



RBS Group's treatment of SME customers referred to the Global Restructuring Group

A REPORT UNDER SECTION 166 OF THE FINANCIAL SERVICES AND MARKETS ACT 2000

PREPARED FOR

Financial Conduct Authority

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CONFIDENTIAL

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Foreword

- i. On 20 May 2014, the Financial Conduct Authority ("FCA") issued a Final Requirement Notice (the "Requirement Notice" or the "Notice") addressed to the Royal Bank of Scotland Plc, National Westminster Bank Plc and a number of subsidiary companies of those Banks. The companies to which the Requirement Notice was addressed are referred to collectively as "RBS Group".
- ii. Under the terms of the Requirement Notice, we were asked to form a view on the RBS Group's treatment of Small and Medium Enterprise ("SME") customers referred to its Global Restructuring Group ("GRG") and, in particular, the validity of the allegations about GRG made by customers and reported by (i) Dr Lawrence Tomlinson and (ii) Sir Andrew Large.
- iii. This report sets out the conclusions of our work. As well as making findings on the points raised in the two reports, we also make various recommendations for RBS and set out more generally some wider lessons for policy makers concerned with SME lending.
- iv. For ease of reference, throughout this report we refer to the RBS Group as "RBS" or the "Bank", unless the context otherwise requires a different interpretation.
- v. Our independent review of GRG's policies and practices, and of a sample of the SME customer cases it handled, was extensive and thorough. We set out in this report how GRG operated and how, in practice, it handled those SME customers in financial distress that were referred to it during the period 2008 to 2013. This review has taken us longer than we would have wished, but the work we have undertaken has been complex and, of necessity, detailed. We have at various stages given our views to RBS, which has then had the opportunity to comment. Some of the comments we received from RBS were themselves complex and were often accompanied by new material that we needed to consider. We spoke with a wide range of people, including many customers among the sample of cases that we reviewed. We extend our thanks to all those to whom we spoke and whose input has been invaluable to us.
- vi. Banks need to manage credit with care – particularly so during, and in the direct aftermath of, events such as the financial crisis that formed the backdrop to the period covered by this report. But at any time customers in financial difficulties need attention and action. Bank turnaround units aim to ensure that where practicable customers in financial distress get the support they need to nurse them back to financial health. Successful turnaround is rightly seen as a 'win-win' for the bank and its customer. But of course a return to health is not always feasible, and businesses should be allowed to fail. So turnaround units also need to ensure that, in the case of businesses that are clearly no longer viable, action is taken to protect creditors and enable the bank to minimise its losses.
- vii. Decisions taken by bank turnaround divisions therefore have profound effects for the businesses concerned, their owners, managers, suppliers and staff. The decisions made will, perhaps inevitably, be hotly contested, especially in the context of SME customers

where the fate of the business and the personal finances and working lives of their owners are often so closely intertwined.

- viii. Our report shows that Dr Tomlinson and Sir Andrew Large were right to identify the complaints they received about GRG as pointing to something much more troubling than simply the understandable disappointment of SME owners who had lost their businesses and blamed a bank – RBS – that had received extensive public support to help it deal with the impacts of the financial crisis.
- ix. Not all the allegations made at the time were valid and some events were misinterpreted. Importantly, we did not find that defaults were engineered to transfer businesses to GRG simply to generate revenue for RBS through fees, increased margins and the acquisition of undervalued assets. Nor did we find evidence to suggest that when GRG acquired assets via its property arm, West Register, the price paid was clearly below the market price for the asset at the time. But, equally importantly, overall we did find that RBS's SME customers were poorly served by GRG.
- x. Our central conclusions are that there was widespread inappropriate treatment of customers by GRG; that this inappropriate treatment was not confined to failures in process; and that in a significant proportion of cases – one in six of the cases we assessed as being potentially viable in our Representative Sample – that treatment appears likely to have caused material financial distress; and in practice yet more customers have valid grounds for considering themselves badly treated by RBS and GRG. We find that this was for the most part a direct result of failings in GRG's governance and oversight arrangements and of the priorities GRG pursued.
- xi. GRG enjoyed an unusual independence of action for a customer-facing unit of a major bank. It saw the delivery of its own narrow commercial objectives as paramount: objectives that focused on the income GRG could generate from the charges it levied on distressed customers. In pursuing these objectives, GRG failed to take adequate account of the interests of the customers it handled and, indeed, of its own stated objective to support the turnaround of potentially viable customers.
- xii. The failings that we identify were not the one-off errors of staff at an institution that was undoubtedly under significant pressure. Rather, they stemmed from more fundamental failings to ensure the effective oversight and governance of GRG, to manage critical conflicts of interest inherent in its activities and to recognise the risks that it was taking in respect of its treatment of customers. We do not, however, in this report seek to identify the actions of any individuals that contributed to the failings we have identified.
- xiii. Most of GRG's customer-facing activities, in common with almost all features of bank lending to SME customers, were not regulated by the FSA (or the FCA) at the time. Nor are they regulated by the FCA today. So the judgments we have made in this report as to inappropriate treatment are not primarily based on regulatory rules or principles. Rather, we have applied the standards RBS and GRG said that they set for themselves, supplemented by what we considered to be fair and reasonable practice at the relevant times. Identifying today the consequence of the inappropriate treatment we have

identified is far from straightforward. Our work concerned the general picture of customer treatment, rather than adopting a legal lens. So we have not expressed any legal views on the rights and wrongs of individual cases and disputes.

- xiv. We recognise that our judgments, which are set out carefully in this report, can be subject to debate and challenge. Doubtless some customers will be disappointed that we do not find the Bank at fault for deciding it no longer wished to lend to many categories of SME customer – particularly in the property related sectors – whilst the Bank may dispute the application of principles of fairness and good practice that we adopt in areas of its business not subject to formal regulation and where it has extensive legal rights as lender.
- xv. Regulators have been reviewing levels of competition in the SME banking sector. That wider debate falls outside the scope of our work. But one reason why the inappropriate actions and poor outcomes that we observed in the context of GRG were able to flourish was that customers were often left with no choice but to continue to deal with RBS and GRG. SME customers were therefore unusually vulnerable. We suggest that clearer and enforceable standards of conduct are established for turnaround units to ensure that SME customers in financial distress are protected in future and that SMEs have wider access to independent dispute resolution and, where necessary, redress. If this proposal is accepted, the judgments we have made in this report about fair practice will benefit from wider stakeholder discussion.
- xvi. Separately we make a series of recommendations for changes in policy and practice which RBS should make to its teams handling SME customers in financial distress. Since RBS officials, in their extensive dealings with us on this report, have strongly denied aspects of the widespread inappropriate treatment of customers by GRG that we find in this report, there can be no guarantee that the changes which RBS says it has now made (and which we did not have an opportunity in the scope of this work to review and test) are in fact adequate.
- xvii. The inappropriate actions we identify, and their wide ranging consequences for customers, arose in areas which, with minor exceptions, were not subject to regulatory rules or principles. Accordingly, the scope for regulatory action is limited, and it seems court action by those affected is unlikely to be practicable. In these circumstances, the primary responsibility for responding to the issues raised by this report, and the distress GRG caused to its customers, rests with the Board of RBS Group.

Sir Callum McCarthy

Introduction

About this report

- i. This report is the final report of Phase One of the review initiated by the Financial Conduct Authority under section 166 of the Financial Services and Markets Act 2000 ("FSMA") into the conduct of the RBS. It has been prepared in accordance with the Requirement Notice issued by the FCA – our terms of reference – which appears at Annex I.
- ii. The report has been produced following a series of other reports and investigations concerning allegations made by customers and former customers of RBS about the way in which they were treated after encountering financial difficulties. Those allegations focused on a division of RBS known as the Global Restructuring Group. The two main reports were:
 - The Tomlinson Report.¹ On 25 November 2013, Dr Lawrence Tomlinson, Entrepreneur in Residence at the Department for Business, Innovation and Skills ("BIS"), published a report entitled *"Banks' Lending Practices: Treatment of Businesses in Distress"*; and
 - The Large Report.² On the same day, Sir Andrew Large published the detailed findings and recommendations on the lending standards and practices of the Royal Bank of Scotland in the Small and Medium Enterprise market.
- iii. RBS Group appointed Clifford Chance LLP to investigate what it viewed as the most serious allegations in the Tomlinson Report – namely that RBS, through its GRG division, was culpable of systematic and institutional behaviour in artificially distressing otherwise viable UK SME businesses and through that putting businesses *"on a journey towards administration, receivership and liquidation."*³ Clifford Chance found no evidence of such behaviour. Its report was published on 11 April 2014.
- iv. On 17 January 2014 the FCA announced the appointment of Promontory Financial Group UK Limited ("Promontory") as the Skilled Person supported by their sub-contractor Mazars to produce an independent report pursuant to section 166 of FSMA.
- v. The terms of reference for our review were set out in a Final Requirement Notice issued by the FCA to RBS Group on 20 May 2014.⁴ In summary, it required us to form a view on RBS Group's treatment of SME customers referred to (or managed by) GRG during the period 1 January 2008 to 31 December 2013 (the "Relevant Period"), and:
 - *"To assess the validity of the allegations of customer treatment in the Tomlinson Report and, where relevant, points raised by Sir Andrew Large; and*

¹ Banks' Lending Practices: Treatment of Businesses in Distress, Dr Lawrence Tomlinson, November 2013

² RBS Independent Lending Review, Sir Andrew Large, November 2013

³ Tomlinson Report, page 5

⁴ Final Requirement Notice, Skilled Persons Report, FCA, 20 May 2014 (as revised)

- *If inappropriate treatment of customers is identified, to form a view on whether it was widespread and/or systematic."*
- vi. The Requirement Notice provides for two phases to the review. Certain matters are identified for Phase Two and, in consequence, are not covered in this report. These issues include questions concerning the root cause of any problems and whether or not any inappropriate treatment of customers was known and/or sanctioned by management within RBS Group. This report represents the conclusions from Phase One of the review. It is for the FCA to determine whether Phase Two of the review is necessary.
- vii. This report is structured as follows:
- Part 1 sets out the Executive Summary, including our principal conclusions and recommendations;
 - Part 2 deals with the background to our work, including the circumstances of the Bank and its customers, the scope and purpose of the review, and the relevant regulatory and other requirements that applied to the issues we have considered. We explain the way in which we have undertaken our work and how we have interacted with RBS. We also set out some general observations about the overall approach we have adopted to the key considerations raised in our work;
 - Part 3 sets out how GRG operated, its objectives and strategy, its arrangements for the governance and oversight of its activities, and the objectives that were set for its staff. We also comment on aspects of the overall culture of GRG;
 - Part 4 describes the various processes and activities of GRG, how the Bank interacted in practice with customers and how it made key decisions as to whether to transfer customers to GRG, how to value property, how to determine prices, the extent of facilities and how it should handle customer concerns and complaints;
 - Part 5 describes the role of West Register and the Strategic Investment Group, which held responsibility for the assets GRG obtained from distressed customers;
 - Part 6 sets out the outcomes experienced by customers and our assessment of the extent that the actions of RBS were likely to have caused material financial distress to otherwise viable SMEs;
 - Part 7 sets out our recommendations and observations; and
 - The report also has a number of Annexes, including a Glossary at Annex II.

About our work and the information on which we relied

- viii. The team from Promontory and Mazars that carried out this work brought together expertise and extensive experience in relevant disciplines, including turnaround units, restructuring, insolvency practice, business banking, customer issues, financial regulation, governance, commercial law and accounting.

- ix. In accordance with the Requirement Notice, we have carried out a thorough and independent review of the treatment of SME customers referred to GRG through a review of policies, procedures, other documentation, interviews and a review of 207 individual cases – which included both a representative sample of 178 cases (the “Representative Sample”) and 29 cases that were referred to us by Dr Tomlinson (the “Tomlinson Cases”).
- x. The scale and scope of the review has been significant. It covered a period of six years, during which GRG handled 5,900 SME cases.⁵ GRG’s personnel, management structure, policies and to some extent systems evolved – in some cases significantly. Our work involved consideration of six years of management reports, committee minutes and other documents, as well as the sample of case files.
- xi. It has been a major exercise to ensure that we have available to us all the relevant information. In carrying out our case sample review in particular, we have been conscious of the need to collect comprehensive information. A typical case contained around 10 A4 binders, some over 60. Collating the thousands of pages of emails and documents we obtained from the Bank was a significant task.
- xii. We supplemented the written material available to us with meetings with the relevant Bank staff and, where possible for cases in our sample, with the customer. We also held meetings with a range of other interested parties and experts who appeared to us relevant to our inquiries. We are grateful to RBS and its customers and the many others who have assisted us in our work.
- xiii. Inevitably, throughout the process we have needed to rely heavily on RBS systems and personnel to capture the information they held. To guard against any suggestion that information has been hidden from us – whether by accident or design – we specified carefully the information we required, and we checked the approach RBS has taken to the collation of that information. To help ensure the completeness of the information available to us, we asked customers to contribute any relevant information they held.
- xiv. The information we required from RBS was typically spread over several systems and physical files (i.e. there was not a single, self-contained file in relation to each customer). In many cases the Bank had retained information only on local files that, in some cases, were still under the control of the member of RBS staff who had dealt with the matter at the time. The poor quality of much of the record keeping we observed had significant consequences for the time and effort that we needed to put into the data gathering stages of our work, with consequences for the project as a whole. We were still receiving information as late as March 2016.
- xv. The length of the period under consideration, and the inherent complexity of the issues that we were investigating, made it difficult for RBS to guarantee the completeness of information. We remained concerned, however, about the degree of delayed and

⁵ Throughout this report, we refer to GRG although our review related to SME customers who were, in the main, dealt with by Business Restructuring Group (“BRG”) and had debts of below £20m. GRG as a whole handled other cases with higher debts that were outside of the scope of our review. For convenience, however, we use the term GRG throughout

incomplete information that emerged during the course of our investigation. Towards the end of the review we asked the RBS Board to attest that the information provided was complete and accurate in all material respects, and in particular, that the information provided had not been restricted to the specific content of our requests where RBS identified further information that might have been relevant. In response RBS stated its belief that it had given us *"all reasonable assistance and that [RBS has] complied to the best of [its] ability with all document requests."* The Bank noted that during the course of the review it had provided us with *"c. 323 gigabytes of data (more than 1,486,500 physical pages and 270,000 emails)."* The Bank said that *"While, to the best of [its] knowledge, all relevant material has been provided to the Skilled Person, this has necessarily been a manual process and so it is impossible to guarantee absolute completeness."* The Bank's Chief Conduct & Regulatory Affairs Officer also subsequently confirmed that RBS was *"not aware of any potentially relevant (non-privileged) information in the hands of the bank or its agents that has not already been drawn to the Skilled Person's attention."*

- xvi. We recognise the extent of the efforts the Bank has made to search for the information we have requested and the difficulties it has faced. However, we remain concerned that the approach RBS took to responding to our enquiries could on occasion be characterised as narrow compliance. This meant that the effectiveness of our enquiries was limited by the precise boundaries of the questions we asked and this in turn added significantly to the length of time our work took, as we pursued follow-up questions not addressed in initial responses. We were also concerned about how difficult it was to collate information for our review, and how much additional information emerged in the course of our work following receipt of the initial file from the Bank.
- xvii. Inevitably, we cannot be certain that we have seen every piece of contemporaneous documentation that existed for each and every case that we reviewed, but on the basis of the evidence available to us, we do not believe that any remaining gaps are material and systematic in nature. We are satisfied that the measures we took have given us a reasonable level of confidence that the information eventually available to us provided a reasonable basis upon which we could reach our conclusions.
- xviii. Finally, each case we reviewed had its own unique set of facts and considerations. This diverse background to cases, the inherent complexity of the issues involved, and qualitative nature of many of the judgments we needed to make, meant that, in compiling this report, it was challenging to provide a complete and quantitative picture of all of the cross cutting themes and issues we identified. Wherever possible, however, we have indicated in how many cases we found an issue. But where this would give a false sense of precision about the extent and nature of our observation or is otherwise impracticable, we simply describe at a high level the cross cutting themes we observed and supplement where relevant by specific case extracts. These themes from our individual case reviews provide important context to the narrative about the customer experience in GRG and are necessary for the reader of this report to relate our overall central conclusions to what was happening on the ground in GRG during the Relevant Period.

Part 1 - Executive summary

- 1.1. Our terms of reference are set out in the Requirement Notice issued by the FCA following its announcement, in January 2014, of its decision to commission a report under section 166 of the Financial Services and Markets Act 2000.
- 1.2. The FCA took that step in the light of disquiet about the way in which the Global Restructuring Group was alleged to have behaved in relation to SME customers. We were accordingly asked to undertake an analysis of the policies and procedures operating within GRG and to consider a representative sample of customers, and then to use the outcome of that work to:
- Form a view on how those customers were treated;
 - Form a view on whether any inappropriate treatment that we identified was widespread and/or systematic;
 - Assess the validity of the allegations of customer treatment set out in the Tomlinson and Large reports; and
 - Enter into dialogue with the FCA in relation to its decision on whether a second stage (Phase Two) investigation should be undertaken to examine certain issues in greater depth.
- 1.3. In the main, this report sets out our views on the first two of these issues, but in seeking to understand what treatment customers themselves regarded as inappropriate we have, as directed by the Requirement Notice, paid attention to certain matters raised in the Tomlinson and Large Reports (particularly the Tomlinson Report) and which were, for convenience, set out in Annex D to the Requirement Notice.

Our key conclusions

- 1.4. We found that:
- There was in certain respects widespread inappropriate treatment of SME customers by RBS throughout the Relevant Period;
 - Some elements of this inappropriate treatment of customers should also be considered to be systematic;
 - However not all the allegations made in the Tomlinson Report were valid; and
 - Of those cases in our Representative Sample that we assessed as being potentially viable - inappropriate treatment by RBS appears likely to have caused material financial distress in one in six (16%) of them.
- 1.5. The inappropriate treatment, of SME customers by RBS, that we identified as being widespread arose from:
- The failure to comply with the Bank's own policy in respect of communicating with customers around transfer. The standard of much communication was poor and in some cases misleading;

- The 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;
 - The failure to document or explain the rationale behind decisions relating to pricing following transfer to GRG;
 - The 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;
 - The failure of GRG to adopt adequate procedures concerning the relationship with customers and to ensure fair treatment of customers;
 - The failure to identify customer complaints and handle those complaints fairly;
 - The failure to handle the conflicts of interest inherent in the West Register model and operation; and
 - The failure to exercise adequate safeguards to ensure that the terms of certain “Upside Instruments”, in particular Equity Participation Agreements (“EPAs”), were appropriate.
- 1.6. We concluded that the inappropriate treatment we have identified should in certain important respects also be viewed as systematic. This treatment did not stem simply from idiosyncratic behaviour on the part of individual GRG staff and managers. Rather, it 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 commercial and turnaround objectives and to put in place the appropriate governance and oversight procedures to ensure a reasonable balance was struck between the interests of the Bank and those of its SME customers.
- 1.7. GRG management was aware (or should have been aware) of these issues but, whilst some improvements were made towards the end of the Relevant Period, it failed to prioritise the changes that were required. Accordingly we view these issues as part of an intentional and coordinated strategy (in the terms of the Requirement Notice) to focus on GRG’s commercial objective and to place inadequate weight on the interests of its SME customers. It was this strategy that not just allowed poor practice to develop unchecked but also was the underlying cause of the poor treatment of many individual SME customers that we have observed.
- 1.8. Specifically, the inappropriate treatment of SME customers we identified as being systematic arose from:
- Failings in GRG to place appropriate weight on turnaround options in its handling of SME customers;
 - Failings in GRG to manage the conflicts of interest inherent in its design and operation of West Register;
 - Failings to handle complaints fairly;

- The undue focus on pricing increases without due consideration of the longer term viability of customers; and
- The undue focus on EPAs.

1.9. It is also important to note that we were satisfied that, whilst we did in some cases identify isolated examples of poor practice, on the basis of the information available to us there was **not** any widespread or systematic inappropriate treatment of SME customers by RBS in a number of areas. Specifically:

- RBS did not set out to artificially engineer a position to cause or facilitate the transfer of a customer to GRG;
- The 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 the Bank 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
- We did not identify any case 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.

1.10. In considering the treatment of SME customers that we judged to be inappropriate and having regard to the issues raised in Annex D of the Requirement Notice, we identified instances of inappropriate treatment on the part of RBS and GRG in 86% of the 207 cases we reviewed.

1.11. These instances varied widely. Some might be considered unlikely to have had a material effect on the customers concerned. But others, including those involving pricing decisions, the application of Upside Instruments, and more generally the failings to adopt good turnaround practice, were clearly significant sources of customer concern at the time. Taken together, the combination of poor practice we observed in many individual cases could, and in some cases did, have profound impacts.

1.12. Many SME customers transferred to GRG were clearly not viable. But of the cases we assessed as being potentially viable in our Representative Sample, inappropriate treatment by RBS appears likely to have caused material financial distress in one in six (16%) of them. In practice we consider yet more customers have valid grounds for feeling badly treated by RBS and GRG.

- 1.13. Material financial distress does not necessarily mean that the actions of the Bank gave rise to the failure of the businesses concerned; indeed some of the cases we identified as suffering from material financial distress eventually returned to mainstream banking. However, the distress caused by the Bank was material in the context of the SME's circumstances at the time.
- 1.14. Most of the 5,900 SME customers transferred to GRG (or placed under its credit management) remained in it for extended periods. Indeed, according to RBS's own data, well over two thirds of those transferred during the Relevant Period remained in GRG at the end of 2013. Some GRG SME customers left the Bank or repaid their debts; one in ten returned to the mainstream RBS bank from which they had been transferred. We estimate in total over a third of the customers transferred to GRG during the Relevant Period could be expected to face insolvency and administration. This figure reflects in large part the perilous financial condition that many customers were in prior to their transfer to GRG. Nonetheless, the reality of GRG for SME customers was very different to the way RBS presented it at the time to its customers and stakeholders.

Background

- 1.15. In the run up to the financial crisis, RBS had become the largest lender in the UK SME sector. The Large Report described the circumstances as follows:
- "pre-crisis growth in the SME market was fuelled by lending to the Commercial Real Estate sector, as well as to businesses utilising real estate collateral to support speculative and other trading activities. RBS built a large share in the SME market, primarily through real estate lending of both types, often relying on rising asset prices to support lending applications rather than analysing the quality of the customer's business and its suitability for bank finance. This resulted in Relationship Managers (RMs) relying too heavily on asset values instead of cashflow analysis in order to make lending assessments. It also raised customer expectations to unsustainable levels, as prices were too low and lending standards too lax."*⁶
- 1.16. These issues and the wider financial crisis brought significant and widely reported challenges for RBS. We do not recount here all of the issues that the Bank faced, but they are relevant background to our review, and we have had regard to them. In particular it is relevant to note that the decision was taken in 2009 to create a Non-Core Division of RBS assets. In 2011, this included some £13.5bn for BRG customers. The Non-Core Division was given a mandate to run off these assets by the end of 2013. Also, as a condition of Government support for the Bank, RBS was required to comply with the terms of the Asset Protection Scheme ("APS") from its inception in 2009 until RBS left it in 2012.
- 1.17. But the most immediate impact of the financial crisis was the increased financial pressure on SMEs and the often significant falls in some assets values. As noted in the Large Report: *"The excessive lending was rapidly manifested by a sharp increase in non-*

⁶ Large Report, page 29

performing loans after the financial crisis in 2008, particularly in the Commercial Real Estate sector.”⁷

- 1.18. Prior to 2008 GRG had been a relatively small and specialised unit of the Bank. But as the effects of the wider financial crisis (and the Bank's own challenged financial circumstances) impacted on SMEs and on the Bank's lending policies, GRG found itself in the centre of the storm. By any measure, the growth GRG experienced – particularly in the period 2008-2011 – was both significant and challenging.
- 1.19. In BRG, the business area of GRG that dealt with distressed SME customers in Great Britain⁸, staffing rose from around 100 in 2008 to a peak of 258 FTE in July 2011, whilst SME referrals increased from 738 in 2008 to 1,497 in 2009⁹.
- 1.20. In total, 5,900 SME cases were referred to GRG over the Relevant Period. The nature of these SME businesses varied widely. The debt to RBS of the group of SMEs we considered ranged from £250k to £20m – around a quarter had debts of under £1m, and the median level of debt to RBS of our sample of cases was around £1.7m. Accordingly, whilst some businesses were significant employers, with a highly professional and experienced management team or were subsidiaries of larger enterprises, others were family businesses or sole traders, with little business experience outside their own trade or profession and no professional in-house financial support.
- 1.21. For some SME businesses, it was clear at the point that they transferred to GRG that there was little if any prospect that the business would be able to continue. We identified around a third of our sample as clearly not viable at or around the time of transfer. For others however, there was at least some prospect of the business, or at least some material part of it, being able to continue and return to the mainstream Bank¹⁰, albeit perhaps with significant support and forbearance by the Bank. Our review focuses on that latter group of customers – SMEs who, whatever their difficulties, had at least some realistic potential to be maintained over the medium term as viable businesses.

Our approach

- 1.22. A central question raised by the Requirement Notice was how should we assess what was and was not “inappropriate” for the purposes of our review. We concluded that we should consider actions, or failures to act, as inappropriate if:
 - They were in contradiction of applicable legal or regulatory rules or regulations; or

⁷ Large Report, page 29

⁸ Except where significant in the context of the issue we do not distinguish in this report between GRG and its sub-division BRG

⁹ Our calculations from RBS data

¹⁰ In common with the Bank, we use the term ‘mainstream’ to mean the normal Bank and banking relationship – in the case of RBS the Business and Commercial Division. Hence ‘mainstream Relationship Manager’ refers to a Business and Commercial manager (or their equivalent)

- They were contrary to the expressed policies of either RBS as a whole or of GRG specific policies within RBS; or
 - We judged that, although no RBS or GRG policy was breached and no relevant rule or regulation was applicable, the treatment or practice was nonetheless inappropriate – i.e. we judged that, having regard to the circumstances, the treatment was not fair and reasonable. In considering what was fair and reasonable we have taken account of the circumstances at the time – for both SME customers and RBS.
- 1.23. With very limited exceptions, GRG's activities were not subject to regulatory rules or the application of the FCA Principles for Businesses.¹¹ Therefore it is important to note in considering this report that our judgments about what we found and which underpin our conclusions are not primarily based on how far RBS complied with the FCA regulatory rules or the high-level Principles for Businesses. Instead, most rely significantly on what RBS stated it would do in its policies and procedures or, given the shortcomings we found in some of those policies, what we considered fair and reasonable.
- 1.24. The focus of the report is RBS's treatment of SME customers in the context of the allegations made previously by customers and reported by Dr Tomlinson. In many cases, we have put our findings in the context of wider observations about the actions of GRG during the Relevant Period, but the Tomlinson Report does not set out to be a full review of all of GRG's activities relating to SME customers.
- 1.25. The Requirement Notice summarises the allegations reported by Dr Tomlinson and the points raised by Sir Andrew Large. That was helpful in ensuring we considered the broad range of issues. We looked back to the original reports to ensure we had understood the precise terms in which the points in the Requirement Notice had been made. As our work developed, so did our understanding of the wider context of many of the points made by the customers who spoke to Dr Tomlinson. An example is West Register, where we found that customer concerns of poor treatment focused at least as much on "Upside Instruments" and the work of the GRG Strategic Investment Group as it did on West Register as a purchaser of property assets.
- 1.26. We also considered it necessary to look at the way GRG treated customers in the round – that is the various individual allegations needed to be considered as part of one overall picture to ensure that what actually happened was properly assessed and understood. We have therefore in this report ensured that we have responded to the central themes of the Tomlinson Report (and the Large Report – in so far as they related to GRG), rather than address seriatim the individual allegations listed in Annex D of the Notice.
- 1.27. The definition of SME customer for the purpose of this review is set out in full in the addendum to the Requirement Notice (see Annex I). In essence, the scope of our review was limited to customers transferred to GRG in the United Kingdom during the Relevant

¹¹ FCA Handbook, Principles for Business: PRIN 2.1

Period with debt levels of between £1m and £20m. A further group of customers – those with debts of between £250k and £1m managed by RBS's Strategic Management Unit ("SMU") – were also included as GRG was involved in the management of their case. Accordingly, the definition we use in this report does not directly relate to wider definitions of 'SME' used, for example, by BIS or to relevant distinctions in FCA regulation such as the definition of a micro-enterprise. Wherever we refer to SME customers in this report in relation to RBS, we are referring to the definition in the Requirement Notice (where we intend a wider definition, for example in some of our recommendations, we make that clear in the text).

- 1.28. We set out further details about the approach we adopted in this review in Chapter 2.2 (About our investigation). However, it should be noted that, in forming our views, we have taken a pragmatic approach, adopting criteria that were intended to reflect what we considered most people would regard as being fair and reasonable. We have avoided the use of any legalistic considerations. This is not least because the Requirement Notice does 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 us to form a view (that is to set out what we found) rather than determine our conclusions by reference to the legal position. It follows that whether actions in individual cases may give rise to a claim in law is not a matter that we have considered or, therefore, addressed in this report.

How GRG operated

- 1.29. At the beginning of the Relevant Period, GRG faced a twin challenge; a sudden and significant growth of activity coupled with a challenging economic environment and new requirements on the Bank. This placed intense stresses and strains on GRG and its staff.
- 1.30. But these challenges were not in our view the cause of the problems we have identified. Rather, those problems and the issues of inappropriate customer treatment we have found stemmed from:
- Fundamental conflicts between the underlying objectives of GRG;
 - The failure of GRG management to identify and manage these conflicts to ensure that an appropriate balance was struck between the interests of the Bank and those of its distressed SME customers; and
 - Clear shortcomings in the governance arrangements that should and could have addressed at an earlier stage the various issues that our review has identified.
- 1.31. We explore these themes below and set out our detailed findings and observations in Part 3 (How GRG operated) of the report.

GRG's objectives

- 1.32. GRG had been established as a unit "deliberately independent from the frontline teams, and with a different culture..." Its specialist role was characterised by a strong belief in the need for individually crafted turnaround solutions for customers. In the Bank's view, this set GRG apart from similar distressed customer units in other banks.

- 1.33. GRG consistently adopted throughout the Relevant Period twin objectives. These were variously expressed in documents including to the RBS Board, to staff and customers and more widely. These objectives were:
- To be at the leading edge of a wider rescue culture – focused on turnaround, rehabilitating customers in distress and working with the aim of returning customers to mainstream banking wherever possible (the ‘turnaround objective’); and
 - To be a major contributor to RBS’s financial objectives (often expressed as a contribution to RBS’s bottom line), which initially focused on revenue generation with GRG as a profit centre within the Bank but later in the Relevant Period evolved to focus on other metrics relating to the protection of capital (the ‘commercial objective’).
- 1.34. The notion of GRG as a profit centre was raised in the Large Report. Senior RBS staff disputed that GRG had been a profit centre – specifically following questioning by the Treasury Select Committee¹² – but later accepted that the formulation used in the Large Report was materially correct.^{13,14} It was clear from our investigation that GRG did act as a profit centre as set out in the Large Report. Specifically, GRG recorded the incremental income it earned from customers (primarily such margin and fees as it levied on the customer over and above those which had applied at transfer but also the gains it made from Upside Instruments) and set that income against its own operating costs.
- 1.35. It is relevant to note that the capital balance of the associated loans remained with the division of RBS that had initiated the loan – and thus any write down of that loan was borne by the originating division and not GRG.
- 1.36. So whilst RBS has stressed that the customers handled by GRG were loss making for the Bank, the internal picture drawn for GRG was more positive. The GRG Executive Committee management information (“MI”) packs started with a statement of “Value Added” that noted the “Additional Incremental Contribution, net of Expenses”. For example, in FY 2011 “Total Income” across GRG amounted to £1,321.3m with “Expenses” of £132.5m – hence GRG’s recorded “Contribution” was £1,188.8m. A point GRG highlighted internally, for example, to the RBS Group Board as one of its “2011 Achievements”.
- 1.37. We do not criticise the Bank for having a commercial objective and in particular for taking steps to protect the Bank’s capital although “major contributor” might be argued to have placed an unrealistic objective on GRG’s staff given the inherently perilous state of the businesses with which it dealt. But in any event, the objectives were not easy bed-fellows, and in many cases, they could be in direct conflict – particularly if the commercial objectives adopted by GRG were short term.

¹² Treasury Select Committee: Oral Evidence SME Lending, Chris Sullivan, Deputy Group Chief Executive, RBS, and Derek Sach, Head of GRG, RBS, 17 June 2014

¹³ Additional Evidence submitted to Treasury Select Committee by RBS, letter from Chris Sullivan, 15 July 2014

¹⁴ Correspondence to Chairman of the Treasury Select Committee, letter from Sir Philip Hampton Chairman of RBS, 22 August 2014

- 1.38. The particular features of GRG's position were also recognised at least in part by GRG itself. Its 2010 procedures and guidance manual said *"TCF¹⁵ is at the heart of how we do business at GRG. It is recognised that GRG plays a slightly different role compared to other divisions within the Group. Typically, we are dealing with customers who are in distressed circumstances therefore it is even more important that we deal with our customers fairly and sensitively, as our aim is to return such businesses back to the mainstream bank. Hence how we treat customers while they are in the care of GRG may impact upon whether the customer decides to remain with RBS once they have been returned to health. Put simply TCF is good for the customer and good for business."*
- 1.39. However as our work demonstrated, these good intentions were not widely carried through in practice, and GRG lacked the systems, policies and processes to deliver them.
- 1.40. There were therefore clear risks to customers inherent in the GRG model. The existence of a commercial objective was not of itself inappropriate, but it gave rise to inherent potential conflicts of interest and risks to customers. In particular, in a turnaround context, where the customer is already exhibiting financial distress, the Bank's short-term commercial considerations need to be balanced against the need to foster an environment that is conducive to the customer's return to health where that is practicable.
- 1.41. Put simply, the risk was 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 simple presence of this risk did not make the GRG objectives inherently inappropriate, but at a minimum it emphasised the 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.
- 1.42. There was therefore in our judgment an onus on GRG (and indeed on RBS) to ensure GRG's twin objectives remained appropriately in balance. We have concluded that the evidence available to us demonstrates that in practice the internal focus was on the commercial objective and much less weight was attached to turnaround in respect of SME customers.
- 1.43. One impact of the failure to manage this conflict of objectives was that the expectations of customers were not appropriately managed. GRG presented itself to customers primarily as being a division that was there to help customers in financial distress and claimed that entry to GRG would help to restore an ailing business back to health. The reality was very different. The failure to appropriately manage expectations has, in our view, given rise to many of the expressions of dissatisfaction that have been made about GRG.
- 1.44. More substantively, the failure to manage the conflicts inherent in GRG's twin objectives also exacerbated a key risk – that GRG, by pursuing its commercial objective, would take action that was unfair and inconsistent with genuine efforts to turn a

¹⁵ Treating Customers Fairly, and referred to throughout as "TCF"

distressed SME around. That might in turn lead to material financial distress for the business or potentially to placing an otherwise viable business on a journey towards administration, receivership and liquidation.

1.45. In addition to these conflicting objectives, GRG also needed to be mindful of the particular features of its role that gave rise to a number of potential conflicts of interest:

- It had an explicit casting vote on decisions about transfers to GRG;
- It operated with considerable internal managerial and credit discretion that was not widely scrutinised by those outside the GRG chain of command (at least for the majority of the Relevant Period);
- Its customer-facing team and management were closely associated with its property valuation team, with West Register (that purchased property primarily out of administration) and with its Strategic Investment Group ("SIG") (the negotiators and owners of any equity or property participation arrangements made with customers in GRG and known as Upside Instruments); and
- It was a major user of third-party providers of relevant professional services (including valuers, solicitors, accountants and insolvency practitioners) that were critical to the fair conduct of distressed accounts.

1.46. In part these potential conflicts were inherent in the role of GRG as a turnaround unit, but others stemmed from the way in which GRG chose to manage and organise its affairs. In practice GRG was slow to recognise the extent of these potential conflicts. We found that as a result it failed to put in place the checks and balances that could have guarded against them.

Governance and policy shortcomings

1.47. The existence of potentially conflicting objectives and wide ranging potential conflicts of interest inherent in the GRG model made it important to have in place effective and appropriate systems of control and effective policies (with adequate policing mechanisms) designed to protect the interests of customers.

1.48. In practice, however, GRG had little by way of meaningful established policy and practice when it came to how customers should be treated. The policies that we reviewed were not of themselves clearly inappropriate although in certain respects they were in our judgment inadequate. But in any event, as a result of the absence of detailed and effective controls and procedures, the policies were often not implemented effectively.

1.49. A good example of this is the Bank's policy in respect of TCF. This initiative was not a regulatory requirement for much of GRG, but from April 2009, RBS adopted a group level policy standard that applied to **all** customer-facing businesses (including GRG). TCF was referenced in GRG policies subsequently. Despite this we did not see how GRG management would have been able to satisfy itself that TCF had been properly implemented and embedded in GRG. In our view it was not.

- 1.50. Financial (and as might be expected in particular credit) information in GRG was generally well developed and subject to detailed scrutiny and oversight. In contrast, we found that information relating to customer outcomes was limited, and where it was routinely reported we found it to be, in important respects, unreliable and unduly positive in the impressions it gave. For example, we found that the reporting of complaints understated the real volume of complaints being raised by customers.
- 1.51. GRG's procedures, policies and practices all pointed to significant discretion for frontline staff in the identification of the appropriate strategy for handling a distressed customer and in executing that strategy. Accordingly, GRG relied heavily on the professional standards of all of its staff. For example, the criteria that governed whether or not a business should be transferred to GRG out of the mainstream Bank were widely drawn and gave the relevant committee significant discretion on how various factors were measured and weighted and consequently which SME customers should be transferred and when.
- 1.52. In a recovery and turnaround unit we would expect to see significant discretion given to frontline staff to allow for individual solutions to the diverse customer circumstances that the Relationship Managers ("RMs") needed to handle. But we would also have expected to observe effective oversight from both frontline management and the second line of defence. In practice we saw little evidence of such oversight.
- 1.53. Individual cases were reviewed at GRG's Strategy and Credit Review meetings which were typically held shortly after transfer and then at regular intervals (at least annually). However, we observed that these meetings focused on the pricing and credit decisions on the account – not on the prospects for turnaround or the manner in which the relationship with the SME was being handled. We saw little evidence of day-to-day supervision of cases and how the Relationship Manager handled their SME customers. Issues relating to potential risks to customers were not subject to routine audit during the Relevant Period nor subject to any other meaningful external scrutiny.
- 1.54. We identified governance and oversight shortcomings in each of the areas we considered. In summary:
- The risk management framework did not include sufficient or appropriate second or third line oversight across the Relevant Period;
 - Key risks to customers were not identified, managed or appropriately mitigated;
 - Management information around key risks to customers was not sufficient or appropriate so as to enable GRG management to have adequate oversight of those risks; and
 - The processes set out in GRG Policy and Guidance were not routinely followed by Relationship Managers, and the lack of effective or appropriate oversight meant that this was allowed to continue across the Relevant Period.
- 1.55. We have concluded that the governance and oversight framework was neither appropriate nor sufficiently robust across the whole of the Relevant Period to provide

effective challenge and oversight relating to the treatment of customers within GRG. In certain respects, this was recognised by RBS.

- 1.56. 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. GRG management was aware (or ought to have been aware) of these shortcomings but took insufficient steps to correct the problem.

Staff objectives, appraisals and culture

- 1.57. These general governance shortcomings were exacerbated by the approach GRG took to objectives and performance measures for staff. Our analysis of the material that we have reviewed leads us to conclude there was, in practice, a greater emphasis on the need to generate income and achieve 'upsides' than on any other measure set in the objectives for frontline staff and that the revenue targets and comments from staff and their managers in appraisals we reviewed influenced the behaviour within GRG toward SME customers.
- 1.58. As a result, the earning of income in the short to medium term by the taking of fees and in the longer term by taking the opportunities represented by "Upsides Instruments" was, in our view, at the forefront of motivation for Relationship Managers. This focus was evident at all levels of GRG. For example:
- Our review of appraisals showed there was a greater emphasis in staff reporting on the generation of income and Upside Instruments than there was on any other factors;
 - Our review of the content of GRG (and BRG) management papers showed a significant focus on financial measures;
 - Our case reviews identified a management focus in the handling of individual cases on GRG's immediate commercial objectives; and
 - Our review of other relevant management communications, including emails and the documents circulated by a team leader in at least one GRG regional office that exhorted staff to "Just Hit Budget" by identifying 16 ways in which fee income could be earned from GRG SME customers (attached at Annex IV), also evidenced this focus.
- 1.59. We found that for much of the Relevant Period there was a focus, not just at a corporate level but also by individual Relationship Managers, on targeting fee generation, the use of Upside Instruments and debt reduction. This was not balanced by a similar focus on the needs of customers, the opportunities to explore turnaround options, and how the Bank might support SME businesses where practicable to return to mainstream banking. This focus was not simply a matter of management reminding frontline staff of the harder edged and more difficult objectives that they should bear in mind in handling cases, but a clear statement of priorities.
- 1.60. We have concluded that there was a general failing to establish and oversee balanced and appropriate objectives for staff to deliver GRG's twin objectives. This was not in our

judgment a result of idiosyncratic decisions by local managers, but was endemic in GRG's arrangements in respect of those dealing with SMEs. This was a failing that GRG management was aware of (or should have been aware of), but the steps necessary to start to address the issues we identified were not taken until the very end of the Relevant Period.

- 1.61. A day-to-day management focus on "how to get a customer to agree chunky fees and upsides and thank you for it" that was uncovered as part of the review of the "Just Hit Budget" document may not have been commonplace, but nor does it seem to have been isolated. The attitudes to customers and the priorities for staff that the author(s) of the "Just Hit Budget" document so graphically illustrated were in our judgment common in the culture of GRG at the time: a culture of 'deal making', with its focus on the financial interests of GRG, that placed little weight on the stated turnaround objective, and less still on the fair treatment of customers.

Overall conclusions on how GRG operated

- 1.62. We conclude that there was a failure on the part of GRG and RBS to fully recognise and manage the conflicts of interest inherent in GRG's twin commercial and turnaround objectives. There was also a failure to put in place the appropriate governance and oversight policies, procedures and processes (including in relation to staff objectives) to ensure that a reasonable balance was struck between the interests of the Bank and those of its SME customers.
- 1.63. It is clear that the Bank was aware, at least in part, of some of these failures but, it would appear, chose not to prioritise action to overcome them. As a result, notwithstanding improvements made in the final months of the Relevant Period, these failings occurred across GRG and across the Relevant Period.

GRG activity

- 1.64. Against the background of the stated approach of GRG, we comment in Parts 4 and 5 of this report on the behaviours we observed towards customers (and some that we did not see) in respect of the various allegations highlighted in the Tomlinson Report or which otherwise appeared to us to be relevant to our review.
- 1.65. In this Executive Summary, we highlight the wider themes that cut across those components to draw out an overview of what the 'GRG way' meant in practice for its SME customers.

Being transferred to GRG

- 1.66. If the transfer to a turnaround unit is delayed, then the customer will not get the focused support that they may require, or necessary recovery action may be delayed. But transferring a customer without cause may harm the interests of the customer (by labelling it a distressed customer), and waste expert resources in the Bank.
- 1.67. So from the perspective of both the Bank and the customer, the decision to transfer the customer to GRG had significant implications. The Bank rightly identified it as a decision to be taken with care. It also required careful communication with the customer to ensure they were aware of the reasons for the decision and its implications.

1.68. In the light of the allegations made, we considered:

- Whether RBS appropriately identified customers for transfer to GRG and the reasonableness of the transfer criteria;
- The governance and appropriateness of the transfer process; and
- The transparency of the transfer/referral process.

1.69. We also considered whether:

- In assessing the move to GRG, businesses were assessed on their potential value to RBS rather than their level of financial distress;
- Businesses which were demonstrating similar levels of performance were treated differently in an inappropriate way, with the treatment depending on the value to be made by RBS;
- Technical breaches of covenants (with no bearing on the performance or viability of the business) were used to transfer a business to GRG; and
- The reasons that triggered the move to GRG were adequately explained to customers.

1.70. Overall, across the cases we reviewed, we were satisfied that almost all of the customers who were transferred to GRG were exhibiting clear signs of financial difficulties and required either turnaround action or collection of the debt. We saw no evidence that persuaded us that there was a general practice of targeting businesses for transfer based on their value to GRG (and not their level of distress). However, in a few cases we saw that other, less appropriate, factors were considered as part of the decision-making process. Examples included an expectation that transfer to GRG would provide an opportunity to address poor original lending and/or pricing decisions, and where GRG's assessment of the appropriateness of a transfer appeared coloured by its perception of its ability to apply what it called "leverage" – that is to have legal or financial grounds that would enable it to renegotiate the terms of facilities. But in each of these cases we were, on balance, satisfied that a transfer could be justified on other appropriate grounds.

1.71. In relation to the transparency of the transfer process, we conclude that there were frequent failings to conform to the Bank's own policy in respect of communicating with customers about transfer. The standard of much communication was poor and in some cases misleading. Taken together, these failings resulted in the widespread inappropriate treatment of customers.

1.72. The situation in Northern Ireland was in certain important respects different from that in the rest of the UK. Whilst the situation in relation to Ulster Bank and its customers at the time gave rise to significant challenges for the Bank, we find that the practices that it adopted were in several respects inappropriate and failed to pay sufficient regard to the needs of the customers involved.

Overall strategy and turnaround

- 1.73. The concept of “turnaround” is fundamental to many of the views that we have formed, within our overall review, about the way in which GRG treated SME customers. It was one of the twin goals of GRG. Customers entering GRG were assured that there would be a focus on how the expertise within GRG could be harnessed to help restore them and their business to financial health, and its success hinged on GRG’s ability to revisit and renegotiate terms, including pricing arrangements.
- 1.74. Turnaround is the art of the possible. The development of an appropriate turnaround strategy for a business is highly fact specific. What may work for one business may not work for another, and the range of variables in any given situation is significant – requiring careful analysis and a balanced judgment about the challenges and prospects of the business.
- 1.75. Turnaround is also about more than simply financial performance. For example, the readiness and capability of the customer or its management team to make any necessary changes will be a critical component of any assessment, as will wider market conditions and developments.
- 1.76. A turnaround unit also needs to deal with businesses that are no longer potentially viable. Where a business is clearly not viable, it is necessary and appropriate to move promptly to recovery action, even if this is not the outcome desired by the owners of the business.
- 1.77. Turnaround is inherently a dynamic process. Business prospects and challenges can alter, sometimes dramatically, in short periods. Turnaround units therefore need to keep a close eye on developments and be prepared to change course where circumstances dictate a need for change. Consistent with this point is that turnaround solutions typically need time to work. Once a plan has been agreed and is being implemented, a period of stability is desirable but the plan should be carefully monitored and tracked.
- 1.78. Finally, turnaround units deal with difficult problems and often very divergent views. Some customers may enter a turnaround process with unrealistic expectations, or owners may have over-optimistic views about the prospects for their business. A turnaround manager will often be in the position in these cases of having to relay some unpalatable truths. The Bank also has an entirely legitimate interest in securing (so far as is reasonably practicable) its own financial position. So the role of any turnaround division is to deal professionally and fairly with these difficult circumstances, balancing appropriately the needs of its customer and those of the Bank.
- 1.79. Because the concept of turnaround is key to many of the areas that we have had to consider, we have kept all of these points in mind when forming our views on those issues.
- 1.80. Our review of the training and guidance material circulating within GRG shows that GRG intended to adopt a strategy that required:

- A careful assessment to be carried out of whether or not a business was viable, or could be made viable (and that assessment should be based on a wide review of the business, not simply immediate technical solvency issues);
 - If the business was clearly not viable, ensuring that it was transferred for recovery action (including appointment processes) without delay; and
 - Where the business was potentially viable, ensuring that a turnaround plan was considered, documented and if practicable implemented to address the underlying business issues that the customer was facing.
- 1.81. It was recognised that turnaround plans might not be practicable in all cases. That might, for example, be because the management team was unwilling or unable to make the necessary changes, or the changes could not be made in time.
- 1.82. Whilst achieving a return to satisfactory (“RTS”) was the stated ‘primary aim’, turnaround might in some circumstances also depend on RBS’s willingness to provide funds – both to continue to provide existing facilities (and in some cases additional facilities) and the terms upon which those facilities were to be offered. If a turnaround plan was not practicable the GRG policy was to support the customer exiting RBS.
- 1.83. Looked at in isolation, we viewed GRG’s stated approach as appropriate and broadly reflective of normal turnaround practice. If this approach had been implemented effectively, many of the failings identified in this report would not have occurred.
- 1.84. In a number of important respects, however, this stated approach of GRG was not widely followed in practice during the Relevant Period, and RBS lacked many of the tools we would have expected to see to conduct a successful turnaround. GRG also focused unduly on certain solutions in developing its customer strategy – namely Upside Instruments and debt reduction. Whilst these might well have a role to play in achieving a practicable turnaround plan, they were not of themselves sufficient to meet the policy objectives GRG had set for itself.
- 1.85. We identified significant shortcomings in the manner in which GRG treated turnaround issues in practice. Whilst the issues raised were often very specific to the circumstances of the individual case, the main issues we observed can be grouped under five headings:
- Delays in transfer impacting turnaround options;
 - Viability studies were absent from most cases;
 - A focus on pricing and debt reduction not turnaround;
 - A reluctance to consider customer proposals; and
 - A lack of appreciation of the impact of Interest Rate Hedging Product (“IRHP”) agreements.
- 1.86. Following our consideration of GRG’s policies and practices, the main outcomes of which are reported in Chapter 4.2 (Turnaround), we conclude that there were frequent failures to pay appropriate attention to turnaround considerations, including as a result of failures to:

- Carry out adequate viability assessments;
 - Consider and implement viable turnaround options including medium and longer term sustainable turnaround solutions (instead focusing on short-term measures);
 - Document clear turnaround plans with appropriate objectives and milestones – and monitor progress against those plans;
 - Make adequate use of a broad range of turnaround tools, including forbearance where appropriate; and
 - Consider the impact of the Bank's actions in repricing/debt repayment/withdrawal of working capital facilities on the ability of the customer to continue to trade.
- 1.87. We also found that notwithstanding its stated objectives, GRG placed little emphasis on turnaround – other than in the sense that GRG wanted customers to meet credit policy requirements. There was in practice little focus on returning customers to financial health and mainstream banking through genuine business restructuring.
- 1.88. Overall, we conclude that SME businesses within GRG were not supported in a manner that was consistent with good turnaround practice. We conclude that this should be considered inappropriate treatment of the customers concerned and that this inappropriate treatment was widespread throughout the Relevant Period.
- 1.89. That this inappropriate treatment occurred, and occurred on a widespread basis, is perhaps not surprising given the limited management focus on 'turnaround' across the Relevant Period. Accordingly, the failings we report we also view as systematic because that inappropriate treatment resulted amongst other things from:
- GRG prioritising its commercial objective at the expense of turnaround objectives; and
 - The failure to put in place adequate and appropriate safeguards to ensure that the turnaround objective was given due weight in GRG's day-to-day interactions with its SME customers.

Facilities

- 1.90. Many of the customers transferred to GRG were in breach of the facilities that had been granted in the years leading up to 2008, on terms which appeared, in hindsight, to have been generous.
- 1.91. We do not criticise the Bank for changing its risk appetite and willingness to lend. In particular it was not unreasonable for the Bank to determine that it no longer wished to lend to certain categories of customer.
- 1.92. However, having made that assessment, we do consider that a bank, mindful of good turnaround practice and its TCF objectives, would need to consider carefully how to execute that objective in a manner that was appropriate and minimised, as far as was practicable, the adverse impacts of its decision on its customers.

- 1.93. In practice we saw few cases in our sample where the Bank offered additional money. Of itself that is not surprising given the nature of the customers it was handling. Where it did provide additional facilities, it did so on terms that normally provided for significant upside income.
- 1.94. We also note that, in practice, there was little oversight of, or challenge to, debt restructuring decisions from the perspective of ensuring that they took account of the needs of the customer.
- 1.95. We also observed GRG pursuing its objective of reducing facility levels with insufficient regard for the impact its decisions had on customers and, as a result, GRG's decision making relating to existing facilities was inappropriate. Whilst it is true that in many cases the Bank extended facilities where it had no formal obligation to do so, it was clear that its overriding objective in respect of facilities was to reduce the Bank's exposure. Those extensions were typically short term and on terms that secured additional income for GRG.

Pricing

- 1.96. Pricing issues were a major feature of the concerns expressed in the Tomlinson Report. 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 for GRG's customers significant additional charges.
- 1.97. As the Bank, in part, recognised in a policy revision in 2013, care needed to be taken to ensure that the customer's cash flow position was *"properly taken into account in all cases"*. 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 in achieving a successful turnaround and RTS.
- 1.98. Nor was it inappropriate that GRG Relationship Managers were vested with considerable discretion as to the application of pricing arrangements. 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. More importantly, the emphasis of the training, overall objectives and guidance we saw, and the clear messages of day-to-day guidance to staff such as that in the *"Just Hit Budget"* document suggested to us that the focus was on how to increase prices and leverage opportunities.
- 1.99. The 2013 revisions to pricing policy were intended to halt some of the more contentious elements of GRG charging. But we do not view those revisions as sufficient given the weaknesses we have identified in the wider environment to which the policy applied.
- 1.100. In practice we noted that many SMEs entering GRG would be subject to upward adjustment to administrative fees and, where the contract allowed, to margin. Often,

the SME would face management fees to reflect the increased costs to the Bank in employing additional staff to deal with cases in financial difficulty.

- 1.101. Normally, more significant were changes to margin. The upward movements we saw have to be interpreted with care. Typically, the original contracts provided for a margin increase of 2% if the customer was in default – the overwhelming majority of customers in GRG were in default, and in general this automatic margin increase was applied by GRG, if it had not already been applied in the mainstream Bank. But facilities were also often re-priced more generally to reflect the increased risk represented by the customer in its current distressed state.
- 1.102. Relationship Managers had significant discretion to set prices within the bounds of a broadly drawn pricing matrix. Again, that discretion was subject to little direct oversight. The Bank's policy of ensuring that price changes were supported by a clear rationale was not widely followed in practice, and we found there was a frequent failure to explain pricing changes adequately to customers. Some Relationship Managers viewed pricing primarily as a commercial negotiation.
- 1.103. We observed GRG levying a wide variety of fees in addition to management fees and margins. These included:
 - Upfront fees charged on granting “new” money (often called “arrangement fees”);
 - Fees which are deferred until the loan is repaid (usually described as an “exit” fee);
 - Sums payable when an “Upside Instrument” matures;
 - Risk fees following default. This is an additional fee charged to reflect the Bank's increased risk profile in continuing to support the customer following the event of default;
 - Waiver fees – which are fees payable to the Bank for agreeing to waive a default by the customer;
 - Payment in Kind (“PIK”) fees – levied where a customer is unable to service interest on its debt, and asks for interest to be rolled up/capitalised;
 - Non-utilisation/commitment fees – fees payable to the Bank to compensate the Bank for holding funds available for drawdown but which are not actually drawn; and
 - Excess or unauthorised overdraft fees – charged when the balance on a customer's current account is either overdrawn, with no formal facility in place, or in excess of any agreed overdraft facility limits.
- 1.104. We were struck in a number of cases by the sheer number and frequency of pricing proposals we observed GRG Relationship Managers make to the customer. Prices and new components to charges could (and did) change with surprising frequency, reflecting in part the short-term nature of the facilities that the Bank agreed in several cases. It was clear to us that this was often disruptive and confusing to customers. At a

minimum, it made long-term financial planning difficult. More generally, there were frequent failures to communicate pricing decisions to customers; this was a known issue, apparent in both customer complaints and in customer surveys.

- 1.105. In addition, there was, in practice, a failure to make, or retain, a clear explanation of how a price was arrived at. This was both contrary to GRG's own guidance, which was contained in legal advice circulated in March 2011, and contrary to what we would expect to be set out in clear policy requirements. Prices were regularly proposed but not progressed. Some were agreed or imposed, but for some reason not implemented. And finally, of course, not all fees that were charged were in the event paid.
- 1.106. We looked carefully at the quantum of prices charged by GRG. It was agreed with the FCA, at an early stage of our work, that we should not carry out a benchmark study of pricing in other institutions. We therefore took a cautious approach to this – it was for the Bank to determine its prices.
- 1.107. Our ability to assess the reasonableness of the absolute quantum of pricing was constrained by a number of factors including the fact that we did not undertake a benchmarking exercise, and the lack of contemporaneous rationale by GRG for pricing on cases. Nevertheless, some of the pricing that we observed was, in our view, inappropriate when assessed against normal risk return principles or otherwise excessive – although we were not always able to evidence this reliably. There was certainly a significant group of cases where pricing appeared to us at best questionable and sometimes opportunistic.
- 1.108. In practical terms, the most important immediate consideration for customers was not so much the notional quantum of the increases that GRG imposed but the short-term manageability of those charges given other financial pressures on the business. As identified by Dr Tomlinson:¹⁶

“Whilst the Bank may argue that [increases] in interest reflect the greater risk the bank faces as a result of the business’ [unstable] position, this is unhelpful for the business, making it increasingly hard for them to trade out of their difficult situation.”
- 1.109. Many of the original facilities we observed in our sample, agreed shortly before the financial crisis, reflected those imprudent times with lending to SMEs attractively priced and heavily reliant on a continuing appreciation of real estate asset values. In addition, many of the customers who entered GRG had taken out medium to long-term interest rate hedges associated with their loans.
- 1.110. In consequence, the impact of GRG's margin changes on the SME was often more significant than the quantum might at first suggest because:
 - The margin shifted from a very competitive level to one reflecting RBS's then current view of market pricing plus the increased margin associated with the risks represented by the customer's challenged financial circumstances; and

¹⁶ Tomlinson Report, page 11

- Any interest rate hedge in place meant that the impact of these increases in margin were not ameliorated by the general reduction in base rates.
- 1.111. More generally any increase in margin, with its attendant impact on cash flow, was unwelcome to the SMEs concerned – especially so given their already difficult circumstances. An acute version of this was provided in the case of property businesses reliant on rental income to meet the costs of credit facilities. In such cases, the Bank and the customer faced some difficult decisions.
- 1.112. These challenges were not unique to RBS. Many banks were over-extended in property related lending and faced similar customer circumstances. But GRG's model, with its emphasis on fee generation, placed yet further strain on these challenges. As will become apparent, the solutions that GRG's management focused on, namely the use of Upside Instruments and the role of West Register as a purchaser of distressed assets, whilst of potential assistance, gave rise to their own conflicts and challenges.
- 1.113. Our conclusions on Upside Instruments are contained in Chapter 5.2 (Strategic Investment Group). Our assessment of the impact of pricing on SME business cash flow is discussed in our assessment of material financial distress in Part 6 (Customer outcomes). Overall, we conclude that 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. For the reasons given at the end of Chapter 4.4 (Pricing) we also regard that inappropriate treatment as systematic.

