex A)(but only where cases originated from SMU, SRM, GRG, BRG or GRGr);
- e. Northern Ireland Business Restructuring Group and Strategic Relationship Management Units;
- f. Strategic Management Unit ("**SMU**") (but only those cases where a units/business area listed at (a) to (e) above managed the credit line of the customer or were otherwise involved in the management of the case);
- g. the predecessors of the above business units/business areas as appropriate.

2. For the purposes of the review "**SME customers**" is defined as all customers who:

- a. were directly or indirectly transferred to and/or managed by SMU (or any predecessor) during the Relevant Period with debt levels of between £250,000 and £20 million; or
- b. were directly or indirectly transferred to and/or managed by any other unit or business area in GRG during the Relevant Period with debt levels of between £1million and £20million,

where, in either case, that transfer and/or management was carried on from an establishment in the United Kingdom."

3. Other

3.1 All other parts of the Requirement Notice remain unchanged.