Valuations

- 1.114. Many customer concerns at the time focused on valuations. Property valuation was a significant factor in the development of GRG's case strategy. We observed in most cases involving loans secured on property some effort to provide an up-to-date valuation on or around entry to GRG. Property-based lending invariably involved covenants on maintaining a maximum loan-to-value ratio, so new valuations could lead to the conclusion that there had been a breach. Such a breach entitled GRG to increase margin, impose management fees and to seek to renegotiate the facilities. Valuations had further relevance in that they would help shape the Bank's strategy for the handling of the case and in some cases the valuation was a critical element in future pricing decisions.
- 1.115. We conclude that the policy framework adopted by RBS was not, of itself, inappropriate. The Group Credit Risk Mitigation Policy provided for independent valuations. The draft Property Advisory Unit ("PAU") policy noted that details of the valuation methodology and supporting comparables should be clearly documented and valuations undertaken by qualified surveyors. We did not see any specific policy, guidance note, or any other document during the course of our review which suggested that valuations should be deliberately low, or that valuation methodologies should be used that would result in systematically low valuations.
- 1.116. We do not consider that there should have been an obligation on the Bank to use external valuations in all cases, and we do not regard the use of internal valuations as

necessarily inappropriate, provided that such valuations are arrived at on an informed basis and in accordance with appropriate guidelines. Third-party valuations come with a greater cost, which would generally be borne by the customer, and having a process that meant that this cost did not need to be incurred by already financially distressed customers was reasonable.

- 1.117. In our view, particular care was required where an internal valuation was to form the basis of a decision that would have significant commercial consequences for the customer. This was acknowledged by the Bank in its evidence to the Treasury Select Committee.¹⁷
- 1.118. We consider that the Bank should have taken steps to consider the appropriateness of its valuations both internal and external before using them as a base upon which to found other decisions such as Bank strategy, pricing and the calculation of Upside Instruments. The Bank should have taken extra care to ensure valuations were as appropriate and robust as reasonably possible, and the Bank should have been clear in its communications with customers about the purpose of internal valuations. RBS has indicated that customers always had the option to use external valuations – but it is not clear that the purpose of the valuations was systematically explained to customers to help them make a more informed decision about whether the cost was worth their while.
- 1.119. Overall, in respect of valuations we conclude that there were frequent failures to:
- Oversee and ensure that appropriate and robust valuations were made by staff; and
 - Evidence that adequate work was carried out 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.
- 1.120. These failures were significant especially where decisions relating to pricing, strategy, covenant breaches, and the base value of Upside Instruments were based on these valuations. In consequence we consider that these failures gave rise to the inappropriate treatment of customers, on a basis we conclude was widespread.
- 1.121. We did not, however, find evidence that valuation practice or methodology systematically undervalued assets or that valuations were manipulated to achieve either a transfer to GRG or for any other purpose. Nevertheless, we considered that the approach taken by GRG to valuations increased the risk that errors would be made and that GRG should have taken more care to ensure that this risk was minimised.
- 1.122. We concluded that in order to provide assurance to customers that the internal valuation process was independent of GRG's preferred strategy or other commercial objectives there would have been merit in securing stronger 'Chinese walls' between the functions. That this did not occur was in our view an error of judgment.

¹⁷ Treasury Select Committee: Oral Evidence SME Lending, Chris Sullivan, Deputy Group Chief Executive, RBS, and Derek Sach, Head of GRG, RBS, 17 June 2014

Customer experience and complaints

- 1.123. As we noted earlier, GRG was expected as part of a group-wide standard to adopt TCF principles. From our review of written customer communication at the time, the accounts that customers gave to us of discussions, and the evidence we have seen from appraisals and internal emails, we have reached the overall view that RBS's communications with its customers fell short of the professional standards it aspired to – rather they were too often insensitive, dismissive and sometimes aggressive.
- 1.124. Taken together with the lack of transparency in key areas, and the related shortcomings we identify in areas like complaints, these failings added to an already inherently stressful situation, making the environment both more antagonistic than was necessary and more error prone.
- 1.125. We found no evidence of excessive requests for information or of the Bank preventing customers from taking action. We did, however, find that GRG policies and procedures concerning the relationship between Relationship Managers and SME customers were inadequate to ensure the fair treatment of those customers. In our view, the failing to adopt adequate procedures and to ensure fair treatment of customers gave rise to widespread inappropriate treatment of SME customers throughout the Relevant Period.
- 1.126. GRG recognised that complaint handling was a regulatory requirement in respect of some customers and a necessary part of its TCF approach to all its customers. Its overall policy on handling complaints included elements that limited its practical effectiveness (such as a focus on “no justified complaints”), and it lacked for much of the Relevant Period sufficient escalation safeguards and consideration of root cause analysis. In these respects its policy was inadequate and thus inappropriate.
- 1.127. There were, in addition, significant failings in the way the policy was implemented, including in the way staff were trained and their objectives were set and overseen. Indeed, too often in our review, we saw attitudes from managers and staff towards complaints and complainants that appeared to us to be dismissive. The situation improved somewhat once the handling of complaints was transitioned to a specialist complaint handling unit within the Bank in September 2012, but remained unsatisfactory.
- 1.128. For the individual customers in our sample, it was clear that a dismissive attitude and the wider failures to handle complaints fairly was a major frustration. It added to the sense that there was no place to turn to tackle what were seen as the wider unfair practices of GRG.
- 1.129. We concluded that these failings to handle complaints fairly resulted in the widespread inappropriate treatment of customers, and that given the failings in policy, staff objectives and controls that we have identified, we view that inappropriate treatment as systematic.
- 1.130. The failure to handle complaints fairly and to understand and tackle the root causes of complaints meant that an opportunity to address areas of customer concern was lost. But this was not the only opportunity. GRG management was aware (or at least should have been aware) of the shortcomings in its service. For example, the GRG customer

satisfaction survey report in 2013 emphasised why customers were dissatisfied with GRG in the following terms:

- *“Customers do not understand why they were transferred to GRG or they are not convinced that they should have been;*
- *They do not find GRG helpful as they do not get the support, contact and feedback they need. Their RM keeps changing and there is a lack of business understanding; and*
- *They feel poorly treated, bullied, threatened often exploited.”*

1.131. The independent survey concluded that the *“whole approach, the formula is problematic.”*

1.132. Our own meetings with customers, and our review of the concerns they raised at the time, supported this assessment.

Third parties

1.133. Third-party firms were widely used by GRG to provide support for its work – for example on valuations and independent business reviews. It is understandable that customers would expect third-party firms to be independent of RBS. It is not surprising that some customers were concerned that RBS was ‘too close’ to third-party firms as they often were aware that the GRG representative they were dealing with was on secondment from a third-party firm.

1.134. GRG should have been aware of the potential conflict presented by the use of staff who had been seconded from third-party firms. It does not appear that monitoring was sufficient to prevent potential conflicts from arising or that conflicts which did arise were managed appropriately.

1.135. However, the potential conflicts that we identified were more likely to impact other third-party firms than they were the customer. This is because the conflicts we identified 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.

1.136. It is understandable that some customers considered that the requirement for a third-party firm to be engaged placed an undue burden on them at a critical time. However, we did not find that use of third-party firms to conduct specific pieces of work was inappropriate given the circumstances in which many customers found themselves.

Exiting GRG

1.137. That customers remained in GRG for an extended period was not in of itself inappropriate, and nor was it necessarily inappropriate that customers did not find it easy to exit GRG. However, the process had the potential to lead to confusion amongst customers about the steps that were required to exit GRG. Customers were typically informed (albeit sometimes incorrectly) about the reasons they were being brought into GRG. But we did not see clear direction to customers on the steps that they needed to undertake to RTS. While we did not consider that there were widespread shortcomings in the process for transferring customers back to the mainstream Bank, the Bank’s

failure to appropriately manage the expectations of customers risked creating a perception that it was all but impossible to leave GRG by means of a successful RTS.

- 1.138. We have seen few cases where we considered that the customer should have returned to the mainstream Bank earlier than they ultimately did. Nor did we see widespread evidence that customers were being kept in GRG for reasons that were inappropriate.

West Register

- 1.139. Central to the concern of many customers was the role of West Register ("WR"), a group of companies that operated from within GRG. Some of the 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 granted the Bank a Property Participation Fee Agreement ("PPFA" or "PPA") or an EPA – both known as Upside Instruments.
- 1.140. 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 owned the shares in their company (in the case of an EPA). In his report Dr Tomlinson made specific reference to West Register in the following general terms:

*"In regards to RBS, there is an additional incentive for these types of revaluations and fire sales – West Register. There are multiple accounts of West Register buying properties later down the line when the business has gone into insolvency at cut prices. When you look at the inaccuracy of the valuations of many of these assets, there is a potential for easy profit to be made from the cheap purchase of properties that later can be resold nearer the original valuation."*¹⁸

"...there is a real potential for conflict of interests in the sale of assets out of the insolvency pot. RBS has a particularly precarious position given its West Register commercial portfolio under which it can make huge profits from the cheap purchase of assets from 'distressed' businesses.

A number of businesses felt that West Register has been interested in taking their property. Others have stated that they believe their property was purposefully undervalued in order for the business to be distressed, enabling West Register to buy assets at a discount price."

*A number of businesses complained about West Register's interest in their property and felt they had been forced into a corner where they had to accept conditions they otherwise would not."*¹⁹

West Register Asset Purchases

- 1.141. Turning first to West Register as a purchaser of assets, we note that RBS does not appear to have made 'huge profits' out of the process. Nor was West Register (we conclude) the driver for transfers to GRG as some customers suspected.

¹⁸ Tomlinson Report, page 7

¹⁹ Tomlinson Report, page 14

- 1.142. From our review of the cases, where we identified some involvement by WR, we were satisfied that:
- There was no evidence that the intent to purchase assets had been formed prior to the transfer of the customer to GRG;
 - On each occasion the price paid by WR was below the level of the debt held by the Bank at that point – in other words the purchase crystallised a loss for the Bank; and
 - In no case did the evidence available to us suggest that a successful bid by WR was clearly below market prices for the asset at that time.
- 1.143. We did, however, note that in at least six cases WR was actively involved in the development of GRG strategy prior to a purchase, for example discussing issues such as whether or not property should be let.
- 1.144. While accepting that WR **could** have a positive use for both the Bank and its customers, we find that the manner in which the West Register model was implemented by RBS was inappropriate and severely flawed. Specifically we conclude that:
- The policies and procedures relating to the management of conflicts of interest in respect of WR were inappropriate throughout the Relevant Period; and
 - In handling individual cases GRG failed to manage conflicts of interest relating to WR appropriately.
- 1.145. Whilst we did identify cases where the involvement of WR was part of a wider picture of the Bank's actions that we judged likely gave rise to material financial distress, we did not identify any case where the purchase by WR (as opposed to by another person) gave rise to a financial loss to the customer.
- 1.146. Nonetheless the failings we did identify 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 WR. Put simply, West Register purchases too often were seen by GRG staff as the easy option to their handling of a case. Its presence provided a mechanism where bad or merely doubtful debts could be crystallised, whilst retaining for the Bank (but not the customer) the potential for upside if prices did improve over time. That was not inherently inappropriate, but its use required the utmost care and should have been limited.
- 1.147. The failings we have identified in respect of West Register were widespread. The failures of the systems of governance, the stated objectives of both GRG and WR and the way in which staff were encouraged to view WR are evidence which lead us to conclude that the issues that we have identified and the resulting inappropriate treatment of customers were both widespread and systematic.

Strategic Investment Group and Upside Instruments

- 1.148. Upside Instruments were important parts of the GRG strategy, emphasised in objectives for staff at all levels. We conclude that whilst they had a valid role in the toolkit of a

- turnaround unit, the focus given to them was disproportionate and inappropriate. They were put in place and managed in conjunction with a part of GRG known as the SIG.
- 1.149. 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.
- 1.150. They were comparatively simple in nature. Whilst we have raised findings concerning the way that the PPFAs were entered into and how prices were calculated, we do not consider PPFAs to be inappropriate per se.
- 1.151. By contrast, EPAs were inherently more complex financial instruments; they required changes to a company's structure, had complex legal documentation, were open-ended and had no clear mechanism for determining value when terminated.
- 1.152. We have concluded that GRG/SIG failed to exercise adequate safeguards to ensure that the terms of EPAs were appropriate. We have observed opportunistic pricing both in setting the initial terms and in negotiation of the terms for a buy out of the EPA that appeared to us to be inappropriate in the context of SME customers.
- 1.153. The close association between SIG and the GRG Relationship Managers handling distressed customers gave rise to further conflicts of interest that were not managed effectively or appropriately. By sharing equity 'prospects' at an early stage in the consideration of the strategy for handling distressed cases (as GRG did at least in the early part of the Relevant Period), there was a risk that strategy would be unduly influenced by SIG's commercial priorities and the encouragement given to Relationship Managers to deliver 'upsides' for the Bank. This could and did result in both customers entering EPAs that were not appropriate for their needs and options for more traditional turnaround being overlooked or simply ignored.
- 1.154. We conclude that the application of EPAs gave rise to inappropriate treatment of customers. In the context of those customers with whom EPAs were agreed, we have concluded that inappropriate treatment was widespread and (based as it was on a clear focus on and encouragement to agree Upside Instruments without any meaningful consideration of the appropriateness of their use) also systematic.
- 1.155. Overall, we have significant reservations about the applicability of EPAs to the SME customers we reviewed. EPAs might be of value and appropriate in the context of the larger customers within our sample – say those with debts over £10m or businesses that formed part of a far larger group or otherwise had access to specialist support and advice – but for the overwhelming majority of cases, EPAs were an inappropriate solution. They should have been seen as the exception for the largest customers of BRG, rather than as a general objective.

Outcomes for customers

What happened to customers

- 1.156. We wanted to know what had happened to SME customers referred to GRG. RBS's own data did not give straightforward answers to this question, not least because during the Relevant Period GRG had not used a definition of customers that was the same as that in the Requirement Notice. Following extensive work with RBS, we were able to produce some information but for the reasons set out in Chapter 6.1 (What happened to customers) there remain questions about both the accuracy and the best way of presenting the data.
- 1.157. We did however conclude that the way in which GRG measured and recorded the outcomes of the SME cases it handled gave a misleading impression from a customer perspective. We concluded that the number of cases that returned to RBS mainstream banking was no more than one in ten of all cases entering GRG during the Relevant Period, and in reality may well have been a significantly lower proportion. Most cases remained in GRG at the end of the Relevant Period.
- 1.158. Whilst 6% had completed an Appointment processes by the end of 2013 another significant group could be expected to face formal Appointment after the end of the Relevant Period. Another 17% were identified for recovery action. Overall we think it likely that around a third of customers were destined to face insolvency and Appointment, albeit in many cases after the end of the Relevant Period.

Distress Assessment

- 1.159. We set out in Chapter 6.2 (Distress Assessment) how customers were affected and consider, in the light of the inappropriate actions by GRG that we have identified, whether it was likely that otherwise viable businesses suffered material financial distress as a result.
- 1.160. Our distress assessment required the in-depth analysis of each of the cases in our sample and was subject to a range of challenges. For example, where the only evidence available to us was the Bank's file, we may not have had a record of all the relevant background circumstances, such as the customer's family circumstances or other financial commitments. Therefore, it was not always clear exactly what event or action (if any) led to distress for the customer. We therefore adopted a 'reasonable likelihood' test to assess whether inappropriate actions led to material financial distress.
- 1.161. In summary, our assessment was predicated on a judgment about whether there was a reasonable likelihood that the inappropriate actions(s) of RBS led to financial distress that was, in our view, likely to be material in the context of the customer in question and went beyond that which the customer would have experienced in any event.
- 1.162. We conducted this distress assessment in respect of the 207 cases that we reviewed. This included both the Representative Sample and the Tomlinson Cases. We present the full results for the Representative Sample.

- 1.163. Our first step was to remove from further analysis those cases that we judged to be clearly not viable. These Group One – clearly not viable – cases accounted for 34% of the Representative Sample.
- 1.164. Of the remaining cases (117 cases) in the Representative Sample (those cases that were in our judgment potentially viable), 92% experienced some form of inappropriate action by RBS. In the majority of cases, however, we concluded that in the circumstances of the case these inappropriate actions were **unlikely** to have resulted in material financial distress.
- 1.165. In 16% of the potentially viable cases in our Representative Sample, we concluded that the inappropriate actions **were** likely to have resulted in material financial distress. Not all of these cases concluded with the insolvency of the businesses concerned. However, in our view, the impacts we observed could reasonably be described in several cases as contributing to a journey towards administration, receivership and liquidation.
- 1.166. The results are summarised in the following table:

Fig. 1: Distress Assessment – Potentially viable cases in our Representative Sample

Distress Assessment Group	Cases	Percentage
No inappropriate actions	9	8%
Inappropriate actions were unlikely to result in material financial distress	89	76%
Inappropriate actions were likely to have resulted in material financial distress	19	16%

- 1.167. We noted that adverse outcomes were **more** likely in the case of trading based businesses (in the case of 22% of potentially viable trading/other businesses we concluded that material financial distress was likely to have been caused). Where we were able to speak to the customer to widen our evidence base, we also saw a higher incidence of likely material financial distress (25%).
- 1.168. The sample size of the Tomlinson Cases was considerably smaller and so caution should be exercised in comparing it with our larger Representative Sample. We were also conscious that the Tomlinson Cases were largely self-selecting and might not be representative of the wider experience of customers in GRG in respect of financial distress. With those caveats we noted that of the potentially viable group in the Tomlinson Cases, in our view, all but one experienced some inappropriate actions. Again, in the majority of these cases we concluded that, in our view, in all the circumstances of each case, those actions were unlikely to have resulted in material financial distress. Of the potentially viable group in the Tomlinson sample, we judge, in all the circumstances of each case, that inappropriate actions were likely to have resulted in material financial distress in 28% of those cases.

1.169. Accordingly, we concluded that the actions of RBS Group were likely to have caused material financial distress otherwise viable businesses. We concluded that the material financial distress we observed was not the result of isolated poor decisions by GRG staff. The proximate causes were case-specific but included:

- Sudden (or at least unduly rapid) requirements to reduce credit facility levels (for example the withdrawal of overdraft facilities);
- Pricing increases that paid insufficient regard to the customer's circumstances and cash flow;
- Upside Instruments that appeared to us to be unreasonable in all the circumstances; and
- A general failure to consider wider turnaround options and identify and implement appropriate alternatives where they existed.

1.170. Although the proximate cause of distress varied, the themes of treatment were widely observed in our sample of cases and did not just occur in respect of those cases where we found RBS's inappropriate actions were likely to have resulted in material financial distress.

Our Recommendations

1.171. In Part 7 (Recommendations) we draw together our specific recommendations and draw out some wider observations in the light of our findings.

Recommendations for RBS

1.172. The terms of reference for Phase One meant that we did not review whether or not the lessons from these events have been learnt by RBS and changes implemented. They also meant that we did not explore, in any depth, the root causes of inappropriate treatment of customers. As we did not review changes made by RBS after the end of the Relevant Period we are conscious that some recommendations may already have been addressed or their relevance superseded by subsequent events. But nonetheless they provide a framework within which future treatment of SME customers can be developed and provide an opportunity to address the weaknesses in governance and oversight, and indicators of poor culture in GRG that we have highlighted in this report.

1.173. The conclusions we have reached in this report warrant a fundamental review by RBS of how it handles its SME customers in financial distress.

1.174. **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 events could not happen in future.**

1.175. We make 22 specific recommendations about the improvements to RBS governance arrangements, policies and practices that we consider RBS should bear in mind in reviewing the future operation of its turnaround division.

- 1.176. Addressing these recommendations will help ensure that similar problems to those experienced in RBS's GRG during the Relevant Period do not occur in future. They do not, however, address the concerns and issues of those SMEs that were handled by GRG.
- 1.177. It is understandable that in the light of the findings in this report there will be calls for RBS to compensate the customers affected. As we explain in Part 6 (Customer outcomes), the extent and nature of financial distress varied considerably and was often hard to quantify with any precision. The circumstances of GRG customers often meant that the Bank had considerable discretion under the law, and those individuals who suffered may not have a straightforward legal position in any case, as the company was the Bank's customer. Moreover, they may no longer be the owners, or the company may have ceased to exist. The inappropriate actions we identify, and their wide ranging consequences for customers, arose in areas which, with minor exceptions, were not subject to regulatory rules or principles. So the scope for regulatory action is limited. Responsibility for responding to these issues, and the distress GRG caused many of its customers, rests with the Board of the RBS Group. We do not underestimate the challenges of any redress scheme. It is likely to require independent, lengthy and complex mediation, operating outside the strict legal framework.
- 1.178. **We recommend that RBS consider the practicalities of providing redress to GRG customers who are likely to have experienced financial distress as a result of its actions.**
- 1.179. There are also some wider issues for RBS to consider. First, the extent to which the issues we report here in respect of GRG were or in particular remain features of other units handling SME customers. **We recommend that RBS reviews the relevance of these findings more widely to its handling of SME customers.**
- 1.180. Second, the terms of the Requirement Notice meant that we did not review the extent to which those in RBS outside GRG were aware of the issues covered in this report. In any event it appears to us that there are wider lessons for RBS to consider in terms of how the events in GRG could have continued for so long apparently either unnoticed or unchallenged by others in the wider RBS Group.

Lessons for the wider market

- 1.181. The FCA has instigated a review of its own approach to SMEs as users of financial services,²⁰ and we see this report and its recommendations as a contribution to that work. Our work highlights the diversity of SMEs and the inequality of bargaining power between the less sophisticated SMEs and banks. It also underlines the lack of protection available more generally to SMEs.
- 1.182. We believe that policies and practices for the SME sector need to be based at least in part on an appreciation of differing customer capabilities if the SME customer is to be treated fairly. It will also be relevant to take account of the stage in the banking

²⁰ Discussion Paper DP15/7 'Our approach to SMEs as users of financial services', FCA, November 2015

relationship reached by the customer to ensure that products, services and communications are appropriate for the needs of the SME customer.

- 1.183. The present regulatory protections for SME-related conduct are limited. Bank lending to SMEs (including to micro-enterprises) is unregulated although micro-enterprises have certain regulatory protections in relation to complaint handling. Given the widespread inappropriate actions identified in this report in relation to SME lending activities, **we consider that the FCA should work with the government to extend the protections available to SME customers.**
- 1.184. One option would be to extend the regulatory perimeter to bring lending to SMEs within the scope of FCA's regulated activities, to ensure that regulatory action can be taken to guard against the unfair treatment of customers and that the principles for business and standards of good governance and personal responsibility apply to this sector as they do to other parts of retail banking. However, a higher priority may be to give SMEs avenues to challenge banks where they are treated unfairly. For example, consideration should be given to extending the unfair contract terms protections to SMEs and give them greater access to the Ombudsman, whilst noting that the FOS award limit (£150,000), coupled with the inability to litigate for any additional compensation following a FOS decision, limits the relevance of FOS as a redress option.
- 1.185. **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.**
- 1.186. An alternative (or supplementary) approach would be to develop professional standards governing banks' lending to SMEs. The Lending Code, and the Institute for Turnaround "Statement of Principles for the UK 'Business Support Units' of Banks"²¹, may both have some role here. What is important is that any self-regulatory action has the confidence of both banks and customers and has independent oversight.
- 1.187. **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.**
- 1.188. The situation in RBS was particular to that organisation at that time. Nevertheless, the themes raised in this report may have wider resonance as banks consider how they should further develop turnaround units. For example, we suggest that banks review how they interact with third-party providers, especially in relation to secondees.
- 1.189. **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.**

²¹ Statement of Principles for the UK 'Business Support Units' of Banks, 2014

Part 2 – Background

- i. In this Part we describe the background to our work including the economic circumstances during the Relevant Period. We also outline the history of and the organisation of GRG itself. We also set out the extent to which the activities of GRG were subject to regulation.
- ii. We then describe the approach we have taken to our review and how we went about assessing whether or not GRG acted inappropriately. We summarise the work we have carried out in our review of GRG policy and procedures and in our sample case reviews, including the extensive steps we took to ensure we had as much information as possible about the cases we reviewed.

2.1 – Background to the Review

- 2.1.1. On 25 November 2013 Dr Lawrence Tomlinson, Entrepreneur in Residence at the Department for Business, Innovation and Skills, published a report entitled *"Banks' Lending Practices: Treatment of Businesses in Distress"*. We refer to that report as "the Tomlinson Report".
- 2.1.2. On the same day Sir Andrew Large published the detailed findings and recommendations on the lending standards and practices of the RBS in the SME market. We refer to that report as the Large Report.
- 2.1.3. Both reports referred to allegations made by customers and former customers of RBS about the way in which they were treated after encountering financial difficulties. Those allegations focused on a division of RBS known as the Global Restructuring Group.
- 2.1.4. The Tomlinson Report did not purport to undertake a full forensic analysis of the many allegations made to Dr Tomlinson during the course of his work. It did, however, exclude from consideration those businesses which Dr Tomlinson believed were clearly not viable. The Tomlinson Report contained serious allegations covering a range of issues.
- 2.1.5. During the course of his review, Sir Andrew Large conducted a customer consultation exercise. Responses to that consultation raised questions about GRG's behaviour and ethics as well as process and governance within GRG. The Large Report did not undertake an assessment of the underlying substance or veracity of the assertions and allegations that had been made. Accordingly, the report recommended that RBS should undertake a separate investigation to substantiate or refute the serious accusations that had been made.
- 2.1.6. In early 2014, RBS appointed Clifford Chance LLP to investigate the most serious allegation contained in the Tomlinson Report, namely that RBS, through its GRG division, was culpable of 'systematic and institutional' behaviour in artificially distressing otherwise viable UK SME businesses and through that putting businesses 'on a journey towards administration, receivership and liquidation'. Clifford Chance found no evidence of such behaviour. Its report was published on 11 April 2014.
- 2.1.7. On 17 January 2014 the FCA announced the appointment of Promontory Financial Group as the Skilled Person supported by their sub-contractors Mazars to produce an independent report pursuant to section 166 of FSMA. In announcing the review under section 166 the FCA set out its aims and overall approach in the following terms:

"The report will examine Royal Bank of Scotland's (RBS) treatment of business customers in financial difficulty and consider allegations of poor practice set out in the report by Dr Lawrence Tomlinson and referenced in Sir Andrew Large's report.

The first stage of the review will consider RBS' treatment of a sample of customers referred to its Global Restructuring Group. This will include some cases where customers

have already raised concerns with Dr Tomlinson, the Department of Business, Innovation and Skills or the FCA.

The review will also consider whether any poor practices identified are widespread and systematic. If this is the case, the second stage of the review will identify the root cause of these issues and make recommendations to address any shortcomings identified.”²²

2.1.8. The team from Promontory and Mazars that carried out this work brought together expertise and extensive experience in relevant disciplines, including of turnaround units, restructuring, insolvency practice, business banking, customer issues, financial regulation, governance, commercial law and accounting.

- Promontory is a leading strategy, risk management and regulatory compliance consulting firm focusing primarily on the financial services industry. It has offices in 14 countries including the UK. Further information about Promontory is available at <http://www.promontory.com/Offices/London>.
- Mazars is an international, integrated and independent organisation specialising in audit, accountancy, tax, legal and advisory services. It has offices in 77 countries including the UK and Ireland. Further information about Mazars is available at <http://www.mazars.co.uk>.

2.1.9. Throughout the report we refer to the review team as “we”, “us” or “our” as appropriate.

The Requirement Notice

2.1.10. The terms of reference for our review were set out in the Requirement Notice issued by the FCA to RBS on 20 May 2014 which is reproduced (as subsequently amended) at Annex I. The Notice sets the scope of the work the FCA wished us to undertake. In summary it required us to “*form a view of RBS Group’s treatment of small and medium size enterprises (“SME”) customers referred to Global Restructuring Group...*” In particular, the treatment of SME customers referred to (or managed by) GRG during the Relevant Period.

2.1.11. The Notice asks us to:

- “*Assess the validity of the allegations of customer treatment in the Tomlinson Report and, where relevant, points raised by Sir Andrew Large; and*
- *If inappropriate treatment of customers is identified, to form a view on whether it was widespread and/or systematic.*”

2.1.12. The Requirement Notice refers to specific areas of concern that were identified from an analysis of the allegations made by Dr Tomlinson and the points raised by Sir Andrew Large. That was helpful in ensuring we considered the broad range of issues. We looked back to the original reports to ensure we had understood the precise form in which the points in the Requirement Notice had been raised. As our work developed so

²²Update on independent review of Royal Bank of Scotland's treatment of business customers in financial difficulty, FCA

did our understanding of the wider context of many of the points raised by the customers who spoke to Dr Tomlinson.

- 2.1.13. As will become apparent, we found some of these allegations to require interpretation following further work. Our report does not answer these points seriatim; but throughout our review we have been mindful of them and, in Annex VIII, we cross reference the specific points in the Notice and show where we have responded to each of them.
- 2.1.14. The Notice provides for two phases to the review. Certain matters are identified for Phase Two and in consequence are not covered in this report. These issues include questions concerning the root cause of any problems and whether or not any inappropriate treatment of customers was known about and/or sanctioned by management within RBS Group.
- 2.1.15. This report represents the conclusions from Phase One of the review. It is for the FCA to determine whether Phase Two of the review will proceed.

About GRG

- 2.1.16. According to RBS, GRG was established (initially as Specialised Lending Services ("SLS")) in 1992, with the objective of supporting customers experiencing financial difficulties, restoring viable businesses to a mainstream banking relationship through financial and operational restructuring, and thereby protecting RBS's balance sheet and profitability. SLS changed its name to GRG from 1 January 2009.²³
- 2.1.17. At the time of the change the then Head of GRG issued a memorandum, dated 9 December 2008, that set out GRG's mandate in the following terms:

"Following the recent announcement that SLS is to have a group wide remit across all group and commercial areas of activity, it is proposed that SLS be re-named Global Restructuring Group ("GRG") which better reflects the main thrust of activities, namely rejuvenating and restoring customers to the business rather than, as sometimes perceived, simply recovery from failed customers. GRG is able to add value to customers in restructuring their businesses as well as financial restructuring.

GRG has been tasked with managing the Group's problem and potential problem exposures. Primary responsibility for the customer including credit and relationship should be passed to GRG when business units or credit areas have concerns over the ability of a counterparty to service its obligations to the Bank.

Given the current economic outlook, it is particularly important that potential problems are identified quickly and referred to GRG, as history has shown that the sooner positive action is taken, the greater the likelihood of a successful corporate restructuring.

This note aims to set out the high level parameters for the transfer of cases to GRG. Each area of the business is to ensure that appropriate procedures are agreed with Group Credit to ensure timely transfers of responsibility for the customer to GRG."

²³ We refer to GRG throughout this report, but we take that to include the period from 1 January 2008 to 31 December 2008 when it was called SLS.

The memorandum continued...

"GRG is a customer facing business whose objective is to improve our position and the financial condition of the customer. One of the key metrics for measuring the success of GRG is the return of customers to the business. Our ability to achieve success is dependent on transfer being made sufficiently early."

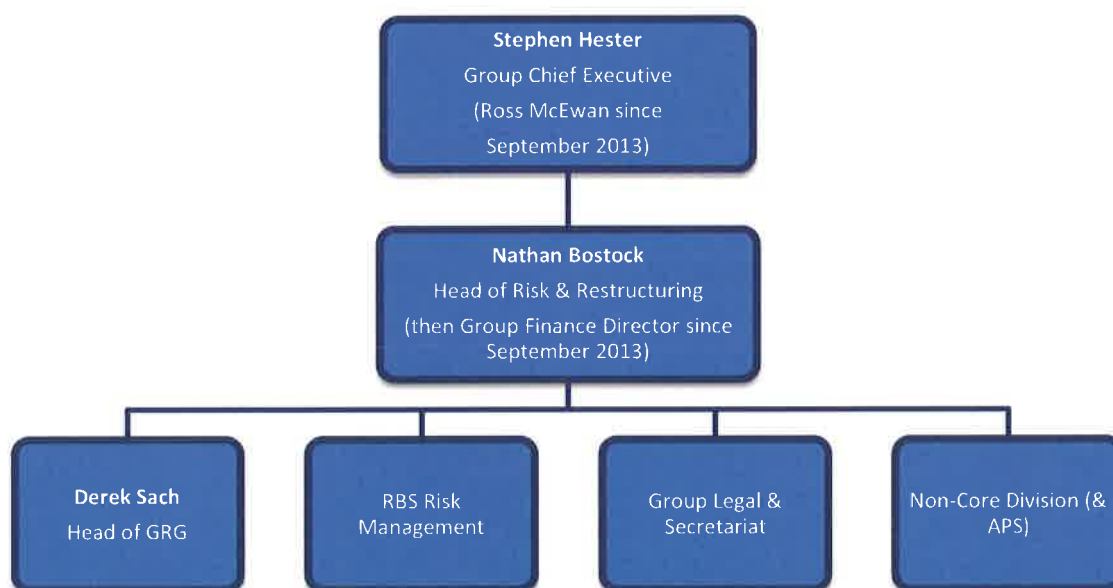
- 2.1.18. RBS told us that, *"As a division of RBS, GRG was deliberately independent from the frontline teams, and with a different culture, focused on turnaround rather than sales, rehabilitating customers in distress and working with the aim of returning customers to the frontline wherever possible. At the same time, it was appropriate to derive a return commensurate with the risk that the Bank was taking in continuing to support a customer. Throughout the Relevant Period the GRG mission statement was to be recognised at the leading edge of a wider rescue culture whilst contributing to the Bank's bottom line."*

Structure of GRG

- 2.1.19. In keeping with this separation from other areas of the Bank, GRG had its own management structure and objectives. We give more details about management arrangements in Part 3 (How GRG operated) in Chapter 3.2 (Governance and oversight), but an understanding of the main features is helpful from the outset. It gives context to the areas that we are required to report on.

- 2.1.20. Within the wider context of the RBS Group, as at January 2009, GRG was a division of the Risk function. It reported to the Head of Risk who, in turn, reported to the Group CEO. We set out the basic management structure in the chart below:

Fig. 2: GRG reporting lines – June 2009 to December 2013

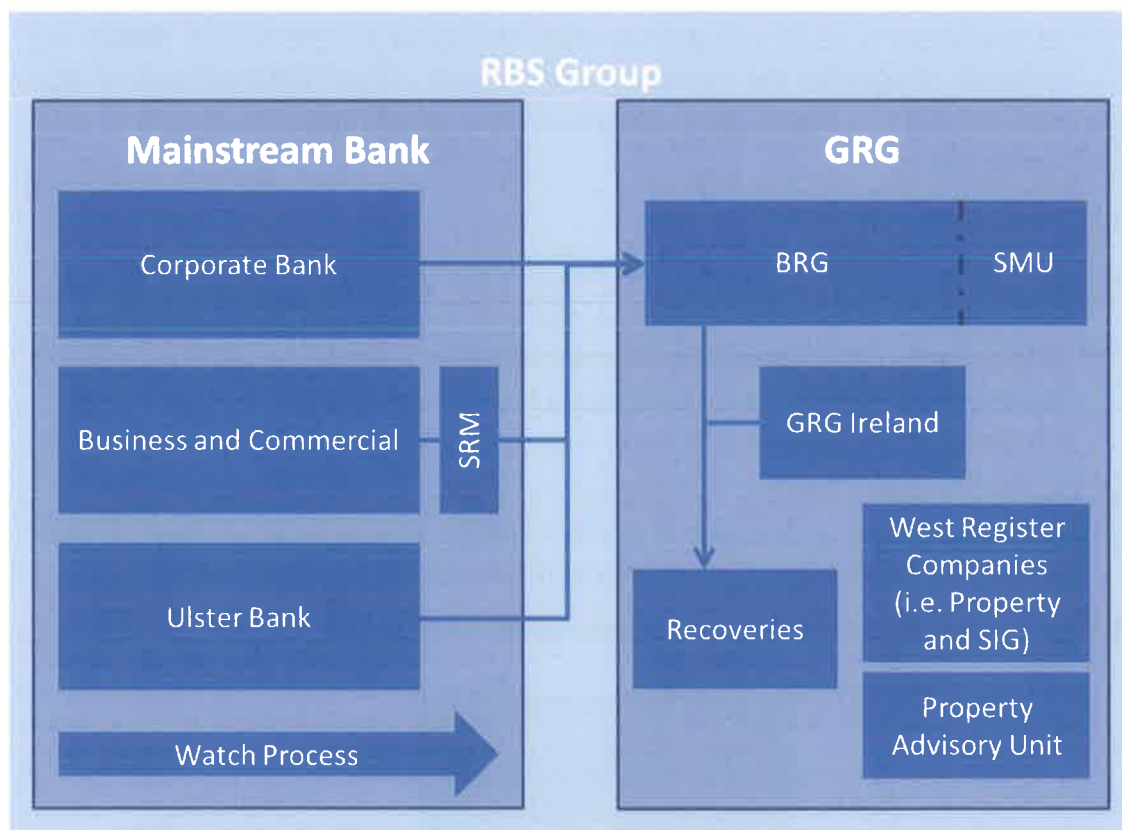


- 2.1.21. GRG was a global division of the Bank. It had responsibilities outside the UK and these were not without significance in terms of the attention required from GRG

management, the objectives that they were set by the wider Bank, and the time which they needed to give to jurisdictions outside the UK.

- 2.1.22. This global aspect to the division was reflected in the makeup of the GRG Executive Committee and the GRG Management Committee. Each of these was, at various points, chaired by the Head of GRG.
- 2.1.23. The chart below sets out, in simplified form, the main units in GRG and the mainstream Bank that dealt with SME customers and that were relevant to our review.

Fig. 3: Schematic of relevant operating units



- 2.1.24. In the UK, GRG comprised a number of units. Of these, the most significant to our review was BRG. This was the unit that dealt with cases in Great Britain where the level of customer debt was between £1m and £20m. Most of the cases that were subject to our review were dealt with by BRG.
- 2.1.25. SMU managed customers that met GRG handover criteria but with aggregate lending facilities of between £250k and £1m. These customers were not subject to the same relationship management handover process as those in BRG as they continued to be managed either by their original Business & Commercial ("B&C") mainstream relationship manager, or by Specialised Relationship Management ("SRM") – a unit of B&C that dealt with smaller businesses facing financial challenges. Thus an SMU case was credit and strategy managed by GRG and relationship managed by SRM/B&C.

- 2.1.26. West Register consisted of various legal entities, all of which were limited companies but operationally were closely related to and managed by GRG. In terms of this review, West Register was particularly relevant for two reasons:
- It bid for, and sometimes purchased, assets from customers who were in GRG; and
 - It was the holding company for Upside Instruments that were agreed between RBS and the customer.
- 2.1.27. SIG was responsible for managing the Upside Instruments GRG negotiated as part of problem debt restructurings. SIG's objective was to maximise the investment returns by managing the Upside Instruments strategies and collecting income including dividends and fees when due. SIG's main Upside Instruments were equity participations (both listed and unlisted) and Property Participation Fee Agreements (PPFAs). Further details about these Upside Instruments are given in Chapter 4.4 (Pricing) and Part 5 of this report.
- 2.1.28. The PAU provided GRG with strategic property and valuation advice. In practice, this property team was subject to significant organisational change during the Relevant Period, which we set out in Chapter 4.5 (Valuations).
- 2.1.29. GRG Recoveries, RBS's recovery unit for businesses (including SMEs), was also contained within GRG and was responsible for managing RBS's involvement in the administration and insolvency of SME customers who were managed by RBS. This would include cases that were transferred directly into GRG Recoveries (i.e. they were never relationship managed within BRG itself). The actions of RBS following the appointment of an insolvency practitioner or administrator in respect of the SME business were outside the scope set for our review.
- 2.1.30. Finally, the arrangements were somewhat different in respect of Northern Ireland, where GRG Ireland dealt with the customers of Ulster Bank.
- 2.1.31. Except where significant in the context of the issue, we do not distinguish, in this report, between GRG and its sub-divisions such as BRG, SMU and GRG Ireland.
- 2.1.32. Each of these sub-divisions had their own management arrangements. Where appropriate we address them in the relevant Chapters of this report. We note here, however, that most of the decision-making committees had common memberships and, in particular, a common Chair in the Global Head of GRG. In particular, at points during the Relevant Period, he chaired:
- GRG Board/Executive Committee ("ExCo");
 - GRG Management Committee ("ManCo");
 - Risk & Controls Committee;
 - Committees responsible for property acquisition by West Register; and
 - Strategic Investment Group.

Wider market conditions

2.1.33. This review also needs to be set against the background of the wider market conditions that persisted during the Relevant Period.

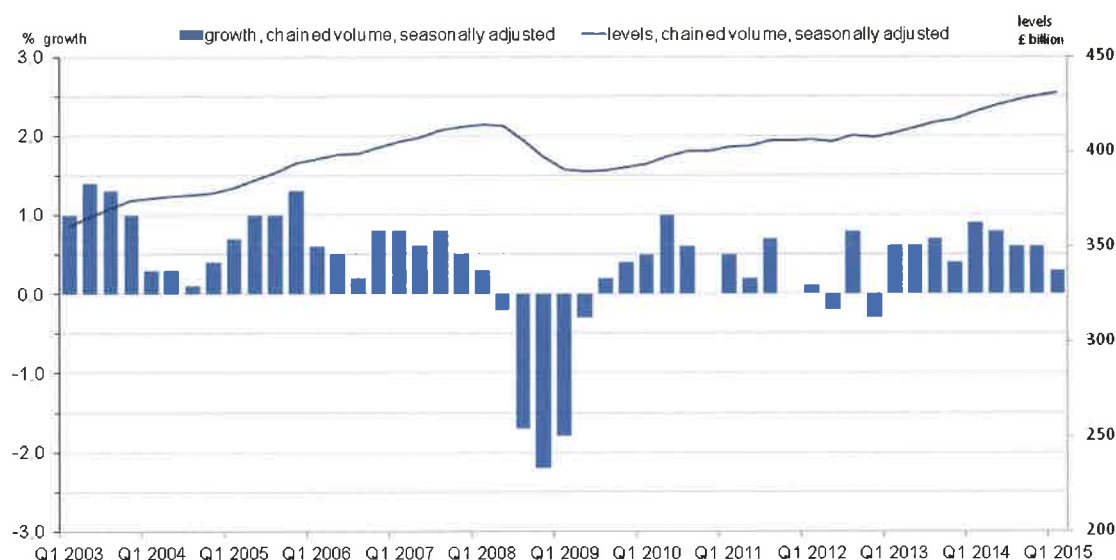
2.1.34. In the run up to the financial crisis, RBS had become the largest lender in the UK SME sector. The Large Report described the circumstances as follows:

“pre-crisis growth in the SME market was fuelled by lending to the Commercial Real Estate sector, as well as to businesses utilising real estate collateral to support speculative and other trading activities. RBS built a large share in the SME market, primarily through real estate lending of both types, often relying on rising asset prices to support lending applications rather than analysing the quality of the customer’s business and its suitability for bank finance. This resulted in Relationship Managers (RMs) relying too heavily on asset values instead of cashflow analysis in order to make lending assessments. It also raised customer expectations to unsustainable levels, as prices were too low and lending standards too lax.”²⁴

2.1.35. The history of the financial crisis is well documented elsewhere. During 2007 there were increasing signs of deteriorating liquidity conditions across the banking system. In September that year Northern Rock received liquidity support from the Bank of England. A year later Lehman Brothers collapsed. In October 2008 RBS received Emergency Liquidity Assistance from the Bank of England.

2.1.36. From late 2008 onwards, the developing banking crisis was increasingly reflected across the economy. The UK experienced a deep recession with significant falls in GDP and household income. In addition, property prices declined significantly in many areas of the country. The following chart shows UK growth and GDP levels across the Relevant Period. There was a sharp and sustained downturn in economic output in the latter half of 2008 and early in 2009.

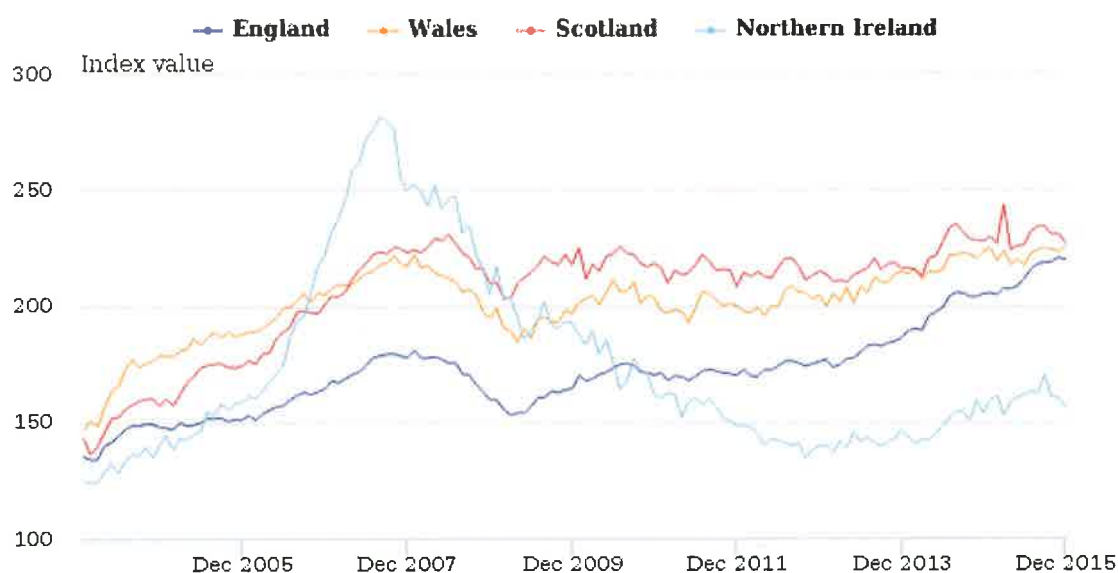
²⁴ Large Report, page 29

Fig. 4: UK quarterly growth and levels of GDP²⁵

2.1.37. The following chart shows the UK House Price Index across the Relevant Period. It shows a significant decline in house prices in the UK during 2008, with a slow and uncertain recovery in prices over the remainder of the Relevant Period.

Fig. 5: Mix-adjusted house price index by UK countries (January 2004 to December 2015)²⁶

Index values February 2002=100

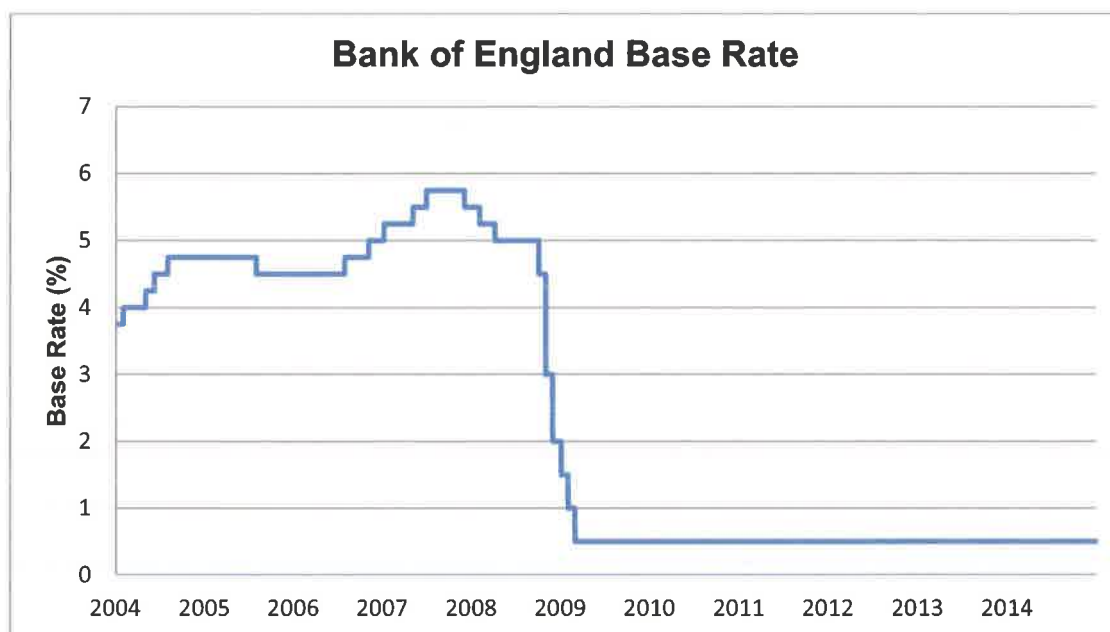


²⁵ Office for National Statistics, Statistical Bulletin: Second Estimate of GDP: Quarter 1 (Jan to Mar) 2015

²⁶ Source: Office for National Statistics, Statistical Bulletin, House Price Index, December 2015. Not seasonally adjusted. Data collected via the Regulated Mortgage Survey.

2.1.38. Liquidity in the banking sector remained under pressure throughout the Relevant Period, which also saw an unprecedented sustained period of low interest rates, with the base rate falling to 0.5% in March 2009 and remaining at that level for the remainder of the Relevant Period.

Fig. 6: Bank of England base rates²⁷



2.1.39. These issues, and the wider financial crisis, brought significant and extensively reported challenges for RBS. We do not recount here all of the issues that RBS faced, but they are important background to our review.

2.1.40. The Relevant Period was also a particularly difficult one for many SME customers. As noted above, economic output fell; asset values also fell, often sharply, and some asset classes were, at least for a time during the Relevant Period, difficult to value. For the customers involved with GRG, these circumstances were often threatening. Businesses that the owners had often made considerable investments in – in terms of both money and time – were subject to unprecedented stress and disruption.

2.1.41. In these circumstances, RBS faced an acute challenge of dealing with large numbers of non-performing loans across its portfolio, including in relation to its SME customers. The Large Report noted: *"The excessive lending was rapidly manifested by a sharp increase in non-performing loans after the financial crisis in 2008, particularly in the Commercial Real Estate sector."*²⁸

2.1.42. The longer term financial impacts of the crisis had two marked effects of relevance to our review:

- First, they resulted in a rapid and significant number of referrals to GRG; and

²⁷ Source: Bank of England

²⁸ Large Report, page 29

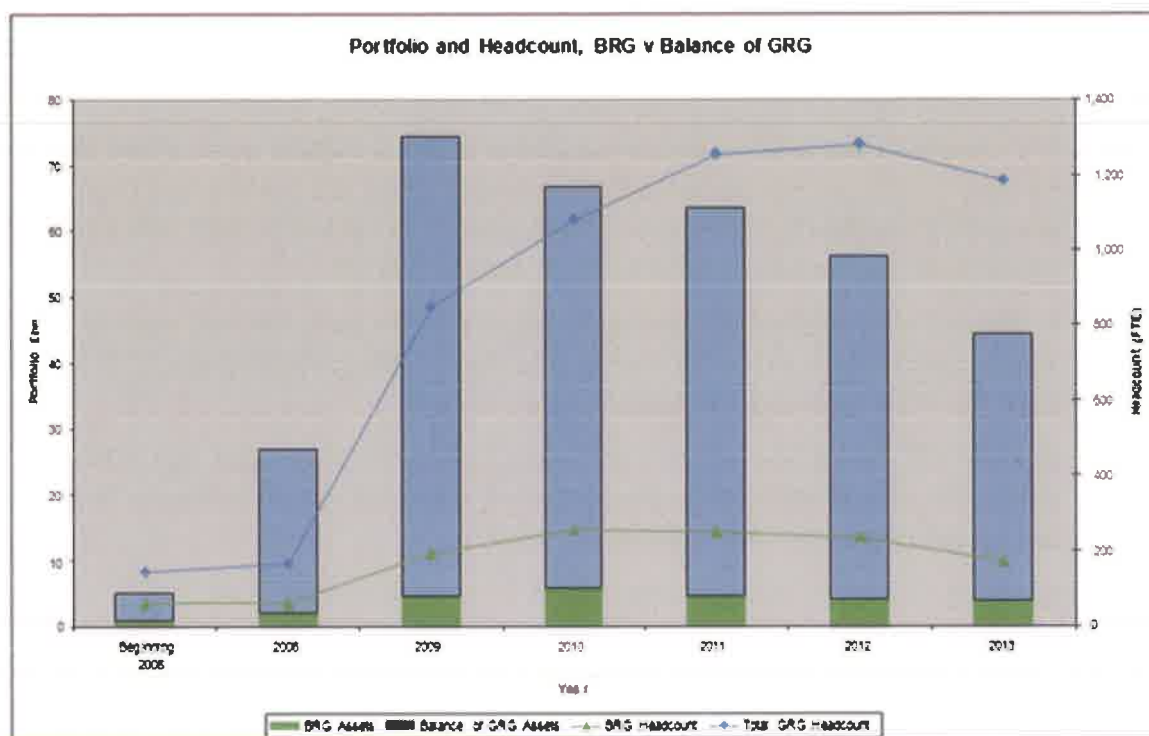
- Second, they provided a challenging ongoing background for the finances of many SME customers and the Bank itself. In particular, the Bank's appetite for lending to many sectors – including many relevant to SME customers – was dramatically reduced.
- 2.1.43. It is relevant to note that the decision was taken by RBS in 2009 to create a Non-Core Division. In 2011, this included some £13.5bn for BRG customers. The Non-Core Division was given a mandate to run-down or exit these assets by the end of 2013, with assets either repaid, refinanced with other banks, or debts written off.
- 2.1.44. In addition, as a condition of Government support for the Bank, RBS was required to comply with the terms of the APS from its inception in 2009 until RBS left it in 2012. We cover the APS in more detail in Chapter 4.2 (Turnaround).
- 2.1.45. Much of this picture was reflected across the banking sector, a factor that made it difficult for many of RBS's SME customers to find alternative sources of finance. But in some respects RBS was more impacted than most.

Impact on GRG

- 2.1.46. Prior to 2008, GRG had been a relatively small and specialist unit of the Bank. By any measure the growth it experienced – particularly in the period 2008-2011 – was both significant and challenging.
- 2.1.47. GRG's assets under management increased some ten-fold during the Relevant Period to peak at nearly £80bn. In 2008 GRG had fewer than 200 full-time equivalent employees, but would have over 1,200 at peak. The increase for those dealing with SME customers however, whilst still significant, was less marked. In BRG, the business area of GRG that primarily dealt with distressed SME customers in Great Britain²⁹, staffing rose from around 100 in 2008, to a peak of 258 FTE in July 2011, whilst SME referrals increased from 738 in 2008 to 1,497 in 2009³⁰ – but the following two years showed no further growth.

²⁹ Except where significant in the context of the issue we do not distinguish in this report between GRG and its sub-division BRG.

³⁰ Our calculations from RBS data

Fig. 7: Portfolio and headcount, BRG versus balance of GRG³¹

- 2.1.48. As can be seen, the SME customers of BRG were a small part of the GRG portfolio – representing 8% of GRG's total portfolio by value and 35% by volume over the period 2008 to 2013. Even once adjustment is made to take account of the separate handling of SME cases in Northern Ireland³², the significance of the UK SME population in GRG's overall portfolio was modest.
- 2.1.49. Unsurprisingly, we saw a GRG management focus in GRG on large and often international restructuring exercises, and that focus was reflected in the ethos of GRG and many of its documented policies.
- 2.1.50. As will become apparent, GRG lacked the systems and governance required to deal with the scale and pace of the expansion it experienced as it attempted to deal with the unprecedented numbers of SME customers who were referred to it during the Relevant Period.

SME customers transferred to GRG

- 2.1.51. In Part 4 (Activities of GRG) we describe the process of transfer and RBS's policies and practices governing that process. In this section, we set out briefly the types of customers that GRG was called upon to handle.

³¹ Source: RBS

³² The arrangements in Northern Ireland were in a number of respects different. Where relevant we draw out those differences by specific reference to Northern Ireland, but for simplicity unless otherwise indicated where we discuss approaches or cases we mean across the UK.

2.1.52. In total, GRG received 5,900 SME³³ customer cases over the Relevant Period. Each case might contain a single entity or be part of a wider 'connection' containing a number of different, albeit related, business entities. The nature of these SME customers referred to GRG varied widely – reflecting the heterogeneous nature of the SME sector itself. The Bank recorded the 'primary industry sector' for each connection as summarised in the chart below. As can be seen, the majority of SME customers were commercial real estate businesses, but there was a wide range of SME activities involved.

Fig. 8: Transfer to GRG by customer business types³⁴

Sector	Number of Customers	% of total transferred
Commercial Real Estate	3,196	54.2%
Leisure	414	7.0%
Retail	341	5.8%
Health	291	4.9%
Construction	280	4.7%
Industrials	185	3.1%
Automotive	154	2.6%
Building Materials	102	1.7%
Professional Services	94	1.6%
Agriculture	88	1.5%
All other sectors	755	12.8%
Total	5,900	100%

2.1.53. The customers also varied significantly in size within the SME category. As an indication, RBS's data suggests that around a quarter had a debt, with RBS, of under £1m, whilst in the cases in our sample the median level of debt to RBS was c. £1.7m, although cases range across the spectrum from £250k to £20m.

2.1.54. The nature of the SME businesses referred to GRG also varied widely. Some businesses were significant employers, with highly professional and experienced management teams or were subsidiaries of larger enterprises. Others were family businesses or sole

³³ As defined in the Requirement Notice.

³⁴ Source: RBS

traders or partnerships, with little business experience outside their own trade or profession and no professional in-house financial support.

Regulatory requirements

2.1.55. Finally in this Chapter we summarise relevant regulatory background, and the relevant industry standards as they applied during the Relevant Period to GRG and its SME customers.

2.1.56. The FCA describes the general position in respect of regulation and SMEs as follows:

“Whether or not the provision of financial services to an SME client is regulated under FSMA (and thus whether the provider of the service needs to be authorised) depends on whether the financial services firm is carrying on a regulated activity by way of business in the UK, as set out in the RAO [the Regulated Activities Order]. Whether this is the case depends in part on the services provided: for example, whether the SME client is seeking to operate a current account, borrow, insure or invest.

Although many financial services provided to SMEs are within this regulatory perimeter, lending to SMEs for business purposes is mostly outside the regulatory perimeter. For example, unsecured lending to an SME borrower for the purposes of their business will only be regulated if the SME is unincorporated and the amount being borrowed is £25,000 or less; mortgage lending for the purposes of a business will only be regulated if (among other things) the borrower is an individual or a trustee.

In general, the boundaries of the regulatory perimeter are determined by FSMA and various pieces of secondary legislation, primarily the RAO, and also EU law. They can therefore be changed by HM Treasury and Parliament and, where applicable, by EU legislation, but we cannot alter the regulatory perimeter by changing our rules.

In addition to our regulatory functions, since 1 April 2015 we have had powers to enforce against breaches of competition law under the Competition Act 1998 and conduct market studies under the Enterprise Act 2002. Our concurrent competition powers are not limited by reference to the regulatory perimeter and instead can be applied in relation to the provision of ‘financial services’. This term is not defined in legislation, but in our view this includes any service of a financial nature such as banking, credit, insurance or investments.”³⁵

2.1.57. The overall picture is that, in large part, the issues that this report considers fell outside (and continue to fall outside) statutory regulation. Unsecured lending to SMEs is an activity that almost entirely falls outside FCA regulation³⁶ and the exceptions are not relevant to the scope of our work. Similarly, regulated secured lending was not a feature of the SME relationships we considered.

³⁵ FCA: Our approach to SMEs as users of financial services Discussion Paper DP15/7 November 2015 [footnotes excluded]

³⁶ Unless the SME is unincorporated and the amount borrowed is £25,000 or less but this is not a feature in the review sample.

- 2.1.58. There were in practice only two FCA³⁷ regulatory requirements that we have had to bear in mind. The first concerns complaints handling rules in respect of micro-enterprise customers and the second, under Principle 11 of the FCA's Principles for Businesses, relates to a firm's relations with the regulator.³⁸
- 2.1.59. The complaints handling requirements are set out in the FCA's Dispute Resolution sourcebook ("DISP") and apply, in the context of SMEs, to micro-enterprises. Micro-enterprises are "*any person engaged in economic activity*" (including the self-employed and partnerships) that at the time the complaint is made:
- Employ fewer than 10 persons; and
 - Have a turnover or annual balance sheet that does not exceed €2 million.^{39,40}
- 2.1.60. The rules that apply to a firm under DISP are described more fully in Chapter 4.7 (Complaints) but cover the fair handling of complaints by the firm, requirements to provide the FCA with information, requirements to consider the root causes of complaints, and requirements around timescales for complaint handling. The rules also provide for customers to refer complaints in certain circumstances to the Financial Ombudsman Service ("FOS").
- 2.1.61. Certain protections for SME customers are also provided under self-regulatory codes, in particular the Lending Code⁴¹. The 2009 Lending Code incorporated the British Bankers Association "*Statement of Principles: Banks and micro-enterprises – working together*" (together referred to here as "the Code" or "the Lending Code") and subsequent editions (from March 2011) combined the principles into the body of the Lending Code. The Lending Code covered micro-enterprises (and retail consumers) and provided various commitments on the part of subscribers to the Lending Code to "*act fairly and reasonably in all their dealings with customers*", to "*lend money responsibly*" and to "*deal quickly and sympathetically with things that go wrong and act sympathetically and positively when considering a customer's financial difficulties*"⁴².

³⁷ For the purposes of this report we do not distinguish between the FCA and its predecessor the Financial Services Authority ("FSA") unless we are reporting specific actions by the relevant regulator at the time. Hence FCA rules should be taken to mean the applicable FSA rules prior to April 2013

³⁸ FCA Handbook: Principles for Business: [PRIN2.1.1R] Principle 11 requires that "*a firm must deal with its regulators in an open and cooperative way, and must disclose to the appropriate regulator appropriately anything relating to the firm of which that regulator would reasonably expect notice*"

³⁹ FCA Handbook Dispute Resolution Complaints: DISP 2.7.3R note also article 4(26) of the *Payment Services Directive* and the Annex to the *Micro-enterprise Recommendation*

⁴⁰ Prior to November 2009 the relevant definition of small business was expressed as a limit of £1m turnover (with no specified limit on number of employees)

⁴¹ Lending Code Standards Board, The Lending Code 2009 (and its subsequent amendments) replaced aspects of the previous Banking Code.

⁴² Taken from the 2009 Lending Code

2.2 – About our investigation

2.2.1. This Chapter provides an overview of:

- The way we have interpreted the key considerations in the Requirement Notice, and in particular how we have defined what actions by RBS should be considered to be inappropriate for the purposes of our review;
- Our approach to considering the evidence available to us;
- The methodology we have adopted to undertake this review; and
- The work that we have carried out.

Our Approach

2.2.2. This section sets out the approach we took to our work; starting with the criteria we applied to determining whether or not GRG's treatment of SME customers was inappropriate.

The criteria we have applied

2.2.3. Central to the judgments we are asked to make is the question of what was and was not 'inappropriate' in the context of handling distressed SME customers during the Relevant Period. One feature that makes this review unusual is that, as noted in the previous Chapter, regulatory standards are largely absent in relation to the conduct expected of RBS. This required us to consider the basis upon which we would assess fair treatment and inappropriate actions.

2.2.4. For the purposes of our review we considered actions or failures to act as inappropriate if:

- They were in contradiction of applicable legal or regulatory rules or regulations, recognising that much, but not all, of GRG SME activity was not subject to particular rules or regulations; or
- They were contrary to the expressed policies of either RBS as a whole, or of GRG specific policies within RBS; or
- We judged that, although no RBS or GRG policy was breached and no relevant rule or regulation was applicable, the treatment or practice was nonetheless inappropriate – i.e. we judged that, having regard to the circumstances, the treatment was not fair and reasonable. In considering what was fair and reasonable we have taken account of the circumstances of the time – for both SME customers and RBS.

2.2.5. We note, as did Dr Tomlinson, that not every business passing into GRG was capable of help; many before they were transferred were insolvent (in both a legal and practical sense) and lacked viability. Whilst Administration in these cases may have been against the wishes of the owners of the SME, it was not inherently unfair or unreasonable for RBS to pursue Administration and seek to recover sums owing to it.

2.2.6. For those entering GRG at a time when they were still viable, it appeared to us that the legal position was generally clear. Most were in breach of their facility, or other,

agreements. As a result, RBS had significant contractual rights to recover sums owing. Contracts setting out the terms of the loans reserved wide discretions to RBS, discretions that are not uncommon in documentation of this kind where lenders understandably seek to ensure that their position is adequately protected in consideration for the granting of the loan. In addition, RBS was afforded a wide discretion whether to enforce a contract for breach of one or more of its terms or to use the event giving rise to that right as a lever to seek to renegotiate the terms and pricing as a condition of continued support.

- 2.2.7. However, in the context of SME lending, such discretions should be exercised in good faith, and in a way that is both transparent and fair and reasonable in the circumstances of each case. In our view, RBS itself accepted that position; it told us that the fair treatment of customers was part of the GRG *“ethos...from its inception.”* RBS also told us that:

“The customer experience was a key consideration throughout the relevant period. The fair treatment of customers has always been a central tenet of the GRG mandate and...is reflected in formal training and informal communications throughout (and prior to) the Relevant Period.”

And:

“Training courses placed great emphasis on understanding the business needs of a customer and being empathetic to their situation, in order to achieve business solutions, and not just banking solutions, for the benefit of the customer and the Bank.”

- 2.2.8. The majority of the assessments we have made in this report are not based on any legal or regulatory requirements – but rather on an independent assessment of what was fair and reasonable in the circumstances of the individual cases, and in the context of GRG's stated policies and objectives.

- 2.2.9. Whilst those judgments were inherently case specific, some common themes emerged. Generally, we looked in each case to see whether RBS had sought to:

- Understand and take into consideration the customer's position;
- Communicate fairly and openly its position, the steps RBS expected the customer to take and their consequences. This matters in the often charged circumstances of a SME customer being transferred to GRG. In this context clear explanations about pricing, valuation decisions and turnaround options assume particular importance;
- Give reasonable notice, wherever possible, of its intention to make significant changes to facilities, such that the customer had a reasonable prospect of making alternative arrangements. We concluded that the simple act of withdrawing (or not renewing) facilities or asking the customer to make alternative banking arrangements was not of itself inappropriate, but we expected to see RBS exercise its right to withdraw such facilities with care and with an eye to the impact this would have on the customer;

- Take due account of the differing needs of the SME businesses with which it dealt. The nature of the businesses for which GRG assumed responsibility varied considerably, from those businesses large enough to employ a professional finance director and with a greater ability to afford legal advice, at the upper end of the spectrum, to (at the lower end) the less sophisticated customer whose knowledge of business affairs (outside of their own field of expertise) was more limited. It was not in our judgment appropriate to approach customers without making due allowance for their individual circumstances; and
 - Deal with customer concerns and complaints carefully. This was of particular relevance for those whose business was outside of the definition of a micro-enterprise where there was no recourse to the Financial Ombudsman Service.
- 2.2.10. In making judgments about behaviours in individual cases we also took into account the relative of bargaining power for most SMEs (exacerbated throughout much of the Relevant Period by abnormal market conditions in which obtaining finance from other sources was very often not a realistic option), their degree of sophistication, and their relative lack of experience in dealing with often complex legal agreements and financial arrangements. We did so against a background where the SME market is subject to few regulatory rules affecting issues of conduct and where such legal protections as those afforded by the Unfair Terms in Consumer Contracts Regulations (1999)⁴³ to consumers are largely absent.
- 2.2.11. In the context of individual cases in our sample we also took careful account of the actions of the customer. In a few cases we observed customers who appeared not to have acted in a transparent and straightforward way in their dealings with RBS, and we noted in one or two cases that there were serious questions about whether the customer was being fully honest with RBS. In such cases, we recognised that it was not unreasonable for RBS to take steps that might not have been judged as appropriate in other circumstances.
- 2.2.12. The same general considerations applied to our analysis of the governance and oversight arrangements in place to ensure that the interests of customers were adequately and appropriately safeguarded.
- 2.2.13. In reaching a view about whether RBS had acted inappropriately, we have judged RBS by reference to the conduct and not its consequence. Thus, we regard inappropriate treatment to occur independently from the creation of customer detriment. In other words, we do not consider that detriment must occur for an action (or lack of action) to be considered to be inappropriate.
- 2.2.14. An example will illustrate the point. It was Bank policy that the customer should be informed in certain terms before they were transferred to GRG. We considered it to be an inappropriate action whenever RBS failed to follow its policy (and indeed in certain other cases where we considered that the exclusion of certain customers from this general policy was not fair and reasonable). We did not restrict our findings about this

⁴³ These regulations have now been repealed and have been replaced with the Consumer Rights Act 2015.

to those cases where it appeared to us that the failure to provide information in advance of transfer had given rise to customer detriment. Consequently, a finding that there was an inappropriate action should not be taken to indicate any conclusion about any impact of that inappropriate action on the customer. We considered the general question of whether the actions of RBS overall had caused financial distress to a customer as part of our distress assessment process which is described in more detail in Part 6 (Customer outcomes).

Our work

2.2.15. To ensure that we had a complete assessment of the position covered by the scope of Phase One, the Requirement Notice envisaged two main areas of focus for our evidence gathering:

- A review of policies and procedures; and
- A review of a sample of cases.

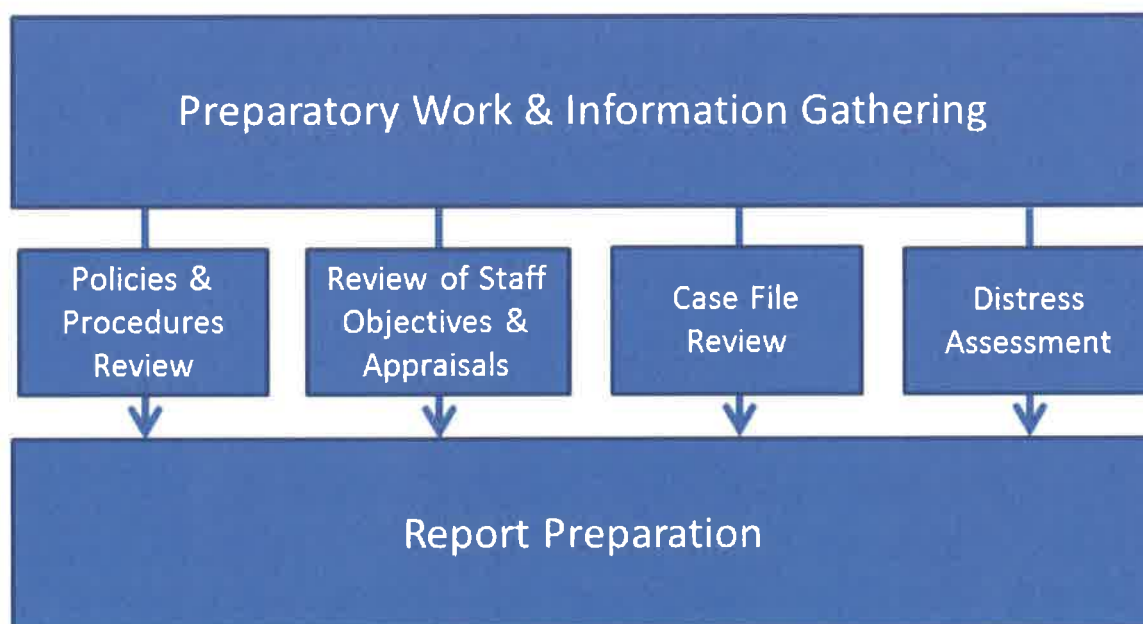
2.2.16. With the agreement of the FCA we supplemented these with

- A limited review of staff objectives; and
- An assessment of financial distress for each of the GRG cases in our sample.

2.2.17. Finally, we drew these themes together in order to produce the overall assessments set out in this report.

2.2.18. A schematic of our work plan is set out in the following chart.

Fig. 9: Schematic of the work we have carried out



2.2.19. At the outset of our work, to help us with the context for this review, we met Dr Tomlinson and Sir Andrew Large. We also met with a number of other parties who seemed to us would have evidence or context that would assist us. In addition, we spoke with a range of third-party firms who supplied services to RBS during the

Relevant Period (including firms who undertook business reviews, firms with valuation expertise, law firms, and insolvency practitioners). Wherever possible, we interviewed the customers covered in the cases we reviewed.

- 2.2.20. We are grateful to all those individuals and organisations, the staff and management of RBS, and to the many SME customers we spoke to in producing this report.
- 2.2.21. Our review covered a six-year period of GRG's operations. During that period GRG handled 5,900 SME cases, and its personnel and to some extent systems evolved – in some cases significantly. It has been a major exercise to ensure that we have available to us all the relevant information. Given the length of time since some of the events, and the poor nature of some of GRG's record-keeping, this proved to be a major challenge in its own right.

Policies and procedures review

- 2.2.22. The objective of our Policies and Procedures Review was to form a view on the appropriateness and reasonableness of RBS's policies and procedures in relation to GRG across the Relevant Period, as required by the Notice. But as our work developed it became clear that the answers did not lie in the policies alone. We also reviewed various other relevant documentation (e.g. agendas, papers and minutes for committee meetings), which helped us to assess how policies and procedures were implemented and monitored.
- 2.2.23. The information that we have considered includes (but is not restricted to):
- Policies and procedure manuals;
 - Guidance documents;
 - Minutes and agendas for various boards and committees within GRG;
 - Management information that was produced;
 - Staff training materials;
 - Material relevant to the structure and governance of GRG;
 - Compliance and audit reports;
 - Customer satisfaction surveys;
 - Staff appraisals and material related to reward and incentive structures within GRG;
 - Aides memoire; and
 - Credit reports.
- 2.2.24. At an early stage of our review, in March 2014, we suggested that RBS set out, in narrative form, the history of GRG, the development of its policies and governance arrangements across the Relevant Period and to use the narrative to answer a number of questions that we had raised. That narrative was supplied by RBS in August 2014 together with extensive appendices which supplemented information that had already been provided to us.

- 2.2.25. Throughout the course of the review we submitted several information requests to RBS for additional material as our understanding of the overall picture developed. In response to these requests RBS has provided hundreds of documents, all of which have been reviewed.
- 2.2.26. To help us understand how the various policies were applied in practice, and the underlying reasons for the introduction or change of a policy or procedure, we interviewed a number of senior staff from various areas of GRG.

Review of staff objectives and appraisals

- 2.2.27. During our review we agreed with the FCA that we would carry out a limited review of the objectives and appraisals of staff in GRG. This followed the release of various emails suggesting an undue focus by management on fee generation early in the Relevant Period, and various references to individual objectives and targets that we came across in the case reviews. This work is reported in more detail in Chapter 3.3 (Staff objectives).

Sample case review

- 2.2.28. Given the central focus of our review related to how customers were treated, we have undertaken a thorough and detailed review of a sample of cases that passed into GRG during the Relevant Period. We have sought to understand how GRG policies and procedures were applied in practice and to consider whether, in the light of the individual circumstances of each case, the actions of RBS were appropriate.
- 2.2.29. In summary, the sample case reviews required the development of a sampling approach through which we selected an overall sample of 207 cases that are discussed in this report. In each of these cases we sought full information from RBS and attempted to contact the customer also to seek their input into our review. Our team reviewed the case information, and where possible met the relevant RBS staff, and also the customer, to ensure the information and the context of the case were fully explored.
- 2.2.30. From that work we drew out a description of the key events in the case – typically in the form of a 'customer journey' document – and set out our key findings around the primary themes in the Requirement Notice. The purpose of the findings on each case was limited to matters that appeared to us likely to be relevant to our review and where it appeared to us RBS had acted inappropriately. We did not set out to assess the legal rights of the parties or to measure customer detriment.
- 2.2.31. RBS agreed with the FCA, at the beginning of the review, that the Bank would have an opportunity to challenge the factual accuracy of our summaries and findings. We therefore provided the 'customer journey' document to RBS and, where we saw evidence for their factual corrections, we made amendments as appropriate (see Confirming Our Findings section below).
- 2.2.32. Given the significance of this work to our review, we set out in the following sections some further detail about how this work was undertaken and the challenges we faced in ensuring we had sufficiently accurate and complete information upon which to base our case reviews.

The file sample

- 2.2.33. We identified the sample of cases with care to ensure that we had observed a reasonable cross section of the SME customers that were referred to GRG during the Relevant Period. We drew our sample from the full population of SME cases provided by RBS. This included all cases classified as managed by GRG in Great Britain and Northern Ireland in the Relevant Period which satisfied the definition of an SME, as set out in the Requirement Notice.
- 2.2.34. Our core sample case review involved:
- A statistically representative sample of cases that satisfied the definition of an SME. A total of 178 cases were reviewed under this category (the Representative Sample); and
 - An additional sample of 29 cases from those customers who had contacted Dr Tomlinson, both before and after the publication of his report (the Tomlinson Cases).
- 2.2.35. In Annex V, we provide greater technical detail on how the cases were selected. We are satisfied that the cases we have reviewed have been sufficient for us to examine all of the areas to which we are directed by the Requirement Notice and that, taken in the round, they represent a reasonable cross sample of the cases passing into GRG during the Relevant Period.

Case information from RBS

- 2.2.36. The starting point of each of our case reviews was to request the relevant information from RBS. Answering such requests proved to be a major challenge and a major contributor to the length of time it has taken us to complete our review. It rapidly emerged that the Bank did not retain a single physical customer file and that the information we required was in practice spread across several electronic and manual systems and archives in certain instances. That had a significant impact on our work because we were dependent on the Bank producing a file from a number of sources. This included extracting information from emails using key words (the 'scrape' process). The net for this was cast widely to ensure that all relevant material was gathered but it then required sifting to identify the information relevant to our case (and not for example information dealing with other cases or customers).
- 2.2.37. Given the way information was organised within RBS, it was difficult for the Bank to ensure that it had provided every piece of information, in respect of a case, that would have been available at the time (i.e. during the Relevant Period).
- 2.2.38. It became clear that the scraping and sifting process did not always provide us with a complete picture. In around three quarters of the cases in our sample at least some further information emerged later in the process. This happened for a number of reasons including:
- We requested a further interrogation of the email system against criteria that came to light during the course of our initial review;

- In our meetings with Relationship Managers we raised issues where there were gaps evident from the file provided by the Bank or where the customer had referred to details that were absent from the file provided to us;
- Additional generic sources of emails were uncovered during our investigation (e.g. an inbox maintained by West Register but not disclosed to us until late in 2015);
- As a result of our queries or the audits we conducted;
- When we interviewed the customer additional material was sometimes given to us that had not previously been provided by the Bank; and
- In responding to our initial findings the Bank itself identified additional material that was relevant to our review.

2.2.39. We were still receiving additional information as late as March 2016. We found this situation to be unsatisfactory both from the point of view of our review and from the very practical perspective that on a change of GRG Relationship Manager there was no definitive file from which a new manager could gain a clear view of the dealings over time in relation to that customer.

2.2.40. Our review considered the actions of the Bank, in respect of customers, often over an extended period of time. As such, the amount of material for each case, once it had been collated, was substantial. The average case file comprised around 10 large Lever Arch folders of documentation. Some of the more substantive cases contained over 60 Lever Arch folders of material. So even most of the smaller cases (by volume of material) contained thousands of pages of documentation. This documentation was often not well ordered when it came to us. These factors meant that undertaking a review of each file was a significant exercise in itself.

2.2.41. The recorded material in emails, letters and file notes at the time inevitably only formed a part of the overall picture. For example, meetings and telephone calls were not routinely recorded, nor were attendance notes always made by either the Bank or the customer. To endeavour to understand the events we were reviewing we interviewed the Relationship Managers and other RBS staff involved in handling the case. In several cases the relevant staff were no longer employed by the Bank and were not available. Many others had been redeployed, but in total we were able to speak to relevant RBS staff in respect of 169 of the cases we reviewed.

2.2.42. In Annex V, we explain some of the steps we took in relation to the reliability of the information provided.

2.2.43. We comment in the Introduction generally about the inherent complexity of the issues that we were investigating, and our concerns about the degree of delayed and incomplete information that emerged during the course of our investigation. We also noted the further steps we had asked RBS to take to provide assurance on the completeness of the information we were able to obtain.

2.2.44. Inevitably, we cannot be certain that we have seen every piece of contemporaneous documentation that existed in relation to each and every case that we reviewed, but on

the basis of the evidence available to us we do not believe that it is likely that any remaining gaps are material and systematic in nature. Overall, we are therefore on balance satisfied that the measures we took give us a reasonable level of confidence that the information eventually available to us provided a reasonable basis upon which we could reach our conclusions.

Case information from customers

- 2.2.45. Customer feedback was a valuable part of the review. We actively sought to contact customers to encourage them to talk to us about their cases and endeavoured to address any concerns they may have had about doing so. Customer meetings focused on exploring the customer's experience including their interaction with GRG. We made it clear to customers that we were not acting as arbiters in any dispute they may have with the Bank. During the course of our review, we spoke with customers in relation to 108 of the cases we reviewed.
- 2.2.46. Many customers we contacted remained under the management of GRG, or had continued as customers of RBS. Many were keen that their observations were not relayed to RBS and we respected their wish for anonymity. We also agreed with Dr Tomlinson that we would not identify to RBS those customers that had contacted him and formed part of our sample.
- 2.2.47. Accordingly, to protect the identity of customers, we normally do not identify separately the results for the "Tomlinson" and "non-Tomlinson" (i.e. the Representative Sample) cohorts of our sample, but record the results for the overall sample of 207 cases. Where it is important to do so, we draw attention to any differences between the Tomlinson Cases and the Representative Sample. The only area where we saw any material difference was in relation to our assessment of material financial distress (see Chapter 6.2 (Distress assessment)). The case studies we have included throughout this report may have been based on either Tomlinson Cases or cases taken from the Representative Sample.

How we assessed the evidence available to us

- 2.2.48. We were conscious that, in respect of both RBS staff and customers, recollections might now be coloured by the publicity surrounding these issues and after several years recollections would have faded. Nevertheless, the opportunity to meet and ask questions of the people directly involved in the issues we were reviewing was of value. The need to protect the anonymity of many customers meant that we could not always share directly with RBS their observations. Whether information came from RBS, or the customer, our general approach was to place less weight on material that we could not disclose to both parties unless we were able to validate it against third party or other contemporaneous evidence. It follows that in reaching our initial conclusions in each case we needed to undertake a careful balancing exercise.
- 2.2.49. Unchallenged contemporaneous documentation was generally the most concrete evidence and we have relied on it wherever possible. In some areas, the Bank's own policy required the production of such evidence, particularly in connection with the transfer from mainstream to GRG, although in many cases we found that the Bank did

not follow that policy. Accordingly, information that should have been provided to the customer in writing cannot be found. In such cases we have considered what both the Bank and, where we saw them, the customer had to say and drew inferences having regard to all of the circumstances.

- 2.2.50. In some cases, the Bank has criticised us for concluding that it is more probable than not that the customer's recollection is more reliable. We do not accept that criticism; each case was approached with an open mind and we paid due regard to how the parties conducted themselves at the time when reaching our view as to which recollection appeared to us to be the more reliable. In some cases we found the Bank to be more reliable; in others the customer.

Confirming our findings

- 2.2.51. As agreed between the FCA and the Bank, as we completed our initial review we made available our individual case findings to RBS (but not to the customer). RBS was then afforded an opportunity to respond to and correct points of factual accuracy. We reviewed our case assessments based on any factual corrections provided by RBS, and made any such changes as we considered were appropriate.
- 2.2.52. It has been a feature of this exercise that, in responding, the Bank has disputed most of our initial findings and accepted very few of them. In doing so, the Bank adopted a broad interpretation of what amounted to a point of "factual accuracy"; it was clear that in most cases it was not agreeing with the conclusions that we had reached. The points raised by the Bank were often detailed in nature and each required us to revisit the case material we had collected and undertake a further review to ascertain whether the Bank had raised issues that, as matters of factual accuracy, required an amendment to our finding. In some cases, the Bank disclosed material that had not been part of the file initially disclosed to us. These factors were also major contributors to the length of time it has taken us to complete our review.
- 2.2.53. At the end of the process we brought together our initial case file conclusions. In considering the treatment of SME customers that we judged to be inappropriate and having regard to the issues raised in Annex D of the Requirement Notice, we identified instances of inappropriate treatment on the part of RBS and GRG in 86% of the 207 cases we reviewed. These findings set out our conclusions based around broad thematic areas reflecting the Requirement Notice themes and the allegations raised about GRG. However, we based the findings on what we saw in the circumstances of each case – so a finding did not necessarily directly relate to the specific terms of an allegation or paragraph of the Notice. Rather, they highlighted areas of practice in the individual case that we judged to be inappropriate. We set out in Annex III a high level summary of the findings we made. We report these in the following Chapters as we describe in more detail the issues we observed.

Distress assessment

- 2.2.54. Once the initial review of individual cases had been completed, each case was considered as part of our assessment of financial distress. This is covered in more detail in Chapter 6.2 (Distress assessment).

- 2.2.55. We developed a methodology against which we assessed each of the cases in our sample. This methodology was agreed with the FCA, and was primarily designed to inform paragraph 4.2.2(3) of the Notice. A Distress Assessment Panel (“DAP” or “Panel”), which consisted of our senior staff from within the team, then reviewed each case in accordance with this methodology.
- 2.2.56. Each case was placed into one of four groups. Those groups were as follows:
- Group 1 – Business clearly not viable;
 - Group 2 – No inappropriate actions identified;
 - Group 3 – Inappropriate actions not likely to result in material distress; and
 - Group 4 – Inappropriate actions likely resulted in material distress.
- 2.2.57. As agreed between the FCA and RBS, the Bank was then provided with a further opportunity to comment on whether there were any factual errors in the material we had used to form our judgment. RBS decided that it would only provide observations on those cases that we considered fell within Group 4 – material financial distress – although it did raise some general comments about our approach. In each case it raised points of detail, many of which were not confined to issues of factual accuracy. In one case those comments raised a point of material factual evidence that caused us to revise our initial assessment.

Draft report

- 2.2.58. We submitted a preliminary draft report, to the FCA, on 24 March 2016. A draft report was submitted, to the FCA, on 6 May 2016 and the Bank was provided an opportunity to comment on this draft report. We received extensive comments from the Bank on the draft report.

Definitions

- 2.2.59. Inevitably, in a review of this nature, we needed to reach views on and define for our purposes important terms. We set out those terms in a glossary at Annex II. Four terms had a particular significance for our review and we discuss them here.

Widespread

- 2.2.60. The Requirement Notice requires us to report on whether the inappropriate treatment we identified was ‘widespread’. However, the Requirement Notice does not define ‘widespread’. For the purposes of this review, we have adopted two considerations:
- First, that an inappropriate treatment existed, and was not confined to a particular regional office within the UK, but occurred more widely; and
 - Second that there was evidence of the inappropriate treatment occurring on a significant scale, so that treatment of a particular kind was not an uncommon experience.

Systematic

- 2.2.61. The Requirement Notice also requires us to reach a view about whether the inappropriate actions we identified were 'systematic', which it defines as "an intentional and co-ordinated strategy."
- 2.2.62. The definition of the work to be undertaken in Phase One sets some limitations on the extent to which it has been possible to test important aspects of this definition (for example, whether inappropriate treatment of customers was known about, authorised and/or sanctioned by management within RBS Group is part of the scope of work for Phase Two).
- 2.2.63. However, strategy, and the intention behind it, can be evidenced in a number of ways and is not, in our view, limited to identifying documentation that clearly sets out a particular, and intended, objective. We have reviewed a substantial volume of material. In certain circumstances the available evidence has led us to form a view that the inevitable and foreseeable consequence of a decision (whether by way of act or omission) was that some other result would ensue. We have formed the view that, by not addressing that consequence, the Bank must be taken to have intended that it should follow.
- 2.2.64. Accordingly, we have judged certain inappropriate treatment (that, in our view, were the result of policies adopted by GRG or allowed to flourish because of shortcomings in the control frameworks that GRG operated) as systematic. Where that is the case we have highlighted the evidence that we have taken into account when arriving at that conclusion.

Customers

- 2.2.65. The Requirement Notice focuses on the treatment of SME customers. For the purposes of this review, SME customers are defined as all customers who:
- 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
 - 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 £1 million and £20 million.
- 2.2.66. But 'customers' is not an expression that is further defined in the Notice. In practice the businesses transferring to GRG include a wide spectrum of structures ranging from sole traders, through to professional partnerships (some of which were limited liability partnerships) to limited companies. In the case of general partnerships and sole traders we have not normally had complete access to the wider personal circumstance of the proprietor/partner(s) (as indeed RBS did not), but recognise that the circumstances of the business and the individuals would have been closely intertwined.
- 2.2.67. In the case of limited companies most in our sample were either wholly owned by an owner manager or jointly owned with close family members or perhaps a business partner. Few had clearly independent shareholders. Accordingly, essentially the same

features arose of a close connection between personal and business finances in these cases.

- 2.2.68. In the case of a limited liability entity, RBS's contractual relationship and legal duties relate to the entity itself. But in certain circumstances RBS may also owe duties to third parties who are, for example, personal guarantors or creditors.
- 2.2.69. We have had to address the issue of whether, in making our assessments, we should be looking at the legal entity alone or the wider picture where the "customer" encompasses the individuals who owned the shares, operated the company, gave guarantees in respect of its obligations and whose main income was derived from the success of the business as conducted by the legal entity.
- 2.2.70. Throughout our review both the review team and RBS have referred to 'customer' in what might be described as a loose way, often referring to the managing director of a small limited liability company as the customer. Thus a Relationship Manager would refer to meeting with "the customer" without drawing the distinction between the individual on the one hand and the legal entity that conducted the business on the other.
- 2.2.71. When confirming the change of name from SLS to GRG in December 2008, the Head of GRG wrote as follows:
- "...it is proposed that SLS be re-named Global Restructuring Group ("GRG") which better reflects the main thrust of activities, namely rejuvenating and restoring customers to the business rather than, as sometimes perceived, simply recovery from failed customers. GRG is able to add value to customers in restructuring their businesses as well as financial restructuring." (Our emphasis)
- 2.2.72. We believe that, in the context of all the SMEs in our sample, that is the only sensible approach. It reflects how 'customers' saw the position themselves and how they were perceived by RBS. Throughout this report "customer" is referred to in this broad sense.

GRG management

- 2.2.73. In the report we use the term "GRG management" to signify those managers who might reasonably have been expected to take responsibility for the oversight and control of the processes we discuss. We did not seek to map such responsibilities in detail over the course of the Relevant Period at this stage of our work, nor did we seek to identify the actions of any individuals that contributed to the failings we identified. Identifying any individuals would require further work to map responsibilities for the various issues from time to time and to identify the specific steps taken by individuals in the light of those responsibilities. This would represent a significant additional activity, and was one that fell outside the scope of Phase One of the Requirement Notice. But in various areas we did conclude that there had been a failing of GRG management to address issues that GRG management either were aware of or, it appeared to us, should have been aware of, given the reasonably expected responsibilities and enquiries of GRG management in a well-run institution.

- 2.2.74.** For the avoidance of doubt the term “GRG management” is not the same as the group identified as specific “senior managers” in Chapter 3.3 (Staff objectives) – that is the selection of senior managers where we examined GRG appraisal documents.

Part 3 – How GRG operated

- i. In this Part we describe the objectives and strategy set for GRG, the governance and oversight arrangements it established and operated during the Relevant Period, and the objectives and appraisal arrangements it had in place for its frontline staff and managers.
- ii. These considerations are important in understanding the behaviours we have observed in our case sample and in assessing whether any inappropriate actions were likely to be widespread and/or systematic.
- iii. We conclude that the inherent conflicts in GRG's twin objectives of contributing to RBS's bottom line, whilst seeking to support distressed businesses and achieve successful turnaround, were not recognised or managed during the Relevant Period.
- iv. There were significant shortcomings in a governance framework that placed insufficient weight on aspects that might have avoided the unfair treatment of customers. These shortcomings were known about (or ought to have been known about) by GRG management but were not adequately addressed; and no meaningful steps were put in place to mitigate the risks that these shortcomings gave rise to.
- v. There were also significant shortcomings in the objectives set for staff that contributed to an environment where the interests of customers were given insufficient weight in the day-to-day conduct of GRG's activities.

3.1 – GRG objectives and strategy

3.1.1. This Chapter describes GRG's objectives and overall strategy throughout the Relevant Period and the key measures that were considered by GRG management.

The objectives of GRG

3.1.2. GRG's objectives were articulated in its mission statement:

"To be the recognised leading edge of a wider rescue culture and a major contributor to the Group's bottom line."

3.1.3. The precise formulation of GRG's objectives varied slightly in different documents across the Relevant Period, including presentations to the RBS Board, to staff and customers and more widely. But the overall message was consistent. GRG had twin objectives:

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

3.1.4. In relation to the 'turnaround objective', the Bank told us that GRG was *"deliberately independent from the frontline teams, and with a different culture, focused on turnaround rather than sales, rehabilitating customers in distress and working with the aim of returning customers to the frontline wherever possible."*

3.1.5. GRG held itself out, in its communications with customers, as being a division that would provide specialist turnaround assistance to them. For example, in Chapter 4.1 (Transfers to GRG), we refer to a pro forma letter that was to be sent to customers regarding transfer to GRG. Internal documentation also stressed the objective to return customers to the mainstream Bank. (See for example the message circulated within the Bank when the former SLS became GRG in January 2009).⁴⁴

A balance of objectives

3.1.6. We do not criticise the Bank for having a commercial objective and, in particular, for taking steps to protect its capital. But in a turnaround context, where the customer is already exhibiting financial distress, such commercial considerations need to be balanced against the need to foster an environment that is conducive to the customer's return to health where that is practicable.

3.1.7. A bank's own commercial interests and the fair treatment of customers in a turnaround unit are, however, potentially in conflict. As the Large Report identified, the interests of

⁴⁴ Quoted in paragraph 2.1.17 above

customers and the Bank can become misaligned when a customer is facing financial difficulties.⁴⁵

“At the point at which the customer’s situation causes the bank to move the SME to recovery or resolution, customer and bank interests can become misaligned. The method by which the bank seeks to protect its interests on behalf of its shareholders may then differ from the customer’s preferred course of action. A Bank will seek to minimise the loss it is exposed to, were the business ultimately to fail and be unable to repay the amount it owes.”⁴⁶

- 3.1.8. The situation in relation to RBS, during the Relevant Period, exacerbated that conflict in two ways. First, the wider economic circumstances and the ongoing challenge for many banks meant that for large numbers of SME customers there was little if any prospect of obtaining alternative banking arrangements. That was not necessarily a feature of the inherent viability of the customer’s business, but simply a function of the attractiveness to lenders of the sector they operated in. But it meant that the final protection available for customers – namely the threat or reality of taking business elsewhere – was not a protection available to very many of GRG’s SME customers.
- 3.1.9. Second, GRG was not just protecting the Bank’s ordinary commercial interest but had its own distinct objective to generate ‘contribution’ as an internal profit centre of the Bank.
- 3.1.10. The Large Report identified that the existence of a motive to generate income from customers exhibiting signs of distress may well give rise to a conflict between the two objectives that GRG set itself:

“GRG is run as an ‘internal profit centre’ with its profit and loss account based on the incremental income that it generates for the bank, less its operating costs. Yet GRG retains the ultimate authority over which customer relationships are transferred to it. In practice, decisions to transfer customers to GRG are usually initiated by the (Specialised) Relationship Manager or Credit Officer within B&C (in consultation with GRG). However, GRG officially retains the ultimate decision making authority rather than an independent body, and there are no other procedural checks and balances in place (such as a negotiated transfer price between B&C and GRG).”⁴⁷

Was GRG a profit centre?

- 3.1.11. The notion of GRG as a profit centre was raised in the Large Report. Senior RBS staff disputed that GRG had been a profit centre – specifically following questioning by the Treasury Select Committee⁴⁸ – but later accepted that the formulation used in the Large Report was materially correct.^{49,50}

⁴⁵ Large Report, page 48

⁴⁶ Large Report, page 48

⁴⁷ Large Report, page 52

⁴⁸ Treasury Select Committee: Oral Evidence SME Lending 17 June 2014 Chris Sullivan, Deputy Group Chief Executive, RBS, and Derek Sach, Head of GRG, RBS

⁴⁹ Additional Evidence submitted to Treasury Select Committee by RBS: letter from Chris Sullivan, 15 July 2014

- 3.1.12. It was clear from our review that GRG did act as a profit centre, as set out in the Large Report. In essence, a profit centre is responsible, at least in part, for generating revenue. It will deduct its running costs from that revenue and add any excess to *“the bottom line”*. Specifically GRG recorded the incremental income it earned from customers (primarily such margin and fees as it levied on the customer over and above that which had applied at transfer) and set that income against its own operating costs.
- 3.1.13. Accordingly, when a loan entered GRG, the balance sheet entry for the capital and existing income from the customer remained with the area of the Bank in which the loan was originated, usually B&C. The *“incremental income”* that was claimed by GRG, and which contributed to its own profit and loss account, was the revenue generated over and above that which was charged at the time of transfer. We note that the objective of being a *“major”* contributor to the bottom line might be argued to have placed an unrealistic objective on GRG's staff given the inherently perilous state of the businesses with which it dealt.
- 3.1.14. The various means by which such *“incremental income”* could be charged to a customer included all of the following:
- Contractual interest increases;
 - Discretionary interest increases justified as a payment commensurate with the additional risk that was being faced by the Bank;
 - Management fees;
 - Ad hoc fees (such as an exit fee); and
 - Payments subsequently received by the realisation of a PPFA or an EPA.
- 3.1.15. The following illustration demonstrates the approach GRG adopted to the calculation of incremental income.

Illustration 1 (this is not a specific case)

ABC Ltd is transferred to GRG with an outstanding loan of £100,000. The interest payable at the time of transfer is 2% over base rate. On transfer the capital and income at 2% over base remain with the mainstream Bank.

ABC Ltd has defaulted on a payment due to the Bank. On transfer to GRG the default enables the GRG Relationship Manager to review pricing. Under the terms of the contract a default can (at the Bank's option) trigger an automatic increase of an additional 1.6% over base, i.e. additional income of £1,600 per annum. The GRG Relationship Manager also takes the view that additional management fees of £3,000 per annum are justified by reason of the additional attention that the case will need. Given the additional risk that the case poses, it is subject to an additional exit fee of £4,500. GRG will claim the benefit of the additional amounts charged following

⁵⁰ Correspondence to Chairman of the Treasury Select Committee; Letter from Sir Philip Hampton Chairman of RBS, 22 August 2014

transfer, and on an ongoing basis.

GRG also required the company to enter into a PPFA for five years as a condition of continued support. This arrangement required no immediate payment by the customer but at the end of the five year period would result in an “upside” payment of £5,000. GRG would be credited with this amount at the time it was paid. It was thus also “incremental income”, in the year in which the PPFA matured.

- 3.1.16. Because some of these sums may still be payable after the customer is returned to the mainstream Bank and others may not come to be realised until after transfer back, it was important for Relationship Managers to maintain records of the amounts that they had recovered and that qualified as income for GRG. They had to do this on a system called the Relationship Manager Platform (“RMP”) system. In our work we saw many references to the need to maintain records on this system (it was, for example, built into objectives for Relationship Managers in the years 2010 and 2011 and its importance was stressed in the “*Just Hit Budget!*” document that appears in Annex IV).

The key risk to customers

- 3.1.17. There were, in our view, clear risks to customers inherent in the GRG model. Whilst the existence of a commercial objective was not inappropriate, it gave rise to inherent potential conflicts of interest and risks to customers. That risk was exacerbated by the way in which GRG was required to make a major contribution to the bottom line and was a profit centre.
- 3.1.18. Put simply, the risk was that in pursuit of its commercial objective GRG would pay insufficient regard to the interest of its customers and that customers would be treated unfairly as a result. The simple presence of this risk did not make the GRG objectives inherently inappropriate, but at a minimum it emphasised the 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.
- 3.1.19. 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 a risk of material financial distress for the business or potentially to placing an otherwise viable business on a journey towards administration, receivership and liquidation.
- 3.1.20. A central issue for our review therefore became whether, given its twin objectives, GRG did enough to successfully mitigate this key risk.

The balance between the objectives in practice

- 3.1.21. In forming a judgment on how RBS and GRG had balanced the twin objectives in practice, we looked at a substantial body of evidence. This took the form of:
- Data provided to GRG management across the Relevant Period;
 - Training material used within GRG;
 - Various policy and procedure manuals used within GRG;

- A number of ad hoc documents that touch upon the issues under consideration;
- Evidence from the sample cases that we have reviewed (which is set out in Part 4 (Activities of GRG) onwards); and
- The work undertaken on staff objectives.

3.1.22. We describe below the evidence we saw in these areas. But to get a complete picture it is necessary to also consider the rest of this report where we describe in more detail what we saw in areas like objectives for staff, turnaround practice and pricing. In this Chapter, we focus on what we saw management focus on through management information and committee work.

Management focus

- 3.1.23. A great deal of information about GRG was inevitably considered by its management over the Relevant Period. In the next Chapter we summarise, at some length, what we saw. But the overarching view we reached was that the preponderance of MI during the Relevant Period focused on the financial and operational management of the business. There was little that could be described as focusing on customer outcomes or on the success of the turnaround objective, certainly at the level of BRG.
- 3.1.24. The collection and analysis of available information is a key means by which management can monitor the performance of a business and keep under review the extent to which its aims and priorities are being met. Such information should highlight areas where success is being achieved but also identify areas where objectives are not being met or where performance against given measures needs improvement.
- 3.1.25. This MI is usually collected and collated on a regular basis (e.g. monthly or quarterly) and would be designed very much to reflect what those reviewing it regard as important. It is thus reasonable to assume that the MI that is collected and presented to GRG management reflects the priorities of GRG.
- 3.1.26. We have reviewed the MI that was produced for the GRG Board (that was renamed to become the GRG ExCo in early 2010), as well as the BRG specific MI that was produced within GRG across the Relevant Period.

GRG Board/ExCo MI

- 3.1.27. The GRG Board had overall responsibility for GRG globally. GRG produced MI packs for its Board, and subsequently the ExCo, on a quarterly basis throughout the Relevant Period. We have reviewed 15 of these packs from across all years of the Relevant Period.
- 3.1.28. Because the Board packs presented MI in relation to a whole range of GRG business units, they were typically longer than the other MI packs that we reviewed, and much of the material was not relevant to our review because it related to non-UK areas of the business.
- 3.1.29. Nonetheless, we noted that the Board packs had a greater focus on financial and portfolio considerations and metrics than on RTS or analysis of customer outcomes.

3.1.30. For example, in the Q3 2008 pack, there was substantial information on income and profit and loss metrics. The key summary information tended to focus on these metrics. RTS was one line item in a table that covered movements in and out of the portfolio.

3.1.31. The Q3 2008 pack noted, in a summary relating to BRG, that:

"The contribution for the nine months to September 2008 is £20.5m against a budget of £10.3m."

3.1.32. It further noted:

"We are continuing to focus on margin and fee enhancement to reflect the current market conditions albeit with a number of the property cases it is becoming increasingly challenging to keep interest current. Upsides continue to be actively pursued."

3.1.33. There was no mention in the summary of RTS, or any detailed MI on RTS or turnaround issues more generally (beyond portfolio movements).

3.1.34. The Board pack for Q3 2009 was similar. In relation to BRG, the summary material contained information on Portfolio, Income and Headcount. In relation to income, the summary noted that:

"YTD Q3 2009 BRG Performance is now ahead of budget in terms of both Income and Contribution:

- *Income is £24.2m against the budget of £22.6m;*
- *Contribution is £18.6m against the budget of £16m primarily due to costs remaining below budget.*

The income targets for 2009 have proved a real challenge as the majority of the property referrals lend themselves to PPA Upside returns rather than immediate cash fees. It is therefore pleasing to advise that during the YTD, 246 PPAs and 15 equity deals have been recorded with a further number at documentation or registration stage."

3.1.35. As in Q3 2008, RTS was one line item in a table that covered movements in and out of the portfolio in BRG.

3.1.36. The packs changed somewhat in terms of content and detail from 2010. Taking a sample of these, the Q2 2010 ExCo Pack provided less specific detail on each of the GRG units (there was little specific data in relation to BRG), and was more focussed on GRG specific financial metrics, although there was data provided on numbers of cases returning to satisfactory. However, the MI started to reflect the change in focus to include financial metrics in addition to incremental income (e.g. risk-weighted assets ("RWAs")), which reflected an increased focus on capital preservation from that point onwards.

3.1.37. The Q2 2010 ExCo Pack included an ExCo dashboard with key headings. These were (with the information included under each summarised afterwards):

- Value-added – included statistics on incremental income, and reduction in exposure from RTS cases;
- Finance – Portfolio value and volumes;

- Business – GRG headcount;
 - Portfolio analytics – Stressed losses;
 - Operational risk – Key operational risks;
 - Regulatory Risk – Key regulatory risks; and
 - Key Ratios – Included ratios such as cost/income and percentage of upsides/new cases.
- 3.1.38. While RTS was mentioned in several parts of the MI pack, it was typically in the context of the financial benefit to the Bank from reductions in losses and exposures.
- 3.1.39. The Q3 2011 MI for ExCo was similar – although the revised value added metrics (as described in the BRG specific MI below) were now also apparent in the overarching GRG packs. The focus of the material remained on various financial considerations. The ExCo packs then remained similar for the remainder of the Relevant Period.
- 3.1.40. In summary, the MI that was collected, collated and overseen by GRG at this level was focused more on financial metrics than any other factor. RTS received scant attention across the Relevant Period. There was never any deeper analysis of RTS data included in the MI, as there was for financial metrics.

BRG specific data

- 3.1.41. A MI pack specific to BRG was produced during the Relevant Period, at least from 2010 onwards. These packs were produced on a monthly basis. We have reviewed 44 of the BRG MI packs from 2010 until the end of the Relevant Period.
- 3.1.42. The vast majority of the MI, in the January 2010 pack, related to financial and portfolio metrics. The overall performance metrics were all financial related and were:
- Fee Income;
 - Interest Recovered;
 - Margin Enhancement;
 - Upside Realisation;
 - Other Income;
 - Total Income taken by BRG; and
 - Contribution.
- 3.1.43. The number of cases that had Returned to Satisfactory was also noted (in one line on the front page) as part of a summary of the portfolio.
- 3.1.44. The detailed analysis included breakdowns of each of the income metrics, noted above, for each of the regional offices and included monthly figures as well as year to date figures. Similar figures were produced for each office in relation to Upside Instruments. We make further reference to these regional budgets in Chapter 3.3 (Staff objectives).

- 3.1.45. Other than the one line item on RTS in the overall summary, there was no further analysis or MI included in relation to RTS.
- 3.1.46. The BRG MI packs remained similar in structure and content throughout 2010 and 2011. However, from April 2011 an additional slide was included in the MI pack that set out what were termed “*BRG Value-Added Metrics*”. These metrics (and RBS definitions) were:
- Incremental contribution – Additional income GRG earned on cases net of expenses;
 - Expected loss mitigation – The difference in Expected Loss on entry to and exit from GRG;
 - Reduction in Limit – Difference in exposure on entry to, and exit from, GRG; and
 - Risk-weighted assets reduction – Key component in calculating Regulatory Capital Required to be set aside by the Bank.
- 3.1.47. The incremental contribution information was, as we have seen, already being reported. However, the additional three metrics were reflective of an increased focus on capital, by GRG, at around that time. They focused on the reduction in the Bank's risk achieved through a combination of RTS cases and cases that had exited the Bank.
- 3.1.48. The style of the MI pack changed from December 2011 onwards. However, much of the content was similar. There were detailed data on income and upsides, as well as key characteristics of the BRG portfolio (including RTS). For the remainder of 2012 and 2013 the MI pack remained the same in style and structure. The number of cases that were returned to satisfactory was noted on the first page of each pack. The rest of the MI packs were focused primarily on portfolio and financial metrics.
- 3.1.49. While we recognise that RTS was included in most BRG MI packs across the Relevant Period, the clear preponderance of MI was focused on financial metrics. For a division with a turnaround objective, we found the lack of detailed information and analysis of case outcomes surprising. This is in contrast with the detailed analysis and information provided in areas such as income and the use of Upside Instruments.
- 3.1.50. Only one of the metrics appears to have been tracked against a specific number in the ExCo packs. That was the metric that tracked incremental income (and the associated “contribution to income”).
- 3.1.51. RBS set what it referred to as a “budget” for incremental income for each of the calendar years within the Relevant Period. This figure covered the whole of GRG and so would have applied to the part of GRG tasked with dealing with the SME businesses that this review is concerned with, as well as the larger corporate part of GRG.
- 3.1.52. As we indicated elsewhere in this Chapter, achieving the incremental income budget was a significant consideration for GRG management.
- 3.1.53. We did not see any budgets or targets with regard to returning customers to the mainstream Bank.

- 3.1.54. Irrespective of the merits of having a specific target for incremental income, or the emphasis placed on that metric over others, the mere existence of the metric with specific targets acted to exacerbate the tension between the GRG objectives and, in our view, contributed to a focus on re-pricing customer facilities, potentially at the expense of turnaround activity.
- 3.1.55. In our judgment, the balance of Board MI and BRG specific MI was suggestive of an approach that was weighted towards prioritising the *“contribution to RBS’s bottom line”* as the most important objective of GRG. The analysis of RTS was typically in respect of its financial contribution. We did not see any evidence of more detailed analysis of how turnaround was working in practice in any of the MI produced during the Relevant Period.

GRG policy and training material

- 3.1.56. We cover specific areas of GRG policy and training material in relevant Chapters of Part 4 (Activities of GRG). However, it is relevant to note here that there were no bespoke training courses on viability or business turnaround (although these topics did receive some limited attention in training for new starters) at any stage during the Relevant Period. But there was a two day compulsory training course that went into detail on pricing of credit facilities and on the use of Upside Instruments. In addition, there were optional training courses available including *“Understanding the Business”*, *“Managing Relationships Effectively”*, *“Credit Skills”*, and *“Communicating Effectively”*. The evidence from the file reviews and the work on staff objectives suggests that little focus was given to turnaround in on the job training.

Our work on the objectives for staff

- 3.1.57. In regards to the MI produced across the Relevant Period, we noted the consistent references to incremental income in relation to the yearly budget for that metric. It became, in practice, a target to be met and, if possible, exceeded. This target was cascaded down so that each regional office was given its own target.
- 3.1.58. While in theory the targets were not cascaded any further down than the regional office level. In practice we saw that the income generated by individual staff members was tracked on a regular basis in both 2010 and 2011. The importance of reaching the budget is clearly set out in the *“Just Hit Budget!”* material that we address in Chapter 3.3 (Staff objectives).
- 3.1.59. RBS has stated that budgets were set so as to encourage staff to renegotiate pricing with customers and indicated that its policy was that repricing was carried out on the basis of risk-return principles. If this were so, the incremental income generated by GRG would be reflective of that process, and arbitrary income generation targets that are set at the start of the year would not be necessary (or would be incapable of being set until the risk profile of customers was known). In addition, a clear explanation of rationale for all elements of the repricing of a customer's credit facility would be apparent from the file. This was rarely the case.

- 3.1.60. The conclusion that we reached in Chapter 3.3 (Staff objectives) was that the earning of incremental income was seen as being a greater measure of attainment than any other objective.

Our review of the files

- 3.1.61. We discuss the practice of GRG's approach to customers in Parts 4 and 5. Of particular relevance here are Chapters 4.2 (Turnaround), 4.4 (Pricing) and 5.2 (Strategic Investment Group) (in relation to Upside Instruments). GRG's strategy emerges clearly from these Chapters and the overall emphasis of treating pricing as a priority on files is consistent with the findings that we have made in relation to staff and the wider GRG objectives.

Our conclusions

- 3.1.62. We reach overall conclusions about the way GRG operated at the end of this Part. But we have noted in this Chapter that:

- GRG had twin objectives:
 - To be a major contributor to RBS's financial objectives (often expressed as a contribution to RBS's bottom line) which initially focused on revenue generation but later in the Relevant Period evolved to focus on the protection of capital, (the 'commercial objective'); and
 - To be at the leading edge of a wider rescue culture – focused on turnaround, rehabilitating customers in distress and working with the aim of returning customers to the frontline wherever possible (the 'turnaround objective'); and
- In practice the 'commercial objective' was the strategic focus of management during the Relevant Period, whereas the 'turnaround objective' received little if any material attention.

- 3.1.63. We do not criticise the Bank for having a commercial objective and in particular for taking steps to protect the Bank's capital, although "major contributor" might be argued to have placed an unrealistic objective on GRG's staff given the inherently perilous state of the businesses with which it dealt. But in any event the objectives were not easy bedfellows and in many cases they could be in direct conflict – particularly if the commercial objectives adopted by GRG were short term.

- 3.1.64. We conclude that:

- There was a risk that in pursuit of its commercial objective GRG would pay insufficient regard to the interest 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; and

- The simple presence of this key risk did not make the GRG objectives inherently inappropriate, but at a minimum it emphasised the 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.

3.2 – Governance and oversight

- 3.2.1. We have identified, in the previous Chapter, the tension between the objectives set for GRG, and the potential this had to lead to poor outcomes for customers. An appropriate governance and oversight framework would have helped to mitigate the inherent risks posed by the GRG model.
- 3.2.2. In this Chapter, we consider the appropriateness of the governance and oversight framework specifically in respect of risks to customers – although we make observations about the general risk framework that existed in GRG across the Relevant Period.
- 3.2.3. The Requirement Notice asks us to form a view on the appropriateness of the governance and oversight procedures implemented in GRG.⁵¹ This has a broad scope and it is relevant to consider this alongside other Requirement Notice considerations including the appropriateness of conflicts of interest policies⁵² (which we summarise in this Chapter, but also provide information about in Chapters 4.5 (Valuations), 4.8 (Third Parties) and 5.1 (West Register Property Acquisitions) and the appropriateness of strategic targets, revenue targets and incentive schemes⁵³ (which we consider elsewhere in Part 3 (How GRG operated)).

Our approach

- 3.2.4. As the activity covered by GRG largely fell outside regulation, the normal requirements on regulated businesses in respect of systems and controls did not apply to this element of its activity. So we have not applied the FCA Handbook provisions to our analysis. We have, however, had regard to some of the principles and rules that were set by the FCA and which applied during the Relevant Period. Our assessment has been guided by the general approach taken under those rules and principles. This is not to argue, or imply, that these regulatory standards applied; but we viewed them as a reasonable general statement of good practice that most businesses operating in a customer-facing environment would wish to follow to ensure good corporate governance.
- 3.2.5. In particular, we were mindful of FCA's Principle 3 (Management and control), Principle 6 (Customers' interests) and Principle 8 (Conflicts of interest). In addition, we were mindful of the requirements set out in the FCA's Systems and Controls Handbook ("SYSC") and, in particular, section 3 of SYSC. SYSC Section 3.1.1 notes that:
- "A firm must take reasonable care to establish and maintain such systems and controls as are appropriate to its business."*
- 3.2.6. We have also borne in mind the arrangements that we would expect to see in equivalent regulated entities to provide some basis for the degree to which GRG had appropriate controls. We believe that this approach is consistent with the fair and reasonable test that we have applied more generally.

⁵¹ Requirement Notice, Annex C, 4.1.1(1)

⁵² Requirement Notice, Annex C, 4.1.1(8)

⁵³ Requirement Notice, Annex C, 4.1.1(9)

Key factors

- 3.2.7. The focus of our investigation has been on the potential risks to customers from the activity of GRG. We recognise that GRG was also responsible for other significant risks (e.g. credit risk to the Bank). The systems and controls framework in respect of credit risk was subject to both internal oversight and external assessment. Our assessment of the risk and controls framework was solely in relation to its appropriateness with respect to risk to customers.
- 3.2.8. In assessing the systems and controls framework that GRG had in place across the Relevant Period we make the following observations:
- GRG took decisions in relation to customers who were already manifesting some signs of financial distress. These decisions (e.g. to increase pricing or to withdraw overdrafts) clearly had the potential to exacerbate the already difficult circumstances in which customers found themselves. They also had the potential to have a significant bearing on lives and livelihoods;
 - The decisions that Relationship Managers and other relevant Bank staff were required to take were often complex, and required the assimilation and assessment of a range of complex information regarding the specific circumstances of each customer;
 - GRG experienced significant growth in the period from 2008 onwards, in terms of the number of distressed customers it was required to deal with. This led to a significant increase in the number of staff employed by GRG;
 - Many of the SME customers transferred to GRG were not financially sophisticated and their financial distress added to their vulnerability. In addition, being inside a distressed unit would have been a new experience for many – and some of the concepts and terms used would not have been well understood; and
 - In many cases the future of the SME business and the personal financial circumstances of an owner/manager were closely intertwined.
- 3.2.9. The potential for harm to customers from inappropriate actions by GRG was therefore significant. GRG management was (or at least should have been) aware of these heightened risks given the context of its work. Accordingly, GRG needed a framework of systems and controls that was appropriate and sufficiently robust to ensure that key risks to customers were identified and appropriately mitigated.
- 3.2.10. The Bank has told us that, in the earlier years of the Relevant Period, GRG relied on assistance from the Group Risk function. GRG had its own policies and procedures, although it made use of some group-wide policies, and it has told us that it received advice from Group Risk in formulating its policies and risk processes. It is unclear to us how effective such arrangements would have been in practice in relation to management of risks to customers. We have not seen any evidence that Group Risk provided any specific oversight of GRG's treatment of its customers.

Areas we considered

- 3.2.11. There are many different ways in which a firm might set up its framework of systems and controls to meet the needs of the business. We have considered different aspects of the operation of GRG, in order to form an overall judgment as to whether the framework of systems and controls that was in existence was appropriate in the circumstances.
- 3.2.12. In particular, in our assessment of the systems and controls that operated within GRG across the Relevant Period, we considered the following areas:
- The risk management framework within GRG;
 - The identification, monitoring, management, and reporting of risks to customers;
 - The oversight of the activity of Relationship Managers within GRG; and
 - The use of policies, procedures, guidance, training and other tools to assist staff in carrying out their duties.
- 3.2.13. We then considered whether the systems and control framework, taken as a whole, was appropriate in the circumstances.

The risk management framework

- 3.2.14. The existence of an appropriate and robust risk management structure is an integral part of ensuring that risks are identified and then managed appropriately and that there is independent assurance that the measures put in place are working.
- 3.2.15. Many large financial institutions have adopted a 'three lines of defence' model. There are different ways in which this model can operate but essentially it would include a clear separation of responsibilities around risk management. One function, within a division, would typically be responsible for identifying and managing risk, and a separate function would have responsibility for challenging and testing against those risks. Typically, an Internal Audit function would have responsibility for overseeing how the risk management process works in practice, and whether it is effective.

What we would expect to see

- 3.2.16. We would have expected that the risk management framework would be appropriate and sufficiently robust so as to enable GRG management to satisfy itself that key risks to customers were being identified, monitored and mitigated as appropriate. At a minimum, this would include the following elements:
- The articulation of clear responsibilities for the management and oversight of risks to customers; and
 - An appropriately resourced 'second line of defence' with responsibility for appropriate oversight of the management of these risks, including the use of assurance testing and challenge as appropriate.

- 3.2.17. We would also expect to see GRG management committees being regularly informed about key customer related risks and evidence to demonstrate that appropriate actions were being taken when risks lay outside of the established risk appetite of the business.

What we did see

- 3.2.18. We have not seen any evidence to suggest that there was any clear set of responsibilities set out for the management and oversight of risks to customers.
- 3.2.19. Following the roll-out of TCF during 2010 (see Chapter 4.6 (Customer experience and TCF)), we did see more customer related material, but we did not consider that it was sufficient to have enabled GRG management to satisfy itself that key risks to customers were not materialising (or, where they were materialising, they were mitigated appropriately).

Frontline oversight

- 3.2.20. GRG's management structure included a regional director for each of the offices, with team leaders sitting below these regional directors. The team leaders were then responsible for a group of Relationship Managers, although team leaders also had their own set of clients. RBS has indicated that team leaders would often attend customer meetings with their Relationship Managers, and would otherwise exercise a degree of oversight of the activity and behaviour of their Relationship Managers.
- 3.2.21. RBS told us that, throughout the Relevant Period, it operated a "four eyes" approach which was reflected in the GRG Policy and Procedures Manual for the years under consideration. However, the focus of this approach was on credit sanctioning and credit review, rather than specifically in relation to the fair treatment of customers. That is, when credit facility extensions, reschedules, restructures or new credit were being sanctioned, either as part of the development of the initial customer strategy on entry to GRG or at any periodic review, a credit sanctioner was required to approve the facility. Those responsible for credit sanctioning were typically more senior GRG staff members, including team leaders and regional directors.

Strategy and Credit Reviews

- 3.2.22. Two key formal oversight processes: the Strategy and Credit Reviews ("SCRs") and Credit Reviews were put in place to oversee turnaround and restructuring decisions. The first SCR of a customer was to be completed within 30 days from transfer of the customer to GRG and the first credit review within 90 days from the transfer.
- 3.2.23. Credit reviews are a mandatory requirement across the Bank, whereas SCRs were unique to GRG and were designed specifically to set out and agree the strategy to be implemented in each case.
- 3.2.24. GRG Policy, throughout the Relevant Period, required that a SCR should be carried out on the cases that were under its management. For most of the cases within GRG (and within our sample), the requirement was for an annual SCR. Where cases had a larger exposure (over £2m) then quarterly reviews were required.
- 3.2.25. The GRG Policy noted that:

“SCRs are a key GRG process to ensure that every 'live' connection is subject to a regular formal, strategy and credit review by a panel of senior GRG staff.”

3.2.26. In relation to SCRs RBS told us the following:

“The overriding purpose of SCRs is to review the strategy being pursued and provide an opportunity for senior experienced members of the team to review the strategy.”

3.2.27. During our review of cases, we saw the submissions to SCRs (which were formed on a regional basis) and assessed whether they met policy requirements. While some resulted in changes to strategy, the majority did not. There was accordingly little evidence that a review by a committee resulted in a different strategy to that initially proposed.

3.2.28. We have also reviewed a sample of minutes of SCR meetings taken randomly from files within our review. The minutes are brief in nature and record little challenge. The minutes did not provide evidence that there was substantial debate or challenge at SCR meetings of the turnaround options that existed for the customer and the strategy to be pursued. The most common entry in the sample that we examined is *“Strategy endorsed”*.

3.2.29. While accepting that the minutes we reviewed were from a random selection, we did observe that the meetings focused on credit management rather than any consideration of outcomes for the customer. By way of example:

- At a meeting held in May 2010, alongside one case the following is minuted: *“Be strict with loan payments. If they default we should reprice”*, while in the same minutes, but relating to a different case, *“Strategy endorsed. To be referred to Recoveries, who should pursue the guarantors vigorously.”*
- At a meeting in June 2010, *“Full cooperation required or re-bank to be implemented failing which transfer to Recoveries.”*
- At a meeting in September 2012, alongside one case the minute records: *“If we have the opportunity to default the facilities, then change to an exit strategy.”*

3.2.30. In addition, our review of customer case files demonstrates that, outside the “four-eyes” credit sanctioner and SCR process, very little review or challenge of the work of Relationship Managers was carried out. This is especially important in areas which require significant judgment and which have a material impact on a distressed customer – including decisions to reduce facilities, pricing, and the valuation of assets.

3.2.31. Accordingly, this aspect of the “four-eyes” approach, on its own, was unlikely to have been sufficient to ensure that key risks to customers would have always been mitigated effectively. We have seen no evidence to demonstrate that the “four-eyes” approach appropriately monitored or constrained frontline staff in their treatment of customers.

3.2.32. Overall we note that, whilst the oversight of credit decisions took place at multiple levels within GRG, there was no material evidence of consideration in these processes of other matters impacting on the customer or more generally any analysis of any adverse impact that the Bank might be having on the customer. It is also relevant to

note here that SCR meetings did not act as a focal point for the development of turnaround options, although we did see reference to Upside Instrument potential and the need to involve West Register in discussions.

Risk and Controls Committee

3.2.33. The establishment of a Risk and Controls Committee ("RCC" or "Risk Committee") was an objective of the Head of GRG in 2010. Its initial terms of reference were agreed in November 2009. We note that the Head of GRG acted as the Chair of this Committee even after the Head of Risk had been appointed. The RCC met on a monthly basis and was established to:

- Act in support of the second line of defence to oversee, co-ordinate and facilitate the effective identification, monitoring and management of risks impacting the business;
- Carry out on behalf of the GRG ExCo its responsibilities relating to internal control, risk assessment and regulatory compliance; and
- Manage the functional, business and regional areas including ensuring adherence to, and development of, policy and divisional standards and any other regulatory requirements through the availability of people, processes and systems to enable it to discharge its responsibilities.

3.2.34. We have reviewed the minutes of 46 RCC meetings covering the period from its establishment to the end of the Relevant Period. We saw scant consideration of risks to customers in these minutes. However, the RCC did start to discuss conduct risk in 2013 and the development of the 'Customer Charter' was discussed at that time.

Second line oversight

3.2.35. A GRG compliance team was established in 2010. We have not seen any evidence that this team undertook any significant assurance testing on customer files to assess customer treatment across the Relevant Period.

3.2.36. Given the increase in the number of cases entering GRG from 2008 onwards, we regard the compliance function as being inadequately resourced. This was recognised by GRG management as being an issue during the Relevant Period. It was raised at RCC as early as July 2010. As such, it was clear that GRG recognised that the lack of a risk function was a key concern, but this persisted for some time before it was resolved.

3.2.37. A Risk Management function was subsequently established in June 2011. It is clear to us, from our review of the papers prepared for the Risk Committee and the minutes of the meetings, that for the first year or so the main focus was on credit risk. That was confirmed to us during the course of an interview we held with the Head of Risk. The Committee focussed on the larger corporate customers within GRG (i.e. typically larger than the BRG SME customers that are considered in this review). An operational risk team was also formed, as part of the Risk Management function, prior to the end of the Relevant Period.

3.2.38. The formation of the Risk Management function in June 2011 provided an extra mechanism that could have been used to mitigate risks to customers. However, the initial focus of that function was on credit issues. We saw no evidence that the Risk Management function provided any oversight over risks to customers across the Relevant Period.

3.2.39. In summary, we saw no second-line assurance testing which involved examination of customer files to assess customer treatment (apart from some testing on complaints across the Relevant Period). We found no evidence that there was any assurance testing undertaken to ensure that key GRG policies and processes were being followed (other than the complaints assurance work), or that key risks to customers were being appropriately mitigated.

Group Internal Audit

3.2.40. Until the formation of the Risk Management function, GRG only had one independent function, RBS Group Internal Audit ("GIA"), providing any oversight over the activity of GRG. GIA provided some oversight of GRG activity across the Relevant Period and undertook audits into different topics of relevance within GRG. Many of these reports were specifically in relation to GRG Ireland and were not relevant to the operation of GRG in the United Kingdom.

3.2.41. We have reviewed the reports provided to us and saw no evidence that GIA undertook any assessment of issues that specifically related to how GRG was treating its customers⁵⁴.

Summary

3.2.42. Throughout the Relevant Period there were significant weaknesses in the framework GRG adopted to manage and mitigate risks to customers. In summary:

- The procedures in place for frontline oversight of Relationship Managers were inappropriate and unlikely to have been sufficient to ensure risks were mitigated appropriately; and
- There was limited second or third line oversight of the activities of GRG across the Relevant Period, in particular in relation to customer issues.

Identification and monitoring of risks to customers in GRG

3.2.43. One of the key features of any risk management framework that purports to protect the interests of customers would be a process for identifying, monitoring and managing key risks (with appropriate oversight).

What we would expect to see

3.2.44. We would have expected to see some framework under which:

- Key risks to customers would be pro-actively identified;

⁵⁴ There was a GIA report early in the Relevant Period which made recommendations in relation to the process for transfer of customers to GRG.

- Risks would be monitored and appropriate mitigants would be put in place where necessary;
- Management information would be developed (and escalated as appropriate) to enable key risks to be monitored appropriately;
- Clear action would be taken where monitoring suggested that key risks were materialising and were not within the Bank's risk appetite; and
- Mitigants would be developed and implemented, where appropriate, to ensure that risks did not materialise, or stayed within that risk appetite.

3.2.45. As we indicated above, we would expect to have seen clear responsibility allocated to carry out this work, with a second line of defence conducting assurance testing appropriate to the nature of the risks identified.

What we did see

3.2.46. We did not see any evidence to demonstrate that the key risks to customers, arising from the GRG model, were appropriately identified, tracked or mitigated. The failure to identify these risks meant that it was difficult to carry out effective monitoring and mitigation of them.

3.2.47. The MI produced within GRG was not sufficiently detailed or appropriate to enable management to be satisfied that key risks to customers were not occurring. The MI was largely focused on complaints data (there were substantial shortcomings in the complaints process and in consequence the complaints data) and a yearly Customer Satisfaction Survey ("CSS"), which was conducted by an external agency from 2011 onwards. While there was a substantive volume of complaints MI, much of it was irrelevant from a customer risk perspective. There was some limited root cause analysis, but there were significant shortcomings in that root cause analysis (we give further information on this in Chapter 4.7 (Complaints)).

Treating Customers Fairly

3.2.48. The implementation of TCF in GRG (see Chapter 4.6 (Customer experience and TCF) for more information) could have acted as a further spur to GRG to ensure that key risks to customers were being identified, monitored and appropriately mitigated.

3.2.49. At a high level, an appropriate implementation and embedding of TCF would have involved, as a minimum, three basic steps:

- Identification of key risks to customers arising from GRG and its activities – not a checklist of process items that needed to be carried out;
- Development of MI against which those key risks could be monitored on a timely basis; and
- Implementation of systems and controls (including governance) to ensure that risks were mitigated and controlled appropriately.

3.2.50. We have concluded that GRG's approach to the implementation of TCF for most of the Relevant Period focused on a very narrow range of process measures including

complaint handling, various communications from senior managers requesting staff to “*treat customers fairly*”, changes to Relationship Manager objectives that would not have been sufficient to address proper TCF concerns, a brief mention in GRG policy and procedures and a compulsory Group Training Module.

- 3.2.51. We regard these measures as an inadequate, and therefore inappropriate, response to the requirements set at a Group level. RBS has indicated that TCF was part of the GRG ethos. In practice, all three of the basic steps we identify above were missing from GRG's response to TCF. Based on the evidence, we do not see how GRG management would have been able to satisfy itself that TCF had been properly implemented and embedded.
- 3.2.52. Towards the end of the Relevant Period, there was some evidence that risks to customers were starting to get greater focus within GRG. For instance, the Risk and Controls Committee was advised, in July 2013, about the introduction of a Vulnerable Customers policy within GRG. While a Vulnerable Customers policy was clearly under production at that point, we have not seen any evidence that it was implemented during the Relevant Period.
- 3.2.53. In addition, late in the Relevant Period a conduct risk (risks to customers) programme was put in train which demonstrated that there was increased thinking about the potential impact of GRG on its customers. For example, in an October 2013 update titled ‘GRG Conduct Outcomes’, the Outcomes that were identified by the Bank as being desirable were:
- *“We have a customer-centric culture and we act in customers’ long-term interests;*
 - *We drive sustainable and stable returns through consistently good customer outcomes;*
 - *Our people are rewarded for consistent behaviours which align to our values;*
 - *We have a positive impact on the communities and markets in which we operate, and have effective controls against financial crime; and*
 - *We deliver beyond the letter and spirit of rules & regulations”.*
- 3.2.54. These developments late in the Relevant Period did not have time to impact the customers in our sample and have not been tested. In our view, they represent a step forward in the recognition by GRG that it needed to do more to treat its customers fairly and have in place the systems, policies and processes appropriate for its role to ensure that this was achieved in practice. But we question whether without more fundamental changes to the objectives and ethos of GRG such changes would have been effective.

Summary

- 3.2.55. In our view, throughout the Relevant Period, there was insufficient focus paid to the identification and monitoring of key risks to customers. GRG management would not

have been able to satisfy itself that key risks to customers were not materialising. In particular:

- There was no articulation of key risks to customers and they were not identified;
- There was no ongoing monitoring or management of key risks to customers;
- Management information that was produced was not sufficient or appropriate to enable risks to customers to be monitored appropriately;
- There was never any assurance work undertaken in relation to key risks to customers (aside from some work on complaints); and
- TCF was not implemented in an appropriate fashion in GRG.

Policies, procedures, guidance, training and tools

3.2.56. There are various ways that potential risks can be mitigated in practice. Ensuring that requirements for frontline staff are clearly set out, and that staff have the appropriate training, guidance and tools to do their jobs effectively are important in this regard.

What we would expect to see

3.2.57. In assessing whether the assistance provided to frontline staff was appropriate, we considered a range of material. We looked for:

- Policy material which would clearly set out the requirements for Relationship Managers and provide them with a clear structure and process to follow;
- Guidance and training material to provide Relationship Managers with further information on how to carry out key tasks. This would include areas such as:
 - Viability assessments;
 - Turnaround;
 - Pricing; and
 - Treatment of customers;
- Tools and templates to assist Relationship Managers to carry out specific tasks. These would ensure key tasks were carried out, and provide a written record. They could be used for areas such as:
 - Viability assessments;
 - Turnaround analysis; and
 - Pricing.

3.2.58. RBS has told us that much of the training for Relationship Managers was delivered “*on the job*”. It is difficult to evidence the extent to which that was the case. Inevitably, many jobs involve some element of “*on the job*” training, as people learn from those around them, and from senior staff. However, that alone is not always sufficient.

What we did see

- 3.2.59. We comment in more detail on the policies and procedures relevant to different topic areas in relevant Chapters in this report.
- 3.2.60. Guidance and training for Relationship Managers in some key areas did exist, although we would have expected to see more bespoke training on viability assessment and the consideration of turnaround. We comment on guidance and training in relation to specific topics in other Chapters in this report (see Chapters 4.2 (Turnaround) and 4.4 (Pricing)). In summary:
- Viability and turnaround – GRG produced guidance which set out, in some detail, factors to consider when assessing a business. RBS told us that this was available on the GRG intranet site, but it is not clear how widely it was reviewed and considered by Relationship Managers. There is little evidence that there was any substantive bespoke training on the assessment of businesses, including viability assessments and turnaround – although the 2008 version of the “Introduction to GRG” training course did include more detail on business assessment than later versions of the course;
 - Pricing – There was more detailed training and guidance on pricing. There was a detailed training course on pricing (“Introduction to Upsides”) which was compulsory for Relationship Managers; and
 - TCF – A Group TCF e-learning module was rolled out to GRG staff (as part of a wider exercise). This provided a very high-level introduction to TCF but was not specifically tailored to GRG. It did not set out how TCF translated into requirements or expectations for GRG Relationship Managers.
- 3.2.61. There was limited use of templates to assist Relationship Managers with key tasks across the Relevant Period. For example, we did not see any evidence of any tools or templates to help Relationship Managers carry out viability assessments or consider turnaround options. These could have been used to help Relationship Managers ensure that they had considered relevant criteria when undertaking viability assessments and a range of options when considering potential turnaround strategy.
- 3.2.62. There were templates and other tools available to assist Relationship Managers with pricing, but evidence from the case files suggests that these were rarely used in practice.
- 3.2.63. In summary, while there could have been more bespoke training on viability and turnaround, it was not the absence of material to assist Relationship Managers that was at fault, but rather a failure to follow the process that was set out in GRG Policy – and the lack of oversight that allowed that to continue throughout the Relevant Period.

Managing other conflicts of interest

- 3.2.64. We have noted the potential conflict between the Bank's own interests and those of its customers in the context of handling distressed SME businesses. But GRG also needed to be mindful of other features of its role that gave rise to potential conflicts of interest and over which careful governance was required. These other features include the way

it handled transfers, the way in which its customer-facing staff interacted with specialist GRG teams such as those in its Property Advisory Unit, West Register and Strategic Investment Group, and the way in which staff who were on secondment from third-party firms operated.

- 3.2.65. All of these were important features of the way in which GRG operated and all had the potential to give rise to perceived and actual conflicts of interest that could have adverse outcomes for customers.
- 3.2.66. The Bank needed to recognise these potential areas of conflict and put in place adequate and appropriate systems that would have helped guard against any adverse consequences, informed management of any developing issues, and ensured that appropriate action was taken.
- 3.2.67. We cover each of these issues in more detail in others Parts of this report but, in summary, GRG was slow to recognise the extent of these potential conflicts and slow to develop the systems and controls that were necessary to mitigate them.

An independent division

- 3.2.68. In reviewing the oversight and governance arrangements in GRG two final points struck us as significant for our review. As RBS noted, GRG was a division of RBS that had been established as deliberately independent from the frontline. Over the Relevant Period it reported to first Risk then Finance functions – not customer-facing divisions. That was not of itself inappropriate but added to the sense that GRG was isolated from common thinking in the Bank about the fair treatment of customers. It had a distinct “GRG way”. We comment further on culture in the next Chapter.
- 3.2.69. Linked to GRG's separateness, the control framework was heavily dependent on a small group of individuals. We noted that theme of common membership of key committees across GRG in Chapter 2.2 (Background to the Review). In the context of the governance and oversight of GRG, it meant that there was no significant external challenge (so far as we were able to identify) to the ‘GRG way’ and the assumptions GRG made about how it should carry out its specialist turnaround role.

Our conclusions

- 3.2.70. We reach overall conclusions about the way GRG operated at the end of this Part. But in this Chapter we have identified shortcomings relating to the overall governance and oversight of risks to customers in GRG in each of the areas we considered. In summary:
- The risk management framework did not include sufficient or appropriate second or third line oversight;
 - Key risks to customers were not identified, managed or appropriately mitigated;
 - Management information around key risks to customers was not sufficient or appropriate to enable GRG management to have clear oversight of key risks to customers; and

- The process set out in GRG Policy and guidance was not routinely followed by Relationship Managers, and the lack of effective oversight meant that that was allowed to continue across the Relevant Period.

3.2.71. We have concluded that the governance and oversight framework was not appropriate or sufficiently robust, across the whole of the Relevant Period, to provide effective challenge and oversight relating to the treatment of customers within GRG. In certain respects, this was recognised by RBS at the time. There was very limited focus on risks to customers during the Relevant Period.

3.2.72. 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. GRG management was aware (or ought to have been aware) of these shortcomings but took insufficient steps to correct the position.

3.3 – Staff objectives

- 3.3.1. In the previous Chapter we explained GRG's governance and oversight framework. We identified significant shortcomings in that framework in so far as it concerned the treatment of customers. These shortcomings increased the risk of adverse customer outcomes but did not of themselves make those outcomes certain. It was possible that adverse impacts could have been avoided through thoughtful and balanced objectives, and by the day-to-day interaction between managers and staff.
- 3.3.2. In this Chapter we consider the performance measures that operated for GRG staff. We review the objectives that were set for GRG's customer-facing staff and senior managers and report on our consideration of a sample of appraisal documents. We also draw from evidence we gathered during our case reviews about the day-to-day priorities of Relationship Managers, and how they handled cases in our sample. Finally we comment on elements of the wider culture of GRG that we have observed in carrying out our work.
- 3.3.3. The Requirement Notice asks us to form a view on the *'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'*.⁵⁵ In light of the distinction in focus between Phase One and Phase Two of the Requirement Notice, other than as covered in this Chapter, we have not considered in detail reward structures for either frontline or senior staff, nor have we considered any material in respect of incentive or reward structures for staff in B&C.⁵⁶
- 3.3.4. In our view, in practice the dominant message from management 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. In contrast objectives that might have mitigated adverse impacts for customers, such as the importance of 'Treating Customers Fairly', the need to explore opportunities for turnaround and successful return of customers to mainstream banking were largely absent from the messages emphasised by managers at all levels. We also observed aspects of culture that led us to consider that the customer interest was not appropriately or consistently respected by the staff or management of GRG.
- 3.3.5. Accordingly, we identify in this Chapter a general failing to establish and oversee balanced and appropriate objectives for staff to deliver GRG's own twin objectives. This was not in our judgment a result of idiosyncratic decisions by local managers, but was endemic in GRG's arrangements in respect of those dealing with SMEs. This was a failing that GRG management was aware of (or should have been aware of), but the steps necessary to start to address the issues we identify were not taken until towards the very end of the Relevant Period.

⁵⁵ Requirement Notice, Annex C: 4.1.1(9)

⁵⁶ Requirement Notice, Annex C: 5.1 (7)

GRG's policy

- 3.3.6. RBS told us that *"Individual performance is managed using a balanced scorecard approach, under five broad areas of strategic progress, business performance, customers, people management and risk management. Detailed objectives evolved over the period to reflect the Bank's changing priorities but the core objectives of restoring customers to satisfactory performance and mainstream banking remained consistent throughout the Relevant Period."*
- 3.3.7. This use of a balanced scorecard would reflect the custom and practice elsewhere; its use is therefore neither surprising nor inappropriate. It was also usual for objectives to be set at the start of each financial year and for them to align across GRG to ensure that all staff were given a consistent focus that would help ensure delivery of GRG's own strategic objectives for the year in question.
- 3.3.8. The Bank stressed to us that the objectives evolved over time but that *"the focus on turning around and rehabilitating customers remained a constant throughout the Relevant Period."*

Our review work

- 3.3.9. We wanted to see how these general observations worked in practice. We asked the Bank to provide the objectives and year-end appraisals for all Relationship Managers in some of the regional offices and those for the top performing and under-performing staff across the whole of GRG for the years 2009, 2010 and 2011. In addition we requested the objectives for certain identified senior positions in GRG across the Relevant Period.
- 3.3.10. The Bank was unable to fully comply with our request. Individual scorecards and detailed appraisal outcomes were not retained on a central database. They were held by the individual members of staff with a copy generally retained by the line manager. Some were better at retaining these documents than others, and in many cases staff and their line manager had moved on. The only central record was that recording the summary numerical scores reached in appraisals.
- 3.3.11. We did however review copies of 91 appraisal forms for staff which gave us a reasonable spread across the sample we had requested.
- 3.3.12. As part of our case review we also observed a number of emails between staff in GRG that appeared to us to be relevant to our assessment of the focus for staff and in some cases relevant also to culture. We have taken these into account in making our assessment.
- 3.3.13. We were also notified by the Bank of a number of emails that had come to light during our review and as a result of the enquiries we made. These emails dealt directly with the generation of income. The nature and tone of the emails suggested that staff within one GRG regional office should focus on the generation of income for RBS in order that the region could meet the income targets that had been set for it. The discovery of these emails resulted in a Bank led inquiry to which we were given access. Again we have taken this material into account in making our assessment.

- 3.3.14. It is important to note that we have not, given the scope of Phase One (versus that of Phase Two), carried out a complete review of staff objectives or undertaken a formal review of culture. In particular we did not interview any of the staff whose appraisals we reviewed (or their managers) with a view to gaining their insights into these matters.

Appraisal documentation

- 3.3.15. We report below on what we found when we analysed the appraisals made available to us. While we undertook numerical analysis based on the 'scores' we observed, inevitably our overall assessment of what we saw is, to a significant degree, subjective. The circumstances of the staff being appraised and that of their managers varied widely and that was reflected in the documents we saw. As is common to most appraisal processes the documents allowed for comment by both the staff member and his/her manager. Those comments provide an insight into what was uppermost in the minds of the staff at the time and serve to indicate how matters were viewed and effectively prioritised in discussion.

Senior GRG managers

- 3.3.16. We examined a total of 25 appraisal documents for specific senior managers from across the Relevant Period. Our focus was on the extent to which incentives may have influenced staff behaviours. The sample was made up as follows:

Fig. 10: Senior manager sample breakdown by year

Year	2009	2010	2011	2012	2013	Total
Number of Appraisals	2	7	6	6	4	25

- 3.3.17. For these purposes, we included as a "senior manager" for this element of the review the Corporate or Regional Directors and the Heads of: GRG, BRG UK, GRG Ireland, GRG UK, West Register and Recoveries.

Senior managers: objectives

- 3.3.18. RBS has confirmed that overall GRG objectives were set, at a high level, by the Head of GRG in conjunction with the strategic objectives he was set. Given his role as head of a global function not all had a direct bearing on the operations in the UK. He in turn cascaded objectives down the management line and amended them, as appropriate, to take account of any specific regional/local or individual role requirements. An individual's objectives would be signed off by his or her line manager.
- 3.3.19. Senior managers' objectives were normally constructed around common themes. These were:
- Strategic Progress;
 - Business Development and Financial Performance;
 - Customers' Expectations;
 - Risk and Control;

- People Management; and
- Personal Skills.

3.3.20. In the main, the objectives we observed under each of these headings were strategic in nature. Precisely how each objective was defined was bespoke to the role.

3.3.21. While, for the most part, these objectives appeared to have been balanced equally, this was not always the case in practice. We observed in some appraisal documents that each objective was also given a specific weighting, as a percentage. For example, in 2010 the Head of BRG UK's *"Business Development and Financial Performance"* was given a weighting of 40% and the remaining objectives 15% each. In 2012 for the Head of GRG West Register, *"Strategic Progress and Business Development"* and *"Financial Performance"* accounted for 25% each, *"Customers' Expectations"* and *"Risk and Control"* 20% each, *"People Management"* 10% and *"Personal Skills"* nothing.

Senior managers: thematic references

3.3.22. For each appraisal we undertook a review to map references to thematic areas that we identified as common or otherwise significant to our wider review. What we counted towards these thematic references varied, some were significant parts of the overall appraisal dialogue, whilst others were more by way of passing references. The following chart sets out our findings.

Fig. 11: Senior manager appraisals: thematic references

Thematic Reference	2009	2010	2011	2012	2013	Total
Income Contribution	2	6	6	4	3	21
RTS	1	1	3	3	3	11
Upsides	2	3	4	3	1	13
Complaints/Customers	1	7	4	5	4	21
TCF	-	2	2	1	-	5
Total Sample	2	7	6	6	4	25

3.3.23. As can be seen, at face value, there was a spread of references across the breadth of GRG's objectives.

3.2.24. We noted that, for the years 2010 and 2011, the Head of GRG had as one of his objectives the embedding of TCF within GRG. Although it was intended that this objective should in turn be cascaded to his direct reports, in this sample even in the years it was rolled out specific reference to TCF was largely absent in the objectives for staff dealing directly with customers. TCF and RTS were contained within the Customers' Expectations objective, as was reference to customer complaints, where

references were more frequent. The extracts below show the type of language we observed in relation to 'Customer Expectations' references.

"All staff completed the relevant TCF training during 2010" Head of BRG UK, 2010

"As at November 2011 cases returned to satisfactory total 738 with 64,000 estimated jobs saved in the UK alone" Head of GRG, 2011

"Zero justifiable complaints. Majority of complaints have been related to BRG implementing appropriate return for risk where this has not been detailed before." Corporate Director 2010

- 3.3.25. The objectives set for this specific group of senior managers normally referenced income generation. We also noted a focus on the use of West Register as an acquirer of property assets and a focus on the generation of "upsides": The extracts below illustrate the type of material we observed in relation to financial and business performance.

"Financial results have been strong but not at the expense of customer satisfaction with a strong mantra repeatedly enforced 'to do the right things at the right time for the right reasons'" Head of BRG UK 2012.

"I have ensured the [Regional] team continue to proactively drive opportunities to West Register. This resulted in several asset purchases and also offers from external offers being maintained at their initial levels." Head of GRG Ireland, 2011

"SIG – increasing the level of upsides taken across the GRG portfolio." Head of GRG, 2012

- 3.3.26. Overall we noted a tone and emphasis in the assessments of these senior GRG managers which placed financial objectives first and emphasised the need for continuing financial performance. These managers were responsible for the oversight of the more junior staff including Relationship Managers; they set the tone and goals for the staff dealing with the smaller SMEs. Our review of the Relationship Manager population, which we set out in the following pages, shows that this tone and emphasis was replicated at that level.

Relationship Managers

- 3.3.27. The following shows the breakdown of the 66 documents that we received for the Relationship Managers (who were graded according to seniority and experience – RM1 being the more senior grade):

Fig. 12: Relationship Manager sample breakdown by year

Year	RM1	RM2	RM3	RM4	Total
2009	9	7	4	4	24
2010	8	7	5	5	25
2011	6	3	4	4	17
Total	23	17	13	13	66

3.3.28. Appraisals and objectives for frontline staff were determined in accordance with a 'balanced scorecard' set by GRG Executive Committee. The objectives for 2009 were as follows:

Fig. 13: GRG 2009 Objectives

Financial Contribution	→	<ol style="list-style-type: none"> 1. To contribute actively towards the department's financial targets. 2. To support the Team Leader in ensuring all team financial targets are achieved. (see attached schedule)
Portfolio Management	→	<ol style="list-style-type: none"> 1. To carry out initial and subsequent case reviews within the agreed timescales in accordance with the Policy & Procedures manual and any timetables issued by the Head of GRG. 2. To improve the Bank's position by establishing the most appropriate course of action for each case. 3. To recommend purposeful and achievable strategies with clear milestones for sanction at the appropriate level of management within GRG or Credit Committee. 4. To implement and regularly review the agreed strategy for each case in accordance with conditions of sanction including receipt of an appropriate risk return. To obtain sanction for any subsequent variations or extensions of time. 5. To create strong relationships that ensure customer retention post RTS.

Relationship Management	→	<ol style="list-style-type: none"> 1. To establish and maintain effective relationships both internally and externally. 2. To participate in presentations and meetings as appropriate with internal and external customers. 3. To network with external professionals to enhance personal and GRG's reputation in the market. 4. To maintain acceptable service standards at all times. 5. To achieve zero justifiable complaints.
Staff and Self Management	→	<ol style="list-style-type: none"> 1. To ensure that all designated reportees receive performance worksheets using the GRG core KRAs and Competencies for their position. 2. To assist the Team Leader to complete Interim and Annual Performance Reviews for all staff within one month of each period end. 3. To support and develop team members through robust sanctioning (within personal sanctioning limit) of proposals and encouragement towards best practice. 4. To provide the Team Leader with constructive advice and support on team matters. 5. To assist with the creation and regular review of a PDP for each direct report for the effective development of their skills and competencies related to current and future jobs, including acting as mentor when appropriate. 6. To create a positive team environment that encourages creative and innovative risk management strategies. 7. To enhance team spirit through personal contributions to the team and unit.
Data Maintenance	→	<ol style="list-style-type: none"> 1. To maintain RMP and file record information for personal portfolio accurately and timeously. 2. To ensure accurate Forecast and Marked Provisions are maintained for each case within personal portfolio at all times. 3. Deal information to be recorded accurately and timorously. 4. Strategy review papers to be created properly and in line with review timetable. 5. To ensure that cases are managed in accordance with the Policy & Procedures Manual

3.3.29. The only direct reference to “turnaround” is item 5 in the heading “Portfolio Management”:

"5. To create strong relationships that ensure customer retention post RTS."

- 3.3.30. The issue of *"Financial Contribution"* appears in the first objective, and there is reference to *"ensuring all team financial targets are achieved"*. For one of the offices in our review no schedules (as envisaged by the objectives) were attached; the office was newly established and *"Financial performance has not been split out for the [Office] team as at this time"*, although it was accounted for in figures for another regional office.
- 3.3.31. For other Regions for which we had information the Relationship Managers were assessed by reference to their individual contribution to income as measured against a pre-set target for the Region, although in none of the appraisals for 2009 have we seen a schedule that sets an individual target.
- 3.3.32. For each of the years 2010 and 2011 the heads of the objectives were:
- **Objective setting** – this was inward looking and typically required Relationship Managers to have in place a personal development plan, contribute toward team objectives and develop their own team (where they have direct management responsibility);
 - **Maintaining the licence to operate** – this required Relationship Managers to minimise complaints (e.g. zero "justified" complaints), comply with the APS and ensure that cases were managed in accordance with the policies and procedures manual;
 - **Execute effective asset management and maximising sustainable fees as a component of minimising losses;** and
 - **Enhance our position at the leading edge of the global business and financial restructuring market** – under this heading staff were assessed on the number of internal/external events attended.
- 3.3.33. Within each of these categories were more detailed objectives of a generic nature and aligned to the role being performed. However, these four heads of objectives remained constant. TCF was not included in any of them.
- 3.3.34. An anonymised appraisal for 2010 is attached at Annex VI.
- 3.3.35. We looked for evidence of the weight that these categories had and of the detailed objectives they contained. However neither the detailed objectives nor the broad categories were given individual scores in the appraisals we reviewed. It is accordingly difficult to state with any certainty that one objective was given more weight than any other.
- 3.3.36. Our analysis of both the top and the bottom performers amongst the Relationship Managers also does not show a direct link between performance against any objective or category for the year and the overall rating given. Generally, a good performer received positive comments under each heading, including the generation of high revenues. Our review of the reasons for the low "under-performing" ratings across the three years shows that in each case particular issues, some related to customer

treatment, gave rise to the outcome. Poor income generation did not appear to directly give rise to any of the low ratings that we examined.

- 3.3.37. However, we had sufficient material from which to analyse evidence and form a view on the issues upon which individual staff and their managers focused in the appraisal reviews. As with the cohort of senior managers, our first step was to identify a number of thematic reference areas within the appraisals. The following table sets out the results of that work; it shows the topics against which we searched, and the number of times each is mentioned within the appraisals.

Fig. 14: Relationship Managers appraisals: thematic references

Thematic reference	2009	2010	2011	Total
Income Contribution	21	17	14	52
RTS	1	9	9	19
Upsides	20	15	11	46
Complaints/Customer	17	20	14	51
TCF	-	-	1	1
Sample Size	24	25	17	66

- 3.3.38. As can be seen, at face value, there was a spread of references across the breadth of GRG's objectives.
- 3.3.39. We note that although TCF did appear in the objectives of the Head of GRG and his direct reports, reference to it was conspicuous by its absence in appraisals of Relationship Managers, albeit there was reference to other customer and complaint issues. There was limited reference to achievements relating to returning customers to mainstream banking. In contrast reference to income generation was normal as was reference to Upside Instruments. This is consistent with the issue that we identified in relation to the senior population.
- 3.3.40. But this reference count only gives a part of the picture. We also considered carefully the context in which these concepts were raised in the individual employee documents. We take each of the areas identified in the thematic references in turn.

Income Contribution

- 3.3.41. Generally, references to income contribution are to the amount which the individual either claims or is told they have contributed toward the overall team budget. Some of the figures for 2009 arise from the allocation of individual financial targets, and we see this reflected in the year-end appraisal comments. But it is also the case that for 2010 and 2011 individual generation of income was seen as a factor important enough to mention by both managers and employees as one of the achievements for the year.

3.3.42. The following remarks are taken from appraisal comments, with a sub-set taken from each of the years in question:

- *"should ensure we are getting a decent return e.g. via significant initial monthly fees to then reduce in lieu of an upside rather than charge low monthly fees and then seek an upside when the information is complete"*
- *"very pleased with his focus on income and ensuring that the Bank gets an appropriate return v risk exposure"*
- *"[Name] has been an integral part of the success of [Regional office] team in 2010 both in respect of its financial performance & the organisational structure he has put in place... [Region] has delivered contribution of £12.5m (over 250% of budget) whilst maintaining operational efficiency."*
- *"Excellent income of £447k achieved from a large and complicated portfolio of 24 cases which is the largest on the team 6 PPAs and 5 other upsides delivered which was a good result and indicates that [Name] is comfortable with and able to "sell the concept" of deferred fees to our customers."*
- *"[Name] has contributed a good level of fee income and managed the Bank's risk of loss in an appropriate manner"*
- *"I have earned the team £57.5k of income by way of margin enhancements & other fee instruments and £343k of debt repaid"*
- *"I have beaten all the targets that I set for myself in my H1 review (Debt repaid £6.2m v £5.2m target, Income £530k v £400k target), and look forward to a challenging 2011."*
- *"Pleased with overall performance in 2010 having delivered strong income figures and completed restructuring deals which have secured valuable upsides for the bank. Against peer group feel that I have been one of the strongest all round performers delivering on strategy, deal completion, service and compliance."*
- *"Has generated good revenues and upsides although with a lot of the property cases achieving the return of the Banks debt/minimising losses would be considered and excellent result and so fees may not be the most important criteria."*
- *"Overall [Region] had a successful year exceeding its budgets for both Income and Contribution but also delivering excellent customer survey results and very positive staff feedback"*
- *"Clear communication has been key and while he has bought into the BRG/GRG culture he could still be more stretching in the rewards/returns that he seeks from clients"*
- *"Income generated from my portfolio (£0.747m) was in the top 25% of the department and I achieved the third highest level of debt reduction (£13.2m)."*

- *"the second half of year has focused on the delivery of deals which has resulted in significant fees, upsides both equity & PPFA's, significant debt repayment and finally a mitigation of Bank losses..."*

3.3.43. Whilst formally from 2010 income was not directly tracked at individual, as opposed to team, level, the information we have from appraisals is that there continued to be a keen interest from the employees and their managers in the individual financial contribution that the member of staff generated from customers. Individuals, it seems, tracked their own income from enhanced margins and monthly charges. This practice was not simply a feature of one office or one point in time. We have concluded that this collection of individual data and focus on it as a measure of staff achievement was a practice that occurred across GRG in the three years in question.

Upside Instruments

3.3.44. Individual appraisals also reflect the management focus on the need for Relationship Managers to negotiate Upside Instruments in the form of PPFA's and EPAs. The references are extensive, but the following excerpts help to give a flavour of the position.

Managers' comments from 2009:

- *"[Name] has negotiated a number of upsides which should have substantial value to the Bank in the future"*
- *"successful in negotiating significant upsides while maintaining customer buy in"*
- *"I expect [Name] to deliver some considerable upsides, his existing portfolio has some excellent opportunities which he is working up at present"*
- *"he should target himself to undertake an equity deal in 2010"*
- *"The challenge... going forward is to expand his technical expertise... whilst not completely leaving property behind because I feel there may be local West Register type deals to be transacted as we move out of recession"*

Managers' comments from 2010:

- *"The portfolio now has several opportunities to deliver upsides notably [customer names list]"*
- *"2011 will place emphasis on upside negotiating & I would encourage [Name] to continue to work closely with her RMs in seeking out further opportunities."*
- *"On Financial/Upsides performance, she has placed an increased focus on this area and has executed some good deals including what may turn out to be a good circa £1m upside on [Case]"*
- *"he is adept at spotting upside opportunities and confident [in] explaining the rationale to customers... from a Credit stewardship perspective again he is organised and thorough, demonstrating a sound knowledge of his portfolio, and driving solid strategies to get the bank in an improved position."*

Managers' comments from 2011:

- *"Whilst Income and Contribution have remained healthy and both have bettered the full year budget figures, we have struggled to get anywhere near the targets set for Upsides in 2011 despite a 15% net growth in the portfolio to circa 585 cases at 30 November. It is arguable whether the Upside targets were ever realistically achievable as it is uncertain on what assumptions they were based at the outset. That said, the senior members of the BRG [Regional] team, including [Name], recognise there is a need to shorten deal delivery and drive robust strategies and this will be an area to concentrate on in 2012."*
 - *"[Name]'s income generation has been solid, and albeit upside opportunities have been thin on her portfolio, she understands the principles and I know that some are currently under negotiation."*
 - *"Advance negotiation skills in order to successfully negotiate equity stakes and other upsides and to clearly communicate the Bank's stance and obtain consensual agreements to the Bank's satisfaction... [Name] has shown by her results in [Regional Office] that her negotiation of upsides is good. Whilst [Name] has not had the time to achieve any upsides in [new office], I think the difficult messages that [Name] has had to deliver to customers who are generally totally unaware of the Bank's stance has been excellent."*
- 3.3.45. These comments are reflected in remarks made by employees about the achievement of upsides. For example in 2009 one Relationship Manager recorded his own objectives for 2010 as including *"spotting opportunities and ensuring that I discuss files as early as possible with SIG"*
- 3.3.46. Taking the appraisals that we have reviewed as a whole, we concluded that management placed emphasis on the need to put in place Upside Instruments, either in the form of PPFAs or EPAs or both, and that the Relationship Managers understood the need to identify such "opportunities" in the cases entrusted to them.
- 3.3.47. We accept that in certain circumstances such arrangements may be of benefit. We address that aspect in Chapter 5.2 (Strategic Investment Group). It would not in those circumstances be inappropriate to encourage Relationship Managers to give consideration to them where it is seen as a useful tool to aid a turnaround objective, such as the reduction of pressure on forecast cash flows. Our reading of the language in which the appraisals are couched leads us to form a view that the focus was on meeting a target rather than using a mechanism that could benefit a customer.
- 3.3.48. Generally such arrangements were perceived as *"opportunities"*; but such opportunities were not seen in the context of the customer. They were intended to be *"to the Bank's satisfaction"*; staff were complimented for having *"negotiated a number of upsides which should have **substantial value to the Bank** in the future"* [our emphasis] and the end result was judged by the longer term reward for the Bank: *"she... has executed some good deals including what may turn out to be a good circa £1m upside on [case]."*

3.3.49. Having regard to all that we have read, we have concluded that there was an inappropriate focus on obtaining Upside Instruments because these were seen as a way of securing medium-term income which accrued to GRG. This focus influenced the behaviour of both management and staff. The position is best summed up by a manager's comments on an appraisal undertaken in 2009:

- “[Name] puts in place effective strategies to get the best return for the Bank.”

Return to Satisfactory

3.3.50. RTS was a measure of performance for Relationship Managers. Given GRG's stated turnaround objectives we expected to see some emphasis given to this measure by both managers and staff.

3.3.51. We noted fewer references to RTS than to income generation and Upside Instruments. Where RTS is mentioned it is generally in a positive light:

- “[Name] has delivered a very strong performance in 2010 with solid income levels, high level of RTS cases all delivered on the back of high levels of housekeeping.”
- “The H2 RTS performance has been very strong and sets [Name] at the top end of her peer group on this measure - this is highly commendable. There has also been some very positive feedback from customers as they go back to the mainstream part of the Bank.”
- “A very strong final outcome for the year in terms of outright income and the number of cases RTS'd which [Name] should be commended for.”

3.3.52. In other cases RTS is referred to as being one of the factors taken into account:

- “Excellent income of £447k achieved from a large and complicated portfolio of 24 cases which is the largest on the team

6 PPAs and 5 other upsides delivered which was a good result and indicates that [Name] is comfortable with and able to “sell the concept” of deferred fees to our customers.

Good relationship skills

No RTSs delivered although this is more reflective of the nature of the portfolio – Property/SPVs/Non-core”
- “In H2 [Name] should look to generate further upsides and review RTS cases in Q3.”
- “Seeking: Income from him and his team, Balanced by upsides negotiated and RTS cases achieved, Need to ensure especially in the final quarter that we RTS cases out of the portfolio.”

3.3.53. Our overall conclusion, having regard to the appraisals and objectives that we have reviewed, is that RTS was seen by both frontline staff and their managers as a measure of performance, but the weight attached to it was significantly less than was the case with both income contribution and Upside Instruments.

Complaints

- 3.3.54. Throughout the Relevant Period, it was the responsibility of the Relationship Managers to identify and log complaints. Until September 2012, they were also responsible for dealing with their own complaints. We deal more fully with that aspect in Chapter 4.7 (Complaints).
- 3.3.55. For each of the years that we have reviewed Relationship Managers had as part of their objectives the metric of having *“zero justifiable complaints”*. This was an area that would be reflected in the year-end assessment of performance.
- 3.3.56. Most of the references recorded on complaints are to note that *“zero justifiable complaints”* had been raised in the year.
- 3.3.57. Among the under-achieving population, which total five of the appraisal documents that we reviewed, four involved cases where customers had complained and the outcome of an investigation resulted in a lower performance rating. That such situations were treated with appropriate seriousness is clear from the language used:
- *“Had 2 customer complaints H1. Put on PDP”*
 - *“...ignored the customer's e-mails for nearly three months and stated to the customer that he had no obligation to respond to them, which was clearly wrong and extremely unprofessional.”*
- 3.3.58. But in other cases, where the Relationship Manager was not regarded as being an under-performer, the language used about complaints was, in our judgment, more dismissive in tone:
- *“Zero justifiable complaints recorded. Majority of complaints have been related to BRG implementing appropriate return for risk where this has not been detailed before...”*
 - *“At H1 had 4 complaints. [Customer name] – on C&Q re fees and default. Not upheld. [Other customer name] – forced monthly debt reduction higher than customer proposal. [Named Senior manager] confirmed this was not a complaint.”*
 - *“There were 2 complaints ([Customer P and Customer Q]) but neither were justified. The former was more Policy related and the latter taking of agreed fees, which [Name] had deferred for a period to the customer's benefit.”*
 - *“One complaint in H2 – [Customer name]. A couple of extreme issues he raised were untrue and the complaint overall was not justified.”*
 - *“Only complaint received from [Customer name] technically justified however complaint was created for a technical reason which could not be identified prior to it occurring”*
- 3.3.59. We conclude that whilst complaints were frequently referred to in the appraisal documents we reviewed, the general sense from most employees and their managers was that complaints were a hazard of the role that should not be considered an

indication of a material failing. Indeed sometimes it was concern about the zero complaint target that needed to be tackled:

"It is an excellent result to have no complaints and one that we should continue to strive for however we also need to have difficult conversations with customers on occasions whether that be on pricing or setting milestones – these conversations/requirements can lead to complaints. On occasions I felt that we could have pressed harder or been more resolute with customers ([Customer A, Customer B]) which might have led to a complaint but which would have been un-justified because they were not delivering on their promised actions."

Treating Customers Fairly

3.3.60. TCF was not a specific objective for Relationship Managers in any of the three years that we reviewed. Senior managers (for these purposes as defined in 3.3.17 above) had a specific requirement in relation to TCF in each of the years 2010 and 2011, with a requirement to ensure that TCF was "embedded" within GRG. We were therefore surprised that there was no direct reference to it in the objectives for frontline staff whose role required daily contact with customers.

3.3.61. In 2010, two managers referred to TCF in their year-end performance reviews. They observed as follows:

"All staff completed the relevant TCF training during 2010"

"I am confident that all staff are aware of and engaged in TCF"

3.3.62. Only one Relationship Manager makes reference to TCF:

"Have led a number of initiatives on behalf of BRG including Complaints & TCF roll out, significant involvement in the Ops transformation projects and regular attendance at the bi-weekly BM/COO forums to ensure all BRG impacted issues are raised and addressed on a timely basis."

3.3.63. At the year-end appraisal for 2011, one of the senior manager population gave their line manager the following assurance:

"TCF firmly embedded and now in the forefront of RM thinking"

3.3.64. The only reference that we found to TCF in that year among the Relationship Manager appraisal documents was the following remark made by a Relationship Manager:

"What is apparent from the feedback is that my relationship style does not work in the current environment both with customers and within the team for whatever reason and as such needs to be both more transparent to my line manager and firmer taking in to account TCF."

3.3.65. The Bank has told us that formal roll out of TCF across GRG was completed in October 2010. It was seen as an important element, when incorporated in the objectives of senior managers, in the same way that compliance with the Asset Protection Scheme was. The latter was included in the objectives of the frontline staff and was included as a specific heading within the category "Maintaining the Licence to Operate" for both

2010 and 2011. While we note that the same category required compliance with the policies and procedures manual we find it surprising that:

- TCF was not incorporated in the objectives for frontline staff, even in 2011; and
- Given the cultural changes required by TCF, frontline staff were not measured against the extent to which they had demonstrated compliance with it, certainly for the year 2011 (i.e. the year following full “rollout”). By not including it the Bank missed the opportunity to put in place a review and control mechanism that would have fitted well alongside the other objectives set for that year, and would have measured how each employee was performing against it.

Overall

3.3.66. Overall, we concluded that (for the three years for which we reviewed detailed information) there was a greater emphasis in staff reporting on the generation of income and Upside Instruments than on any other factors. We draw this conclusion from an analysis of the way in which both Relationship Managers and their team leaders referred to income related issues in appraisals. This was the measure of performance that mattered. Other considerations were referenced less in the spirit of drivers of the overall assessment.

3.3.67. Appraisals are of course not the sole, or even necessarily the most important, means by which management communicates its priorities to staff. During the course of our review we also saw other material that appeared to us to be relevant to the assessment of how Relationship Managers were directed and the behaviours that were encouraged by GRG managers. We review that material in the next section.

Other material relevant to our assessment of staff objectives

3.3.68. We found a number of emails on customer files which indicate that Relationship Managers were tracking, at an individual level, the contribution that they had made toward income targets. By way of example:

- An email sent by the then Corporate Director of BRG in a regional office on 17 November 2010, to the regional team:
“This month’s income/upsides/debt repayment breakdown – and YTD so useful when putting together the data requested re end of year appraisals as well!!!”
- An email circulated to another Regional Office of BRG on 15 July 2010 attaching a spreadsheet setting out income and other measures (including RTS) achieved by individual Relationship Managers *“against our team budget to the end of July”*.
- An email dated 3 September 2011 from a Relationship Manager to his line manager showing how the meeting of income targets could have a direct impact on the way that prices were structured for customers:
“As you know proposing an equity stake in this one and numerous ppfas...”

Where are we income wise as a team as probably could leverage some fee income from this one but not sure if we need it or if we are looking for medium term income instead."

3.3.69. The response, dated 5 September 2011, reads:

"We will be 35% ahead of plan so go for medium term not short term income."

3.3.70. These emails indicated that income was tracked at an individual and team level, and its generation was seen as important to those responsible for managing customers and negotiating fees and other income streams with them following their transfer to GRG.

3.3.71. In June 2014 the Bank alerted us to a number of emails that had come to light which dealt directly with the generation of income in one BRG Regional Office.

3.3.72. RBS conducted a review by its Special Investigations Unit ("SIU") within RBS Internal Audit. We attended interviews conducted by SIU and were afforded the opportunity to formulate questions of our own. We examined the emails and attachments and have considered the responses given in the interviews that took place with two members of GRG staff.

3.3.73. Among the documents we reviewed was an email from a team leader, responsible for the management of staff at a Regional Office, dated 4 May 2009 to all BRG staff in that Regional Office (which we refer to in this Chapter as Office K). This document indicated the extent to which targets influenced the behaviour of management and staff. In it he notes that the region was seriously behind budget and needed *"to deliver"*. He stated he would be holding an income workshop on 6 May to which all were welcome. The objective of this workshop was *"to share experience of income and deal generation in GRG but also detail of how to implement and record them"*. An aide memoire and budget spreadsheets were to follow.

3.3.74. On 6 May 2009 the same team leader sent an email to all staff at Office K and attached a two page aide memoire entitled *"Just Hit Budget!"* The subject of the email was *"JHB"*. The attachment was subsequently used as a training aide during income workshops that the same team leader ran in May and September 2009 within that region of BRG.

3.3.75. The *"Just Hit Budget"* document is reproduced in full at Annex IV. It is in our view a relevant piece of evidence that goes not just to the immediate priorities for staff in that regional office at that time, but also gives a wider sense of the culture of GRG at that point.

3.3.76. The *"Just Hit Budget"* document sets out the tactics and tips that its author recommends including:

- *Manage expectations, - "set the tone at the handover meeting";*
- *Maintain momentum;*
- *"Use facility letters – if they sign they can't complain";*
- *"Basket cases: Time consuming but remunerative";*

- *"Missed opportunities will mean missed bonuses. You can always revisit an earlier deal";*
 - *"Be specific: avoid round number fees - £5,300 sounds as if you have thought about it, £5k sounds like you haven't";*
 - *"Rope: Sometimes you need to let customers hang themselves. You have then gained their trust and they know what's coming when they fail to deliver".*
- 3.3.77. The author then provides *"16 Ways to generate income"*. With the various fees (monthly fees, exit fees, facility fees, conditional support fees default interest fees, and so on) the author explains how staff can "claim" the income and in some cases gives advice for the levels of fees staff should target – for example *"Facility fees: Aim for 2% but if doing a restructure aim much higher although may have to add to our debt"*.
- 3.3.78. Subsequently, on 26 August 2009, the same team leader issued an electronic invitation (subject *"JHB"*) for a meeting on 11 September 2009 to all staff at Office K and attaching the *"Just Hit Budget"* document. The author notes that the session is for *"new starts and anyone else who would like a refresher on how to get a customer to agree chunky fees and upsides and thank you for it."*
- 3.3.79. There is evidence of further circulation of the *"Just Hit Budget"* document within Office K. The author attached it to other emails he circulated when he was raising income related issues. For example, on 9 September 2009 he issued a reminder on how to process *"new money"* deals to ensure income was properly recorded. He also attached the two page *"Just Hit Budget"* document commenting *"You should now all be familiar with this but I am issuing it again."*
- 3.3.80. Further emails show that the document was sent to at least one other regional office in July and again in August 2009.
- 3.3.81. Other emails showed that from June 2009 onwards, weekly reports were circulated within Office K showing achievement against financial targets. Typically the emails also highlighted significant income items or debt repayment achieved by a Relationship Manager, reminders as to the taking of monthly management fees and to ensure that frontline staff correctly recorded all income so that it was attributed to the unit. Some of the emails have a congratulatory tone in relation to those staff named. There were also references to which teams within Office K had performed best during the week.
- 3.3.82. The evidence showed that incremental income was a key focus of management attention for GRG during the period covered by the emails (September 2008 to December 2009), at least in respect of Office K.
- 3.3.83. Having considered this material and the responses of staff interviewed by RBS as part of its own investigation, we advised the Bank of our views, in relation to Office K, as follows:
- Individual Relationship Managers had their income generation performance tracked on a monthly basis;

- Staff appraisals commented on the strength of individuals' contribution to regional income generation targets;
- There was a clear desire expressed by GRG management (including from head office level) for income targets to be met and there was concern expressed when income generation was behind target in the earlier part of 2009;
- Additional training sessions focusing on income generation were scheduled where the "*Just Hit Budget*" document was used. These training sessions may have been for new staff but there were indications that existing staff may have also been required to attend;
- Weekly emails congratulated staff on doing income deals and highlighted the level of income from each deal. There is evidence to suggest that these emails were used in a similar fashion in at least one other regional office;
- Interviews with staff confirmed the focus on income generation was considered a key issue for staff at the time;
- Office K noted its performance in relation to other regional offices in terms of the level of income generation; and
- The "*Just Hit Budget*" document was widely circulated. The content and tone of the document were never challenged at a senior level.

3.3.84. The evidence that we have found randomly on case files indicated that the issues at Office K were unlikely to be confined to that Region.

Wider observations on culture

3.3.85. Phase Two of the Requirement Notice includes an assessment of the 'culture in GRG' as part of considering the root causes of any inappropriate customer treatment identified in Phase One. Our observations at this stage therefore are limited. But given the scope of our enquiries, not least the work reported in this Chapter, we consider it appropriate and helpful to make reference to our initial views on the overall cultural approach within GRG. In doing so we recognise that we have not carried out a full review of culture, nor have we interviewed relevant RBS staff about these issues. But a consistent theme emerges from various aspects of our review.

3.3.86. GRG was managed as a division of the Bank that operated many of its own policies; it was deliberately set up that way. We highlight that in Chapters 2.1 (Background to the Review) and 3.2 (Governance and oversight). The culture was also said by RBS to be different; it was to focus on turnaround "*rather than sales*", but overall our work indicates a culture – the GRG way – that had, as its paramount focus, the generation of income, the creation of upsides and at times a cavalier and inappropriate approach to customers.

3.3.87. We saw this manifest itself consistently across the areas that we have reviewed. In our analysis of objectives, it was clear that the focus was more on income generation than on turnaround. That was apparent not just from the way in which data on income generation was seen as important but also from the language used by both

management and frontline staff. There was a recurrent reference to “deals”, especially in relation to the obtaining of Upside Instruments.

3.3.88. For example:

“On Financial/Upsides performance, [Name] has placed an increased focus on this area and has executed some good deals including what may turn out to be a good circa £1m upside on [case reference].”

“Focus for H2 should be on driving upsides deals”

“helped to instil the GRG deal doing/transactional culture”

3.3.89. And in one office in 2009 the following comment from a manager when appraising staff was a recurrent phrase:

“The culture of BRG is that we must always

Actively manage cases to optimise return to the Bank while managing risk

Matching Risk with reward and

Developing innovative solutions”

3.3.90. This focus on income generation is apparent from our review of the files. We found scant evidence that turnaround options were considered at the initial assessment of the case. Instead, the first consideration was the amount of additional income that could be generated from a customer.

3.3.91. Attitudes toward customers, particularly those who complained, were, in our view, often dismissive. We refer to some of the comments that we found in that regard when dealing with objectives, and we saw it reflected in cases as well where we made a number of findings about the failure to identify and properly manage complaints, including some that were regulated by the DISP regime.

3.3.92. The “Just Hit Budget” document and related material showed a day-to-day management focus on “how to get a customer to agree chunky fees and upsides and thank you for it.” The tone of the document, that was widely circulated to all BRG staff within Office K and was sent to at least one other regional office at the time, and appears never to have been challenged at that time (including by the Regional Director who was aware of its circulation at the time), was indicative of an unprofessional culture that set little store by the interests of the customers handled by GRG. Rather customers were viewed as “opportunities”.

3.3.93. This was reflected in the wider management environment. The “Just Hit Budget” document might not be significant were it clearly an isolated example of poor management judgment. However our work has suggested that the attitudes to customers and the priorities of the role of GRG staff that the author(s) so graphically illustrate were not isolated, but were common in the culture of GRG at the time. That culture of deal making, with its focus on the financial interests of GRG, placed little weight on the stated turnaround objective of GRG, and less still on the fair treatment of customers.

- 3.3.94. We also found material on files that is suggestive of the cavalier approach to which we have referred. For example, the following email sent to 24 staff (and subsequently but belatedly withdrawn) found on a case where the retail customer was placed into liquidation:

"Subject: Nobody beats [Customer] ... in Administration anyway!!!

*Team, I've saved a list for the [customer] sale - Other/[GRG Office]/[customer] list. Can you go in and add your name and what you want under two categories - key/large items and miscellaneous (if for example like me and [staff name] you're kitting out a new spot). It's looking tight from [name's] view to get any special treatment here, so keep things to staff only and don't take the p*ss. We may not get special treatment but we'll push for it!*

P.S. I've sent this to the people who have expressed an interest only ... not all [GRG Office], so if you are aware of anyone not on the list but who wants in, forward to them ... but it's GRG only!"

- 3.3.95. On another case, involving a foreign national we felt that the wording of some emails was so inappropriate that we made the following observation in our case findings to RBS:

"We note that some email correspondence relating to this case fell short of the professional standards to which we would expect the Bank to aspire. In particular the mimicry contained in the email of December 2010 was disrespectful of the customer's nationality.

And the email exchanges on 'negotiating tactics' in 2013 do not appear consistent with treating customers fairly and with respect and in our view suggest questionable professional standards."

- 3.3.96. Such communications were not commonplace; but they crop up on files and appear to have largely gone unchecked. They are not consistent with a culture that has, as its focus, the interests of the customer.

Conclusions

- 3.3.97. We have concluded that although Relationship Managers had a "balanced" scorecard, the outcome that took precedence over any other aspect was the generation of incremental income. That included both immediate income (in the form of margin enhancements and fees) and future income from Upside Instruments.
- 3.3.98. The language used and the frequent references to income generation that we saw in the material that was provided, which is clear from the *"Just hit Budget"* document, was cogent evidence of an inappropriate concentration on this aspect with far less regard for the turnaround of customers or their fair treatment. These themes emerge from a number of offices and were not limited to Office K.
- 3.3.99. We have concluded that there was a general failing to establish and oversee balanced and appropriate objectives for staff to deliver GRG's twin objectives. This was not in our judgment a result of idiosyncratic decisions by local managers, but was endemic in

GRG's arrangements in respect of those dealing with SMEs. This was a failing that GRG management was aware of (or should have been aware of), but the steps necessary to start to address the issues we identified were not taken until the very end of the Relevant Period.

3.4 – Part 3 conclusions

3.4.1. This Chapter sets out our key conclusions from this Part.

A Conflict of objectives

3.4.2. GRG consistently adopted, throughout the Relevant Period, twin objectives. These were variously expressed in documents, including to the RBS Board, to staff and customers and more widely. But the overall message was consistent, the two objectives were:

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

3.4.2. We do not criticise the Bank for having a commercial objective and in particular for taking steps to protect the Bank's capital. But in a turnaround context, where the customer is already exhibiting financial distress, such commercial considerations need to be balanced against the need to foster an environment that is conducive to the customer's return to health where that is practicable.

3.4.3. There were, in our view, clear risks to customers inherent in the GRG model. Whilst the existence of a commercial objective was not inappropriate of itself, it gave rise to inherent potential conflicts of interest and risks to customers. That was exacerbated by the way in which GRG was required to be a "major contributor" to the bottom line and a profit centre.

3.4.4. Put simply, the risk was 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 simple presence of this risk did not make the GRG objectives inherently inappropriate, but at a minimum it emphasised the 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.

3.4.5. There was therefore in our judgment an onus on GRG (and indeed on RBS) to ensure that GRG's twin objectives remained appropriately in balance. We have concluded that, of the two objectives that GRG set itself, the evidence available to us demonstrates that in practice the internal focus was on the commercial objective and far less weight was attached to turnaround in respect of SME customers.

3.4.6. One impact of the failure to manage this conflict of objectives was that the expectations of customers were not appropriately managed. GRG presented itself to customers primarily as being a division that was there to help customers in financial distress and claimed that entry to GRG would help to restore an ailing business back to health. The reality was very different. The failure to appropriately manage expectations has, in our

view, given rise to many of the expressions of dissatisfaction that have been made about GRG.

- 3.4.7. More substantively, the failure to manage the conflicts inherent in GRG's twin objectives also exacerbated a key risk – that GRG by pursuing its commercial objective 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.

Governance shortcomings

- 3.4.8. The existence of this conflict made it important to have in place effective and appropriate systems of control and effective policies (with adequate policing mechanisms) designed to protect the interests of customers.
- 3.4.9. We identified governance and oversight shortcomings in each of the areas we considered. In summary:
- The risk management framework did not include sufficient or appropriate second or third line oversight across the Relevant Period;
 - Key risks to customers were not identified, managed or appropriately mitigated;
 - Management information was not sufficient or appropriate so as to enable GRG management to have clear oversight of key risks to customers; and
 - The process set out in GRG Policy and guidance was not routinely followed by Relationship Managers, and the lack of effective or appropriate oversight meant that this was allowed to continue across the Relevant Period.
- 3.4.10. We have concluded that the governance and oversight framework was not appropriate or sufficiently robust, across the whole of the Relevant Period, to provide effective challenge and oversight relating to the treatment of customers within GRG. In certain respects, this was recognised by RBS at the time.
- 3.4.11. 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. GRG management was aware (or ought to have been aware) of these shortcomings but took insufficient steps to correct the position.

Staff objectives

- 3.4.12. These general governance shortcomings were exacerbated by the approach GRG took to staff objectives. Our analysis of the material that we have reviewed leads us to conclude there was, in practice, a greater emphasis on the need to generate income and achieve "upsides" than on any other measure set in the objectives for frontline staff and that the revenue targets and incentive schemes influenced the behaviour of GRG management and staff.

- 3.4.13. We arrive at that conclusion because of the language used and the preponderance of references to these matters over others in the individual appraisals, together with the other evidence about the priorities of managers that we have seen during our review – including but not limited to the *"Just Hit Budget!"* document and directly associated material. This was not simply a matter of management reminding frontline staff of the harder edged and more difficult objectives that they should bear in mind in handling cases, but a clear statement of priorities.
- 3.4.14. The earning of income in the short to medium term by the taking of fees, and in the longer term by taking the opportunities represented by "upsides" was, in our view, as a result at the forefront of motivation for Relationship Managers.
- 3.4.15. We have concluded that there was a general failing to establish and oversee balanced and appropriate objectives for staff to deliver GRG's twin objectives. This was not in our judgment a result of idiosyncratic decisions by local managers, but was endemic in GRG's arrangements in respect of those dealing with SMEs. This was a failing that GRG management was aware of (or should have been aware of), but the steps necessary to start to address the issues we identify were not taken until towards the very end of the Relevant Period.

Culture

- 3.4.16. Our work has suggested that the attitudes to customers and the priorities of the role of GRG staff that the author of the *"Just Hit Budget"* document so graphically illustrate were not isolated, but were common in the culture of GRG at the time. That culture of deal making, with its focus on the financial interests of GRG, placed little weight on the stated turnaround objective of GRG, and less still on the fair treatment of customers.

Overall conclusions on how GRG operated

- 3.4.17. We conclude that there was a failure on the part of GRG and RBS to recognise and manage the conflicts of interest inherent in GRG's twin commercial and turnaround objectives, and to put in place the appropriate governance and oversight policies, procedures and processes (including in relation to staff objectives) to ensure a reasonable balance was struck between the interests of the Bank and those of its SME customers.
- 3.4.18. The overwhelming features of GRG's conduct towards its customers and its management of conduct issues generally, including conflicts of interests, were not subject to regulatory rules or standards. So our conclusion is not tied to any failing to meet specific regulatory requirements, but represents a statement of a shortcoming against our assessment of what was in accordance with the Bank's own policies and otherwise what was fair and reasonable.
- 3.4.19. This absence of appropriate governance and oversight, including the 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. It is clear that GRG management was aware, at least in part, of some of these

shortcomings but, it would appear, chose not to prioritise action to overcome them. As a result these failings occurred across GRG and applied for most of the Relevant Period.

Part 4 – Activities of GRG

- i. In this Part, we set out the main areas of activity of GRG which were based around a typical timeline for a customer. The first Chapter deals with the identification of customers for transfer and the transfer process.
- ii. We describe the approach GRG took to the question of whether and how it could support customers as part of its turnaround approach.
- iii. We then consider how it made decisions on the level of facilities it provided to customers, the pricing it adopted for facilities and the other fees it levied, together with its approach to valuations of property.
- iv. We then turn to customer experience and how GRG went about handling the Bank's commitment to TCF. We also describe how GRG handled complaints, before commenting on the role of third parties and the issues customers faced who wished to exit GRG.
- v. We do not comment on those specific issues that arose during the course of our review in relation to West Register in this Part. We comment on these issues in Part 5 (West Register).
- vi. We are mindful that the reality of the position for both the Bank and the customer was that there was a significant degree of overlap between the issues here. The position for the customer would depend on the level and nature of the facilities the Bank was prepared to make available, the pricing for those facilities and the other fees that GRG would levy. These in turn would be critical to understanding whether there was a path for the customer to undergo a successful turnaround. And the level of facilities and pricing would often depend on the level of security and the valuation of assets.
- vii. So from both the perspective of the Bank and that of the customer, these issues needed to be considered in the round. In Parts 3, 4 and 5 however we have attempted to make each of these components of the report reasonably self-standing – in that these Parts are designed to report on what we found and to respond to the various allegations and customer concerns relevant to the specific area under consideration.
- viii. We bring the themes back together again in Part 6 (Customer outcomes) when we consider customer outcomes. But where it appears to us of particular importance, we draw attention to dependencies between the issues in the following Chapters.
- ix. What emerges is a complex pattern of interdependent issues, but with some common themes.

4.1 – Transfers to GRG

- 4.1.1. The transfer to a division responsible for dealing with a business in distress was an important event for customers. It involved a change in Relationship Manager, sometimes away from one with whom the customer had been dealing for years.
- 4.1.2. In many respects customers were heading into the unknown, with little knowledge about what to expect, what the impact might be on them, and what role the Bank was going to play going forward. In addition, it may have increased the difficulty customers had in moving to other banks or providers of finance.
- 4.1.3. For these reasons, it was important that RBS was careful in decisions that it took to transfer customers to GRG, and was careful about the messages that customers were given about key areas such as the reasons for the transfer and about what to expect when in GRG.
- 4.1.4. This Chapter sets out the approach RBS Group took to identify customers for transfer to GRG and describes how customers were transferred from the mainstream Bank to GRG. In particular we consider:
- Whether RBS appropriately identified customers for transfer to GRG;
 - The governance and appropriateness of the transfer process; and
 - The transparency of the transfer process.
- 4.1.5. We also consider whether:
- In assessing the move to GRG businesses were assessed on their value to RBS rather than their level of financial difficulty;
 - Businesses which were demonstrating similar levels of performance were treated differently in an inappropriate way, with the treatment and the process depending on the value to RBS;
 - Technical breaches of covenants (with no bearing on the performance or viability of the business) were used to transfer a business to GRG; and
 - The reasons that triggered the move to GRG were adequately explained to customers.
- 4.1.6. We conclude that almost all of customers transferred to GRG were exhibiting clear signs of financial difficulty and could have benefited from the support of a turnaround unit. We saw no evidence that persuaded us that there was a widespread practice of targeting businesses for transfer based on their value to GRG (and not their level of financial difficulty), although we did see a small number of cases where the background reasons for transfer included considerations that appeared to us to be inappropriate.
- 4.1.7. However, the transfer process was not well governed and the Bank failed to recognise the potential conflicts of interest involved in GRG's power to transfer individual businesses. The transfer process itself was also not transparent in that communication

with customers during the transfer process was poor and in some cases misleading, as the reasons for transfer were sometimes not fully or correctly set out.

The Bank's procedures and policies governing transfer decisions

- 4.1.8. The general process for the identification and transfer of customers to GRG did not change materially across the Relevant Period.
- 4.1.9. From 2009, RBS operated a Watch Forum framework where individual cases were monitored prior to transfer to GRG. Members of SRM, B&C Credit and GRG attended this forum, although generally B&C Credit decided which cases were to be included. The forum did not have any decision-making authority, including with respect to the transfer of customers to GRG.
- 4.1.10. The RBS definitions for each watch status were as follows:
- *“Watch-Amber: customer exhibits signs of potential stress that, if not overcome, may result in the customer not being able to meet their obligations to the RBS Group;*
 - *Watch-Red: customer exhibits signs of actual stress that, if not overcome, will result in the customer not being able to meet their obligations to the RBS Group; and*
 - *Default/Watch Black: a customer that is in default.”*
- 4.1.11. Watch-Amber customers were identified by B&C Relationship Managers using metrics available in credit and operational systems (such as RMPS), or through manual identification (e.g. by the Bank's Problem Identification Team).
- 4.1.12. The decision to transfer a customer to GRG was taken jointly by the SRM Relationship Manager, B&C Credit and GRG. In the event of disagreement, GRG was the final decision-maker. In addition, GRG had the authority to request the transfer of a customer directly. RBS told us that, in practice, disagreement on the appropriateness of transfer to GRG was rare and that GRG did not generally exercise its right to request a customer to be transferred directly. We saw no evidence that GRG exercised this right in any of the cases in our sample.
- 4.1.13. Latterly, RBS has accepted Sir Andrew Large's observation that RBS did not do enough to address the potential for conflicts in its governance arrangements relating to the transfer of customers to GRG. Sir Philip Hampton (the then chairman of RBS Group) in his letter to the Treasury Select Committee⁵⁷ re-emphasised that to GRG's recollection the power to “call in” a case had not been used during the Relevant Period in respect of SME customers. He then added, *“Nevertheless, I share Sir Andrew's view that the existence of the authority, regardless of whether it was used or not, could create a perceived potential conflict of interest.”*
- 4.1.14. RBS told us that, in considering whether or not to transfer a customer, it used transfer criteria against which an assessment was made. These criteria varied slightly over the

⁵⁷ Sir Philip Hampton, Chairman RBS Group, letter of 22 August 2014 to the Chairman of the Treasury Committee

Relevant Period but the main themes were constant. The table below gives an example of the criteria that existed during part of the Relevant Period.

Fig. 15: GRG transfer criteria (February 2010 – September 2011)

Mandatory transfer to GRG	Mandatory referral to/discussion with GRG
<ul style="list-style-type: none"> • PD⁵⁸ is 24 or greater with no justifiable override appropriate • Need to record Stressed Loss • Customer litigates against the Bank • Accountants investigation (IBR) required • Current/proposed insolvency or other action against customer or management – Includes any Phoenix proposal. • Fraud by owner or management, incl. cross-firing (unless otherwise instructed by GS&F) • Debt has to be restructured outside of normal senior debt parameters 	<ul style="list-style-type: none"> • Any other Bank initiated request for external accountants involvement where PD is 18 or greater • Default on any funding lines with RBSG/other banks • Withdrawal of licence/registration etc. from main trading business • Breakdown of customer relationship or any proposed exit strategy • Regular/significant unpaid items that threatens the future of the business • Sustained losses/cash absorption that seriously compromises serviceability • Property investment exposure with unacceptable LTV/DSC profile • 2 consecutive years operating losses where customer is unable to service borrowings • Two or more consecutive (uncovered) loan arrears • A change/strengthening of a customer's management team at the Bank's insistence and more specifically if there is the introduction of interim specialists to assist the management team

4.1.15. As can be seen, these criteria for transfer were quite widely drawn, and included some aspects that do not necessarily relate to the financial difficulties of the business. For example, a customer with a legal dispute with RBS was subject to a mandatory transfer to GRG. Similarly, the mandatory criteria of breakdown of customer relationship did not necessarily relate to financial difficulty, although in practice we did not observe these criteria being used in isolation from financial concerns.

⁵⁸ PD is the Probability of Default and is defined in Annex II.

- 4.1.16. Retaining some discretion in this area appears to us to be appropriate, but with that goes a need for checks and balances to ensure that discretion is being exercised fairly and consistently. However, there was at minimum a risk that a transfer to GRG was seen as an opportunity to handle problems that went beyond GRG's core mandate.
- 4.1.17. In January 2009, Group Internal Audit ("GIA") reported on the GRG transfer process. It noted that GRG had, at that time, stopped attending the Watch Forum as *"they did not have a formal role in decision making"*. GIA recommended that GRG should attend meetings concerning cases that would require GRG involvement and noted the proposals to give GRG a more formal role including taking responsibility for all cases rated Red. The GIA report also identified a problem with late transfers.
- 4.1.18. GIA also noted that the transfer criteria were widely drawn and inconsistently interpreted by GRG. GRG (according to GIA) looked for trigger events that then require a transfer, whilst B&C Credit took a more subjective view based on case characteristics. GIA proposed streamlining the transfer criteria. This, however, did not take place.

What we observed in practice about transfers

- 4.1.19. The extensive nature of the GRG transfer criteria set out in policy gave the Bank many reasons for transfer. It is not surprising therefore that, with one possible exception, we did not find any cases clearly transferred in a way incompatible with these criteria, although in a few cases we saw additional and less appropriate criteria considered in the decision-making process. Indeed, the SME customers who were transferred to GRG were in our opinion almost all exhibiting clear signs of financial difficulty. Overall we assessed 34% of our Representative Sample as being clearly not viable at or around the point they were transferred to GRG⁵⁹. That included a number of customers who were only transferred when it was clear that insolvency, administration or receivership proceedings had already started or were imminent – perhaps because of the decision of a third party.
- 4.1.20. The Bank stressed to us the pressures that GRG was under given the significant increases in the volumes of customers being referred. There were periods when those pressures placed available resources under strain and this may have contributed to cases not being transferred at an earlier stage. In our analysis of the sample of cases we considered, we were more likely to conclude that *delays* in transfer had been an adverse factor in the customer's treatment, than we were to identify premature or unnecessary transfers. We identified 11 cases where we concluded that a delay in transfer had meant that the customer was not able to access turnaround solutions in a timely way.
- 4.1.21. We paid particular attention to any suggestion that the decision to transfer had been 'engineered' – for example by manipulating defaults or breaches of covenant. Dr Tomlinson referred to:

"The experiences of many businesses across the country suggests that, at least within RBS, there are circumstances in which the banks are unnecessarily engineering a default

⁵⁹ See Chapter 6.2 for the explanation of how we approached and defined this group

to move the business out of local management and into their turnaround divisions, generating revenue through fees, increased margins and devalued assets.”⁶⁰

“There are numerous mechanisms by which a business may be put into default and transferred to business support by the bank. This often takes the form of one of the following:

- *Reassessment of loan to value – revaluation which significantly undervalues the business’ assets and puts them in to breach of their covenants*
- *Technical breach of covenants – such as a temporary dip in EBITDA or a late submission of information. These are often breaches that have no bearing on the performance or viability of the business*
- *Removal of or change to facilities and the move to asset based finance ”⁶¹*

4.1.22. It is correct that the criteria for transfer to GRG did not require more than a breach of covenants, a reassessment of the loan-to-value ratios or a fall in profitability. Customers could be, and were, transferred for these reasons. Such factors could, we recognise, appear contrived from an SME customer’s perspective, particularly where repayments had been maintained. However, it is to be expected that a Bank would be concerned about signs that the risk of the facility was increasing because of changes in the loan-to-value ratio (“LTV”), or that the customer was otherwise no longer maintaining the various terms, including any covenants incorporated in the terms and conditions that had been agreed as part of the original lending decision. A failure to meet the terms of covenants was a reasonable indicator of impending financial stress. Whilst the SME might be confident that the business would be able to trade its way out of difficulties, or that the fall in property values was temporary, it was not inherently unreasonable for the Bank to take a more questioning approach.

4.1.23. Overall, across the cases we reviewed, we were satisfied that almost all of the customers who were transferred to GRG were exhibiting clear signs of financial difficulty that required either turnaround action or collection of the debt. They therefore met the criteria for transfer. In a few cases, however, there were expectations that transfer to GRG would also provide an opportunity to address poor original lending and/or pricing decisions.

4.1.24. The following case extract gives an example, albeit here the business was not (initially) transferred to GRG and GRG was concerned that there was a “*lack of leverage*”.

Case Extract 1

Following a challenging period of trading, the Customer was referred to GRG. At this time the Customer was exhibiting various features of distress. GRG rejected this case on the basis that there had been no event of default and citing concerns that the “*lack of leverage on the facility docs, with no covenants etc. trading/financial profile of business*”

⁶⁰ Tomlinson Report, page 2

⁶¹ Tomlinson Report, page 5

is poor with a deteriorating trend, overdrawing of profits clearly a case where we will try to flush out equity/further security."

The customer was instead transferred to SRM, with a subsequent transfer to GRG occurring less than 6 months later. Rather than attempting to provide the business with its turnaround expertise, it appears that GRG was primarily concerned that it lacked leverage to improve the Bank's position.

- 4.1.25. These observations about future handling of the case need to be placed in context. First, in this case we were satisfied that on balance a transfer to a turnaround division was warranted given the SME's circumstances, notwithstanding these other considerations. Second, in this case the Bank was discussing problems and potential solutions internally from a Bank perspective. It was not unreasonable that, for example, the Bank might no longer wish to grant facilities to customers of a particular description and, if a customer was not in a position to re-bank or repay the debt in some other way, that this would be material in the assessment of the next steps in the relationship between the Bank and the customer.

Transparency of the transfer process

- 4.1.26. Both the Large and Tomlinson reports refer to the significance of good communication and the transparency of the process by which a customer is transferred to GRG. The Large Report put the matter in this way:

"Any alterations of terms in the bank's favour are liable to provoke a reaction, particularly if not transparently and well explained. This can damage the good relationships that a bank has built up with its customers. This is the case both for instances where the bank's own economic and risk standards considerations apply, but particularly where deteriorating financial performance is the driver.

- *At the point at which the customer's situation causes the bank to move the SME to recovery or resolution, customer and bank interests can become misaligned. The method by which the bank seeks to protect its interests on behalf of its shareholders may then differ from the customer's preferred course of action. A bank will seek to minimise the loss it is exposed to, were the business ultimately to fail and be unable to repay the amount it owes;*
- *Particular care is needed in the SME sector, because business and personal finances are often interconnected. Consequently, any decisions that banks might take which affect the financial position of the business are complex, and can affect the livelihood and lifestyle of the people involved in that business. Unsurprisingly, therefore, these decisions can evoke strong emotions.*

*Challenges arise both in terms of the key decisions which need to be made and the means by which they are communicated to the customer."*⁶²

⁶² Large Report, page 48

4.1.27. The Tomlinson Report dealt with the issue as follows:

"It is vital to stress in regards to all that has proceeded so far, that this is not a transparent process. There is much confusion on the part of the businesses that are unaware of what is happening. Cases have even been submitted where the default that triggers the businesses descent into business support has not been adequately explained. Whilst looking at cases after the fact, there appears to be a clear movement towards the business' final destination, the rationale and reason for their treatment is not clear to the business at the time it happens.

[...]

*Transparency is vitally important, especially for the business once they are in or about to go into business support. If the bank is aiming to put the business into insolvency from the outset, this should be made clear to the business so they may try to find alternative sources of finance, pay down their debt if they have personal wealth or prevent them from taking decisions in the winding down of the business worsens their own position."*⁶³

4.1.28. Transfer from the mainstream Bank had various effects, both direct and indirect. RBS describes the purpose as establishing a more expert and more direct interaction between RBS and companies encountering difficulties. Some customers appear to have initially welcomed this additional expertise.

4.1.29. In practice, the transfer also had other important effects. The first was that the customer was transferred from their normal RBS Relationship Manager to a new manager; the GRG relationship with that customer was intended to be closer and more interventionist. RBS practice was that once a transfer to GRG was implemented then the pre-existing mainstream Relationship Manager should no longer be in contact with the customer. We did not see that practice as inherently objectionable – indeed maintaining two customer relationships would be both inefficient and likely to give rise to confusion. However, the speed and absolute nature of the changeover of managers was clearly disruptive to some customers, especially where they had established a strong and long-lasting association with the mainstream Relationship Manager. This was most likely to be an issue for the ongoing relationship between GRG and the customer if the mainstream Relationship Manager had relevant sectoral experience that the GRG manager lacked.

4.1.30. We found no evidence of a mainstream Relationship Manager being disciplined for maintaining contact with a customer, although it was clear that the practice was discouraged.

Case Extract 2

The customer's business model involved long-term projects funded by borrowing which was repaid once these projects were sold. The connection was transferred to GRG on the basis that the Bank was no longer willing to provide facilities on these terms, and

⁶³ Tomlinson Report, pages 9 and 10

due to the borrower being unable to agree to monthly capital and interest payments (as his business model did not allow this).

Following the transfer of the connection to GRG, a number of restructuring proposals were made, all of which called for the accelerated repayment of the company's facilities. The customer noted in discussions with us that the business was *"a bespoke company that GRG had not understood"* and that the GRG Relationship Manager had *"insufficient business experience or knowledge to provide business support."*

- 4.1.31. Second, the transfer was often accompanied by the rescheduling of the arrangements between RBS and the SME on terms justified by GRG as better reflecting the time required to support the customer and matching the additional credit risks being run by RBS.
- 4.1.32. As we note in Chapter 2.1 (Background to the Review), in the circumstances of the economic crisis after 2008, re-financing for many sectors was often not a viable option, although over the Relevant Period the position eased. Following a transfer to GRG, the position of an SME seeking alternative financing from a source other than RBS would also have been impeded by both the need to declare that it was within GRG and by other factors, such as involvement in an industry for which funding was unlikely to be available from other sources.
- 4.1.33. These implications were serious for the customer, and it made both the need for consistent and fair decision making about transfer, and clarity in the communication by RBS of the reasons for and implications of this transfer, all the more important.
- 4.1.34. The customer handover procedures were set out in GRG's Policy and Procedures Manuals and remained relatively consistent across the Relevant Period. The policies reflected the need to ensure open and transparent communications with customers.
- 4.1.35. The policies provided that a 'pre-handover' letter was sent to the customer and that a handover meeting with the customer should be held, normally at the customer's premises, and be attended by the B&C Relationship Manager and the intended GRG Relationship Manager. The pre-handover letter and handover meeting were to include:
- An explanation of the reasons for transferring the relationship;
 - An introduction to GRG by the GRG Relationship Manager setting out the general principles of the GRG approach to distressed customers;
 - A detailed introduction by the customer of their business, including a tour of the business premises;
 - A review of latest financial performance (where information was available); and
 - An agreement as to the next steps to be taken.
- 4.1.36. The template letter, set out in the table below, provides an example of what the customer was led to expect in the initial letter from their B&C Relationship Manager announcing the intention to transfer the customer to GRG. In practice this letter was often heavily edited by Managers and, as our review of files identified, was not always sent.

Fig. 16: Template pre-transfer letter from RBS to SME customer

Strictly Private and Confidential

[*Company name and address*]

[*Date*]

Dear [*Company Contact*]

I write to confirm our meeting arranged for [*time and date*]. As discussed, I will be accompanied by [*GRG Relationship Manager*], who is a colleague from our Global Restructuring Group ('GRG'). GRG have expertise in corporate turnaround and specialise in assisting our customers who, for whatever reason, are exhibiting signs of distress or general underperformance that is impacting on financial viability.

Your file has been referred to [*GRG Relationship Manager*] predominantly due to [*reasons for Bank's concerns to be detailed in a clear and concise manner – refer to appendix for examples*].

[*GRG Relationship Manager*]'s role is to seek to understand the problems the business is currently facing and to explore possible solutions. If up to date management accounts, aged debtor and creditor listings and forecasts can be made available ideally prior to, but otherwise at the time of, the meeting, this will greatly assist with their understanding.

They will explain their role in greater detail at the meeting and answer any questions you may have. The aim of GRG is to work constructively with you to develop a strategy which addresses the Bank's concerns and, where possible, ensures a turnaround or recovery plan is delivered.

We look forward to meeting you shortly.

Yours sincerely

Frontline Relationship Manager

- 4.1.37. Throughout the Relevant Period, GRG policy also required a follow-up letter confirming the position and setting out the next steps.
- 4.1.38. These policy requirements, and compliance with them, were key mechanisms to ensure that the customer was given clear and important information about their position. The content and tone of the follow-up letter would influence the customer's perception of their position and would enable them to reflect on what had been done by RBS and why it had been done. The letter in particular would be useful to third parties whom the customer may approach for advice and would protect RBS against misunderstandings in the future. The form and content of the post-handover letters was mandated by RBS.
- 4.1.39. In many of the cases that we have reviewed we found that the reasons for transfer were inadequately explained to the customer. We made 104 findings on this issue in our case review.
- 4.1.40. RBS told us that much of the information was provided orally in meetings, or phone calls, with the customer. This may be so, although it is difficult to have confidence in the precise content of unrecorded meetings that took place some years ago. In any event,

the complexity and significance of the information to be communicated was such that it appears to us inappropriate to rely solely on oral communication.

- 4.1.41. Written communications were important and were mandated in RBS policy. We view the absence of adequate communication about the transfer as inappropriate treatment of the customers concerned. On the basis of the evidence from our sample of cases, we conclude that there were frequent failures to provide clear and timely information about the transfer process.
- 4.1.42. We also note that GRG management was aware (or at least should have been aware) of these failings. The GRG customer survey showed low levels of satisfaction with the transfer process. For example, in 2013 45% of the sample was 'very or fairly dissatisfied' with GRG's communication of the reasons for transfer and 29% very or fairly dissatisfied with the written handover of communication. But we saw little evidence that GRG monitored or enforced compliance with its own policy in this area.

What customers were told on transfer

- 4.1.43. The official messages given to SME customers at the point of transfer by RBS were positive and supportive and it was stressed that GRG had *"expertise in corporate turnaround and specialise in assisting our customers who, for whatever reason, are exhibiting signs of distress or general underperformance that is impacting on financial viability."* The stated aim of GRG was similarly supportive: *"The aim of GRG is to work constructively with you to develop a strategy which addresses the Bank's concerns and, where possible, ensures a turnaround or recovery plan is delivered."*
- 4.1.44. These messages were consistent. The follow-up letter, which was to be issued to SME customers by the GRG Relationship Manager, started by describing GRG as *"the area of the Bank that focuses on corporate turnaround."* The letter continued: *"The goal of GRG is corporate turnaround; we focus on identifying risk, addressing corporate distress, crisis management and business stabilisation. Our objective is to return you to mainstream banking once the issues you are facing have been overcome."* And the letter ended: *"Finally I would like to reassure you that the main objective of GRG is corporate turnaround and I look forward to working with you albeit during challenging times."*
- 4.1.45. Doubtless, customers welcomed this objective and took comfort in the reassurances given about the approach GRG would take. However, the reality for most customers was that these objectives were in practice given little weight during the Relevant Period – rather there was a focus on revenue generation and debt reduction following transfer. This mismatch between customer expectations fuelled by RBS's own presentation of GRG's role, with the reality of GRG's actual conduct, was in our judgment a major factor in driving the degree of customer dissatisfaction that Dr Tomlinson and others reported.

Northern Ireland

- 4.1.46. RBS told us that the arrangements in Northern Ireland were different from those in the rest of the UK. That was borne out by our work on policies and the review of cases in our sample.

- 4.1.47. In relation to the transfer of customers there were material differences, particularly in 2011 when, following a project to consider how best to deal with pressures across Ulster Bank, RBS instituted a bulk transfer of approximately 300 'problem cases' to BRG in Northern Ireland. RBS told us that *"In view of the speed and scale of the migration of cases [a] small proportion of relationship managers were transferred into GRGI with all/most of their portfolio, and so customers would not have been "transferred" into GRG in the normal way with the corresponding change in relationship manager. Over time portfolios were however redistributed in order to meet the Group's requirement for GRG to apply a "fresh pair of eyes" to a case post transfer."*
- 4.1.48. As part of this bulk transfer exercise, the *"process of issuing a pre-transfer letter; followed by a tri-partite meeting between the customer, mainstream RM and GRG RM; and followed up by a post-transfer letter was not followed."* RBS told us that customers were *"in many cases"* given a verbal communication about the changes, although our case sample suggested that this was not a clear or established process. In part, that was because GRG in Northern Ireland continued to find it difficult to resource and handle the volume of cases it needed to deal with. RBS told us that:
- "Cases were prioritised following an initial "triage" analysis (akin to an informal internal SCR process), in order to ensure that the most pressing cases were dealt with first, such as those with immediate cash flow issues."*
- 4.1.49. We observed that, in practice, many customers were left for considerable periods with little or no communication.
- 4.1.50. Whilst we recognise that the situation in relation to Ulster Bank and its customers at the time gave rise to significant challenges for the Bank, we find that the practices that it adopted were in several respects inappropriate and failed to pay sufficient regard to the needs of the customers involved. The 'bulk transfer' was a pragmatic solution to the circumstances, but it meant that customers were not adequately informed about an important change in their status. We also note that cases with lower priority (typically but not only smaller accounts) could be left for a considerable time before receiving appropriate attention. Delays in addressing turnaround considerations are undesirable because the business' financial and operational problems may not be addressed and hence options for turnaround can be lost simply because the customer remains uncertain about the Bank's readiness to support the SME through a challenging period.

Our conclusions on transfer issues

- 4.1.51. We have reached the following conclusions about the transfer process:
- Overall, across the cases we reviewed, we were satisfied that almost all of the customers who were transferred to GRG were exhibiting clear signs of financial difficulties and required either turnaround action or collection of the debt. We saw no evidence that persuaded us that there was a general practice of targeting businesses for transfer based on their value to GRG (and not their level of distress). However, in a few cases we saw that other, less appropriate, factors were considered as part of the decision-making process;;

- The widely drawn transfer criteria gave significant discretion to the RBS staff managing the process and in particular to GRG itself. We were attracted to the RBS GIA conclusion that there would have been merit in simplifying the criteria used, but we do not conclude that the criteria were of themselves inappropriate;
- GRG had an effective veto over transfer decisions and the power to call in cases and clearly exercised significant influence over a subjective process. This ability to direct the transfer of cases co-existed with the twin objectives (i.e. the 'turnaround objective' and the 'commercial objective'). The simple fact of transfer had substantial consequences for customers. RBS was slow to recognise the potential conflicts of interest involved. We conclude that GRG failed to adequately recognise the risks posed by these foreseeable conflicts and, accordingly, did not take adequate steps to mitigate them;
- We identified, in a small number of cases, that GRG considered, during the transfer process, its own perception of the advantage to GRG of particular customers. But we saw no case where a transfer could not have been justified by reference to appropriate considerations; and
- Overall we conclude that the transfer process was not well governed and there was a failure to mitigate the conflicts of interest inherent in the transfer process given GRG's twin objectives. This was a notable failing in RBS's governance arrangements that placed SME customers at material risk of inappropriate treatment.

4.1.52. We have reached the following conclusions about the transparency of the transfer process:

- There were frequent failings to comply with the Bank's own policy in respect of communicating with customers around transfer. The standard of much communication was poor and in some cases misleading. Taken together, these failings resulted in the inappropriate treatment of customers on a scale that was widespread; and
- GRG management was aware (or at least should have been aware) of these failings but took little or no action to ensure compliance with its own policy.

4.1.53. We have reached the following conclusions in respect of transfer issues in Northern Ireland:

- Whilst the situation in relation to Ulster Bank and its customers at the time gave rise to significant challenges for the Bank, we find that the practices that it adopted were in several respects inappropriate and failed to pay sufficient regard to the needs of the customers involved;
- The 'bulk transfer' was a pragmatic solution to the circumstances but it meant that customers were not adequately informed about an important change in their status; and

- 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.

4.1.54. We make the following observations about the impact these findings had on customers:

- The failings that we have noted here did not generally give rise to clear financial distress for the customers involved, although we do not rule out the possibility in individual cases. The poor standard of 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; and
- The communications to customers, by RBS, at the time of transfer were important in managing the expectations of those customers. Many customers were led to expect a level of service and assistance that, in the end, they feel they did not receive. The failure to appropriately manage customer expectations was, in our judgment, a major factor in explaining many of the concerns expressed by customers about the way they had been treated whilst in GRG.

4.1.55. We have therefore concluded that the expectations of customers were not appropriately managed; they were led to believe that entry to GRG would help to restore an ailing business that was otherwise viable, to health. The failure to appropriately manage those expectations has, in our view, given rise to many expressions of dissatisfaction that have been made about this part of the Bank.

4.2 – Turnaround

- 4.2.1. In this Chapter, we describe the ways in which GRG determined the strategy it would adopt in respect of the SME businesses transferred to it, how it viewed turnaround and viability considerations and how its policies operated in practice in the cases in our sample.
- 4.2.2. The early identification of challenges facing SME customers, and assessment of a workable strategy for handling the SME customer, were recognised by GRG as being critical to its success. The earlier the position of the customer was analysed and a strategy determined, and hopefully agreed with the customer, the greater the chances of a successful turnaround: or if the outlook was less positive, the sooner resources could be re-deployed and recovery action (if that was the appropriate step) commenced.
- 4.2.3. In describing the role of GRG, RBS talked about being at the leading edge of a wider rescue culture. The unit had been renamed GRG in 2008 to better reflect *“the main thrust of activities, namely rejuvenating and restoring customers to the business rather than, as sometimes perceived, simply recovery from failed customers.”* Both at the time, and subsequently, RBS and GRG emphasised the focus that GRG had on *“rescue culture”, “turnaround” and “restoring viable businesses to mainstream banking”*.
- 4.2.4. In practice, however, in respect of the SME customers in our sample, we found a lack of structured analysis of the turnaround options available, and in many cases a lack of clarity of GRG's strategic intentions toward the customer. This had adverse impacts for many customers, if only that hopes built up of turnaround and ongoing support would be dashed. But more significantly the shortcoming in analysis, and the lack of management focus on turnaround, meant that credible options to support customers were not always explored, let alone followed. We consider the failures to adopt good turnaround practice in respect of SME customers resulted in inappropriate treatment that was both widespread and systematic.

Turnaround practice

- 4.2.5. Early in our enquiry, we reviewed international and UK experience of turnaround and looked for evidence about good practice in the sector. There are various sources of information including studies, general principles and codes of conduct in relation to good restructuring of business debt and/or turnaround practice by banks in the context of managing distressed businesses.
- 4.2.6. We reviewed the following papers:
- A World Bank Study Out-of-Court Debt Restructuring, 2012, World Bank;
 - The London Approach and Corporate Restructuring;⁶⁴
 - The INSOL⁶⁵ principles;

⁶⁴ The London Approach and Corporate Restructuring, Gerald E. Meyerman, Private Sector Advisory Service, The World Bank, 27 November 2000

- IMF: Approaches to Corporate Debt Restructuring in the Wake of Financial Crises, January 26, 2010, SPN/10/02; and
 - World Bank: Principles for Effective Insolvency and Creditor Rights Systems.⁶⁶
- 4.2.7. Having reviewed the material, we noted that the weight of comment and study focuses on the larger business sector. There was a lack of generally recognised and accepted guidance or standards with specific reference to the SME sector. Accordingly, whilst the material above provides some useful context, we also recognised that the scale of the debts being considered (i.e. those of larger corporate entities) meant that it was economic for the parties to employ more in-depth studies and approaches. But applying those same approaches to smaller businesses might be uneconomic.
- 4.2.8. The main SME specific document we reviewed, that was specifically in relation to the UK, was produced in 2014 following Dr Tomlinson's report and after the Relevant Period. The Institute for Turnaround's Benchmark Code of Conduct for Business Support Banking (the "Turnaround Code")⁶⁷ set out what it considers to be good practice in the sector today, but we did not consider it appropriate to retrospectively apply the precise principles of the Turnaround Code to our review.
- 4.2.9. However, we make the following observations in relation to the Turnaround Code:
- Its principles were largely those enshrined in the earlier documents set out above albeit tailored for SMEs;
 - The principles in the document are consistent with the internal GRG documentation we saw on turnaround; and
 - It is consistent with the basis on which we conducted our assessment.
- 4.2.10. We have not mapped out our own turnaround approach or attempted to define new standards in respect of turnaround practice. Rather, for the purposes of our review we have, where possible, considered RBS's own internal guidance and training to identify what RBS considered (at least in theory) should be happening during the Relevant Period as it assessed customers and considered the prospects for turnaround. We have formed our own view as to what a fair and reasonable approach was in respect of individual cases.
- 4.2.11. It is nonetheless relevant at this point for us to make some general observations about turnaround practice to set the scene for the specifics of GRG's approach.
- 4.2.12. Turnaround is the art of the possible. The development of an appropriate strategy for a business is highly fact specific. What may work for one business may not work for another and the range of variables in any given situation is significant – requiring careful analysis and a balanced judgment about the challenges and prospects of the business.

⁶⁵ The International Association of Restructuring, Insolvency & Bankruptcy Professionals, "Statement of Principles for a Global Approach to Multi-creditor Workouts", October 2000

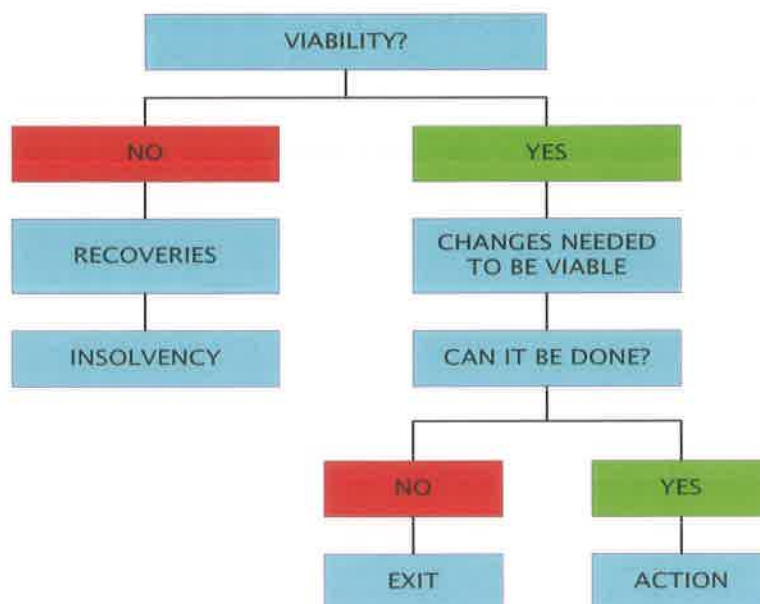
⁶⁶ The World Bank, Principles and guidelines for effective insolvency and creditor rights systems, April 2001

⁶⁷ Institute for Turnaround: Benchmarking Best Practice in Business Support Banking, IFT® Code of Conduct for Business Support Banking, Higher Standards, Better Outcomes, 2014. See also the announcement in October 2014 of the principles

- 4.2.13. Turnaround is also about more than simply financial performance. For example, the readiness and capability of the customer or its management team to make any necessary changes was a critical component of any assessment, as were wider market conditions and developments.
- 4.2.14. A turnaround unit also needs to deal with businesses that are no longer potentially viable. Where a business is clearly not viable, then it is necessary and appropriate to move promptly to recovery action, even if this is not the outcome desired by the owners of the business.
- 4.2.15. Turnaround is inherently a dynamic process. Business prospects and challenges can alter, sometimes dramatically, in short periods. Turnaround units therefore need to keep a close eye on developments and be prepared to change course where circumstances dictate a need for change. Consistent with this point is that turnaround solutions typically need time to work. Once a plan has been agreed and is being implemented a period of stability is desirable, but the plan should be carefully monitored and tracked.
- 4.2.16. Finally, turnaround units deal with difficult problems and often very divergent views. Some customers may enter a turnaround process with unrealistic expectations, or owners may have over-optimistic views about the prospects for their business. A turnaround manager will often be in the position in these cases of having to relay some unpalatable truths. The Bank also has an entirely legitimate interest in securing (so far as is reasonably practicable) its own financial position. So the role of any turnaround division is to deal professionally and fairly with these difficult circumstances, balancing appropriately the needs of its customer and those of the Bank.
- 4.2.17. Because the concept of turnaround is key to many of the areas that we have had to consider, we have kept all of these points in mind when forming our views on those issues.

GRG's stated approach

- 4.2.18. Guidance on assessing viability and on turnaround was not comprehensively enshrined in RBS policy or procedural documents. Rather, elements of recommended practice were provided in the form of staff training materials and Aides Memoire – General SLS/GRG Analysis Aides Memoire (2004, 2008 and 2009), and the 'Introduction to GRG' training provided to Relationship Managers throughout the Relevant Period.
- 4.2.19. The basic approach taken by GRG in determining the high-level strategy for cases entering GRG is summarised in the following chart (which was included in GRG policy and was also used in training material during the Relevant Period).

Fig. 17: RBS schematic for GRG case strategy development

- 4.2.20. As can be seen, this approach required two fundamental pieces of analysis to be conducted. First, an evaluation as to the viability of the business, and second an evaluation as to whether a turnaround strategy (that identified the changes needed to the business and its financing to make it viable) could be achieved. The GRG Aide Memoire was clear about the significance of these evaluations.

"The evaluation should help clarify whether the under-performance is due to a one-off incident, market dynamics outside the company's control or poor management control and enable us to answer the fundamental questions over whether or not we have a viable business. If we do, what requires to be changed to turn it around. If we do not have a business that can be made viable it should help evaluate the options open to the Bank and the business to obtain best possible recovery of debt to avoid loss."

- 4.2.21. Whilst the consideration of viability and turnaround options overlap in certain respects, we comment on each separately below.

Viability

- 4.2.22. RBS told us that *"The strategy for managing a distressed loan starts with a rigorous assessment of the viability of the business and the ability of management to address the underlying causes of financial distress."*
- 4.2.23. An assessment of viability is a key component of turnaround or restructuring. The viability of a customer's business must form the basis of any turnaround or restructuring plan. An efficient plan does not necessarily restructure all debtors, but allows the debtor and the creditors to analyse possible solutions to the financial difficulties, and take, as soon as possible, the decision that is better suited for the debtor's business and for the creditors' interests.
- 4.2.24. Accordingly, the notion that a viability assessment is conducted on, or soon after, transfer (as required by GRG policy) appeared to us to be appropriate and represent

good practice – indeed it was an essential precursor for the next steps in developing an appropriate strategy for the individual customer.

- 4.2.25. There was, however, no generally accepted definition of viability within RBS during the Relevant Period, nor accepted guidance on how viability should be assessed in the context of a turnaround unit. At its simplest, viability can be viewed as a business' financial ability to continue or survive and trade on an ongoing basis.
- 4.2.26. In practice, almost without exception, the SME cases that we considered were suffering from some level of financial difficulty before GRG became involved. It is important therefore to draw an early distinction between questions of viability and solvency. Many of the customers examined were technically insolvent, in the sense that they were unable to repay their debts as they fell due. However that is not the same as viability.
- 4.2.27. It is clear from the Aides Memoire and other documents produced that GRG itself did not take viability to be simply defined by short-term solvency considerations. The questions RBS was asking itself (or at least stated as its intention to ask itself) were more medium-term in their horizon. For example, the opening list of issues to be addressed in developing the GRG strategy according to the Aide Memoire included *"Is there a viable business **or one that can be made viable?**" (our emphasis), whilst the GRG Procedures & Guidance Manual describes evaluation of viability driven by analysis "in appropriate medium term revenue and cost projections together with the resultant cash flows."*
- 4.2.28. As will become apparent, we found that in relatively few cases in our sample was there any clear analysis of the viability of the business. So we needed to reach our own views about the degree to which the business was or was not viable in order to assess the appropriateness of the treatment the customer experienced. We explain more about our own approach to that viability assessment in Part 6 (Customer outcomes), but at a high level at least our approach does not appear to us to be in conflict with the approach RBS stated at the time that it should adopt to those assessments.
- 4.2.29. For cases that did not pass the viability assessment, the logical consequence was referral to the Recoveries team with the prospects being formal appointment and insolvency. For those that were potentially viable, the issue was whether a workable turnaround plan could be formulated.

Turnaround assessment

- 4.2.30. Having identified the business as viable (or at least potentially viable), the issue to be addressed was the nature of the changes required to achieve a successful turnaround and whether those changes were practicable.
- 4.2.31. The 2009 Aide Memoire noted that the intent was:
"...to provide a framework to help us evaluate why a business is under performing and/or in decline, to assess whether there is a sustainable business, consider the options available to the business and the Bank, and decide on an appropriate course of action...."

...It is important to ensure the customer completes a thorough diagnosis (with appropriate support if necessary) of the current situation, and the Bank's own analysis will complement this. Likewise, the Bank will work with the business to ensure a realistic Turnaround Plan is developed."

4.2.32. The GRG Procedures & Guidance Manual noted:

"Unless the circumstances dictate the approach to be adopted by GRG, e.g. formal insolvency, the initial strategy is likely to be dynamic. This reflects the fact that information is often incomplete or in the course of being revised at the time of transfer. The strategy will therefore respond to emerging facts.

"Wherever possible rehabilitation of the case to enable RTS will be the primary aim, but equally risk management and efficient capital allocation will on occasion dictate exit is the appropriate route."

4.2.33. The 2009 Aide Memoire provided further guidance on how the assessment of turnaround options should be undertaken. This included (our summary):

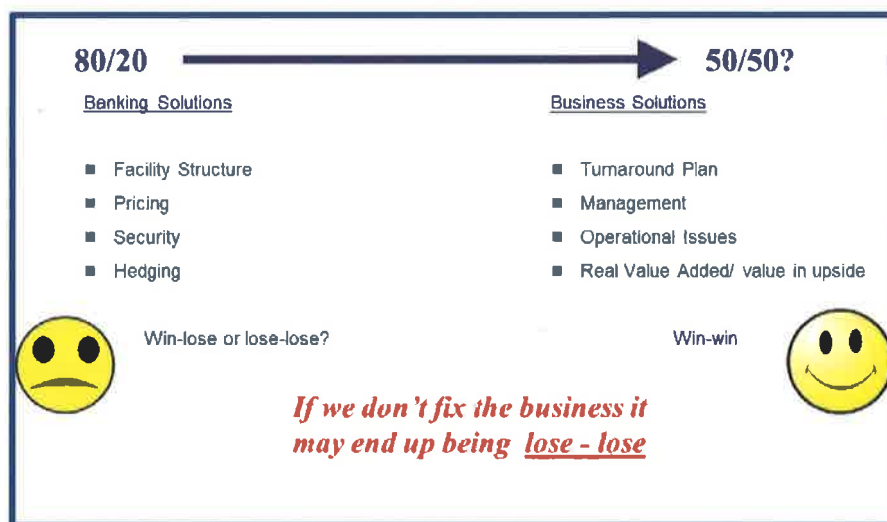
- **Business and Sector Analysis:** Consideration of whether management is attuned to the changes going on in the sector. Involves analysis of market position, current/potential customers, competitors, suppliers, opportunities/risks.
- **Analysis of Management:** Consideration of whether management is competent and has a vision for the business. Involves analysis of strategic plans, business plans, financial projections, turnaround plans and use of performance measures.
- **Financial Analysis:** Objective assessment of the real financial position of the business. Involves analysis of audited accounts, budgets, forecasts, cash dynamics and management letter.
- **Security & Asset Quality:** Assessment of asset quality goes beyond assessment of viability of the business associated with a customer. The focus is on examining ways that security can be accurately assessed and improved.
- **Assessment of Turnaround Prospects:** Assessment of whether the turnaround plan is achievable. If new money is required, are the investment returns supportable? What strategies can be employed to address causes of decline (for example organisational change, cost reduction, improved marketing) and what short-term stabilisation is required?

4.2.34. GRG recognised that, in some cases, it would be necessary to supplement in-house expertise and resources with consultant support to assist customers and where appropriate carry out more detailed Independent Business Reviews ("IBRs").

4.2.35. This fundamental approach to viability and turnaround was reflected in key GRG training materials. New staff joining GRG were required to attend an "Introduction to GRG" course as part of their induction. The course took the format of presentation based on a set of slides. The slide presentations evolved across the Relevant Period, although they did not change to any material extent.

- 4.2.36. We reviewed several versions of the training material, including versions from 2008, 2012 and 2013.
- 4.2.37. The 2008 version included, early in the presentation, a slide stating that the question of viability should be considered. The 2008 slide presentation went on to give quite some detail about factors to consider when assessing a business. Pricing was covered at the end of the presentation.
- 4.2.38. The versions we saw from 2012 and 2013 were all very similar. They covered a broader range of topics relevant to GRG, and there was less focus on the assessment of the business per se. However, the requirements to undertake a viability assessment and consider turnaround options were clearly stated.
- 4.2.39. In addition, there was a recognition by RBS that *"business solutions"* were likely to result in better outcomes for both Bank and customer than purely *"banking solutions"*. In other words, solutions that focused solely on the repayment of debt, the improvement of security or the re-pricing of facilities were less likely to lead to the best outcome for both RBS and the customer. Rather, when both RBS and the customer focused on addressing the underlying business issues using a combination of measures (ranging from changes to management to operational and capital structure), then a better longer term outcome for both RBS and the customer was more likely. Put simply, a customer whose underlying business issues had been addressed was more likely to be a better and thus more profitable asset of RBS than would be the case if a Bank side solution only was adopted.
- 4.2.40. An example of an excerpt from one of these training courses which clearly expresses this focus on turnaround and joint customer/ bank side solutions is set out below:

Fig. 18: Extract from GRG training material



- 4.2.41. Of course, *"business solutions"* required specific actions – typically by both the Bank and the customer. It was therefore important that there was an established and (in so far as was possible) agreed approach. That required a turnaround plan setting out specific actions to be pursued with specific objectives and milestones together with the approaches the Bank was prepared to adopt (including debt restructuring/ repayment

options). Hence we viewed a clear turnaround plan as a highly desirable component of turnaround practice, consistent with the Bank's stated policy and the fair and reasonable treatment of customers. However, the absence of written plans or agreed actions, on the files we reviewed, meant that we could not see evidence of how the "win-win" set out in the Bank's policy approach worked in practice.

Overview of GRG policy

4.2.42. Our review of the training and guidance material circulating within GRG shows that GRG intended to adopt a strategy that required:

- A careful assessment of whether or not a business was viable or could be made viable should be carried out (and that assessment should be based on a wide review of the business, not simply immediate technical solvency issues);
- If the business was clearly not viable, ensuring that it was transferred for recovery action (including Appointment processes) without delay; and
- Where the business was potentially viable, ensuring that a turnaround plan was considered, documented, agreed with the customer and, if practicable, implemented to address the underlying business issues that the customer was facing.

4.2.43. It was recognised that turnaround plans might not be practicable in all cases. That might, for example, be because the management team was unwilling or unable to make the necessary changes, or the changes could not be made in time.

4.2.44. Whilst achieving a RTS was the stated "*primary aim*", turnaround might in some circumstances also depend on RBS's willingness to provide funds – both to continue to provide existing facilities (and in some cases additional facilities) and the terms upon which those facilities were to be offered. If a turnaround plan was not practicable, the GRG policy was to support the customer exiting RBS.

4.2.45. Looked at in isolation, we view the stated approach to be adopted by GRG, as set out above, as appropriate and broadly reflective of normal turnaround practice.

4.2.46. As we will see, however, in a number of important respects this stated policy of GRG was not widely followed in practice during the Relevant Period. RBS lacked many of the tools we would have expected Relationship Managers to have at their disposal to support their analysis of the financial situation of their customers, analyse the turnaround options available and assess client proposals. These tools might have included: cash flow models; tools to support the assessment of historical financial performance and future projections and budgets; viability templates; business plan checklists; and tools to support the assessment of profit performance, cash performance, working capital, funding structure, and the customer's balance sheet position.

4.2.47. GRG also focused unduly on certain 'solutions' in developing its customer strategies – namely Upside Instruments and debt reduction. Whilst these might well have a role to play in achieving a practicable turnaround plan they were not of themselves sufficient to meet the policy objectives GRG had set for itself.

What we saw in practice

4.2.48. Our case reviews identified a wide range of practice across the Relevant Period. Much depended on the approach adopted by the individual Relationship Manager and the particular circumstances of the customer, but we can draw out some general themes. The assessment of the impact these points had is addressed in Part 6 (Customer outcomes).

4.2.49. In all we made findings in 77 cases in respect of turnaround related issues. The analysis below reflects both those findings and our wider observations about the practices we observed. Whilst the issues raised were often very specific to the circumstances of the individual case, we group the issues we saw under five headings:

- Delays in transfer impact turnaround options;
- Viability assessments were absent from most cases;
- A focus on pricing and debt reduction not turnaround;
- A reluctance to consider customer proposals; and
- A failure to appreciate the impact of Interest Rate Hedging Product agreements.

4.2.50. We consider each in turn in the following sections.

Delays in transfer impact turnaround options

4.2.51. Our first observation is that, in some of the cases we reviewed, the transfer of the customer to GRG came too late for it to be able to provide any turnaround assistance. It was clear from the files we reviewed that delays in transfer remained a significant frustration for some staff in GRG – especially early in the Relevant Period. We saw some evidence that staff in the mainstream Bank could slow the process down and there was a sense that at least some mainstream managers were reluctant to bring their relationship with their client to an end. But we reach no firm view on the causes of these delays. Our sample focused on those cases that were referred to GRG, not those that were not referred but successfully resolved financial challenges working with the mainstream Bank. In any event it is perhaps inevitable that the handover process represented something of an institutional barrier. It was one recognised by RBS, where continuing efforts were made to ensure timely transfers. In our view those efforts were not entirely successful.

4.2.52. We believe that over one in ten of the cases in our 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.

4.2.53. We were more concerned by those cases that were still potentially viable when they were transferred. The transfer delays we observed did in our view restrict the ability of GRG to make meaningful contributions in some cases.

Case Extract 3

Our review of the file found that the customer, who was internally recognised as a “*remunerative connection*” by the mainstream Bank, showed signs of stress that ought to have triggered a referral to GRG as the area of the Bank that was able to address the underlying issues.

The triggers identified for transfer had been present for a considerable period prior to transfer to GRG. We note this view had been expressed in internal correspondence including email from the mainstream Relationship Manager to his manager: “*The position is worse than previously reported into us in terms of amount of arrears etc. I know it’s a cliché but on reflection I should have passed up to SLS [the predecessor of GRG] when we spoke about this file 8 months ago. There are also some wider key learnings for me here.*”

The Bank, by failing to address the triggers in a timely manner demonstrated that RBS did not appropriately identify the customer for transfer to GRG in this case.

We duly reported this as one of our findings and the Bank agreed with it.

Case Extract 4

Our review of the case showed that it was clearly acknowledged on the file that the customer could have benefited from the support of a turnaround unit at an earlier stage as evidenced by a note from a senior officer of GRG shortly following the actual transfer:

“I have printed off and read the last credit paper (which is not the easiest to follow so may have got 1/2 things wrong) and looked at account conduct. Also as far as I can see [customer] has had two years of operating losses and therefore should have been referred to GRG before? Am not going to try to re-calculate the disputed security position as in reality this is not key issue but rather liquidity which is function of trading performance, asset sales and bank willingness to support. Recent trading is concerning and asset sales will be slow. I suspect that further bank support is right strategy but as always within the right structure/controls and appropriate pricing. I would see that best done within GRG as so far the management seems to have reacted too little/too late and not necessarily with full transparency.”

Viability assessments

- 4.2.54. Given the Bank's own view that the strategy for managing a distressed loan “*starts with a rigorous assessment of the viability of the business*” we noted that evidence of such an assessment was missing from many of the files that we examined.
- 4.2.55. In some cases this was understandable, particularly where it was clear on transfer that the customer could no longer continue their business venture and where recovery of the debt was the only realistic option. In other cases, GRG referred customers to external advisers to obtain an independent review of the potential for the business and

an appraisal of the strategy that would best improve its prospects for turnaround. In those cases an assessment of viability could normally properly be left to the external reviewer.

- 4.2.56. But the majority of the cases that we reviewed were not passed directly for recovery of the debt nor was a third party review obtained. In those cases we expected to find evidence that an assessment of viability had been undertaken but in most of them did not find such an assessment.
- 4.2.57. One impact of the lack of documented consideration of viability was that businesses that we considered to be clearly not viable remained under GRG management for considerable periods, rather than being identified for recovery action at an early stage. We comment on that group further in Part 6 (Customer outcomes), but in summary, delays resulted in mixed messages to customers and additional and largely unnecessary fees being levied by the Bank, when earlier recovery action would have been appropriate and a better use of resources.
- 4.2.58. Perhaps more significantly 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.

A focus on pricing and debt reduction not turnaround

- 4.2.59. We comment further on pricing and facilities later in Part 4, but it is relevant to stress here that we observed a primary focus in GRG in the handling of cases in our sample on adjusting pricing upwards and seeking debt repayment. These were, in practice, the primary focus of GRG engagement with customers – considerations of the customer's longer term viability were secondary.
- 4.2.60. This was a general theme in most of the cases we reviewed. As we note in Chapters 4.3 (Facilities) and 4.4 (Pricing), it was not inappropriate of RBS to seek to reflect the risk it was bearing in its pricing, nor in many cases for it to reduce facilities over time. The issue we observed was that these objectives were not balanced appropriately with the options for turnaround. In all we made over 60 findings where we considered that there was evidence that GRG had not followed good turnaround practice.
- 4.2.61. In practice, RBS sought to increase fees and charges without proper consideration of viability and the potential implications for the business. Alternative approaches to handling the case would not have had such direct impacts on cash flow. Similarly, proposals (and in some cases requirements) to reduce facilities were put forward with insufficient consideration as to the impact this could have on the customer's ability to trade.
- 4.2.62. RBS told us that GRG provided customers with various "options" that they could pursue. Indeed it described these to us initially as turnaround plans. However, in cases where this occurred, these options were almost always in relation to the credit facilities and pricing – rather than wider attempts to assist the business with turnaround. An example

of the type of options GRG provided customers, and the material that it initially described to us as a turnaround plan, is shown in Annex VII.

- 4.2.63. In contrast, we rarely saw evidence in cases to demonstrate that GRG had actively considered a variety of potential options that may have helped the customer achieve successful turnaround. We would have expected to have seen some documented assessments by the Relationship Manager of the options available and a copy kept in the customer's file. But this was not evident in the files we reviewed. Indeed, in almost all of the cases that we have reviewed, we found no evidence that a rigorous assessment of turnaround options had been undertaken. This meant that genuine options for turnaround were often missed or overlooked or became impractical because they were not implemented promptly. In addition, we did not see a documented turnaround plan with agreed actions and milestones on a single case in our sample.
- 4.2.64. In the context of a turnaround unit – and in particular one that sought to be at the “leading edge” of industry practice – we would have expected to see genuine attempts to understand the nature of the customer's business and provide them with advice on how they may be able to turn their business around. In addition, we would have expected to see appropriate use of the following strategies:
- New money (not just some renewal of existing facilities);
 - Management change;
 - Refinancing;
 - Debt for equity swap; and
 - Forbearance, including debt forgiveness and payment ‘holidays’.
- 4.2.65. In practice, it appeared to us that GRG staff focused on short-term measures such as rescheduling or renewing an existing credit facility on revised terms. Other wider tools relevant to a turnaround unit, including greater forbearance where appropriate, were notably lacking in many of the cases we observed. There was a risk that in taking this approach GRG failed to grasp the fundamental issues facing the customer and indeed the Bank – what some describe as ‘kicking the can down the road’.

Reluctance to consider customer proposals

- 4.2.66. Closely related to this was a reluctance by Relationship Managers, in some instances, to engage with counter proposals put to them by customers. Whilst these were on occasion commercially unrealistic or impracticable, our impression was that GRG was unwilling to engage with customers and that its fall-back position was a “take it or leave it” approach in respect of its own proposals. Certainly this was the impression that many customers gained. We viewed this as inappropriate and poor practice – not least in the light of RBS's own observation about the desirability of business as opposed to simply banking solutions and the statement in the Aide Memoire “*the Bank will work with the business to ensure a realistic Turnaround plan is developed.*”

- 4.2.67. We identified at least 17 cases where a potentially credible (or at least not clearly unworkable) way forward was advanced by the customer and was not materially addressed by RBS. Whilst some or all of those proposals may not have provided a sound and mutually agreeable basis upon which to proceed, the absence of engagement with customer proposals was in our view a material shortcoming in GRG's approach.

Case Extract 5

The Customer was a hotel business that ran into difficulties. The Customer's accountants advised RBS that their clients wanted to put the hotels on the market for sale, ahead of the summer period, as this would have been the best time to market the hotels.

All valuations conducted had shown a higher value for the hotels when operating, as opposed to being closed, and as such the customer's proposal involved the sale of the hotels as ongoing trading ventures. RBS refused to consider this strategy until an updated valuation was conducted. This took five months to complete and a further month for an IBR to be concluded. This meant that the customer was unable to put any of the hotels on the market during the summer period and pursue a sales strategy in the optimum sales period.

The Customer made a number of restructuring proposals to RBS in advance of a meeting. These were dismissed the night before the meeting by the Relationship Manager who stated in an email to the Head of SRM, who was due to lead the meeting, *"I'll save you some time....the answer is no on all points...quite entertaining if you have the time."*

Our review of the file found no analysis of the proposals by RBS. We would have expected, at least, for RBS to have analysed these proposals and discussed the proposals with the Customer at the meeting even if ultimately an agreement could not be reached. We would also have expected RBS to prioritise this analysis in order to ensure that the maximum value for the sale of the hotel was achieved by putting it on the market in the summer trading season.

Appreciation of impact of IRHP agreements

- 4.2.68. Several of the customers in our sample had agreed to take out IRHPs alongside their original facilities. RBS had introduced the customer to the IRHP, in some cases making it a term of the loan, and agreed extended terms – typically of five or more years.
- 4.2.69. The impact of these products on some customers has been well rehearsed elsewhere. Consideration of whether these products were mis-sold fell outside of the scope of our review – as they have been covered by other regulatory and industry action.
- 4.2.70. In the context of our review, IRHPs often had a significant role in the turnaround environment. Whilst we did not conclude that GRG should have appreciated the sales issues generally associated with many of these products prior to the announcement of the FCA industry review, we did expect that it would exercise care in factoring the impact of the IRHP into any turnaround plan. In practice, we saw some confusion about the way in which IRHP products worked and a lack of appreciation of the cash flow

impact that could occur if income producing assets were sold to reduce indebtedness (but not the IRHP liability).

- 4.2.71. That was particularly apparent in property related cases where pressure to reduce facilities by selling properties produced a particular pressure on the customer as the IRHP charges would continue and not be reduced in line with the reduction in the facility level. Typically for SMEs with small property portfolios, those parts that were the easiest to sell were also those that generated the most rental income with which to settle not just RBS's interest charges, fees and capital repayments, but also the IRHP fee/premium. So selling property, whilst desirable from a Bank perspective as a way of reducing the SME's liability, could dramatically worsen the SME's cash flow position. Understandably, in these circumstances, where customers understood the implications of the sale of assets they were keen to avoid property sales.

Overview of practice

- 4.2.72. The specific issues highlighted here raise concerns about the general approaches adopted by RBS. Certainly GRG practice was very different from the focus on turnaround options set out in its documentation, public statements, training and core documents like the GRG Aide Memoire. The specifics of turnaround practice also have to be set alongside wider aspects of the way that GRG interacted with customers, the issues around pricing and facilities, the use of Upside Instruments, and GRG's communications and complaints handling, to reach an overall view of how GRG performed as a turnaround unit. We consider the financial impact these practices had on customers in Part 6 (Customer outcomes).

The relevance of the Asset Protection Scheme

- 4.2.73. At various stages in our review, RBS suggested that the APS represented a material constraint on its normal practices and that we should consider its impact in assessing how GRG operated during the Relevant Period that it subscribed to the Scheme. RBS described the APS in the following way:

"The APS was a credit protection scheme, designed to provide protection against future losses on some of the riskiest assets held by the bank. Approximately £242bn of assets were covered by the Scheme when the Bank first entered it in December 2009. The majority of GRG connections (for these purposes "assets") were covered by the APS as the priority was to place assets with the highest potential risk-weighting and/or loss into the scheme.

Under the APS, RBS undertook to comply with the Asset Management Objective ("AMO") in relation to most actions on the assets. The AMO had to be applied at all times and took priority over all ordinary course business and banking policies, practices and procedures (subject to certain limited exceptions e.g. operation of law).

The AMO was to maximise the net present value of the assets, including by minimising losses and potential losses and maximising recoveries and potential recoveries in respect thereof.

Such analysis had to be undertaken for asset actions such as the release of security, disposal of assets, restructurings and re-financings.

The approval framework for agreeing asset actions evolved over the life of the scheme, but the vast majority of asset actions required some form of approval, either by a central APS team and/or individual sanctioners within GRG and/or the internal APS department who had been trained and accredited to assess proposed actions and agree them if they met the AMO. Certain actions required approval by the Asset Protection Agency, a government agency reporting to HM Treasury.

This approval framework applied until July 2011 when the rules were simplified and refined to focus on a smaller group of large value risky assets. At that point BRG ceased requiring APS preapproval for actions on their assets but the AMO continued to apply until October 2012 when RBS exited the scheme."

- 4.2.74. From our review of the minutes of management committees and of the objectives of frontline staff within GRG for 2010 and 2011, it was clear that RBS was concerned to ensure that it complied with the terms of the scheme. The completion of the necessary forms, for submission to the Asset Protection Agency ("APA"), was an issue that was mentioned in management meetings and staff appraisals.
- 4.2.75. It was important to us to have a clear picture, drawn from available evidence, as to the link between (a) the APS requirements and (b) the way in which those requirements affected the treatment of customers and the decisions that were taken with regard to individual files.
- 4.2.76. At the outset of our review, Mr Sach (Head of GRG) indicated that there was, in effect, no link and this was confirmed by Mr Bostock (Group Finance Director), when interviewed by us on 26 March 2014. In his view, the conduct approach to customers was not 'shaped' by either the APS or considerations relevant to the Bank's capital. In November 2014, we interviewed the current Head of Risk (who was employed at a senior level within GRG throughout the Relevant Period), and he confirmed that compliance with the scheme made no difference in practice to the way in which customers were treated.
- 4.2.77. Our own observations from reviewing the individual files lead us to a similar conclusion; we have not seen evidence on any cases in our sample where the existence of the APS had an effect on how RBS approached the customer.
- 4.2.78. Toward the end of our review RBS, having obtained the consent of HM Treasury, sent to us a number of additional files which contained the submissions to the APA on the files in our sample. In doing so, RBS asked us to bear in mind the control and oversight that existed across RBS under the APS rules, and their effect on the overall operating environment within GRG. We have reviewed a number of the documents disclosed to us in the light of our original findings and have found no evidence that would cause us to alter our assessment.⁶⁸

⁶⁸ We note that the Clifford Chance Report was unable to determine the precise extent to which the APS impacted upon SME customers: Report Paragraph 5.58 page 27

Our conclusions on turnaround

4.2.79. Overall, we conclude that businesses within GRG were not supported in a manner that was consistent with good turnaround practice. We conclude that this should be considered inappropriate treatment of the customers concerned and that this inappropriate treatment was widespread throughout the Relevant Period.

4.2.80. Following our consideration of GRG's policies and practices, and the individual cases, the main outcomes of which are reported in this Chapter, we conclude that there were frequent failures to pay appropriate attention to turnaround considerations, including as a result of failures to:

- Carry out adequate viability assessments;
- Consider and implement viable turnaround options including medium and longer term sustainable turnaround solutions (instead focusing on short-term measures);
- Document clear turnaround plans with appropriate objectives and milestones – and monitor progress against those plans;
- Make adequate use of a broad range of turnaround tools, including forbearance where appropriate; and
- Consider the impact of the Bank's actions in repricing/debt repayment/withdrawal of working capital facilities on the ability of the customer to continue to trade.

4.2.81. We also found that, notwithstanding its stated objectives, GRG placed little emphasis on turnaround – other than in the sense that they wanted customers to meet credit policy requirements. There was in practice little focus on returning customers to financial health and mainstream banking through genuine business restructuring.

4.2.82. That this inappropriate treatment occurred, and occurred on a widespread basis, is not surprising given the limited focus on “turnaround” across the Relevant Period. We also view the inappropriate treatment of customers resulting from failings in GRG to place appropriate weight on turnaround options in its handling of SME customers during the Relevant Period as systematic. We say this because (notwithstanding the emphasis in GRG's policy on turnaround) in practice:

- GRG prioritised its commercial objectives at the expense of turnaround objectives (as explained in Chapter 3.1 (GRG objectives and strategy));
- the overall management and oversight of risks to customers in GRG was inadequate and did not treat turnaround as a priority (as explained in Chapter 3.2 (Governance and oversight));
- GRG did not place appropriate emphasis on turnaround in its staff objectives, instead focusing on pricing (as explained in Chapter 3.3 (Staff objectives));

- GRG placed an undue focus on pricing and debt reduction without due consideration of the longer term viability of customers (as explained in Chapters 4.4 (Pricing) and 4.5 (Valuations));
- GRG did not adequately manage the conflicts of interest inherent 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 and there was a reduced focus on customer led recovery and turnaround (as explained in Chapter 5.1 (West Register Property Acquisitions)); and
- 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. In particular:
 - GRG lacked many of the tools that would be expected to be observed in a turnaround unit to support good turnaround practice;
 - GRG did not routinely carry out adequate viability assessments;
 - GRG did not develop or document turnaround plans with appropriate objectives and milestones – and did not monitor progress against them; and
 - There is scant evidence of GRG management engaging with turnaround considerations in practice in connection with the handling of SME customers (for example in Strategy and Credit Reviews).

These were shortcomings that GRG's management was (or should have been) aware of during the Relevant Period, but insufficient steps were taken to correct the position.

- 4.2.83. We considered the impact on customers of this inappropriate treatment as part of our assessment of financial distress in Part 6 (Customer outcomes).

4.3 – Facilities

- 4.3.1. In this Chapter, we consider the approach GRG adopted to making credit facilities available to customers and in the following Chapter the prices it charged for those facilities and more widely for the services provided by GRG.
- 4.3.2. We use the word “facilities” to refer to any contractual arrangement under the terms of which customers were lent money by the Bank. 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 (“RBSIF”).
- 4.3.3. The contracts governing facilities were on terms that conferred wide discretions on the Bank. These included the contractual rights to increase margin as well the discretion to use breaches of terms of the loan as the basis to renegotiate the overall financial position.
- 4.3.4. 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.
- 4.3.5. We appreciate that the Bank needed to address its own balance sheet; it had committed lending at competitive rates before the economic downturn and those commitments could be of several years duration at very low rates of interest, usually linked to Bank of England Base Rate which declined appreciably. At the same time, the value of the underlying security, particularly land and property, depreciated by a sizeable margin. These factors rendered it unattractive to lend in certain sectors, particularly those involving property.

Non-Core Division

- 4.3.6. To address the issues the Bank established a Non-Core Division (“NCD”) and transferred to it assets that were no longer within its revised lending criteria. The establishment of this division occurred toward the end of 2008. The Bank told us that this division:

“...was created to manage c.£258bn of assets that were no longer core to RBS strategy and the continuing operations of the Group. The purpose of the NCD was to run-down or exit these assets over a 5 year period (by end 2013)...

NCD was to be the primary driver for reducing the Group's overall risk exposure, the intention being to aid the reduction of the Group's balance sheet by up to 20% and to rebalance the Group's risk exposure by exiting more capital intensive assets and assets no longer deemed core to RBS strategy... The overriding approach to non-core assets was that there was no appetite for increases in facilities and rebanking/repayment was to be sought at the earliest opportunity, albeit this should be achieved having regard to TCF principles.”

- 4.3.7. The Bank estimated that non-core assets made up about one half of those managed within GRG as a whole, but represented on average 14% of the BRG book by number of connections and 24% by portfolio value over the period 2011-2013.

4.3.8. RBS also told us that:

"Since 2009, GRG's financial objective has evolved from adding value to the Bank's bottom line (by minimising losses and maximising recoveries) to greater emphasis on capital management by reducing Risk Weighted Assets and exiting Non-Core assets. This emphasis on capital management is a product of management and regulatory focus on the capital position of the banking sector."

4.3.9. It also confirmed the following to us:

"GRG retained the ability to support customers with longer term strategies where it was identified that there was scope to rebuild value over a longer term and had the ability to rehabilitate and RTS BRG customers if the loans could be restructured to meet mainstream credit policies. In the final two years of the Non-Core five year plan, there was greater focus on achieving exits from non-core assets, with particular emphasis on large corporate exposures and real estate loans. GRG had an overall target to achieve £6bn of Non-Core asset reduction in 2013. This was not cascaded into BRG objectives or targets as the focus was on large corporate loans and associated derivatives, real estate owned assets and equity positions, which were the most capital intensive assets under GRG management."

4.3.10. Given that non-core was a significant feature of the makeup of cases in BRG, it was important for us to establish whether a customer who was regarded as non-core (and thus where the presumptive strategy was an early exit) would otherwise be treated in a way that was different to one who was still regarded as core. We were assured by the Group Finance Director that there was no difference in their treatment among the customers the review was asked to consider. We also note that seeking an early exit for the customer was subject to the caveat: *"this should be achieved having regard to TCF principles"*.

4.3.11. Of the 207 cases that we reviewed, we saw at least 70 cases that were classified as being non-core. The true figure may have been slightly higher as the categorisation was not clear for some cases. Our approach to cases that were classified as non-core did not differ from our approach to customers who were classified as core. We recognised that RBS had a right to change its view on which customers it wished to lend to.

4.3.12. But we also concluded that where changes were proposed by a turnaround division, a review of the facilities should be undertaken as part of a genuine exercise to address and help correct underlying financial difficulties experienced by the customer. In other words, we expected the discretions available to the Bank to be exercised in a fair way.

Our approach

4.3.13. The Requirement Notice required us 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 businesses⁶⁹. For the purposes of this report we have included asset based finance as an integral part of our work on facilities.

⁶⁹ Requirement Notice: Annex C, 4.2.2(3)

- 4.3.14. We have examined the various policies and procedures that applied across the Relevant Period to the restructuring of facilities and do not find any of them to be inappropriate.
- 4.3.15. Accordingly, the main issue that we have assessed is how the discretions and policies were applied in practice.
- 4.3.16. In addressing that issue, we have looked at the individual cases where facilities were restructured, rescheduled, amended or withdrawn while the customer was in GRG and judged the Bank's actions by reference to what was, in the circumstances, fair and reasonable in relation to that customer, bearing in mind that we are analysing the decisions of an area of the Bank which had a turnaround as well as commercial objective, and was handling financially distressed SME customers.

What we saw in our case sample

- 4.3.17. Almost all customers who entered GRG were already exhibiting clear signs of financial difficulty. In many cases, this also meant that the customer 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 agreement. The fact that the customer was in breach of the terms of the facility (or that the facility had expired) gave GRG the contractual and wide discretions to which we have referred.

Restructuring

- 4.3.18. Debt reduction was a major feature of the cases we sampled. That was not of itself inappropriate given the Bank's risk appetite and the customers' financial difficulties. We considered whether a reduction in facilities was inappropriate in relation to the specific circumstances of cases, and assessed whether the impact of any inappropriate reduction was material or not, in our assessment of financial distress. However, we did consider that 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.
- 4.3.19. The typical ways in which RBS sought to reduce the level of facilities included:
- Requiring asset sales to enable some repayment of the outstanding debt;
 - Encouraging customers to refinance with third parties;
 - Withdrawal of or reductions in working capital facilities (including overdrafts) – sometimes at short notice; and
 - Replacement of on-demand facilities with term-loan facilities.
- 4.3.20. The Bank sometimes also sought additional Personal Guarantees ("PGs") which, while not reductions in facilities, would have meant the customer, or third-party guarantor, providing additional security against the credit facility. This was an issue that was raised in the Tomlinson Report, and we address it further below.

Property Cases

- 4.3.21. 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.
- 4.3.22. In these cases, the principal credit facility was usually a short-term loan facility (e.g. a facility for a period of two to three years) with a bullet repayment at the end. While they also sometimes included other facilities, it was typically the short-term loan facility that was the key issue in cases of this kind. The significant decline in the property market in 2008 and 2009 meant that many of these developments were now valued at significantly less than the level of the debt and were often very difficult to sell in markets that were less liquid than they had been.
- 4.3.23. A common scenario in such cases was that a customer borrowed, say, £2m in 2007 to develop a plot of land into units for sale upon completion. The facility provided was for two years with full repayment at the end of the facility. When the development was completed, the expected sale price of the units was impacted by the decline in property values and accordingly the expected proceeds from the sale would no longer be sufficient to meet the loan repayment at the end of the two-year period.
- 4.3.24. The challenge was more acute in such scenarios where delays had occurred and the developments were not completed to time and original budget.
- 4.3.25. In these cases, 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 (e.g. in the case of unit developments) to repay outstanding debt and/or to rent out the properties to cover at least interest on the loans.

Case Extract 6

The customers established a Special Purpose Vehicle owned 50:50 by two experienced property developers to develop a property in London. The Bank in September 2007 sanctioned two facilities comprising a residential land loan of £842k and a property development loan of £781k to assist with the purchase and development of the site. The total purchase price of the land including other costs was £1.047m. The customers contributed £290k and the balance of the bank facility was used to fund rolled up interest and to meet minor development costs.

The land loan was due for repayment in October 2008. At that stage the development had not been completed and the expected value of the property (even when completed) had fallen. In the circumstances, the Bank extended the loan to June 2011 and increased the exit fee.

Although a tenant had been found for the completed property, the rental return was inadequate to meet the cost of the interest payments. The value of the property was below the level of borrowing and, in November 2011, the case was referred to Recoveries.

- 4.3.26. We understand that many customers in these circumstances wanted the Bank to continue to provide funding in the hope that the property market would recover. Customers were frustrated that the Bank did not do so. We concluded that it was not reasonable to expect the Bank to continue to finance assets that had little realistic prospect of recovering value within a reasonable period of time. It was far from clear that property prices would rise at all, let alone the timescale over which they might do so.
- 4.3.27. Accordingly, we did not consider that it was 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.
- 4.3.28. In practice, the picture in respect of individual SMEs 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. Our general approach to these cases was to consider whether it was fair and reasonable 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.

Trading Cases

- 4.3.29. 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.
- 4.3.30. Overdrafts, in particular, are of critical importance to SME businesses. Many SME trading businesses simply would not be able to operate effectively without the existence of an overdraft that was appropriate for their circumstances.
- 4.3.31. Overdrafts allow trading firms to better manage key issues such as:
- Seasonal fluctuations – some businesses perform better at particular times of the year than at others. For example, we saw cases such as pubs and restaurants that were heavily reliant on Christmas trading; and
 - The difference in timing of payments to suppliers and receipts from sales.
- 4.3.32. Changes in the credit facilities made available to trading businesses came with increased risk that they could have potentially significant impacts on the ability of the businesses to operate.
- 4.3.33. In cases where the Bank provided the customer with sufficient notice of its intentions, and was clear as to the course of action that it intended to take, we were less likely to consider that a reduction in facilities was inappropriate.
- 4.3.34. These cases were not always easy to resolve, but we viewed each of them on their own facts and decided whether the Bank, in acting as it did, 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.

- 4.3.35. In other cases, a change to facilities resulted in adverse outcomes. The challenge in these cases is the extent to which any one single action by the Bank led to an unfair outcome for the customer. Generally, a change to facilities was part of a wider picture, and was the means by which the Bank achieved its overall ends.
- 4.3.36. We give some brief case examples to illustrate this range of challenges:

Case Extract 7

The Bank's strategy, both before and following a delayed transfer to GRG, was one of debt repayment rather than considering other options (such as providing a period of time for the business to stabilise without further reductions in debt and allowing the business to retain adequate cash/ working capital to trade) and thereby provide greater flexibility to the business.

We took into account that this was not a business without trading difficulties, but it had nonetheless been able to make a very substantial reduction in its indebtedness over a comparatively short period. It had also met from its own resources all maintenance costs on equipment essential to the business.

The focus on reducing the debt, without considering alternatives and without giving credit to the customer for the substantial capital payments that it had made, had caused financial difficulties to the business.

Case Extract 8

The Customer operated a small business and was extended credit by his main supplier who held a second legal charge on certain premises. The Bank had agreed to an increase of £250k in an overdraft facility on terms that required the supplier to remove its second charge, thus giving the Bank, which held the first charge, greater security. The supplier thereafter required a cash payment with each order. This had an adverse impact on the customer and in particular there was a negative impact on his cash flow. Subsequently the Bank gave the customer three months' notice to repay the additional £250k but without considering the effect this would have on the business.

The Customer placed the business into administration citing cash flow as a significant factor in its failure.

Case Extract 9

The Customer had access to an Invoice Financing Facility in excess of £2m, although in practice only utilised about £1m of it. The Company experienced some difficulties and RBSIF considered that an IBR would be appropriate. Such a requirement acted as an automatic trigger to GRG. We did not regard that of itself to be inappropriate.

However, the invoice financing facility was also reduced at very short notice to £250k. Less than 28 days' notice was given. The customer had indicated that they were in negotiations with another provider of such facilities but no hand over arrangements were in place, and those negotiations failed.

The accountants undertaking the IBR expressed concern at the consequence this would have on the business. An internal email records: *"Can we have a chat about it asap tomorrow as [the accountant] has been in there this afternoon and believes we either provide more funds by relaxing RBSIF reduced facility limits or the Company may enter insolvency next week?"*

As a result, there was a temporary increase in the facility and subsequently the customer arranged alternative invoice financing. However, we regarded the Bank's actions in reducing the facility at such short notice as inappropriate because the Bank had no confirmation of alternative arrangements and that no transfer to another provider had been initiated. It would also have been appropriate to wait and decide upon the appropriate action once the IBR was to hand. The withdrawal of a facility of this size and in these circumstances was unreasonable.

- 4.3.37. We found evidence that suggested changes to facilities were used by the Bank to encourage customers to follow the Bank's preferred course, and we address that in Chapter 4.4 (Pricing).

Forbearance and 'new' money

- 4.3.38. The wide discretions afforded to the Bank in applying contractual provisions also afford it flexibility to exercise forbearance in the right circumstances. In appropriate cases, the Bank may consider advancing more money either within the terms of the existing facilities or on the basis of new ones. These tools are essential for a turnaround division to have at its disposal.
- 4.3.39. The Bank explained the position in this way:
- "GRG has the ability to make decisions outside mainstream credit and risk appetite, including lending new money and right-sizing debt where appropriate, to maximise the chances of successful restructuring of viable businesses. It can also agree forbearance (and has done so extensively) to allow customers "breathing space" to develop and implement consensual restructuring or exit Strategies."*
- 4.3.40. GRG had no specific policy on the exercise of forbearance until after the Relevant Period, although it introduced reporting mechanisms in June 2013 to capture the amount of forbearance extended. This enabled the Bank to produce statistics for 2013

on the amount of forbearance recorded across BRG, and the figures reflect that forbearance had taken place.

- 4.3.41. We found examples of acts of forbearance across the Relevant Period in the sample that we reviewed and regard those acts of forbearance to be appropriate. But it is in those cases where forbearance was not exercised or was limited that we have found difficulties. In other words, in relation to the fair handling of customers, forbearance becomes an issue by reason of its absence as opposed to its presence.
- 4.3.42. While agreeing that forbearance was exercised by the Bank, many of the cases where we found the Bank 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.
- 4.3.43. In those cases where new money was injected, the price for it was usually substantially greater than the existing arrangements. We accept that the Bank was assuming greater risk, and we address pricing in the next Chapter, but note here that the injection of new funds was often conditional upon the customer granting either a PPFA or an EPA. This in reality made it difficult for the customer to seek to negotiate; the monies were required to keep the business alive and seeking funding from other sources was often not a realistic option. We would have expected to see some recognition of that given the Bank's stated customer focus and the desire to treat customers fairly. In practice, we saw very little account being given to the comparative weakness of the customer.

Case Extract 10

The customer operated a number of food outlets and had expanded in the period leading up to the recession. With the general economic decline the customer accepted that there was a need to retrench and downscale the size of the business, following a sharp decline in profitability.

A transfer to GRG was appropriate and duly took place in mid-2010. There was no viability assessment or turnaround plan on the file, but the Bank did exercise a degree of forbearance to allow time for the customer to sell two of the outlets. In the meantime, the customer was working with the Bank in order to improve the underlying cash flow of the business, and in July 2010 he cancelled a standing order payable to himself of £6,500 per month and a relative introduced some cash into the business.

By the autumn of 2010 one property had been sold and the capital value of the debt was substantially reduced. A credit paper on the file dated October 2010 reads: *"debt reduction is presently £13,500 p.m. I would propose to leave the repayments on the property loan undisturbed (despite the fact that we could reduce bearing in mind the debt will be halved) and going forward the DSC's [Debt Service Cover] will be £4k pm*

on sale of [one of the properties]."

The same paper noted that *"customer has also agreed to a 6 month moratorium on his personal mortgage which will save £2,700 p.m."*

When the second of the two properties was sold, the customer asked to retain £50k from the proceeds to pay other creditors including payments due to HMRC in respect of VAT. The Bank only permitted him to retain £20k. In advising him of this the Bank wrote:

"we appreciate that the initial £20k will mean cash flow will be tight and as such you are approaching the VAT authorities to discuss an upfront amount and a short term repayment cycle for the latest quarter."

On 16 November 2010, after consulting professional advisers, the customer appointed administrators with the Bank's consent as Debenture holders. There is an internal email dated 18 November 2010 which stated *"out of the blue XX (customer) decided he could no longer cope with the pressure of running the businesses and decided to appoint an administrator. We are liaising with ZZ in this regard."*

Personal Guarantees and cash injections

- 4.3.44. In considering ways of reducing its exposure to customers, GRG routinely offered customers the option of making cash injections and in some cases considered PGs from the owners of the SME business or, on occasion, a combination of both. PGs were typically requested when the existing security had deteriorated in value such that it was no longer sufficient to cover the value of the loan.
- 4.3.45. In almost all cases where we saw RBS ask the customer to provide cash injections and additional PGs, it was in the context of negotiation over the continued provision of credit facilities.
- 4.3.46. We observed three cases where RBS asked for additional PGs or cash injections where the Bank already appeared to have determined that it wished to exit the relationship with the customer, or where the Bank had not yet determined what strategy it was going to adopt in respect of the customer. In none of these cases did the customer actually provide any additional PG or cash injection.
- 4.3.47. There were some cases where the Bank withdrew support quite some time after the initial restructure of the credit facility (which may have included additional PGs or debt repayment). In no cases where that happened did we conclude that it was clear that the Bank had a pre-determined strategy to withdraw support at the time the PG or cash injection occurred. It typically occurred where the passage of time proved insufficient to solve the financial problems that the customer was experiencing.
- 4.3.48. In some other cases, we observed that RBS did ask for PGs or cash injections in order to extend the credit facility. There were cases where the customer determined that they did not wish to inject further funds, or provide additional PGs, and the Bank sometimes then adopted an exit approach to the customer (i.e. it determined that it would no longer support the customer). In these cases, we can understand why the customer

might consider that RBS had requested additional cash or PGs when it had no intention of supporting the business. However, we did not consider that this change of approach from the Bank was necessarily inappropriate.

4.3.49. In his report, Dr Tomlinson expressed it in this way:

“To provide themselves with more security over the loans, banks ask for personal guarantees (PG) and cash injections into the business. Whilst it is fair to ask for security over loans and to ask the business owner to demonstrate their own confidence in the business, it is not fair to do so if the bank has no intention of supporting or helping the business. Many businesses that go into GRG/BSU are encouraged to invest more of their personal wealth into the business and increase their PGs, in return for which the bank will continue to support the business. Unfortunately, we have heard of many circumstances in which the bank has made these representations to the business but in quick succession the business has been put into administration and the business owner left bankrupt as a result.”⁷⁰

4.3.50. This is reflected in Annex D of the Requirement Notice. We have found no widespread or systematic practice under which the Bank misrepresented the true position to the customer with the intent of obtaining further funds or guarantees.

Our conclusions on facilities

4.3.51. We conclude that GRG did not act unreasonably in seeking to reduce facility levels in most cases it dealt with. 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.

4.3.52. We do not criticise the Bank for changing its risk appetite and readiness to lend. In particular, it was not unreasonable for the Bank to determine that it no longer wished to lend to categories of customer – including those in the non-core division. However, we consider that the Bank, having made that assessment and being mindful of good turnaround practice and its TCF objectives, would need to consider carefully how to execute that objective in a manner that was appropriate and minimised, as far as was practicable, the adverse impacts of its decision on the customer.

4.3.53. In contrast, we observed GRG pursuing its objective of reducing facility levels with insufficient regard for the impact its decisions had on customers and as such GRG's decision making relating to existing facilities was inappropriate. Whilst it is true that in many cases the Bank extended facilities where it had no formal obligation to do so, it was clear that the overriding objective in respect of facilities was to reduce the Bank's exposure. Those extensions were typically short-term and on terms that secured additional income for GRG.

4.3.54. We saw few cases in our sample where the Bank offered new additional money. Of itself that is not surprising given the nature of the customers it was handling. Where it

⁷⁰ Tomlinson Report, pages 12 and 13

did provide additional facilities, it did so on terms that normally provided for significant upside income.

- 4.3.55. We also found cases where the Bank had exercised forbearance. But our findings of inappropriate treatment of customers in this area arise from failings by the Bank to exercise forbearance when it would have been fair and reasonable to do so. This was often linked to the failure to undertake any meaningful assessment of viability or turnaround options coupled with an overriding objective to reduce the debt and reprice when possible. The failure to exercise forbearance, in circumstances where it would have been appropriate, occurred on a scale that was widespread.
- 4.3.56. Finally, we note that in practice there was little oversight or challenge of restructuring decisions from the perspective of ensuring that they took account of the needs of the customer, an issue that we cover in more detail in Chapter 3.2 (Governance and oversight).

4.4 – Pricing

- 4.4.1. In the previous Chapter, we referred to the contractual right of the Bank to revisit the terms on which credit facilities, in their various forms, were granted. We refer to them generally as “loans”. This capacity to reassess the terms of the loan extended to the “price” of the borrowing paid by the customer.
- 4.4.2. In this Chapter, we consider the way in which GRG sought to apply contractual increases to the price payable and renegotiate other financial terms.
- 4.4.3. In large part this related to the margin that the Bank charged on the facilities provided. But GRG levied other fees, which the Bank told us related to the provision of facilities, and more general management fees relating to the costs of the additional oversight these customers received while in GRG. We cover these in this Chapter. However, a significant pricing component for many customers in our sample was the use, or suggested use of, Upside Instruments, which we discuss briefly in this Chapter and cover in greater depth in Part 5 (West Register).
- 4.4.4. Pricing is inextricably entwined with other areas of GRG's interaction with its customers. Pricing was highlighted in GRG's objectives and was the means by which it earned “*incremental income*”. It was a focus of staff motivation as reflected in our work on Staff Objectives. Valuations, which we consider in the next Chapter, were often used in identifying cases where covenants had been breached and in calculating the level of prices to be charged.
- 4.4.5. Pricing decisions were understandably also a focus for customers. They were a common cause of the complaints we saw. But customers often also struggled to understand the proposals that the Bank was making and simply sought clarity about what the Bank was proposing and how its proposals were justified.
- 4.4.6. We identify in this Chapter approaches to pricing that we considered inappropriate and a significant group of cases where pricing appeared to us at best questionable and sometimes opportunistic. But perhaps the most important consideration for customers was not so much the notional quantum of the increases that GRG imposed but the short-term manageability of those charges given other financial pressures on their businesses.

How GRG was able to adjust pricing

- 4.4.7. When a facility was initially granted, the cost of borrowing would have been agreed with the customer and was normally expressed as either a fixed percentage for a specified period or by reference to a link with an external index, usually Base Rate. Thus a loan at 2% over Base Rate would maintain a margin of 2% but would otherwise fluctuate as movements in Base Rate (both up and down) occurred.
- 4.4.8. Once that rate was agreed and set out in the contract, it would apply for the duration of the loan, but could be revisited if certain terms of the original contract were breached. This might occur in a number of circumstances, including a default in payment by the customer, or where the covenants and ratios upon which the loan had been established

were no longer being adhered to. An obvious example is where the loan is granted on the assumption that the value of property taken as security will remain above a given percentage of the outstanding loan. This LTV was an important measure for the Bank in assessing the amount of its own capital that may be exposed to risk; a fall in the value of the underlying security could result in a loss that had not been anticipated at the time when the Bank agreed to lend. Thus a negative movement in LTV could give rise to a breach of contract, which entitled the Bank to increase the interest rate payable by the borrower.

4.4.9. Pricing, however, is not limited to the margin on the facility. Customers entering GRG were often required to pay a regular administration fee and in practice many faced a wide range of fees and other charges. The term “pricing” in this Chapter means any one, or a combination of any, of the following:

- Increases to the margin paid on the loan;
- 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);
- Upfront fees charged on granting “new” money (often called “arrangement” fees);
- Fees that are deferred until the loan is repaid (usually described as an “exit” fee);
- Sums payable when an Upside Instrument matures;
- Risk fee following default – a risk fee is an additional fee charged to reflect the Bank’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 the Bank, and the Bank needed to ensure that it was appropriately rewarded for continuing to offer support at a risk level that would not normally be accepted;
- Waiver fees – waiver fees are fees payable to the Bank for agreeing to waive a default by the customer. The rationale was that the Bank had provided the customer with a benefit by waiving its legal rights;
- Payment in Kind (PIK) fees – if a customer is unable to service interest on its debt, the customer may ask for interest to be rolled up/capitalised. If the Bank agreed to vary the loan terms in this way, it also charged fees for doing so;
- Non-utilisation/commitment fees – non-utilisation/commitment fees are fees payable to the Bank to compensate it for holding funds available for drawdown but which are not actually drawn; and
- 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.

4.4.10. We found examples of each of these mechanisms in the cases that we reviewed, and formed views on their use both generally and in relation to specific cases. Although

certain increases to margin were contractual in nature (e.g. an additional fixed 2% when terms are breached), the discretions afforded to GRG were, in practice, much wider and extended to decisions as to whether to trigger the contractual entitlement to the increased margin, or to take steps to restructure the loan at an entirely new rate of interest.

- 4.4.11. The use of pricing therefore needs to be seen against the policy and procedural background. We analyse that aspect first, and then consider the application of the policies in practice.
- 4.4.12. Finally, we were conscious that from a customer perspective the costs of being in GRG were perceived more widely. When they were transferred to GRG, customers were expected to meet certain costs incurred by third parties, and which could be debited to the loan. These include legal fees payable to solicitors who undertook a review of any security⁷¹ and could include valuation fees and the costs of an IBR if undertaken. For some customers these fees were not insubstantial and need to be taken into account when assessing the overall cost to that customer of their time in GRG. We accordingly have given due regard to them when making an overall assessment of the additional costs payable, but most of this Chapter deals with those additional payments required as a result of the Bank's own pricing decisions.

The Bank's policy approach to pricing

Pre June 2013

- 4.4.13. GRG policy, across much of the Relevant Period, was to ensure that pricing was reflective of the risk the customer presents to the Bank. It referred to this as *"risk-based pricing"*.
- 4.4.14. In 2008, GRG policy required that:
- "A risk pricing model must be consistently applied across the UK for all action cases."*
- 4.4.15. In 2010, this was altered to:
- "It is the policy of GRG to ensure that lending returns are earned commensurate with the lending risks being assumed. In the cases where it is not possible to secure an appropriate return using traditional banking methods then a relationship manager must look to utilise other more bespoke methods of obtaining possible future income, such as procuring equity in the borrowing business."*
- 4.4.16. While the wording of the policy changed slightly, GRG's approach to pricing, in terms of its theoretical underpinnings, did not change significantly from the start of the Relevant Period until June 2013, when revised pricing guidance was issued.
- 4.4.17. In an Aide Memoire from 2008, and available to all Relationship Managers, to help determine an appropriate return on the credit facilities, RBS classified debt according to three categories:

⁷¹ To ensure that security remains valid and to identify any third party interests that may arise.

- **“Senior Debt:** the portion of debt made available to a customer and which is secured and fully performing is classified as senior debt. Senior debt is the amount of debt the Bank could lend a customer in accordance with normal lending policies. In October 2009 the Asset Pricing Calculator (a tool established and used to price senior debt in the then Business & Commercial unit of the mainstream bank and which has been amended and updated from time to time) was introduced by the Bank and was available to be used by BRG as an additional tool for calculating pricing. This allows pricing on senior debt to be benchmarked against the Business & Commercial approach for new lending. Prior to the introduction of the Asset Pricing Calculator in GRG, senior debt was priced by reference to the Bank's normal lending policies and subject to a maximum return of 10%;
 - **Mezzanine Risk:** where a portion of debt is either unsecured, exceeds 70% Loan to Value or cannot be amortised from operating cash flows over a timeframe considered appropriate for senior debt, this will be categorised as mezzanine risk. Key ratios, such as debt serviceability and interest cover, would also be below the level considered acceptable for senior debt. The return sought on mezzanine debt is typically between 10% and 25% depending on the risk profile;
 - **Equity Risk:** any portion of debt which is unsecured, where debt cannot be serviced and does not conform to the characteristics of senior or mezzanine debt would be classified as equity risk. This is the highest risk element in the capital structure and would typically represent the level of risk being adopted by shareholders. Equity risk would typically have an expected internal rate of return of 25% or greater.”
- 4.4.18. The Aide Memoire issued in 2009 set out the debt categories in the following terms:
- **“Senior Debt** – Acceptable Financial ratios, stable profit/cash flow and/or fully WD security cover, able to repay capital over acceptable period
 - **Mezzanine** – Able to service interest, but unable to repay capital from existing profit and cash flow over acceptable period and/or unsecured
 - **Equity** – Not serviceable from existing profit stream and cash flow forecast. Unsecured. Risks here can range fairly considerably.”
- 4.4.19. Whilst the detail of the underpinning approach changed slightly over these four years as might be expected, the overall themes remained constant. The table below summarises the various pricing categories that we have identified from GRG documents.

Fig. 19: GRG Pricing Categories

Debt classification	September 2008 pricing memo	August 2009 Aide Memoire	2011 and 2012 Upsides training
Senior Debt	Base + 1.85% to 5%	Base + 1% to 4%	Base + 1% to 5% Priced to produce an Internal Rate of Return ("IRR") of between 6% and 10% based on average historic "through the cycle" wholesale funding rates of 5%
Mezzanine	Base + 5% to 20%	Base + 4% to 25%	Priced to produce an IRR of between 10% and 25%
Equity	IRR 25% plus	IRR 25% plus ⁷²	IRR 25% plus

4.4.20. In considering pricing, GRG took the approach that debt classification had to be assessed against the situation of the business at the time of the new lending decision, not at the time the original loan was underwritten. That was not inappropriate, but it had significant impacts for customers in an environment where lending criteria had tightened significantly. For example, whilst an LTV ratio of, say, 80% might have been acceptable in the past, by 2008 lending beyond 70% LTV was classified as mezzanine debt upon which additional higher margin should be charged.

4.4.21. A further factor was the way the shift in wholesale funding influenced pricing. During 2011, there was pressure to shift facilities away from margins over Bank of England Base Rate to margins over LIBOR. This was not uncommon practice at the time and reflected the increased divergence between Base Rate and interbank lending rates, but from the customers' perspective it represented a further unwelcome upward pressure on the margin payable.

Post June 2013

4.4.22. In December 2012, GRG produced a document titled *"Enhancing RBS Support for SME Customers in Distress"*. It was written against the backdrop of adverse feedback from a Customer Satisfaction Survey and recommended that some changes be made to the pricing framework that had operated in BRG until that point. In particular, it recommended that default interest would not be charged to trading customers for the first 90 days post transfer to GRG. The estimated cost of this measure was "c£1m pa".

4.4.23. Importantly, it also made the following recommendation:

"We recommend that imposed fees which are applied to incentivise a customer to exit and/or agree terms on a consensual restructuring should be discontinued and only arrangement/restructuring/exit fees agreed in writing by the customer be permitted. Estimated cost c£4-6m p.a."

⁷² True upside - no cap

4.4.24. In recommending the waiving of risk-based fees, the document noted that the pros of that would be:

- *“An improvement in the customer position/liquidity; and*
- *A reduction in reputational risk from ‘unreasonable’ fees.”*

4.4.25. But it noted that the “cons” included a removal of *“the stick and carrot to influence outcomes”*.

4.4.26. The paper also noted that in September 2012 GRG had abolished the use of “Behavioural fees” which had been imposed to *“encourage compliance with facility terms”* such as the requirement to provide regular information on the current state of the business.

4.4.27. Accordingly, there was a revision to policy in June 2013 which touched upon aspects of pricing that have a direct bearing on issues that we identified in reviewing individual cases. This revised policy recognised that risk fees should be charged on a deferred basis only for future restructuring of credit facilities (i.e. they would not impact immediately on cash flow). RBS told us that one of the reasons this was done was to ensure that proper account was taken of a customer’s financial position when agreeing pricing. In addition, a cap of 9% above Base/LIBOR was imposed in respect of the interest margin to be charged.

4.4.28. An email was issued to all GRG staff in June 2013 which noted the following:

“Approach to fees and interest margin

Risk fees (i.e. non-deferred fees) which reflect increased lending risk and directly impact cash flow will no longer be charged. The BRG Reservation of Rights letter templates on [GRG system] have been updated to remove references to Risk Fees. Relationship Managers should continue to ensure GRG's risk/reward principles are observed. Care must be taken to ensure the customer's cash flow position is properly taken into account in all cases. In doing so, the following options should be considered when agreeing revised terms with the customer:

- *Interest margin which is due and payable on an ongoing basis (NB. must not exceed 9% over base or LIBOR rate - this is a maximum limit rather than a recommended rate)*
- *Deferred fees payable upon a future event (e.g. upon sale of asset, change of control, refinancing etc.) or agreed future date (based upon projected affordability)*
- *Interest roll up/PIK*
- *Property Participation Fee Agreements*
- *Equity stakes (including warrants, options etc.)*

Other fees which are contemplated by relevant Credit Policies, such as Commitment Fees and Arrangement/Facility Fees continue unaffected. However, the key principles set out below should be followed when agreeing such fees.

Key Principles to be Followed:

As ever, when agreeing any fees and interest margin with a customer, care must be taken to ensure:

- *the amounts to be charged are (i) fair, reasonable, transparent and objectively justifiable, (ii) set using applicable pricing models (including e.g. where appropriate, the Asset Pricing Calculator) and (iii) in compliance with applicable Credit Policies*
- *an appropriate affordability assessment has been undertaken*
- *there is no element of double-charging*
- *the agreement with the customer clearly sets out the fees and interest margin*
- *a clear internal audit trail is maintained which sets out the rationale for charging the fees and interest margin and the amount charged (pricing models should be attached to RMP Credit Application and placed in files as part of this requirement)."*

4.4.29. This memorandum was replicated on the GRG intranet site as guidance for Relationship Managers in relation to pricing for BRG.

Guidance

4.4.30. There was no mandatory pricing matrix that set out specific fees and pricing for SME customers in GRG. However, as we explain above, aides memoire were produced and used as guidance for Relationship Managers on pricing. One was produced in 2008, and variants appeared in 2009 and 2011, and they were made available to Relationship Managers on the intranet site. The matrices of prices proposed were summarised earlier in this Chapter.

4.4.31. It is notable that the guidance allowed Relationship Managers considerable leeway in determining appropriate pricing for individual customers.

4.4.32. An IRR tool (in Microsoft Excel form) was developed for use within GRG to calculate the IRR for different levels of pricing – particularly for upsides. So a Relationship Manager could tailor a pricing strategy that achieved a particular IRR. This might include delaying the imposition of some pricing for a period of time (i.e. the model allowed for flexibility in terms of the level and timing of any pricing changes).

4.4.33. The GRG Aide Memoire summarised the expected approach to pricing in the following way:

Fig. 20: GRG Aide Memoire strategy and pricing summary table

Turnaround Outlook	GRG Strategy	Pricing Approach
Dead on Arrival	Insolvency	Risk/Management Time Fee
Short Term Survives, Medium Term Likely to Fail	Managed Exit plus Quick Fix	Fee (possible PPFA)
Survival but Unexciting Growth Prospects	Action – but cautious funding strategy	Property Participation or Equity Participation plus deferred fee
Sustainable Recovery with Good Growth Prospects	Action	Equity Participation

4.4.34. In March 2011, written guidance was issued by RBS Group Legal to GRG on the procedures to be followed when considering charging customers default fees and when it was appropriate for fees to be charged. The legal guidance noted that:

“Where a customer is in default, the Bank is entitled to charge the customer a number of different fees including (for example) for the provision of further facilities, to reimburse the Bank for increased management time or to compensate the Bank for additional risk.

Any fees imposed by the Bank should only be charged where it is right and proper to do so and all customers must be treated fairly throughout the process. Any fees charged must be commercially justifiable in the circumstances of any particular case.”

4.4.35. That document listed the different types of fees and charges that were common within GRG. It then set out the following advice:

- *“Consider the type of fee and the amount you propose to charge. Any fee must be commercially justifiable in the circumstances and the Bank must be able to explain the commercial rationale/purpose, and the basis of calculation, of the fee. **Keep a clear record on the file of all decisions in this regard** [our emphasis]*
- *Check whether there is any danger of double-charging – i.e. where the Bank may intend to charge default interest, management fees and increased risk fees, could the Bank be accused of double-charging? The Bank must take care to ensure that it does not charge customers more than once for the same thing*
- *It is important that wherever a fee is to be charged, the file shows a clear paper trail evidencing the rationale for both the charging of the fee itself and its amount. All internal documents (emails, notes), showing thought processes may be disclosable in the event of a claim against the Bank. Ensure you keep a paper trail reflecting the Bank’s commercial decision making.”*

- 4.4.36. While the legal guidance was not issued until March 2011, it does provide guidance on expected practice in some areas of pricing. For instance, the need to avoid double-counting and the need to evidence the rationale for pricing were clearly stated. It would be appropriate, fair and reasonable to have expected both to have occurred across the Relevant Period, regardless of whether there was specific guidance or not. A customer would be entitled to know both that they were not being charged twice and that there was a clear rationale that informed the price they were expected to pay. The legal advice thus does no more than reflect prudent practice. In our view, the policies adopted by GRG throughout the Relevant Period ought to have already contained a requirement that reflected the need to set out and retain on the file a clear explanation of how pricing changes were arrived at. The absence of such a policy requirement points to a failing that is systematic in nature.

Training and oversight

- 4.4.37. In relation to training, the *"Introduction to GRG"* course provided some material on pricing – although this tended to be relatively high-level and introductory, rather than a detailed explanation of GRG's approach to pricing.
- 4.4.38. The most extensive training that we saw was the *"Introduction to Upsides"* course. It was compulsory for Relationship Managers to attend it and it was spread over two days. It covered different aspects of pricing but with a focus on Upside Instruments.
- 4.4.39. These Upside Instruments play a significant role in some of the cases that we looked at; we consider them more fully in Chapter 5.2 (Strategic Investment Group). In essence they defer payment of increased pricing until some point in the future, either by way of a percentage on the value of property or by taking an equity stake in the customer's limited liability company. The income generated from them accrued to GRG at some point in the future when they crystallised. We note here the emphasis accorded to the training around them.
- 4.4.40. Much of the written material associated with the upsides training struck us as professional and appropriate. There was however one area that we noted (and had been noted by Clifford Chance in its review) that caused concern. This was in a section about pricing negotiation where the material suggested various approaches, including (with our emphasis):

"Negotiation where there has been no breach of Facility Agreements

There are two options in these cases:

- *Utilise a convertible fee agreement or equity warrant such that an upside is taken in the event that there is a subsequent breach or*
- *Focus upon the existing under-performance of the business against expectations/forecasts, using the on demand nature of the overdraft to leverage against."* [our emphasis]

- 4.4.41. RBS told us that a lot of Relationship Manager training (including in relation to pricing) was delivered "on the job". It has not been possible for us to evidence the extent to which Relationship Managers were really provided with suitable training "on the job".

The balance of evidence from our work on staff objectives and from case file reviews did not provide us with the confidence that on the job training was substantive or appropriate.

- 4.4.42. The “*Just Hit Budget*” document (see Annex IV), with its “*16 Ways to Generate Income*”, contained information on techniques for implementing pricing changes. While this appears to have been circulated in a limited number of regional offices, we have seen the types of approach it encouraged applied on a frequent basis. We report on that in more detail in the following section that deals with the material we have seen on the cases.

Case Extract 11

The customer requested agreement for month-end excesses and the GRG Relationship Manager agreed £100k excess subject to £500 fee per excess. When we asked the Relationship Manager how he calculated the £500, he responded: “*There was no rationale or methodology to that...It was a figure which I didn’t want to appear to be excessive but equally penal enough for the Customer to be incentivised not to use it if at all possible.*” There are no calculations or assumptions on file to support the basis for the fees charged and the rationale for these charges had not been clearly explained to the customer.

- 4.4.43. To some extent, any shortcomings in training or guidance could have been mitigated by appropriate oversight of pricing decisions, preferably before the issues were raised with the customer. The only mechanism that we have identified that could in principle have undertaken that role was the SCR Committee. We noted, however, in Chapter 3.2 (Governance and oversight), there was no evidence of any substantial debate or challenge at SCR meetings of the approach suggested in relation to individual cases. Specifically we saw no evidence to suggest that the SCR sought assurance that prices were not just generating incremental contribution, but were otherwise fair and took account of the customer’s circumstances and the impact the fee might have on the scope for successful turnaround. We conclude that these Committees were therefore inadequate and failed to operate appropriately if their role was to give input to decision making on pricing.

Our overall findings on policy and procedures

- 4.4.44. 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. As the Bank in part recognised in its 2013 policy revision, care needed to be taken to ensure that the customer’s cash flow position was “*properly taken into account in all cases*”. 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 RTS.

- 4.4.45. Nor was it inappropriate that GRG Relationship Managers were vested with considerable discretion as to the application of pricing arrangements. 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. In particular, we found limited evidence of the use of calculators, tools or guidance on what pricing element to pick and how to “size” it. More importantly the emphasis of the training, objectives and guidance we saw, and the clear messages of day-to-day guidance to staff, such as that in the *“Just Hit Budget”* document, suggested to us that the focus was simply on how to increase prices, and leverage opportunities.
- 4.4.46. The 2013 revisions to pricing policy were intended to put an end to some of the more contentious elements of GRG charging. They came too late in the Relevant Period for us to be able to test what effect they had. In any event, we did not view those revisions as sufficient to address the shortcomings in policy we have identified given the weaknesses we have demonstrated in the wider environment to which the policy applied.

Our review of cases

- 4.4.47. We are required by the Requirement Notice to form a view about the appropriateness of costs imposed on businesses once in GRG.
- 4.4.48. This is inherently a relatively subjective issue; and it required a careful analysis of each case to determine what can be regarded as “appropriate”. In seeking to answer the question, we have had regard to the criteria set out at the start of this Chapter.
- 4.4.49. It was agreed with the FCA at an early stage of our review that we would not undertake a benchmarking exercise to compare the prices charged by the Bank with the prices set by others. In the context of SME customers in GRG, such an exercise would be of limited value. They were not in a position to “shop around” for a solution to the problems that they faced.
- 4.4.50. Nor have we made any assessment of the competitive position or reasonableness of the original pricing agreed between the customer and the Bank, and entered into what other alternatives may have been more readily available to the customer. We regard that as being outside of the scope of our review.
- 4.4.51. The overall increases in pricing, faced by some customers, is something that we have taken into account, especially in our assessment of the extent to which inappropriate actions by the Bank likely caused material financial distress. We have therefore looked at the issue of quantum of increases by considering the overall position of the customer at the time when the increased pricing was imposed.
- 4.4.52. In assessing whether there was inappropriate treatment of customers by RBS in relation to pricing, we focussed on four key areas:
- Whether there was evidence on the file to justify GRG’s pricing decisions;

- Whether pricing changes were properly explained to the customer;
- Whether the quantum of pricing was fair and reasonable in the individual circumstances of each customer and the extent to which increases would affect such issues as cash flow; and
- Whether the pricing complied with RBS guidance.

4.4.53. We will take each of these in turn. But to give some overall perspective, we note here that we have made findings of inappropriate treatment of customers in relation to pricing on 118 cases in our sample (57%). It represents the thematic area where the highest number of findings was made. In the majority of cases, our findings were 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. But for the reasons we explain later in this Chapter, this should not be taken as suggesting that we viewed the level of prices as satisfactory.

Was GRG's rationale for the pricing decision clear and justified?

4.4.54. We made a finding on 103 cases that the file did not contain any or any adequate rationale for the pricing decisions that had been made in relation to the customer. This failure to make, or retain, a clear explanation of how a price was arrived at was both contrary to GRG's own guidance, which was contained in the legal advice circulated in March 2011, and contrary to what we would expect to be set out in clear policy requirements.

4.4.55. We note that Clifford Chance encountered similar issues in reporting the findings of their investigations in April 2014. Thus, at paragraph 6.12 they report:

"The fairness and reasonableness of BRG's fees led us to a separate issue, which is transparency. We found it difficult to understand precisely how the bank calculated the fees which it proposed to customers case-by-case (whether the proposal was accepted or not; in some cases the fee was never agreed because the customer pursued some other option, such as repaying the debt, reducing its borrowings through asset sales or re-banking). We therefore found it difficult to assess allegations of unfairness (in cases where this was alleged) or potential unfairness (in cases where no such allegation was made)."

4.4.56. This inability to find evidence of what led to suggested price increases was particularly acute in those cases where there were multiple amendments to the overall pricing matrix. We give two examples of the complexity faced by customers in that situation:

Case Extract 12

The business was a limited company which owned several care homes. It was owned by a husband and wife.

During their time in GRG, the customer faced additional pricing and costs from:

- The restructure of several loans which included increases in interest rates;

- Loan restructure fee;
- Several overdraft arrangement fees;
- An Equity Participation Agreement; and
- Various third-party fees – including legal fees, fees for a valuation and fees for a business review.

We were unable to ascertain from the file what factors had been taken into account and what weight had been attached to any aspect over any other in determining the fees to be applied and the level of those fees.

We found *“the Bank imposed a material range of additional fees and charges on the customer, a number of these were not explained to the customer nor is an explanation of them or the assumptions on which they are based on the file.”*

Case Extract 13

The connection consisted of various entities which were primarily trading businesses in nature.

During their time in GRG, the customer was subject to additional pricing and fees for a variety of reasons. These included:

- Quarterly fees;
- Arrangement fees for the overdraft and loan which expired when the customer was in GRG;
- Loan arrangement fees;
- Development loan exit fees; and
- Land loan exit fee.

We found no evidence on the file to support pricing proposals or decisions in this case. We concluded:

“There were no pricing model or assumptions on file to support the basis for the calculation of revised pricing and fees levied;

The rationale for the fee model, the additional cost to the Bank in dealing with the case, and other relevant factors are not apparent on the file and had apparently not been explained to the customer in line with the Bank’s policy, which they should have been.”

4.4.57. We found that this failing to set out and retain details of pricing decisions was widespread in nature. It was difficult for us to assess from the material produced by GRG at the time whether this led to prices that were too high (or indeed too low). But the apparent absence of analysis was inappropriate and clearly led to a concern that the prices GRG charged were not well founded on a consistent and logical approach. It was

in particular difficult to identify where more than one fee was being applied whether GRG had understood and properly accounted for the cumulative impacts of the fees being proposed.

- 4.4.58. As the author(s) of the *"Just Hit Budget"* document put it *"avoid round number fees - £5,300 sounds as if you have thought about it, £5K sounds like you haven't"* or, as we were told by a GRG Relationship Manager on one case: *"I mean it's not rocket science. You know, it would have been just sort of done in your head really."*

Were pricing decisions adequately explained?

- 4.4.59. We made findings in 83 cases that there had been a failure to adequately explain pricing changes to customers. This was also an area addressed by Clifford Chance; their report noted, at paragraph 6.15 (footnote omitted):

"GRG engages an external company to conduct a poll amongst its customers. The poll, which was run annually from at least 2008 and included several hundred BRG customers, includes a number of points of positive and negative feedback. The poll identified 'clarity of explanation of the bank's pricing' as a priority area for improvement."

- 4.4.60. It was a common feature of many of our pricing findings that there had been an absence of transparency with the customer as to how decisions or proposals about pricing were arrived at. We give an example:

Case Extract 14

Upon transfer to GRG, an introductory letter was sent to the customer dated 6 December 2010.

The customer responded to this letter on 13 December 2010 and challenged various aspects of the GRG letter. In addition, the customer stated that *"I feel aggrieved at the fact that you want to charge the company £1,000 per month for the privilege"* and *"you mentioned in your letter that it is your aim to return us back to normal banking, please can you advise what the trigger point is?"*

No response to either of the customer's points was found on file.

- 4.4.61. As Clifford Chance notes, the Bank was aware of these concerns, certainly by the end of the Relevant Period. The amendments to policy introduced in June 2013 contained the following provision:

"The agreement with the customer clearly sets out the fees and interest margin."

- 4.4.62. It was also clear that when customers complained about the absence of a clear explanation, the Bank found the position hard to justify:

Case Extract 15

In responding to a Member of Parliament ("MP"), the Bank stated that: *"we may not have communicated the rationale for our proposed pricing as clearly as possible."*

Case Extract 16

In responding to a complaint, the Head of BRG wrote as follows: “....the basis of the Bank’s proposed pricing for its non-standard risk should have been set out more clearly including the rationale and basis of calculation for” the revised pricing.

- 4.4.63. The evidence on this issue is clear; GRG was not transparent with customers about how pricing was arrived at. The result was that customers were not treated in an open, transparent or appropriate manner. Despite warnings from complaints and customer surveys that this was a major issue for customers, guidance only reflected those concerns when it was changed in June 2013.
- 4.4.64. In our view, this lack of transparency is more significant than simply the absence of adequate paperwork. It reinforces our view in the previous section that pricing proposals lacked careful analysis. Moreover, the lack of transparency would, in our judgment, have made it more difficult for the customer to understand and evaluate the potential impact on their business.

The reasonableness of quantum

- 4.4.65. For the reasons given above, we have not made comparisons between the prices charged by GRG and those charged by other organisations.
- 4.4.66. But we have as part of our review, considered two aspects in relation to the quantum of pricing. We sought to assess whether:
- The quantum of pricing on individual cases was appropriate taking into account where relevant risk-based considerations (i.e. did it comply with GRG policy); and
 - Whether the quantum of pricing was otherwise appropriate given the circumstances of the business and the turnaround objective of GRG (i.e. was it fair and reasonable in the circumstances).
- 4.4.67. These two tests are different. What may be appropriate from a risk-return perspective may not be fair and reasonable given the circumstances of the business at the time. The assessment of whether pricing was fair and reasonable given the turnaround objective was conducted through our assessment of financial distress that we describe in Part 6 (Customer outcomes).
- 4.4.68. There were issues that made it difficult to assess whether pricing was appropriate on individual cases. These included:
- Pricing calculations were absent from most of the files where pricing was a feature of a debt restructure – this meant that we were not able to determine the basis on which pricing had been arrived at on most cases;
 - Upside Instruments were features of a number of cases. The value of these Upside Instruments is difficult to determine at the point at which they are entered into and the final price is heavily dependent on future events. As such,

determining the value of an Upside Instrument at the point at which it is entered into is not straightforward, although the Bank did, at the outset of pricing these instruments, make an assessment of what it thought the future return may be;

- Other deferred risk fees were not uncommon and these were often dependent on specific future events that were not certain – or were dependent on the timing of specific future events;
- The extra pricing and risk-based fees and charges faced by customers were not smooth over time and it was not straightforward to determine the period of time over which any assessment should be made (£100k spread over 6 months is not the same as £100k spread over 12 months); and
- More prosaically – but often significantly – the Bank's records of pricing decisions and outcomes were often unclear. Prices were regularly proposed but not progressed. Some were agreed or imposed, but for some reason it seems not implemented. Finally, of course, not all fees that were charged were in the event paid.

4.4.69. This made the analysis difficult. Given the lack of contemporary rationale for pricing on cases, we could not establish with confidence the degree of risk inherent in the transaction; nor could we benchmark against others at the time the reward the Bank assessed as appropriate. We therefore took a cautious approach to this – it was for the Bank to determine its prices. However, some of the pricing that we observed was, in our view, inappropriate when assessed against normal risk-return principles, or otherwise excessive – although we were not always able to evidence this reliably. There was certainly, however, a significant group of cases where pricing appeared to us to be questionable and sometimes opportunistic. We set out in the following case extracts some brief examples of the sort of pricing proposals we observed.

4.4.70. But in practical terms the most important immediate consideration for customers was not so much the notional quantum of the increases that GRG imposed but the short-term manageability of those charges given other financial pressures on the business. As identified by Dr Tomlinson:

*"Whilst the Bank may argue that [increases] in interest reflect the greater risk the bank faces as a result of the business' instable position, this is unhelpful for the business, making it increasingly hard for them to trade out of their difficult situation."*⁷³

Case Extract 17

Even before transfer to GRG, it was clear the customer was having difficulty meeting his commitments. A letter from SRM had outlined *"concerns by the Bank about the ability of the business to generate sufficient income to service borrowings and meet your required living expenses and personal drawings."*

Despite this, following transfer to GRG, the Bank wrote to the customer and advised: *"In addition, to reflect the change in risk profile as a result of your loan being in default, and*

⁷³ Tomlinson Report, page 11

until we are presented with proposals and timescales for the sale, a monthly support fee of £5,000 shall accrue."

There was no explanation provided to the customer as to how this figure was calculated. Prior to sending the letter, a draft version was sent to RBS Legal who commented as follows: *"Given that the arrangement fee was £7,000, this appears to be a high monthly fee, nearly 10% of the loan amount, per annum. Does this reflect the Bank's actual costs? Please also clarify when the fee will be charged from, again, is it the date of this letter?"*

Whilst it would seem that these fees were meant to accrue, £5,000 was debited a month after the above mentioned letter was sent and £19,000 was debited four months later.

The Relationship Manager acknowledged that he had been told to take the fee, but did not know how they were calculated and that the £19,000 fee was taken at that time so it wouldn't be "lost". It would seem these fees were debited from the account when it was clear from the file the Bank knew that the customer could not afford to pay them.

Case Extract 18

Following transfer to GRG, the GRG Relationship Manager wrote to the customer giving *"one month's notice that during the period until the bank's facilities are restructured onto a firmer footing, your account will be met with a monthly management fee of £4,167 to meet the additional work and time that go into the account."*

When interviewed by us, the Relationship Manager stated: *"I think that was a Lombard fee...from my experience (GRG) that would be high. That would be very, very high."*

We therefore raised a query with the Bank to ascertain whether this was a Lombard fee or a GRG fee and the Bank confirmed it was a GRG fee. There are no calculations or assumptions on file to support how this figure was arrived at and, by the Bank's own admission, the fee seems high.

Other issues

- 4.4.71. During the course of our review, we noted that pricing proposals, often coupled with proposed changes to facilities, were handled in ways that we judged to be inappropriate. We draw attention to three issues here, frequency of proposals, leveraging to achieve Bank objectives and ratcheting.

Frequency

- 4.4.72. We were struck in a number of cases by the number and frequency of pricing proposals we observed the GRG Relationship Manager make to the customer. Prices and new components to charges could (and did) change with surprising frequency, reflecting in part the short-term nature of the facilities that the Bank agreed in several cases. It was clear to us that this was often disruptive and confusing to customers. At a minimum it made long-term financial planning difficult.

Case Extract 19

As part of a restructuring within GRG, the loans were moved from Base to Libor, costing approximately £62k over the GRG period and the loan was moved from a margin of 1.75% to 2%, costing an additional £12k.

The Bank also charged a restructuring fee of 1.2%, being £64k. These increases were levied following transfer to GRG on the basis that the company could not service interest – which appears to be in conflict with turnaround objectives. The customer in his meeting with us indicated that he had not understood the implications of the change from Base to LIBOR or the additional 0.25% margin on the loan and there is no evidence on file to suggest they had been properly explained to him.

In addition, the customer signed a three year PPFA, priced based on a PAU valuation, which had fees at the higher of £300k or 6% of the sales price.

In emails subsequent to the repricing in GRG, we note comments on the file indicating that a number of Relationship Managers considered the agreement reached favoured the customer. SCR of 12 February 2011 stated *"Panel recognised that deal has been agreed but appears biased towards the company... Relationship Manager to review ability to breach if necessary and restructure."* No breach or breach potential was identified by the Bank so the pricing remained at the agreed levels.

However, we consider it inappropriate that an *"ability to breach"* was considered on the basis of a target of improving the Bank's position.

Leveraging

- 4.4.73. The issue of leveraging arose in the context of upsides training – that is the extent to which the withdrawal or threatened withdrawal of overdrafts or other facilities were used as "leverage" to get the customer to accept pricing proposals. But we also identified references to 'leveraging' fees in other material. It was a matter that was raised in the Treasury Select Committee on 17 June 2014:⁷⁴

"Q571 Mr Ruffley: *What about the underlying business practice of threatening to remove a business overdraft in order to get more leverage in negotiations about equity? I know you have changed the wording of the manual, but what about that practice?*

Derek Sach: *The reality is not so either.*

Q572 Mr Ruffley: *You just deny that ever took place?*

Derek Sach: *Yes, and I have found no examples of it. Clifford Chance asked me about that in my interview with them and it would be something that concerned me. I and they can find no evidence of that happening."*

- 4.4.74. We found that GRG did seek to use what it sometimes called "leverage" as negotiating tactic to achieve its objectives, including fee increases and agreement to Upside Instruments. In many of the cases, we identified proposed changes to terms that we

⁷⁴ Treasury Select Committee: Oral Evidence SME Lending 17 June 2014 Chris Sullivan, Deputy Group Chief Executive, RBS, and Derek Sach, Head of GRG, RBS

considered to be more negotiating tactics than considered proposals. For example, in one case an overdraft was withdrawn at very short notice as a means to “encourage” the customer to enter into an EPA:

Case Extract 20

An email, internally sent within the Bank, records the reason why an overdraft facility of £175k was withdrawn at very short notice:

“As mentioned we withdrew overdraft to get [Bank’s own consultant] in. Customer needs it back by Wednesday (no new money) to pay [a key] supplier. There is no group and propose we get 20 percent in both [Companies in the customer connection]. Customer has injected 150k to keep trading and that will stay in. The overdraft will peak at 170k and is against stock and debtors as before and lending formula will be introduced. Ledger too small and spread for an ID line.

Fundamentally [Bank’s own consultant] reckons this will fly post economic downturn... I will get Heads of Terms for Monday, legal Tuesday, and complete Weds. Cash chaps to supplier on completion... Need to move fast as he has third party investors but they can’t deliver on Weds.”

The Bank in response to our findings remarked that “elements of the bank’s approach in this instance fell short of best practice”.

Ratcheting

- 4.4.75. Pricing was also used to “encourage” customers to behave more in accordance with the Bank’s wishes than they seemed inclined to do. The existence of fees that were used for this purpose was acknowledged in the document produced in December 2012^{75,76}. We saw the application of fees in this context and other contexts in some of the cases in our review. The following cases illustrate the issues.

Case Extract 21

The business was a manufacturer based in the north of England. It was a limited company and was run by a family and had been in existence for over 30 years.

On transfer to GRG, the customer was expected to complete a restructuring of all facilities in the short term with the Bank awaiting financial information before this could take place.

The restructuring agreement included an increased margin, arrangement fees, legal fees and monthly management fees, as well as a 15% EPA agreement.

Despite this, shortly after transfer, an internal email to the GRG Relationship Manager stated: “Pls start charging weekly excess/monitoring fees - c£2k pw seems reasonable.

⁷⁵ See paragraphs 4.4.21-4.4.25 above.

⁷⁶ “We recommend that imposed fees which are applied to incentivise a customer to exit and/or agree terms on a consensual restructuring should be discontinued and only arrangement/restructuring/exit fees agreed in writing by the customer be permitted. Estimated cost c£4-6m p.a.”

It will concentrate customers' minds/galvanise them into action !!"

- 4.4.76. In other cases, a mechanism by which fees were increased over time to encourage certain actions was employed:

Case Extract 22

The business, a limited company, was involved in property construction.

In the months following the transfer to GRG, GRG looked to restructure the credit facilities that had been extended. Included in that was a PPFA which included a price ratchet. The Bank would receive more, as a percentage of sale proceeds, the longer the customer took to sell properties (i.e. the ratchet would increase each year).

Case Extract 23

The pricing structure put in place around restructuring included a renewal fee of £1,165, followed by an arrangement fee of £19,590 (equivalent to a further 1.7% of facilities) and a ratcheted fee structure whereby no fee would be paid if all debt was repaid within a year rising to £150k if repayment did not occur for three to five years. The customer achieved some reduction in debt by selling stock and thereby reduced the fee to £35k. The justification for this fee structure - beyond a desire to encourage a reduction in the facility or re-banking - is unclear and was not explained either internally or to the customer.

Case Extract 24

GRG Relationship Manager wrote to the customer stating that, after consideration, the Bank had no appetite to provide increased support and given this the Bank saw the following options available to the customer: 1) Sufficient cash injection from the current shareholder/third parties to meet the full forecasted additional cash requirements of £250k or 2) Refinance all of the Bank's facilities with an alternative lender.

The Bank offered to support the customer in the short term if they were unable to inject monies themselves and wished to refinance. The overdraft facility would be increased for three months to allow them to find a suitable alternative funder. The fees for the £125,000 overdraft would be £1,000 per month, if the facilities were repaid within 10 weeks, but otherwise the fees for the three months would be £6,000 (£2,000 a month).

- 4.4.77. It was not in our view unreasonable for the Bank to adjust prices upwards over time if the customer's actions (or more frequently inaction) added to the risks the Bank faced. But the way this was done needed to be appropriate and bear in mind the customer

perspective and the reasonableness of the level of charges proposed. We found many cases where this was not done.

Our conclusions on pricing

4.4.78. We have concluded that:

- GRG sought to impose on customers a wide range of pricing increases and charges;
- There were wide discretions available to Relationship Managers, but the failure to provide proper oversight about how that discretion was exercised was inappropriate and, coupled with the failings we have identified earlier in relation to governance and objectives, gave rise to an environment where there were inadequate controls over pricing practice;
- The evidence available to us suggests that there was an undue and inappropriate focus throughout the Relevant Period on the generation of income in the form of pricing increases from SME customers;
- 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 cases in our sample and was, in any event, too generic in nature;
- There was however legal guidance, from March 2011, on the need for GRG to set out a clear rationale on pricing decisions in order that the Bank could justify them if called upon to do so; that advice was not followed in most of the cases that we have reviewed;
- The absence of adequate records of the rationale for decisions rendered it difficult, and often impossible, for us to consider how a decision on price had been arrived at;
- 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;
- Our ability to assess the reasonableness of the absolute quantum of pricing was constrained by a number of factors including the fact that we did not undertake a benchmarking exercise, and the lack of contemporaneous rationale by GRG for pricing on cases. Nevertheless, some of the pricing that we observed was, in our view, inappropriate when assessed against normal risk return principles or otherwise excessive – although we were not always able to evidence this reliably. There was certainly a significant group of cases where pricing appeared to us 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 but the short-term manageability of those charges given other financial pressures on the business;
- Pricing was, for much of the Relevant Period, used on occasions as a mechanism to encourage the customer toward taking a course proposed by the Bank and

there was evidence that the Bank used its pricing discretion as leverage to achieve its objectives; and

- 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. Of 24 cases we have reviewed in which working capital facilities were either reduced or withdrawn by the Bank, 19 of these customers were subject to pricing increases whilst in GRG.

4.4.79. Overall we conclude that 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.

4.4.80. We also conclude that this inappropriate treatment of customers resulting from the undue focus on pricing increases, without due consideration of the longer term viability of customers, was systematic. We say this because:

- GRG prioritised its commercial objectives at the expense of turnaround objectives (as explained in Chapter 3.1 (GRG objectives and strategy));
- The 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 a focus on income (as explained in Chapter 3.2 (Governance and oversight));
- The focus of GRG Management Information was on pricing related metrics, not risks to customers (as explained in Chapter 3.2 (Governance and oversight));
- GRG, in operating its staff objectives, focused on pricing, and it placed less emphasis on other objectives such as treating customers fairly (as explained in Chapter 3.3 (Staff objectives));
- The GRG staff objectives in practice, material on case files and the Just Hit Budget document 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' (as explained in Chapter 3.3 (Staff objectives));
- 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 (see this Chapter); and
- 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:
 - 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;
 - There is scant evidence of GRG management 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 is the management focus was on income generation; and

- There were inadequate controls over pricing practice generally.

4.4.81. These were shortcomings that GRG's management were aware of (or should have been aware of) during the Relevant Period, but insufficient steps were taken to correct the position. We note that the revised pricing policy adopted in June 2013 included a number of changes to limit the adverse impact of GRG's previous pricing practice. We view that late change of policy as positive (if too generic in nature), but it also underlines our concerns about prior policy and practice. Our conclusions on Upside Instruments are contained in Chapter 5.2 (Strategic Investment Group). Our assessment of the impact of pricing on SME business cash flow is discussed in our assessment of material financial distress in Chapter 6.2 (Distress assessment).

4.5 – Valuations

- 4.5.1. Valuations played a significant role at various stages in a customer's journey into and through GRG. That significance was recognised by the Tomlinson Report, which refers to valuations as being used by the Bank in a way that *"significantly undervalues the business' assets and puts them in breach of their covenants."*⁷⁷
- 4.5.2. The Tomlinson Report identifies revaluations and changes to LTV as being *"one of the most common complaints"* that Dr Tomlinson received. The concern was that a bank may have the ability to manipulate valuations *"especially when additional circumstances such as quick sales are added to the mix."*⁷⁸
- 4.5.3. Secured loans were normally made on the assumption of a given maximum LTV ratio. The ratio decreased if property prices increased, but a downward trend in market prices could leave the Bank exposed. We accept that this raised issues for the Bank in the management of its capital and prudentially it was an area that all banks kept under close review. We have borne that in mind when addressing the issues addressed in this Chapter.
- 4.5.4. We did not find any evidence that RBS adopted an approach to internal valuations that would have systematically resulted in valuations that were too low. However, the internal valuations that were used were often not accompanied by evidence that supported how they had been arrived at. This does not mean that such valuations were necessarily wrong, or that the valuation methodology undervalued properties, but it increased the likelihood that they may have been. The absence of any oversight of the process increased the risk that any incorrect valuations would not be identified.

Background

- 4.5.5. The existence of a property element was apparent in many of the cases that we considered. Around four in ten of the cases we assessed could be categorised as primarily property related businesses of one form or another. These were typically residential or commercial property developments – where the customer had borrowed from RBS with the intention of developing property for the purpose of sale after completion, or to rent out.
- 4.5.6. There were other cases that we classified as hybrid cases, where property may have been an important part of the business, but it was not a pure property business – some other trading element was involved (often these cases involved a customer who had a trading business but had diversified into property). We classified around one in five of the cases in this hybrid category.
- 4.5.7. For a non-amortising facility, the value of the security was an important factor in determining both the ability of the customer to repay the loan as it fell due (for example, for property developments) and in determining the extent to which the Bank

⁷⁷ Tomlinson Report, page 5

⁷⁸ Tomlinson Report, page 7

was exposed to potential losses. In turn, this had the potential to impact any additional risk-based pricing that was proposed by GRG.

- 4.5.8. The true value of an asset is the price for which it sells, generally at arm's length and on an open market. Without a sale, a value can only be estimated (i.e. it is not an exact science). Any estimate will undoubtedly be subject to some element of judgment on the part of the valuer. Given the turbulence of the market, particularly in the early part of the Relevant Period, the valuer's task was a difficult one.
- 4.5.9. As we illustrate in Chapter 2.1 (Background to the Review), property prices decreased in varying proportions across the UK with the onset of the recession during 2008. The market for commercial properties, in particular, ceased to function in any meaningful way for a period of time. This was apparent in varying measure across the UK. The falling price of assets, and the lack of liquid markets, rendered recent sales data for comparable property less reliable, and in some cases would not have been available. This increased the risk that valuations that were conducted would be more prone to error.

Why did RBS obtain valuations?

- 4.5.10. RBS told us that the primary purpose of a valuation (whether internal or external) was to assess whether the lending was still within policy and risk appetite and how this impacted the Bank's capital reporting. For example, if the value of the security held against a specific loan had deteriorated, the Bank might have to hold more capital.
- 4.5.11. While capital considerations may have been an important driver of the need for up-to-date valuations, RBS also used them in relation to issues such as:
- The decision to transfer to GRG;
 - The initial viability assessment;
 - The assessment and formation of restructuring or renewal proposals for expired facilities;
 - Determining the pricing in respect of the Bank's credit risk;
 - Testing the customer's compliance with financial covenants in its lending agreements;
 - Assessing credit risk for capital reporting purposes; and
 - Determining if additional security was required.
- 4.5.12. Valuations were also undertaken when RBS considered the use of a Property Participation Fee Agreement, both at the time it was entered into and at the time that it matured and payment was due to the Bank.
- 4.5.13. Our assessment of cases has indicated that valuations have been taken into account in each of the areas indicated by the Bank – although the specific use of valuations differs from case to case. As such, valuations were potentially important for customer outcomes because, as highlighted by Dr Tomlinson, their accuracy, or otherwise, could

play a significant role in key decisions that would impact the customer and which could have commercial consequences for their business.

- 4.5.14. Given these considerations, we consider that it was fair and reasonable to expect RBS to take steps to ensure that valuations were appropriate and as robust as was reasonably practicable in the circumstances. To test whether this occurred, we have reviewed both the policy position and what we saw in practice during the course of our review of the customer files.

RBS approach to valuations

- 4.5.15. RBS told us that updated valuations would be obtained at regular intervals (for facilities above a certain amount this was mandated by Bank policy). This would include when a valuation had not been carried out for some time, or when a customer's lending facilities were being restructured.
- 4.5.16. The valuations that were used by RBS were either carried out by third-party valuation firms, or were internal valuations that were conducted by RBS staff primarily employed in their property division, but all of whom, we have been told, were qualified valuers (we set out further information below about how GRG organised its property team).

RBS policy

- 4.5.17. RBS Group Credit Risk Mitigation Policies set out some high-level detail on valuations. This policy applied across the Bank, and was not specific to GRG. The February 2009 version of the Group Credit Risk Mitigation Policy noted the following:
- *“Credit Risk Mitigants must be valued prior to acceptance using agreed Valuation Methodologies and/or external or internal Valuers with appropriate expertise;*
 - *External Valuers must be independent of the provider of the Mitigant;*
 - *Internal Valuers must be independent of business origination units unless otherwise permitted in Divisional policy and agreed with GCR e.g. a manager's “drive by” valuation for low value/LTV facilities;*
 - *Valuers must be on an Approved Panel or individually approved in accordance with Divisional policies; and*
 - *Values must be updated at a frequency appropriate to the Mitigant taking into account the value and nature of the Mitigant, the ease and costs of valuation and the volatility of the value of the Mitigant value in line with Divisional policies setting out minimum frequencies and permitted valuation methodologies.”*
- 4.5.18. While there were changes to the wording of the policy across the Relevant Period, the substance did not change significantly. We do not regard the policy as being inappropriate.

External (third-party) valuations

- 4.5.19. External valuations were those carried out by third-party firms. RBS had a panel of approved firms for this purpose. RBS told us that external valuations would be used in a range of circumstances, which would include those where contractual documents

stipulate that a valuation is required and there is no agreement between RBS and the customer to use an internal valuation.

- 4.5.20. The customer could also opt for an external valuation particularly where the restructure or renewal of facilities were under consideration. Where an external valuation was sought, it was standard practice that the cost of it was borne by the customer. A tender process (involving firms included on the Bank's panel) was sometimes (but not always) run to determine the best option for the customer. RBS would require that a firm included on the relevant panel be used to conduct any external valuation if the Bank was to accept it.

RBS (internal) valuations

- 4.5.21. Valuations undertaken by staff employed by the Bank were often used within GRG. The Bank told us that such staff were chartered surveyors and so were regulated by the Royal Institution of Chartered Surveyors ("RICS") – and that, as such, while internal valuations did not constitute formal "Red Book"⁷⁹ valuations, they would be provided in line with "Red Book" standards and with opinions of value based on "Red Book" definitions.
- 4.5.22. We have not sought to ascertain the qualifications of each individual staff member who conducted valuations across the Relevant Period and so we have not measured the extent to which the Bank complied with its own policy, at least in that regard. However, we did see that valuations were normally (but not always) undertaken by staff from within a specialist property unit when that unit was in operation.
- 4.5.23. The way GRG arranged property-related advice is relevant to our review. RBS told us that before 2010 GRG had a single pool of real estate experts (known as the Property Management Unit ("PMU")) providing a mix of strategic property advice on certain cases and the ability to own and manage assets it acquired following an insolvency process. In April 2010, the team was dispersed, and the staff assigned either to a new Property Advisory Unit or West Register, depending on whether individuals were working in an advisory capacity or on acquisitions by West Register.
- 4.5.24. PAU was required to opine on possible value and provide strategic property advice to GRG. In April 2012, PAU was disbanded and the individuals (mostly surveyors) absorbed into GRG to provide ongoing expertise on property matters including strategic advice, marketing advice, consent to sales and leases and informal opinions of market value. Broadly the policies and practices of these various units were, for present purposes, comparable, and for ease of reference we refer to these property activities generically as PAU.
- 4.5.25. RBS told us that the duties of these valuers included:

⁷⁹ Professional Standards (the "Red Book") contained mandatory rules, best practice guidance and related commentary for all members undertaking asset valuations. The "Red Book" is issued by RICS as part of its commitment to promote and support high standards in valuation delivery worldwide. The publication details mandatory practices for RICS members undertaking valuation services.

- *“Working with GRG Relationship Managers and customers to identify solutions to protect and enhance value of property charged to the Bank.*
 - *Assessing the potential for improvements to property and asset management that might facilitate wider debt restructure. Focus on improving and stabilising rental income, reducing costs and improving/ stabilising value.*
 - *Engaging and monitoring third-party professionals to ensure appropriate due diligence, advice and valuations provided.*
 - *Reviewing customer-led marketing processes to ensure property was marketed correctly and openly.”*
- 4.5.26. RBS told us that *“The valuation methodology adopted in undertaking internal valuations would be dependent on the nature of the property and, where requested, any special assumptions. The methodology adopted would be based on the experience of the surveyor. Valuation methods used included: sales comparison; income capitalisation; and land residual approach.”*
- 4.5.27. RBS also told us that PAU was required to provide a report or email, including workings, and where possible, comparables. Examples of methods employed included:
- Sales comparison – Comparable evidence analysis of recently sold properties with analysis on a floor area unit basis;
 - Income capitalisation – Used for income producing property with analysis of rental income and yield. The analysis should, where possible, reflect comparable sold/ let property in the area; and
 - Income capitalisation – (Land residual basis) Used to assess the value of a site with the benefit of planning permission. Residual land value was assessed by analysis of Gross Development Value of the scheme less costs to develop, finance costs and developers profit. Analysis compared against comparable land sale transactions.
- 4.5.28. In January 2011, a PAU Policy and Procedures Manual was developed. We understand that this policy document was never formally implemented and that it remained in draft form – but it nonetheless provides some detail on the approach to be taken by PAU.
- 4.5.29. The draft policy noted that a Strategic Valuation Paper should be prepared when a property (or multiple properties) was being valued. It noted that a market value should be provided on two assumptions:
- *“Market value with a full marketing period;*
 - *Market value with a restricted marketing period.”*
- 4.5.30. It noted that certain key information should also appear in the valuation, including:
- Information in relation to the property being valued – (e.g. a description of the property and pictures and plans of the property);
 - Historic valuation details for the property;

- Property recommendations and strategic advice;
 - Details of the valuation methodology and supporting comparables; and
 - Facts and assumptions on which the valuation has been based.
- 4.5.31. From a policy perspective, the key issue was that only those qualified to do so should undertake valuations, and we find that to be an appropriate approach.
- 4.5.32. We conclude that the policy framework adopted by RBS was not of itself inappropriate. The Group Credit Risk Mitigation Policy provided for independent valuations. The draft PAU policy noted that details of the valuation methodology and supporting comparables should be clearly documented, and valuations undertaken by qualified surveyors. We did not see any specific policy, guidance note, or any other document during the course of our review which suggested that valuations should be deliberately low, or that valuation methodologies should be used that would result in systematically low valuations.
- 4.5.33. In particular, we do not consider that there should have been an obligation on the Bank to use external valuations in all cases, and we do not regard the use of internal valuations as being necessarily inappropriate, provided that such valuations are arrived at on an informed basis and in accordance with appropriate guidelines. Third-party valuations come with a cost, which was typically borne by the customer, and having a process that meant that this cost did not need to be incurred by already financially distressed customers was reasonable.
- 4.5.34. It should also be borne in mind that valuations were used in a range of circumstances. In some cases all that was required was an indication of possible value and it was not necessary to obtain a full valuation. In such cases a “drive by” valuation may have sufficed. In any event, it would have been prudent to obtain the customer’s agreement.
- 4.5.35. In our view particular care was required where the valuation was to form the basis of a decision that has a significant commercial consequence to the customer. In his evidence to the Treasury Select Committee, Mr Sach acknowledged that in that event a more thorough valuation would be required:

*“It is often very useful for someone internally to say, “I would estimate that property is worth X.” But no significant decision is ever taken on the basis of that sort of valuation. It is an informal part of the internal process. If we want to take action and the customer disagrees, then we would have a formal valuation done by a third party that the customer would instruct in nearly all circumstances. The reason we do it internally sometimes is because it saves the customer money because you need a figure to talk. Particularly in 2009 and 2010 most of this property was unsaleable, so somebody saying, “This is worth £1 million” is a sort of benchmark and to spare the person £5,000 to get a valuation”.*⁸⁰

⁸⁰ Oral Evidence SME Lending, , Chris Sullivan, Deputy Group Chief Executive, RBS, and Derek Sach, Head of GRG, RBS, 17 June 2014

- 4.5.36. In practice, this dividing line between informal valuation on which little turned, and a formal valuation where it would have potentially material consequences for the customer was not in practice widely adopted. We consider that the Bank should have taken steps to consider the appropriateness of its valuations both internal and external before using them as a base upon which to found other decisions such as Bank strategy, pricing and the calculation of Upside Instruments. The Bank should have taken extra care to ensure valuations were as appropriate and robust as reasonably possible, and the Bank should have been clear in its communications with customers about the purpose of internal valuations.
- 4.5.37. Finally, we note that the Bank from time to time accepted staff from third-party valuers on a secondment basis into PAU. These secondments were not uncommon nor were they confined to valuation firms. Solicitors and accountants also provided secondees to RBS as part of their panel arrangements. Such arrangements, while not uncommon, require careful policing given the inherent conflicts of interest that can arise.

Our observations from cases

- 4.5.38. In 152 of the cases in our sample, some form of valuation followed the transfer. This was split broadly equally between internal and external valuations – although some cases had both internal and external valuations conducted at some point in time. We saw internal valuations in 75 of the cases that we reviewed.
- 4.5.39. In 52 of those 75 cases, we had concerns about the amount of work that had been conducted internally to arrive at the valuation. In many of these cases we were not able to evidence, from the files, the calculations and assumptions used to arrive at the valuation. We consider that there was a common failure to properly document the assumptions and rationale for the valuations that were conducted within the Bank.
- 4.5.40. We considered that the failure to record assumptions and calculations was not in line with the expectations RBS set for itself. Given the importance of valuations to decisions that may, and often did, have a commercial consequence to customers, we consider that it would have been fair and reasonable to expect that appropriate records were kept.
- 4.5.41. However, while this failing to document assumptions and calculations for internal valuations was common, this did not necessarily mean that these valuations were not reasonable estimates of value. But it increased the likelihood that they were not: in a few cases we noted that valuations adopted by the Bank may have ignored potentially significant considerations including other valuations that may have been relevant.
- 4.5.42. In several cases in our sample, the customer challenged the valuation that had been arrived at by the Bank. In other cases, a third-party valuation was available that was different from the Bank's valuation. In these cases we would have expected the Bank to reconsider its own valuation to satisfy itself that it was appropriate and robust, and pass the new information to its own valuer to validate the original valuation. This was not generally done.

Case Extract 25

The valuation of the property undertaken at the suggestion of RBS by Valuer A (external) was challenged by the Customer based on their view that there were factual inaccuracies in the report.

A second valuation was provided by the Customer conducted by Valuer B (also external) as part of a refinancing exercise with another bank. The valuation included in this report was significantly higher than that provided by Valuer A (a difference of some £850k on a circa £2m valuation).

The valuation report provided by Valuer A stated *"In the event that any of our assumptions are found to be incorrect, no reliance should be placed upon the valuation until it has been reviewed by [Valuer A] in the light of that additional information."* RBS acknowledged that there were inaccuracies in the report but decided that their valuation (prepared by Valuer A) should be used to assess the security value for the Bank nonetheless.

Further to the second valuation, and the noting of errors in Valuer A's valuation on which GRG was relying, there is no evidence that RBS reverted to Valuer A to obtain confirmation of the valuation or conducted other work to ensure that the valuation that they were using was based on the correct assumptions.

- 4.5.43. RBS has indicated that customers always had the option to use external valuations, but it is not clear that the purpose of the valuations was systematically explained to the customer to help them make a more informed decision as to whether to use an external valuer. We recognise that the use of internal valuations meant that customers could save on cost. However, without knowledge of the purpose of the valuation (or of being aware that the option of an external valuation was available to them), customers were not in a position to make a properly informed decision about whether it was worth their while incurring the cost of an external valuation.
- 4.5.44. In order to provide assurance to customers that the internal valuation process was made independent of GRG's preferred strategy or other commercial objectives, there would have been merit in securing stronger 'Chinese walls' between the functions. That this did not occur was, in our view, inappropriate and an error of judgment. RBS should have been aware of the potential conflicts of interest involved and done more to address them.

The impact of valuations

- 4.5.45. It was not possible for us to determine that valuations on any specific case were clearly incorrect (although on some cases subsequent sales prices certainly indicated that they may have been so). Inevitably, the economic environment (particularly in the earlier part of the Relevant Period) rendered precise valuations difficult and would suggest that valuers might have adopted a more cautious approach. But this made it all the more important for there to be adequate oversight and validation of valuations, and we saw no evidence that this had occurred.

- 4.5.46. In part, valuations were used to determine the relative risk of the loan facilities that had been advanced to the customer, particularly where the asset being valued was held as security against the loan. Chapter 4.4 (Pricing) sets out in more detail how pricing was designed to work in theory. In short, a lower valuation (other things being equal) would mean that a loan facility would be assessed as being higher risk, and the pricing would need to be reflective of that greater risk profile.

Case Extract 26

An internal GRG PAU valuation, estimating value at circa £400k, was carried out shortly after transfer to GRG. There is no evidence on file of any calculations to support this valuation, any assumptions used in its preparation or any property visits conducted – it appeared that the PAU valuer only looked at the company website and did not conduct any further work to support his valuation.

The property had been valued around £800k (externally) when the customer was in the mainstream Bank some four years earlier, meaning the new PAU internal valuation was half the external valuation. On the basis of this internal PAU valuation, the GRG Relationship Manager calculated a security shortfall and priced the customer's facilities on a mezzanine risk (i.e. higher cost) basis.

- 4.5.47. Because there were very few cases where the rationale for pricing decisions was clear from the file, it has not been possible for us to determine the extent to which valuations were used to calculate pricing more generally. However, it was clear that they were used in some cases. We consider it was likely that the valuation was a factor in the pricing in other cases as well. Some of these valuations were likewise unsupported by evidence as to how they were arrived at.
- 4.5.48. The valuation of the security held also had an impact on the strategy that the Bank adopted in other areas. These include decisions on RTS (where covenant compliance would be a consideration), the baseline value for a PPFA and the amount payable to the Bank when a PPFA reached the end of its term by effluxion of time as opposed to an outright sale.

Conclusions

- 4.5.49. We consider that the Bank should have taken steps to consider the appropriateness of its valuations both internal and external before using them as a base upon which to found other decisions such as Bank strategy, pricing and the calculation of Upside Instruments. The Bank should have taken extra care to ensure valuations were as appropriate and robust as reasonably possible, and the Bank should have been clear in its communications with customers about the purpose of internal valuations.
- 4.5.50. Overall in respect of valuations we conclude that there were frequent failures to:
- Oversee and ensure that appropriate and robust valuations were made by staff; and

- Evidence that adequate work was carried out 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.
- 4.5.51. These failures were significant especially where decisions relating to pricing, strategy, covenant breaches and the base value of Upside Instruments were based on these valuations. In consequence we consider that these failures gave rise to the inappropriate treatment of customers, on a basis we conclude was widespread.
- 4.5.52. We did not find evidence that valuation practice or methodology systematically undervalued assets or that valuations were manipulated to achieve either a transfer to GRG or for any other purpose. However, we considered that the approach taken increased the risk that errors would be made, and that GRG should have taken more care to ensure that this risk was minimised.
- 4.5.53. We were not able to determine whether valuations, in individual cases, were necessarily incorrect. But the shortcomings in process and practice we identified did lead to an increased risk that some valuations were incorrect and disadvantaged customers. Accordingly, we view this use of internal valuations based on insufficient and/or inadequate work as an inappropriate treatment of customers on a widespread basis.
- 4.5.54. We concluded that in order to provide assurance to customers that the internal valuation process was independent of GRG's preferred strategy or other commercial objectives, there would have been merit in securing stronger 'Chinese walls' between the functions. That this did not occur was in our view an error of judgment.

4.6 – Customer experience and TCF

- 4.6.1. In this Chapter, we set out RBS's approach to the handling of customers, including how it set about implementing the TCF initiative in GRG and what customers said they experienced, as well as what we saw. We also address two specific issues raised in the Requirement Notice: requests for information and restricting customers from taking action. The next Chapter (Complaints) deals with the specific issues arising in relation to those customers who expressed dissatisfaction and complained to GRG about their treatment.
- 4.6.2. Many of the concerns expressed in the Tomlinson Report focused on the general poor treatment of customers in GRG. The same views have been expressed elsewhere and were reflected in comments that customers made to us. Whilst some customers welcomed the increased focus that a transfer to GRG brought, others expressed strong reservations about the way they were treated. Accordingly, the Requirement Notice asks us to form a view on the *"Appropriateness of policies and procedures governing the relationship between relationship managers and SME customers in GRG."*⁸¹

RBS's approach to the treatment of customers and TCF

- 4.6.3. TCF was a priority FSA initiative in 2006 and 2007 and was based around six TCF outcomes. The obligation for firms to Treat Customers Fairly, as one of the FSA's principles for business, pre-dated the specific initiative. The FSA produced various papers that set out how firms should implement and embed TCF, including examples of MI that could be used to measure adherence to the TCF outcomes. The TCF initiative was designed to ensure that customers were treated in a manner appropriate to their individual circumstances and their overall position. Properly implemented, TCF would enable firms to identify and understand the key risks to their customers and be able to act swiftly to mitigate them.
- 4.6.4. In April 2009, the RBS Board issued a group policy standard titled *"Treating Our Customers Fairly"*. RBS noted that *"this Policy Standard sets out the requirements for ensuring that the fair treatment of customers underpins the way we do business and is an embedded part of our policies, standards, procedures and our culture."*
- 4.6.5. During the Relevant Period, GRG carried out activity that was largely unregulated (with the exception of some complaint handling). As such, there was no regulatory requirement to implement TCF within GRG. However, RBS explicitly applied the Group policy standard to:
- "All employees, in customer facing businesses, support functions and control functions, in every part of the world whose role is relevant in some way to dealing with customers and with selling or administering our products and services."*
- "The policy standard applies not only to those who are directly involved in the design, sale or administration of products and services, but also extends to cover management,*

⁸¹ Requirement Notice: Annex C paragraph 4.1.1 (4)

support, and any other employees who have a direct or indirect influence on our relationship with customers."

- 4.6.6. As such, the application of TCF within GRG was a standard required by RBS. While TCF was a specific requirement of the RBS Group Board from April 2009, RBS has told us that this was not required to be implemented in GRG until 2010.
- 4.6.7. However, RBS has also told us that *"The essence of the requirement to treat customers fairly, in accordance with good practice and regulatory requirements (Principle 6), has been part of the ethos of GRG from its inception."* We found scant evidence of any reference to TCF in the earlier years of the Relevant Period (although we note the "customer expectations" objective set for the Head of GRG for 2009 was to *"treat customers appropriately and fairly whilst maintaining the right level of return for the RBS Group"*).
- 4.6.8. There was a formal roll-out of TCF within GRG during 2010. RBS indicated that this roll-out programme was a focus of the GRG Manco in the second half of 2010.
- 4.6.9. TCF was explicitly referenced in the GRG Policies and Procedures from December 2010 onwards: *"TCF is at the heart of how we do business at GRG. It is recognised that GRG plays a slightly different role compared to other divisions within the Group. Typically, we are dealing with customers who are in distressed circumstances therefore it is even more important that we deal with our customers fairly and sensitively, as our aim is to return such businesses back to the mainstream Bank. Hence how we treat customers while they are in the care of GRG may impact upon whether the customer decides to remain with RBS once they have been returned to health. Put simply TCF is good for the customer and good for business."*
- 4.6.10. The programme put in place to implement TCF in GRG included changes to senior staff objectives so that they included compliance with TCF as a measure of performance, a change to the GRG mission statement to include customer focus, improvements in relation to complaints handling, publication of TCF guidance on the GRG intranet site, an RBS-wide training module that covered aspects of TCF for staff, a Customer Satisfaction Survey (from 2011) and the provision of mouse-mats for staff listing the six TCF outcomes.
- 4.6.11. As part of the TCF programme roll-out, a "Customer Experience Schematic" was developed. The focus of the Schematic is on the journey of the customer into and out of GRG. It covers key points for Relationship Managers at various stages of their interaction with customers, but does not go into any detail about expectations around the treatment of customers within GRG. It does not, for example, set out clear requirements that Relationship Managers should be transparent with customers with regards to issues like pricing or turnaround plans.
- 4.6.12. Prior to that point, we saw no evidence that GRG set, in writing, clear expectations to Relationship Managers about the way they should interact with, and treat, customers.
- 4.6.13. Overall we saw no evidence that there was any process to identify what key risks to customers might be, how they would be monitored and how they might be mitigated. We also noted that:

- The reported data focused on complaints data and a yearly Customer Satisfaction Survey;
 - There was some TCF training for Relationship Managers but it was not specific to the roles they were carrying out and it would not in our view have been sufficient to mitigate key risks to customers;
 - There was no MI dashboard that covered the TCF outcomes or that tracked against any risks to customers;
 - We saw no evidence that any specific work was carried out to translate the spirit of TCF (and the six principles) into outcomes that were appropriate given the GRG business model; and
 - The objectives of senior managers⁸² on TCF did not cascade down to frontline staff.
- 4.6.14. A greater focus on TCF began to emerge near the end of the Relevant Period in 2013 with the publication of the “Customer Charter” in July and the appointment of an executive accountable for conduct risk and complaints in October 2013.
- 4.6.15. The July 2013 Customer Charter contained four key elements:

“Service

- *Your GRG relationship team will be in regular contact and will be available to respond to any concerns and queries*
- *If your relationship manager changes we will explain the reasons behind this change and ensure a smooth handover*
- *In addition to your relationship team we will provide you with access to a named senior manager for you to escalate any serious concerns*
- *An independent complaints team (within the RBS Group) will investigate any concerns you may have with our service*

Transition

- *We will arrange to meet with you and your relationship manager, within an agreed timeframe, to deliver a smooth transition into GRG*
- *We will invest time and expertise to understand your business*
- *We will explain how our restructuring team will work with you to help develop solutions that are right for your business and for the Bank*

Restructure

- *We will explore all options with you in honest discussions and will be clear if some options are not suitable*

⁸² As defined in paragraph 3.3.17 above

- *We will set out any proposed terms clearly and will be available to discuss them with you. We will only propose solutions which we believe are fair and appropriate for your business*
- *We will explain the process clearly and seek to agree a timescale to complete the restructuring, including actions and milestones*

Other Options

- *Where we are unable to continue to provide facilities we will explain our reasons*
- *We will aim to allow reasonable time for you to explore other options (including refinancing) where possible*
- *If we cannot agree on a suitable option we will clearly explain the next steps"*

4.6.16. The Customer Charter was much clearer about the expectations of Relationship Managers. In particular, the requirement to take the time to understand the business, and to be open and honest with the customers, is key to many of the issues we have identified in our review.

4.6.17. In addition, in October 2013 as part of the then developing thinking on risks to customers, a document titled "GRG Conduct Outcomes" set out the outcomes that were identified by RBS as being desirable:

- *"We have a customer-centric culture and we act in customers' long-term interests*
- *We drive sustainable and stable returns through consistently good customer outcomes*
- *Our people are rewarded for consistent behaviours which align to our values*
- *We have a positive impact on the communities and markets in which we operate, and have effective controls against financial crime*
- *We deliver beyond the letter and spirit of rules & regulations"*

4.6.18. These developments at the end of the Relevant Period did not have time to impact on the customers in our sample and have not been tested in practice. In our view, they represent a step forward in the recognition by GRG that it needed to do more to treat its customers fairly and have the systems, policies and processes appropriate for its role to ensure that this was achieved in practice. But we question whether without more fundamental changes to the objectives and ethos of GRG such changes would be effective.

Customer focused policies

4.6.19. As noted previously, the scale and nature of the customers handled by GRG varied widely, from larger corporates with ready access to necessary skills and advice to much smaller SMEs. Some SMEs in our sample were closely associated with sophisticated owners and had good access to independent advice. Some had their own professional finance director. But many of the businesses we reviewed were far more modest, with

no meaningful internal financial expertise and little realistic prospect of accessing substantive external advice. Many customers were sole traders or owner/managers.

- 4.6.20. For many customers the future of their business and their own personal and financial circumstances were closely intertwined. For example, several owners faced the prospect of losing their livelihoods and perhaps their homes, and some faced bankruptcy. Several also recorded difficult personal circumstances during their time in GRG including stress, ill-health, divorce and bereavement, all of which could and did have an influence on their ability to interact with GRG. GRG should have recognised the vulnerable nature of such customers, and in some cases it did so.
- 4.6.21. GRG's policy framework did little to suggest any variation in treatment for this heterogeneous customer base. In general, GRG adopted policies and practices which, whilst potentially appropriate for larger, well-resourced customers, appeared to us to be increasingly out of step with the needs of smaller and less sophisticated customers.
- 4.6.22. For example, the approach to pricing and valuation and much of the communication with customers tended to assume that the customer had ready access to professional advice with the relevant expertise to understand the RBS's proposals and negotiate. Whilst, of course, SME customers did make use of professional advisers, the costs of doing so were clearly a major constraint for many in our sample, and so in practice many SME owner/managers relied heavily on their own general business experience and knowledge of their own sector.
- 4.6.23. In practice, this group of customers, with limited access to support and little financial expertise, was a significant part of GRG's SME customer base. We attempted to categorise each of the businesses we considered in this way – drawing a distinction between customers who clearly had good financial knowledge or ready access to financial skills (for example, through their own Finance Director), and those with less financial sophistication. We therefore assessed each case on its own facts and did not follow the approach adopted in the IRHP review. On the basis of our assessment, we concluded that almost 50% of our sample lacked financial sophistication.
- 4.6.24. Overall, customers who lacked financial sophistication were not more or less likely to be faced by actions we viewed as inappropriate, nor was there a clear pattern of more (or less) adverse outcomes. Nonetheless, we found this a helpful way to understand how GRG had interacted with the customer and the wider impact this was likely to have had.
- 4.6.25. On occasion, Relationship Managers noted and made some allowance for customer circumstances. For example, we saw allowance made on several cases where the owner/manager faced ill-health or bereavement. But overall, GRG's approach to customers was shaped by RBS's desired outcome and the overarching strategy for handling that case. No systematic consideration appears to have been given to whether customers of different descriptions warranted different approaches, or whether GRG's underlying systems and processes were appropriate. We have noted that GRG lacked a policy framework that considered the need for different approaches.
- 4.6.26. Toward the end of the Relevant Period, there was evidence that GRG, as part of an RBS group-wide exercise, had considered a Vulnerable Customers policy. However, it did not

appear to have been formally introduced prior to the end of the Relevant Period and, as such, was not relevant for the purposes of this review. In any event, the need for more customer centric processes was not, in our view, limited to those customers who were clearly vulnerable in the sense that might be understood in the personal account market, but was a wider point about the need to shape practice to the likely capabilities of a diverse customer base.

Customer experience

4.6.27. GRG dealt with SME customers under financial stress during a period of exceptional economic pressure, and when RBS had to make decisions that would have a critical impact on the future of those businesses. Inevitably this led to tensions between GRG and its customers. The scope for misunderstanding and customer concern (justified or not) was therefore large. It was therefore imperative that RBS provided customers with clear communication and was considerate of the circumstances in which many customers found themselves.

4.6.28. We interviewed 108 customers as part of our review of cases. Some of the more common issues that were identified by them included:

- Some customers considered that GRG did not do what they said they were going to do – that is, they did not feel that they received any help from GRG in turning their businesses around;
- Some customers considered that they had no option but to do what GRG asked them to do;
- Some customers considered that GRG did not take a sufficient interest in their business and did not seek to understand their business;
- Some customers saw their entry to GRG in a positive light and welcomed the expertise made available to them; and
- A few said GRG staff were aggressive in their behaviour towards them.

Case Extracts 27 (from more than 1 case)

Extract A: The Customer told us that the Relationship Manager's *"personal conduct and unacceptable behaviour were not in keeping with the professionalism expected from a banker, at one point [the Relationship Manager was] banging on the table with his hand really loudly, shouting at the top of his voice, issuing threats of instant receivership... [Relationship Manager] was told that his manner was unacceptable. He replied that he wasn't interested in helping the companies finish the project, only to get the money back for the Bank."*

Extract B: We noted an email on file from the customer in which he confirmed that he had decided to move to another bank. He also wrote to the GRG Relationship Manager advising that he had been *"highly supportive, responsive, flexible and understanding"* ...and that he was *"both an effective servant and great ambassador."*

Extract C: The Customer sent a formal complaint email to his Relationship Manager's line manager. The complaint sought to remove the Relationship Manager with

immediate effect, referring to his “confrontational” style that resulted in “anxiety” for the Customer and that the Relationship Manager had shown “a lack of support and understanding unlike previous relationship managers.” The Relationship Manager sent the email to a secondee from a legal firm not associated with the case stating: “If you get a couple of minutes you may find this entertaining...”

- 4.6.29. The volume of contemporaneous complaints that we identified on cases in our sample indicated that customers were not happy with many aspects of GRG. However, we accept that in a division of a bank dealing with distressed customers, complaints that are not justified will be raised. We consider complaints issues in the following Chapter.
- 4.6.30. The absence of clear guidance to Relationship Managers on their handling of customers resulted in a variety of approaches and behaviours. Some practice was good, and recognised the difficulties that unsophisticated customers faced. However, more commonly the issues raised by smaller and less sophisticated customers were, in our view, handled with insufficient care or sensitivity. This was contrary to RBS's assertion to us during the course of our review that it treated customers “empathetically”.
- 4.6.31. Many customers were clearly under the impression that GRG was there to help turn their business around, and it came as a surprise to many upon transfer that one of the earliest conversations related to increasing prices that customers were paying. In our judgment, the failure on the part of RBS to manage the expectations of customers was a significant factor in the subsequent concerns that have been raised about their treatment while in GRG.
- 4.6.32. We have noted that some customers were clearly not as open with RBS as they should have been. Understandably, that will have constrained RBS's readiness to assist the customer; but we are satisfied that most customers did not fall into that category.
- 4.6.33. These points were reflected in part in the customer surveys that GRG obtained in the second half of the Relevant Period. For example, the survey in 2013 in describing the overall experience for customers in GRG emphasised why customers were dissatisfied in the following terms:
- *“Customers do not understand why they were transferred to GRG or they are not convinced that they should have been;*
 - *They do not find GRG helpful as they do not get the support, contact and feedback they need. Their RM keeps changing and there is a lack of business understanding; and*
 - *They feel poorly treated, bullied, threatened often exploited.”*
- 4.6.34. The independent survey concluded that the “whole approach, the formula is problematic”.
- 4.6.35. On the basis of the evidence available to us, we concur with that assessment of customer views and consider it likely to have been a feature of customer opinion of GRG throughout the Relevant Period.

Requests for information

- 4.6.36. An issue raised by Dr Tomlinson was the extent to which requests for information give rise to a process which:

“...is often repetitive, distracting the business from being able to concentrate on their day to day tasks, with the risk that their facilities may be pulled if they do not provide the information requested. The whole system is so laborious that the Directors of the business are not able to run the business effectively, putting increasing pressure on the businesses operations and making it even harder for them to ‘turnaround’.”

- 4.6.37. In our review of cases, we have borne this concern in mind and address it here.
- 4.6.38. Following transfer to GRG, it was not uncommon for RBS to seek information from the customer that would not routinely have been collected when the customer was handled by the mainstream Bank. There are valid reasons for this to be the case.
- 4.6.39. It is standard practice for banks to collect information from SME customers who have been provided with credit facilities. Banks collect this information so that they can monitor against any terms and conditions, including covenants, that may be included in the loan documentation, and so that they can better understand the risk profile of the customer. RBS was no different in that regard.
- 4.6.40. The customers entering GRG were almost all in some degree of financial difficulty or were at least exhibiting signs of financial stress. From the perspective of RBS, the cohort of customers in GRG represented some of the more commercially risky customers that were on the RBS books. In these circumstances, it is understandable that a bank would want to monitor a customer more closely than would normally be the case. Indeed, given the importance of good information to turnaround as well as to credit risk management, we would have considered it inappropriate if the Bank had not sought up-to-date information on the circumstances of the customer.
- 4.6.41. Accordingly, because of the status of many customers in GRG, it was not inappropriate for GRG to seek information from them that they would not have been asked to provide before (when they were in the mainstream Bank), or to seek information on a more regular basis than had been the case previously. Many customers were asked to provide additional information soon after they were transferred to GRG, often with further requests thereafter. The type of information that RBS sought tended to be case specific, but as an indication might include one or more of the following:
- Up-to-date financial statements;
 - Management accounts;
 - Cash flow forecasts;
 - Business plans;
 - Specific creditor details or listings;
 - Statements of assets from directors;
 - Details of any actions being taken by the management; and

- Proposals from management.
- 4.6.42. These classes of information would typically be of a kind that a sizeable SME business would readily have to hand. However, in some cases it was clear that the customer was not easily able to comply with the information requests that had been made. For those SMEs, particularly those at the smaller end, the time and resource necessary to prepare detailed management information were often lacking and that management infrastructure was seen by some as unnecessary for the conduct of their business. So they were not in the habit of keeping, and updating regularly, financial information relevant to the business. The absence of such information may have been a contributing factor in the decline in the health of the underlying business.
- 4.6.43. Customers were typically given a deadline by RBS to provide the additional information that had been requested. As such, it is not surprising that some customers considered that the information requests were overly burdensome and distracted them from the running of the business. Nonetheless, we observed only two cases where we considered that the extent of information requested in the timescales provided was inappropriate in the circumstances and was thus unduly burdensome for the customer.
- 4.6.44. While in isolated cases requests may be regarded as excessive, overall, we find no evidence of widespread inappropriate treatment of customers relating to RBS making requests for information from customers that were unnecessarily burdensome so as to impact the ability of directors to run their business.

Preventing customers from taking action

- 4.6.45. 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. RBS was likely concerned that customers were making payments out of their accounts (for example, to suppliers) or otherwise taking cash out the business, when that cash could have been used for the repayment of debt that was past due.
- 4.6.46. RBS was aware of the potential risk that staff could end up acting as “Shadow Directors”⁸³ and Bank policy explicitly excluded its staff from acting in a Shadow Director capacity. While mindful that the term “Shadow Director” has a particular meaning in law, our review has looked at the position from a wider perspective and takes into account the position as, we consider, it would have been perceived by the customer and in the sense included in the Requirement Notice. Thus conduct, which seeks to inhibit the customer from taking certain actions or, conversely, leaves the customer feeling under undue pressure to act in a particular way, is included for this purpose, even if such conduct falls short of that which would attract the strict legal definition.
- 4.6.47. We saw eight cases where it appeared to us that there was at least a risk that GRG's observations were understood by the customer as instructions to take specific action, for example to:
- Delay payments to HMRC; or

⁸³ “Shadow Director” is a term defined by section 251 of the Companies Act 2006

- Delay payments to suppliers and other creditor; or
 - Cancel existing orders; or
 - Make specific staff or other appointments.
- 4.6.48. We did not find that these practices were widespread, although where they occurred they were not always appropriate. However, it is understandable that, in some cases, the customer perceived RBS decisions and observations as akin to preventing them from taking action, or requiring that they take certain action.

Our conclusions

- 4.6.49. We have concluded that GRG's approach to the implementation of TCF for most of the Relevant Period focused on a narrow range of process measures that failed to address the key risks to customers in the GRG model.
- 4.6.50. We regard the measures taken by GRG as an inadequate response to the requirements set at a Group level. At a high level, a robust implementation and embedding of TCF would have involved, as a minimum:
- Identification of key risks to customers arising from GRG and its activities – not a checklist of process items that need to be carried out;
 - Development of MI against which those key risks could be monitored on a timely basis; and
 - Implementation of systems and controls (including governance) to ensure that risks were mitigated and controlled appropriately.
- 4.6.51. In practice, all three elements were missing from GRG's response to TCF. Based on the evidence, we do not see how GRG management would have been able to satisfy itself that TCF had been properly implemented and embedded.
- 4.6.52. From our review of written customer communication at the time, the accounts that customers gave to us of discussions, and the evidence we have seen from appraisals and internal emails, we have reached the overall view that RBS's relations with its customers fell short of the professional standards it aspired to – rather, they were often insensitive, dismissive and sometimes unduly aggressive.
- 4.6.53. Taken together with the lack of transparency in key areas, and the related shortcomings we identify in areas like complaints, these failings added to an already inherently stressful situation, making the environment both more antagonistic than was necessary and more error-prone.
- 4.6.54. We find no evidence of widespread inappropriate treatment of customers in respect of requests for information or preventing customers from taking action.
- 4.6.55. We do, however, view the GRG policy and procedures concerning the relationship between Relationship Managers and SME customers as inadequate. In our view, the failure to adopt adequate procedures and to ensure fair treatment of customers gave rise to widespread inappropriate treatment of SME customers throughout the Relevant Period.

4.7 – Complaints

- 4.7.1. The formal complaints channels are often the last resort for customers who are dissatisfied with the treatment that they have received.
- 4.7.2. Many customers in our sample complained, often determinedly, to the Bank about their treatment. We found frequent failings in the way these complaints were handled. Several were simply ignored as being part of “commercial negotiations” or as expressions of dissatisfaction that were treated as not warranting a response, especially if the complaint involved pricing or credit decisions as many did.
- 4.7.3. Many of the cases in our sample fell outside the ambit of the regulatory rules on complaints (“DISP”). But RBS adopted a policy that all customer complaints should be handled in general accordance with the approach in DISP. So irrespective of its regulatory obligations, there was an onus on GRG to ensure that these complaints were treated appropriately. Whilst practices started to improve towards the end of the Relevant Period, we have concluded that there were frequent failings to handle complaints fairly.

Background

- 4.7.4. Complaints handling is the only area of activity within GRG that is touched by any form of direct regulation, but only in respect of complaints made by a “micro-enterprise”. For these purposes a micro-enterprise is defined as:

“An enterprise which:

- *Employs fewer than 10 persons; and*
- *Has a turnover or annual balance sheet that does not exceed €2 million*

In this definition, “enterprise” means “any person engaged in an economic activity, irrespective of legal form and includes, in particular, self-employed persons and family businesses engaged in craft or other activities, and partnerships or associations regularly engaged in an economic activity.”⁸⁴

- 4.7.5. Complaints made by such an enterprise must be dealt with in accordance with the FCA’s DISP rules that applied throughout the Relevant Period.

- 4.7.6. These rules define a complaint as:

“Any oral or written expression of dissatisfaction, whether justified or not, from, or on behalf of, a person about the provision of, or failure to provide, a financial service or a redress determination, which:

- *Alleges that the complainant has suffered (or may suffer) financial loss, material distress or material inconvenience; and*
- *Relates to an activity of that respondent, or of any other respondent with whom that respondent has some connection in marketing or providing financial services*

⁸⁴ FCA Handbook Glossary

or products, which comes under the jurisdiction of the Financial Ombudsman Service.”⁸⁵

- 4.7.7. Some of the businesses that we considered in our sample were micro-enterprises for the purpose of DISP, but many were not. Determining whether or not a business was a micro-enterprise is not always straightforward. It requires access to specific information, such as the number of employees, which may vary over time and reflect the prosperity of the business or mirror seasonal requirements. So firms at the margin can easily change categorisation across time as they expand and contract.
- 4.7.8. DISP also requires firms to conduct root cause analysis of complaints to ensure that systematic causes of DISP complaints are identified and remedied as appropriate.
- 4.7.9. In particular, DISP 1.3.3[R] notes:
- “In respect of complaints that do not relate to MiFID business, a respondent must put in place appropriate management controls and take reasonable steps to ensure that in handling complaints it identifies and remedies any recurring or systemic problems, for example, by:*
- *Analysing the causes of individual complaints so as to identify root causes common to types of complaint;*
 - *Considering whether such root causes may also affect other processes or products, including those not directly complained of; and*
 - *Correcting, where reasonable to do so, such root causes.”*
- 4.7.10. In our view, it was incumbent on GRG to ensure that all complaints were handled in a fair and consistent way. This was important for a number of reasons:
- Complaint handling, at least in relation to micro-enterprises, involved regulatory obligations set out in DISP;
 - Good complaint handling was clearly a significant factor in the Bank's approach to treating customers fairly;
 - The fair handling of complaints gave an opportunity to correct any problems that did occur with the customer concerned; and
 - As part of the wider set of systems and controls, consideration of root causes of complaints would enable the Bank to ensure that lessons were learnt so that similar problems did not occur in future.

GRG's approach to complaints handling

Responsibility for Complaints Handling

- 4.7.11. From the start of the Relevant Period until September 2012, the individual Relationship Managers were principally responsible for identifying and handling the majority of complaints made by those customers that they were dealing with. The Relationship

⁸⁵ FCA Handbook, Glossary

Manager was required to identify the complaint, treat it in accordance with policy, and respond to the complaint within the required periods wherever possible.

- 4.7.12. Where a complaint was made to a more senior officer of the Bank, it was dealt with as an “executive” complaint and handled by a separate team.
- 4.7.13. In September 2012, the handling of most complaints was migrated to the independent Corporate Banking Division Customer Complaints Centre (“CCC”). This had initially been established in September 2010 to deal with complaints made in the mainstream Bank. The handling of executive complaints was transferred to the CCC in December 2012.
- 4.7.14. In Northern Ireland, complaints handling was moved to a dedicated complaints unit, established in Ulster Bank, in 2013.
- 4.7.15. Following the transfer of complaint handling to the CCC, Relationship Managers were no longer responsible for the handling of complaints. However, it remained the responsibility of Relationship Managers to identify the complaint, log it correctly and ensure that all relevant information was passed on to the CCC⁸⁶.

Complaints policy, guidance and training

- 4.7.16. RBS told us that, throughout the Relevant Period, GRG was subject to an RBS Group Policy Standard on Complaints Handling that was designed to ensure adherence to the requirements under DISP. It noted the definition of a complaint as “any expression of dissatisfaction”.
- 4.7.17. However, we found no reference to the Group Policy Standard on Complaints Handling in the GRG Policy and Procedure documents until December 2010. This was different to some other Group policies, which were specifically referenced in the GRG Policy and Procedure documents. The GRG Procedures and Guidance Manual published in December 2010 noted:

“How we handle customer complaints is a fundamental part of the customer relationship with GRG. Customer Complaints are an important benchmark by which we can measure the success of the TCF initiative in GRG. It is also, put simply, our opportunity to do better by our customers by allowing us to directly improve our customer experience. As our main aim is to return our customers back to the mainstream Bank, how we deal with customers while they are in the care of GRG may be the determining factor in the customer’s decision to continue their relationship with RBS. We never forget that customers have a choice.

GRG is committed to dealing with all customer complaints promptly and in an effective and transparent manner. All GRG staff are required to familiarise themselves with the GRG Guidance – Complaints Handling and ensure the revised processes are adhered to.”

- 4.7.18. Within GRG, complaints followed the same route, regardless of whether they were within DISP. The only distinction was that a DISP eligible complainant was advised of their right to refer their issue to the Financial Ombudsman Service if they were not satisfied with the outcome from the Bank’s internal process.

⁸⁶ Except in cases where the complaint went directly to the CCC, or to an executive within RBS

- 4.7.19. This Policy was entirely appropriate; it ensured that the same time limits and general principles of fair handling of complaints as are set out in DISP applied to all customers regardless of the limited scope of the formal regulation.
- 4.7.20. The handling of complaints appeared to receive increased focus in GRG at around the time of the roll-out of TCF from late 2010 onwards.
- 4.7.21. RBS told us that, up until November 2010, Relationship Managers learned how to handle complaints through both 'on the job' training and guidance and supporting documentation on the group intranet, and that mandatory reading relevant to complaints existed for Relationship Managers earlier in the period.
- 4.7.22. RBS provided us with a 2010 version of the regular reading and viewing module on Complaints Handling. This document was designed for staff who had particular responsibility for dealing with complaints, as well as those who did not have such a specific responsibility. The document emphasises the importance of assessing a complaint and the need to treat it fairly. In our judgment, the guidance was appropriate. However, we are not able to verify which Relationship Managers were aware of its existence, or had read the guidance.
- 4.7.23. In November 2010, a new GRG Complaint Handling Process was rolled out. This included supporting guidance, process maps and letter templates.
- 4.7.24. The supporting guidance was in relation to the process for treatment of executive and non-executive complaints (described below). This guidance was updated in March 2011, although the changes were not substantive.
- 4.7.25. The process maps provided detail on the process a Relationship Manager would need to go through to handle a complaint, but did not provide practical guidance on how to identify a complaint or how to assess the complaint in practice.
- 4.7.26. For these normal cases, the complaints handling guidance required that:
- *"Complaints be logged on the "Concerns and Queries" ("C&Q") system;*
 - *Relevant correspondence is scanned into C&Q;*
 - *The complaint is investigated and assessed;*
 - *A determination on whether redress is appropriate should be made;*
 - *The complaint is resolved and a letter sent to the complainant; and*
 - *The complaint is closed on the C&Q system."*
- 4.7.27. A formal training course, designed specifically for GRG staff, took place in September 2012. This was conducted by the Technical Learning and Development team within RBS and appeared to be a pre-cursor to the transfer of complaints handling responsibilities to the CCC. It focussed on a description of the new process, and the ongoing requirements for Relationship Managers to log complaints and to pass all relevant information to the CCC.

- 4.7.28. Complaint handling was added to the *“Introduction to GRG”* training course in 2013. There was no mention of complaints handling in the versions of the course that we have seen prior to 2013.
- 4.7.29. In summary, the material produced to assist Relationship Managers with complaints handling improved significantly from late 2010 onwards. There appeared to be a greater focus on complaints handling following the roll-out of TCF within GRG. From that point the available material, had it all been read by Relationship Managers, would have provided them with a reasonable basis for handling complaints appropriately. In the period prior to late 2010, we have not been able to evidence that training and guidance were sufficient.

Staff objectives

- 4.7.30. Complaints featured in the objectives of Relationship Managers across the Relevant Period. One of the objectives against which a Relationship Manager's performance would be measured was that of *“zero justifiable complaints”*. These objectives reflected those of the Head of GRG, whose performance in relation to customer treatment was measured by the percentage of justifiable complaints.
- 4.7.31. Using complaints as one measure of customer experience, and hence of relevance to the assessment of the performance of customer-facing staff, is common practice. However, introducing a concept of *“justifiable”* cases (and implicitly *“unjustified”* ones) has clear dangers.
- 4.7.32. Within GRG, certainly until September 2012 when Relationship Managers were responsible for identifying and dealing with their own complaints, this could create a strong disincentive to identify complaints or handle the complaint fairly or transparently. Even if a complaint was identified, the incentive was to dismiss it as unjustified. There was in our view a clear conflict between the staff objective and the fair treatment of those complaining.
- 4.7.33. We did not see evidence of this risk being identified and therefore it was not actively monitored or mitigated. The upshot was a dismissive attitude to customers who complained or expressed a grievance. We refer to some of the language used in appraisals in Chapter 3.3 (Staff objectives), but we saw it also in files that we reviewed.

Case Extract 28

The issues we saw were not restricted to GRG Relationship Managers. A small property development case was being managed in SRM and the strategy at the time was explained by the Relationship Manager internally as *“By taking hefty renewal fees I have incentivised him to get a move on with the sale of units”*. In late 2010 the customer, who appears to have been a micro-enterprise customer, wrote to the Relationship Manager expressing his displeasure at his treatment: *“[you] announced that you would attend the meeting pre planned for the XX December with the sole aim to quote....put our margin rates up through the roof” unquote, and charge exorbitant renewal fees”, [these are] “cynical and bullying tactics from you which are, quite frankly way out of order”*.

The SRM responded to the complaint: *"I accept that I have recently started to maintain pressure on you to deliver on promises you made to the bank with regard to the disposal of your assets...[Customer first name], I am devastated you have felt it necessary to write in such terms about my handling of your affairs ...I believe you know I am the most senior Relationship Director in my part of the Bank in this location....I am not sure what you are asking of me in terms of seniority, or if you are asking to be moved onto the next level in our risk management structure where we will consider, amongst other options, undertaking the sales of your properties via an LPA Receiver....You are of course free to write again asking for a written response and review by my line manager."*

Assurance testing

- 4.7.34. The existence of an appropriate and robust control framework would have allowed GRG to carry out regular assessment of whether complaints handling processes were working effectively. We have seen some evidence that assurance work was undertaken in relation to complaints handling, although this assurance testing occurred following the TCF roll-out (from the period from June 2011 to June 2012) and was probably reflective of the increased attention given to complaints handling in that period.
- 4.7.35. We saw no assurance in relation to complaint handling prior to June 2011 and that lack of oversight increased the risk that any failure in the complaint handling process would not have been identified and corrected. We note that when assurance work did take place it found significant shortcomings in relation to some key aspects of complaints handling.
- 4.7.36. There was some limited assurance work undertaken in relation to handling of complaints in Q2 and Q3 of 2011. Both recommended that guidance be issued to help Relationship Managers determine whether the customer was expressing a query or a complaint.
- 4.7.37. The most substantive assurance undertaken, and the only one for which a documented report was produced, occurred in Q1 2012. GRG conducted assurance testing of aspects of its complaints handling. The assurance testing was limited in scope and only 33 complaints cases were assessed, all within the period from November 2011 to January 2012. The report found that:
- *"Relationship Managers were generally dealing with complaints in a timely manner and resolving them within the spirit of Treating Customers Fairly;*
 - *There was a lack of evidence of documentation in the C&Q complaints system; and*
 - *There was a lack of understanding that an expression of dissatisfaction constitutes a complaint, which contributed to them not being logged in C&Q."*
- 4.7.38. We saw no evidence that any assurance work was undertaken in relation to complaints handling at any other points during the Relevant Period.

Customer satisfaction survey

- 4.7.39. Customers, in general, were not satisfied with how their complaints were dealt with by GRG. The Customer Satisfaction Survey asked customers to indicate how satisfied they were with the way their complaints had been dealt with. In 2011, 69% said they were dissatisfied. In 2012 it was 67% and, in 2013, it was 53%.

Complaints MI and root cause analysis

- 4.7.40. A GRG monthly complaints MI pack was launched in June 2011. It was circulated to business heads and business managers and a summary was reviewed on a quarterly basis by the GRG Management Committee. Complaints data had been reviewed on a quarterly basis by the GRG Board beforehand.
- 4.7.41. We have reviewed 25 of the complaints MI packs covering the period from June 2011 to the end of the Relevant Period. We have also reviewed several excel spreadsheets setting out complaints MI from the middle of 2010 to June 2011. The complaints MI pack remained consistent in format and content from its introduction in June 2011 until the end of the Relevant Period. The earlier MI was substantially similar to that described below, although presented in a different form.
- 4.7.42. The data included statistics for the BRG component within GRG, as well as for GRG as a whole.
- 4.7.43. The December 2011 MI pack included, for BRG, charts and tables that set out the following:
- New cases per month;
 - Total cases per month;
 - Age band for open cases;
 - Open and resolved cases per month; and
 - Age band for resolved cases.
- 4.7.44. The complaints data that we have reviewed did **not** include details of the number of complaints that RBS had upheld or rejected, nor were there details of the number of times that the FOS upheld or rejected eligible complaints, and the grounds upon which the decisions had been made.
- 4.7.45. The root cause analysis was set out as follows:

Fig. 21: Root cause analysis by month

Root Cause Analysis per month												
RCA	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Lending/Borrowing/Advances	4	5	5	3	2	2	5	8	5	7	10	4
Account/Card Transactions	7	7	4	5	3	3	2	1	2	2	6	1
Charges/Fees and Interest Paid and Recei	5	4	4	7	5	2	2	1	4	1		
Charges/Fees and Interest								2	2	3	9	2
Staff/Queueing/Property		3	1	1			1	1	2	2	1	
Regular Payments	1	1			1	1			1	1		
Cheque and Paying in Books	1		1		1						3	
Opening/Closing/Amending Accounts				2								2
Statements/Certificates/Audit letters							2				1	1
Customer Records						1			1		1	
Internet/Electronic Banking		1								1		1
General/Group Policies									1		1	
Marketing and Product benefits/features		1		1								
Total	18	22	15	19	12	9	12	13	18	17	32	11

4.7.46. There was no further analysis provided other than the content of this table.

4.7.47. The RBS root cause analysis was based on grouping complaints under various headings. This allowed GRG management to identify the number of complaints, per month, and the category into which each complaint fell. They could track these complaints numbers over time. In our view, this does not constitute appropriate root cause analysis. We would expect to see more detailed analysis on the causes of the complaints, and not just an identification of the topic against which the complaints were made.

4.7.48. The categories that were used by GRG to assess root causes were, in our view, too generic to enable an effective understanding of what the real causes of complaints were. Although customers expressed dissatisfaction about a range of issues whilst in GRG, the largest number of complaints related to pricing. Our file reviews found a number of complaints about the way in which pricing was explained to the customer or the charges that were being applied. The root cause analysis was not sufficiently detailed to identify these as being specific issues. In addition, it is not clear what actions, if any, were taken by GRG based on such root cause analysis that it did undertake.

4.7.49. The December 2011 pack lists the number of new BRG complaints for each month of the year (amounting to 198 complaints for the year, when added up). A similar presentation was adopted in the December 2012 and December 2013 packs (adding up to 144 and 168 new complaints for 2012 and 2013 respectively).

4.7.50. The MI pack also breaks down monthly DISP eligible complaints. In total these equated to:

- 41 new FSA complaints in 2011;
- 20 in 2012; and
- 101 in 2013.

- 4.7.51. The MI that was produced appears to significantly under-report the actual level of complaints within BRG. We noted complaints in 125 of the 207 cases that we considered – which included a combination of cases where GRG had identified the complaint, where it had failed to identify the complaint, and where it had identified a complaint but failed to log it on its own reporting system. In addition, we saw some cases with multiple complaints. Given the incidence of complaints we saw on cases, we are of the view that the true level of complaints was significantly higher than was reported.
- 4.7.52. We also consider that it was likely that the number of DISP eligible customers was being under-reported and the likely level of DISP eligible complainants was higher than RBS figures suggest. Our analysis indicated that 31 of the 52 cases where we had concerns around complaints handling were likely to be DISP eligible.
- 4.7.53. Complaints were a key part of the GRG roll-out of TCF and were a key metric used by GRG management to satisfy itself that customers were being treated appropriately. The failure to identify and log complaints correctly significantly undermined this reliance on complaints data.

Our approach to assessment of cases

- 4.7.54. We have approached the review on the basis that (except in relation to certain procedural matters) RBS did not distinguish between DISP eligible and non-eligible complainants, in substance, in the way in which it handled complaints.
- 4.7.55. The key areas against which we have assessed RBS are:
- The identification of complaints;
 - The process by which complaints were handled; and
 - Responding to the complaint.
- 4.7.56. We did not make an assessment as to whether a complaint was valid or should have been upheld.
- 4.7.57. However, where we found shortcomings in complaints handling, we did consider whether those cases were likely to be DISP eligible or not. For those customers who are likely to have met the definition of a micro-enterprise, we have borne in mind the additional requirements relating to the need to inform customers of their rights to refer a dispute to FOS.

What we saw in cases

- 4.7.58. Despite the existence of the training and guidance material, and the Group Policy Standard on Complaints Handling that required complaints to be handled in a way that would, for regulated complaints, have complied with DISP, we found a frequent failure to handle complaints appropriately across the Relevant Period.
- 4.7.59. We found that there were some expressions of dissatisfaction in 125 of the cases that we considered. We found that there were failings in complaints handling in respect of

52 of those cases. In some cases, there were multiple failures. In particular we found issues with regard to:

- The identification of complaints – there were 22 cases where we considered that an expression of dissatisfaction had not been identified as a complaint;
- The process for handling the complaint – there were 31 cases where we considered that there was some shortcoming in relation to the handling of the complaint (e.g. it did not comply with the Bank's own procedures for handling complaints); and
- Responding to the complaint – there were 11 cases where we considered that the Bank did not respond to the complainant.

- 4.7.60. For each of the cases where we have found shortcomings in the handling of complaints, we assessed whether they were likely to be DISP eligible or not. In some cases, the information we have available is inconclusive, but other information that is available is indicative of the type of customer being considered.
- 4.7.61. Whilst this was not therefore a full analysis of all the factors (and so individual cases may have been misallocated), we are confident that the results of our assessment provide a good overall view of the extent of DISP eligibility. Of the 52 cases where we found shortcomings in complaint handling, we assessed that 31 (59%) were likely to be DISP eligible.
- 4.7.62. A number of complaints we have seen in our sample concern the fees and charges incurred by businesses whilst in GRG, or the re-pricing of facilities. We recognise that, in the course of commercial negotiation, it is sometimes difficult to distinguish between a genuine complaint, and an expression that is used as part of the negotiation process. The onus was on RBS to ascertain whether the customer's expression of dissatisfaction was a complaint and, in many cases, it failed to do so.
- 4.7.63. We did, however, note that genuine complaints were often downplayed by Relationship Managers and not treated in an appropriate way. As we noted in Chapter 3.3 (Staff objectives), the measure of "*zero justifiable complaints*" may have discouraged staff from identifying complaints and thereafter handling them in a way that was appropriate.
- 4.7.64. Some customers undoubtedly had unrealistic expectations. A few customers, in their discussions with us, indicated that they had 'tried it on' with the Bank. But the majority of customers who complained did so from a genuine sense of grievance about the treatment they received and the actions of GRG.

Case Extract 29

We observed in the region of 20 separate instances where the Customer registered an expression of dissatisfaction where there was no evidence that the Bank had recorded matters in accordance with its policy, or notified the customer of their FOS rights.

We noted the following internal correspondence on the customer's file *"no real clarity for logging complaints here. But seems [Manager] is not for recording this on the C&Q system"* and additionally *"When the new complaints model was rolled out in 2011, GRG made a decision to stay outside the model. As part of this exceptional process GRG decided letters or calls from customers expressing their dislike of GRG and its strategies and staff etc. should not be logged as complaints and since then we have not logged these on C&Q. This is also the case in SRM who fall under the new model but still do not log such complaints."*

There is evidence on this file to suggest that GRG may not have logged the complaints or treated them as complaints due to the expectation that the case would go into insolvency in the coming weeks. For example, in email correspondence between GRG Relationship Manager to a GRG colleague shortly before the insolvency appointment *"I'm keen this gets logged as a complaint, as [Senior Manager] is aware of it and will expect to see it listed as a complaint in stats for [GRG-office]. Hopefully this case will move into insolvency process in the next two weeks and we can then close it off"*, and a separate email *"Can you please close this complaint on basis that bank has formally called debt and moved to appoint receivers/administrators."*

- 4.7.65. The Bank disputed most of our findings relating to complaints. But some it did not, including in one case where we made an express finding that:

"We note a number of instances on file while which clearly demonstrate that the Bank's complaints process was not working effectively. The substance of the complaints made were not addressed by the Bank and the customer was not advised of his rights to write to the FOS as he should have been".

- 4.7.66. We also found a number of instances where a complaint by a customer was either not addressed or resolved in favour of the Bank, but when the complaint was then taken up by the customer's MP, the Bank reached a conclusion that was more favourable to the customer.

- 4.7.67. That the Bank did have a different approach when an MP was involved is clear from material we found on some of the cases:

Case Extract 30

We noted that the customer expressed his dissatisfaction on a number of occasions and in addition two executive complaints were raised on his behalf by his MP.

The Bank failed to address many of the actual complaints. From the evidence on file the letter to the MP and constituent do not appear to have accurately recorded the Bank's intentions in respect of the customer and the Bank's focus was on minimising its reputation risk as evidenced by the following Bank comments:

- In an email from a Bank director: *"... This customer already complained to the executive once and our stance will almost certainly trigger another one."*
- An email from the Executive Response Team to the customers Relationship Manager in relation to drafting a response to the MP which outlined *"The MP's arguments seem reasonable, to me, what course of appeal is there for a longer term facility - perhaps even 12 months would seem like a compromise?"*
- A draft response to the MP was prepared that included the statement *"As part of our strategic plan, the bank needs to repair our balance sheet and this includes rebalancing our lending book over a period of time. We have a significantly greater concentration of Real Estate than our competitors, and we need to manage this down to more reasonable levels."*
- In response to this part of the draft we would highlight the following comment in an email from GRG: *"If we were to go back to the MP and just say that this is Bank Policy for non-core property assets, this would not go down well in parliament."* The proposed section was not contained in the final letter which was signed and sent by the Bank.

Case Extract 31

In 2010 the customer contacted the Bank to voice some concerns. His *"primary concern was the PPA"* which had been proposed by the Bank. A discussion was held with the customer the next day. The following day the GRG Relationship Manager confirmed to the customer that *"the arrangement fee would not be amended"*.

The GRG Relationship Manager called the customer after he expressed concern *"to confirm that there would be no further changes to the Bank's offer of support."* A week later the customer wrote to the Bank returning a new facility letter stating that *"we would like it noted that although we have signed the letter we feel that we have no alternative as we do not have enough time to try and find another bank who would be willing to help us, our main objection is having to pay the bank 6% of each house sale and we would like to know if this is a standard fee for all house builders or is this solely a fee just for us?"*

The customer's MP wrote to the Bank at that time on the customer's behalf. The Bank responded to the MP promptly and said that: *"we may not have communicated the rationale for our proposed pricing as clearly as possible"*. The Bank then also stated that – *"in light of your letter I have asked my colleagues to re-open these discussions and bring them to a final landing."*

- 4.7.68. In reviewing the expressions of dissatisfaction we have seen in the sample, we noticed that there was a link between the length of time that a customer had banked with RBS

and the instances of expressions of dissatisfaction recorded. While this does not impact on our findings on how RBS managed customer complaints during the Relevant Period, it is perhaps indicative of how a customer's relationship with RBS changed once their relationship had been transferred to GRG. For example, we recorded expressions of dissatisfaction on 82% of the cases where customers had banked with RBS for 20 years or more. Where the customer had banked with RBS for five years or less this figure is reduced to 50%.

4.7.69. In relation to those complaints that we judged to be DISP eligible, we found issues with:

- The identification of complaints – there were 13 cases where we considered that an expression of dissatisfaction had not been identified as a complaint;
- The process for handling the complaint – there were 21 cases where we considered that there were shortcomings in relation to the handling of the complaint (e.g. it did not comply with the Bank's own procedures for handling complaints);
- Responding to the complaint – there were five cases where we considered that the Bank did not respond to the complainant; and
- Not notifying the customer of their right to refer the complaint to FOS – there were five cases where we considered that RBS did not notify the customer of their right to refer their complaint to FOS.

4.7.70. The first three areas were also reflected in our findings about cases that we judged to not be DISP eligible.

Our conclusions

4.7.71. We have reached the following conclusions in respect of complaints and complaint handling:

- RBS recognised that complaint handling was a regulatory requirement in respect of some customers, and a necessary part of its TCF approach to all its customers in GRG. Its overall policy included elements that limited its practical effectiveness (such as the early focus on "*zero justified complaints*"), and it lacked, for much of the Relevant Period, sufficient escalation safeguards and consideration of root cause analysis. In these respects, its policy was inadequate and thus inappropriate;
- There were failings in the way the policy was implemented, including in the way staff were trained and their objectives for "*zero justifiable complaints*" were set, although (as set out in paragraph 4.7.29) we noted significant improvement from late 2010 onwards;
- The situation improved somewhat once the handling of complaints was transitioned to a specialist complaint handling unit within the Bank, but remained unsatisfactory;
- We found that there were inappropriate actions by the Bank in 52 cases – which included 31 cases that we considered were likely to be DISP eligible; and

- GRG management was aware of these failings (or at least could and should have readily identified these failings), but did not take adequate or appropriate steps to address the problem.
- 4.7.72. Of itself the failure to handle complaints adequately and appropriately was not a driver of direct financial distress to customers. However, the failure to handle complaints fairly, and to understand and tackle the root causes of complaints, meant that an opportunity to address areas of customer concern was lost. Indeed, too often in our review we saw attitudes from managers and staff towards complaints and complainants that appeared to us to be dismissive.
- 4.7.73. For the individual customers in our sample, it was clear that dismissive attitude and the wider failures to handle complaints fairly were a major frustration. It added to the sense that there was no place to turn to tackle what were seen as the wider unfair practices of GRG.
- 4.7.74. We conclude that these failings to handle complaints fairly resulted in the widespread inappropriate treatment of customers.
- 4.7.75. We also conclude that this inappropriate treatment of customers resulting from the failings to handle complaints fairly was systematic. We say this because:
- The management focus on “*zero justifiable complaints*” and the way this was interpreted in practice by GRG meant that the policy of fair treatment of complaints was not followed in practice;
 - GRG did not put in place adequate safeguards to ensure that it in fact applied its policy in practice and there was no meaningful process to check compliance with DISP requirements for those cases that did fall within the scope of DISP;
 - The evidence from cases suggested to us that managers and staff often took a dismissive approach to complaints;
 - The MI reports on complaints were unreliable; and
 - GRG did not undertake adequate root cause analysis so GRG management was unable to learn the lessons of the complaints that were received.
- 4.7.76. GRG management was aware (or should have been aware) of these failings but did not take adequate or appropriate steps to address the problem.

4.8 – Third parties

- 4.8.1. The use of third-party firms to carry out specific pieces of work was a common feature of the cases that we considered. There were two broad areas where concerns were raised, in the Tomlinson Report, in relation to third-party firms. These were:
- That the actions of third-party firms affected the viability of businesses; and
 - That the relationship between third-party firms and the Bank was too close and this had the potential to lead to conflicts of interest which the Bank failed to manage appropriately.
- 4.8.2. This Chapter considers both of these issues. In summary, we saw no evidence that third-party firms distressed businesses, or that RBS appointed the same third parties to such an extent that there was a clear conflict. However, we did conclude that there were failings, on the part of the Bank, to ensure that conflicts presented by the use of seconded staff were managed appropriately.
- 4.8.3. Because GRG used many secondees from third-party firms, and many customers were aware that some of the staff they were dealing with were not permanent RBS employees, it is not surprising that customers considered that third-party firms had undue influence over their affairs.

Background

- 4.8.4. The most common work carried out by third-party firms can be broadly categorised under the following headings:
- Security reviews – these were reviews by lawyers of the security held by the Bank against the credit facilities of the customer. These reviews were usually undertaken at the outset of the transfer to GRG and RBS told us that there was a cap of £2,000 for the majority of these initial security reviews;
 - Valuations – from time to time, valuation firms were engaged to provide professional opinions on the value of an asset, or assets, held by customers and against which loans were secured;
 - Business reviews – in some cases, third-party firms were engaged to undertake some analysis/assessment of the financial performance and future for the business or IBRs. These were typically undertaken on transfer or soon after the customer had transferred to GRG; and
 - Administrators/insolvency practitioners – businesses that were no longer viable ended up in appointment. Our Review has not assessed cases beyond the point at which an appointment was made.
- 4.8.5. RBS did not sell the debt of SME customers to third-party firms in any of the cases that we considered, and we saw no evidence that it did so at all for the SME population across the Relevant Period.

The appointment of third-party firms

Insolvency practitioners

- 4.8.6. Administrators and insolvency practitioners became involved in cases that had reached the stage when an appointment was required.
- 4.8.7. GRG policy expressly excluded the Bank from appointing an Insolvency Practitioner if they had provided pre-insolvency investigative advice (for example, carrying out an IBR) in relation to that customer. Any exceptions required pre-approval. When we spoke with third-party providers, they confirmed to us that the Bank applied this strictly and only permitted an exception if requested by the customer.

Legal firms

- 4.8.8. RBS told us that legal appointments had to be made from a panel of law firms, with any exceptions requiring approval from RBS Legal. The legal panel was maintained by the RBS legal department and so was determined independently of GRG.

Valuation firms

- 4.8.9. RBS told us that external valuations would be obtained from a firm selected from the Bank's panel of approved valuers. The Bank's GB panel was set independently of GRG by the Property Finance Group. The customer would usually be given a shortlist (taken from the panel) from which they could select a valuer.

Business Reviews

- 4.8.10. Again, RBS had panel arrangements in place for firms to conduct third-party work. The panels included a range of accountancy firms. The terms of these third-party reviews were set by the Bank but required the agreement of the customer and the firm undertaking the review.

Tendering for work

- 4.8.11. In some cases, a tender/bidding process was run for each individual engagement, but this did not occur in all cases. In some locations, GRG tended to use the same firm to conduct specific pieces of work. There may have been good reasons for this (e.g. local expertise) which may have meant that it was sensible to use that same firm on a consistent basis.

What we saw in our case sample

Legal reviews

- 4.8.12. We saw legal reviews on the security across many of the cases that we considered. These legal reviews appear to have been undertaken by a variety of firms and were typically priced at around £2,000 each. We saw very few cases where the security review cost more than that amount. The customer would probably have had only limited contact, if any, with the firm conducting the security review as access to, for instance, firm premises or financial information would not have been required.

Valuations

- 4.8.13. We identified one third-party firm that appeared to get a significant amount of valuation work within a specific location. However, (as discussed in Chapter 4.5 (Valuations)) valuations are often difficult and local knowledge is often beneficial in the provision of more accurate valuations. As such, it is not necessarily inappropriate that one firm may appear to dominate the work within a specific area.
- 4.8.14. We did not identify any other trends in terms of the specific firms unduly dominating the valuation work that was conducted across the sample of cases that we reviewed.

Business reviews

- 4.8.15. We saw business reviews carried out in 21% of the cases that we considered. We saw no pattern, or evidence on individual cases, which might suggest that specific firms were granted undue favour in the decision about which firm would conduct a specific piece of work.

Impact of third parties

- 4.8.16. The various reviews that were carried out by external parties were designed to provide RBS and the customer with additional information about:
- The likely value of an asset – in the case of valuations; and
 - Some aspect of the operation of the business – in the case of business reviews.
- 4.8.17. These were done with the purpose of providing the Bank and the customer with additional information so that better decisions could be made by both parties going forward. In theory, the third parties do not have the power to direct either the Bank or the customer to take a specific course of action. The ultimate decision-making authority remains with the Bank or the customer.

What did we see in cases?

- 4.8.18. There were examples of third-party involvement in many of the cases that we considered. The findings and judgments of these third parties did influence outcomes for customers.
- 4.8.19. For example, as we discussed in Chapter 4.5 (Valuations), the asset values that were determined were often used to calculate margins, fees and Upside Instruments in respect of credit facilities.
- 4.8.20. From time to time, RBS required business reviews to be undertaken. These third-party reviews were on terms set by the Bank but required the agreement of the customer and the firm undertaking the review.
- 4.8.21. Business reviews are typically more useful in cases where there is some ongoing trading element – there is limited value in doing business reviews on pure property-related cases (e.g. residential or commercial developments). This was reflected in the cases where we did see business reviews taking place.
- 4.8.22. Third-party business reviews were typically conducted by accountancy and audit firms – including well know large- and mid-tier audit firms. Business reviews were usually

undertaken to focus on some specific areas of concern that the Bank wanted further information on. Common areas of investigation by the firms engaged to conduct business reviews included:

- Cash flow;
- Strength of the balance sheet;
- Trading potential;
- Liabilities;
- Supplier arrangements and contracts;
- Sales or margin mix;
- The profitability of individual products or services;
- Management accounts; and
- The potential viability of the business.

4.8.23. Third-party reviews can be beneficial for the customer and for the Bank. They allow for some professional and independent analysis of key areas of a business and can make recommendations for both the Bank and the customer. As such, we do not consider that it was inappropriate for RBS to require some customers to have third-party business reviews conducted.

4.8.24. The conclusions reached and recommendations meant that third parties who carried out business reviews were sometimes influential in the decisions that were subsequently taken by RBS with respect to the customer. As such, the work conducted by the third party could be significant in terms of the overall outcome for the customer, but we did not see any cases where that outcome was not the result of decisions taken by either RBS or the customer following the business review.

4.8.25. However, given the potential importance of the conclusions of any review, it would be reasonable to expect that the customer would be given the opportunity to comment on a draft version of the report and to highlight any areas of concern that they may have about the factual accuracy of the report. This would include checking that material facts contained within the report were correct.

4.8.26. As part of our review, we spoke to various providers of third-party business reviews. We understand that it would be common practice to provide customers with draft versions of the reviews (with any sensitive material redacted as appropriate) so that customers would have the opportunity to comment on factual accuracy.

4.8.27. Dr Tomlinson, in his report, was concerned that *"Businesses were not allowed to read Independent Bank Reviews which is unfair"*. We found five cases where we could not evidence that the customer had been provided with a copy of a business review in draft. We did not, however, conclude that there was a common failure to provide customers with business reviews.

4.8.28. A business review for a SME firm usually cost between £10k and £20k. This additional cost further added to the financial burden customers felt soon after they entered GRG.

- 4.8.29. In addition, the use of third-party business reviews was likely to add to the time and resource burden that customers felt. The third-party firm would require the customer to provide it with information to enable it to undertake the work.

Staff secondments

- 4.8.30. The number of cases entering GRG increased significantly from around 2008 onwards. The number of staff in GRG also increased substantially. Some of those staff members were sourced from other areas within the Bank. However, GRG made extensive use of secondments from third-party firms to help meet its staffing needs.
- 4.8.31. We spoke to a range of third-party firms who have provided services to RBS over the Relevant Period. The firms that we spoke with indicated that it was common for at least one (if not more) of their staff members to be on a secondment within GRG at any given time. It was apparent that seconded staff were involved in some of the cases within the sample that we considered.
- 4.8.32. However, there were weaknesses in GRG's management of potential conflicts of interest with respect to seconded staff. We have seen 14 cases where the use of seconded staff clearly led to a potential conflict of interest in respect of that case. In particular, we have seen cases where seconded staff attempted to favour their firm in the decision about which third-party firm would be selected to undertake a specific piece of work. This level of intervention has varied across cases from ensuring that their firm appears on the tender list through to providing information on the content of other bids to their parent firm. In some cases seconded staff sent emails to customers from the address of their firm.

Case Extract 32

A solicitor acted for the Bank as a Relationship Manager on a Customer's case whilst being a permanent employee of a legal firm and being paid by that firm. The solicitor requested a tender from their own firm, using their GRG email account and submitted the tender to the GRG Relationship Manager on behalf of the firm from their firm's email address.

Whilst working on the case, the seconded solicitor had been privy to tenders received from other legal firms in relation to the same work for which they submitted a quote in their capacity as an employee of their legal firm.

- 4.8.33. We did not see any evidence that GRG sought to manage the potential conflict presented by the use of seconded staff. In our view, such a conflict should have been subject to clear and appropriate policy guidelines and a mechanism to monitor compliance with it.

Conclusions

- 4.8.34. It is understandable that customers would expect third-party firms to be independent of RBS. It is not surprising that some customers were concerned that RBS was 'too close' to third-party firms when they often were aware that the GRG staff member they were dealing with was on secondment from a third-party firm.

- 4.8.35. 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.
- 4.8.36. However, the potential conflicts that we identified were more likely to impact other third-party firms than the customer. This is because the conflicts we identified 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.
- 4.8.37. We did not see any cases where third-party firms directed customers to take specific actions that were detrimental to them. Decisions on actions to take in respect of individual customers were taken by RBS, although we recognise that these decisions were sometimes based on information that had been provided by third-party firms.
- 4.8.38. It is understandable that some customers considered that the requirement for a third-party firm to be engaged placed an undue burden on them at a critical time. However, we did not find that use of third-party firms to conduct specific pieces of work was inappropriate given the circumstances in which many customers found themselves.

4.9 – Customers exiting GRG

- 4.9.1. One of the issues raised in the Requirement Notice related to the ability of customers to return to the mainstream Bank once they had transferred to GRG. Specifically the Requirement Notices seeks our view on the:

“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.” With regard to our sample of cases: “The transparency of the referral process (both into and out of GRG) to customers and other parts of the RBS business...”

- 4.9.2. It is understandable that customers were of the view that, once they were transferred into GRG, then it was almost impossible to return to the mainstream Bank. Of the 5,900 SME customers transferred to GRG over the Relevant Period, over 4,000 remained in GRG at the end of 2013, whereas only 608 were recorded as ‘RTS’.⁸⁷ The perception was probably exacerbated by a failure, on the part of the Bank, to set out clearly the reasons for transfer into GRG, and the failure to develop turnaround plans with clear milestones and requirements for returning to the mainstream Bank.

- 4.9.3. This Chapter considers whether the process for transferring customers back to the mainstream Bank was appropriate. In summary, we concluded that, while it was not necessarily easy to leave GRG, and the Bank failed in some cases to give clear and consistent information on the criteria for returning to mainstream, the process was not inappropriate, and customers who should have been transferred back generally were.

Customers returning to satisfactory

- 4.9.4. The data set out in Chapter 6.1 (What happened to customers) suggested that around 10% of cases returned to the mainstream Bank. However, we note that this analysis was based on the Bank's data, and that our own analysis of the outcomes for the customers we considered in our sample of cases suggested that this was likely to be an overestimate. Nonetheless, it is clear that some customers did return to the mainstream Bank and it is possible that others would have done so after the end of the Relevant Period.

GRG Policy

- 4.9.5. GRG Policy included reference to various key points at which Relationship Managers were to consider whether a case may be suitable for RTS. In this regard, the Policy was, in our view, appropriate and provided for sufficient consideration of RTS for cases.
- 4.9.6. The Policy also set out the characteristics to be considered when thinking about whether a case should RTS or not. These were:
- *“Account profile satisfactory – facilities respected, term debt amortising in line with agreement/covenants met;*

⁸⁷ See Chapter 6.1 for further information.

- *Facilities acceptably structured against Balance Sheet, income streams and for the Sector Business operates in;*
 - *Receipt of Acceptable Financial Information in line with the complexity of the business;*
 - *Security/Personal recourse appropriate for risk profile of the business;*
 - *No more than 3 Low Quality Exposure (LQE) triggers and no mandatory GRG triggers should exist;*
 - *All Strategy Issues should have been resolved/concluded; and*
 - *Risk rating to be PD 23 or better."*
- 4.9.7. The decision to transfer a customer back to the mainstream Bank however was not one solely for GRG to take. The mainstream Bank itself had to agree to take the customer back. However, GRG would identify, in the first instance, those cases it considered would be suited to a return to the mainstream Bank.
- 4.9.8. Once it had been determined that a case was ready to go back to the mainstream bank, and in preparation for cases returning there, there was usually a period of shadowing by a mainstream Bank Relationship Manager, although responsibility for the customer would remain with GRG. While this is sensible banking practice, it could act to extend the time that customers spent in GRG.
- 4.9.9. The criteria and process for return were reasonably exacting. The customer needed to have achieved a fully satisfactory financial status before returning. Again the policy left significant room for interpretation. For example, what would evidence *"all strategy issues being concluded"*? This, and the expected shadowing arrangement, could make return an extended and challenging process.
- 4.9.10. Overall, however, we concluded that the policy and process for transfer of customers back to the mainstream Bank (including the criteria) were appropriate. It provided for regular reviews of potential for transfer, and set out criteria to be considered. It also provided for a period whereby the mainstream Relationship Manager could 'get to grips' with the case before formally taking over its management.

Transfer back to mainstream in practice

- 4.9.11. Whilst it was relatively easy for customers to trigger a transfer to GRG, an RTS was in reality more difficult, as invariably customers needed to comply for an unspecified period of time with any new lending policy/terms and conditions that were in existence at the time that RTS was being considered.
- 4.9.12. We noted (when dealing with credit facilities) that RBS tightened many of its lending policies at the beginning of the Relevant Period. Customers who had been provided facilities under earlier, looser, credit criteria were likely to enter GRG when they were (or were likely to be) in breach of their existing facilities. Of course, for many customers RBS did not really intend an RTS. The appetite for lending had changed and for non-core customers the expected outcome was Exit not RTS. But even core customers, in order to leave GRG, usually had to meet the new credit policies of the Bank in order to leave

GRG; it was not always sufficient just to have resolved the original issue (or issues) that brought the customer into GRG. So customers, who may have found it relatively easy to meet old lending criteria, would find it very difficult to meet new, tighter criteria. This would particularly be the case where the facility was significantly higher than the new lending criteria. So simply addressing the concerns raised at the point of transfer could often be insufficient to permit RTS.

- 4.9.13. There was also a lack of clarity about how transfer criteria would apply to the individual customer. RTS might be held out as a realistic prospect, but typically only in generalised terms, leaving the Bank with ongoing discretion to interpret the circumstances of the customer as appeared appropriate in the light of developments. As the process was extended those criteria and customer circumstances could change, leaving some customers with a feeling that the goalposts were moving.
- 4.9.14. Of those customers that returned to the mainstream Bank in our sample of cases – 27 did – we noted that some cases appear to have been delayed, whilst others appear to have been returned prematurely with significant issues still outstanding. The case extracts set out some of what we found.

Case Extract 33

"I am pleased to confirm that the Bank no longer has concerns regarding the borrowings of the company. As such I am able to transfer the control of your borrowings to a normal "frontline" relationship manager."

The customer had extensive debt with the Bank, which his modest business could only manage with difficulty. He had been making interest only payments in GRG but this was changed to capital and interest payments, although it was clear the Bank doubted this could be sustained. Similarly the Bank converted the customer's personal overdraft to a term loan. These changes inevitably caused significant cash flow problems for both the Company and the Director personally. It seems the incentive to make these changes was as much the desire to achieve an RTS to reduce the Relationship Manager's portfolio size, as it was the proper interests of the Bank and its customer. The Company entered administration three months after being returned to the mainstream Bank.

Case Extract 34

A credit paper in November 2011 stated that the file was on course for a RTS. After receiving a second accountant report the following Spring, the Bank endorsed the strategy which proposed RTS before the end of the year and increased pricing. RTS was sanctioned in November 2012 with the file being handed back to mainstream six months later in May 2013. It is understood the time lag was a result of trying to locate the correct 'home' for the file, however, the customer continued to be charged a monthly management fee by GRG throughout this period.

The customer had been identified as being appropriate for RTS having paid down much of his debt and complied with the Bank's requests. He was told by his

Relationship Manager that he would RTS, and yet it took over a year and a number of requests to his Relationship Manager to secure his return to mainstream.

Conclusions

- 4.9.15. That customers remained in GRG for an extended period was not of itself inappropriate; nor was it necessarily inappropriate that customers did not find it easy to exit GRG. However, the process had the potential to lead to confusion amongst customers about the steps that were required to exit GRG. Customers were informed (albeit sometime incorrectly – see Chapter 4.1 (Transfers to GRG)) about the reasons they were being brought into GRG. But we did not see clear direction to customers on the steps that they needed to undertake to RTS. As we noted in Chapter 4.2 (Turnaround), the Bank did not put in place turnaround plans with milestones clearly set out. While we did not consider that there were widespread shortcomings in the process for transferring customers back to the mainstream Bank, the Bank's failure to appropriately manage the expectations of customers was likely to lead to a perception that it was all but impossible to leave GRG by means of a successful RTS.
- 4.9.16. We have seen few cases where we considered that the customer should have returned to the mainstream Bank earlier than they ultimately did. Nor did we see widespread evidence that customers were being kept in GRG for reasons that were inappropriate. In general, the customers who should have been transferred back to the mainstream Bank generally were.

Part 5 – West Register

- i. In this Part we address the issue of West Register, a group of companies operated from within GRG. Some of the 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 granted the Bank a PPFA or an EPA; these were known as Upside Instruments.
- ii. 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). The 'Turnaround Plan' at Annex VII provides an illustration of how West Register's role was presented to customers in relation to PPFAs.
- iii. In his report Dr Tomlinson made specific reference to West Register in the following general terms:

*"In regards to RBS, there is an additional incentive for these types of revaluations and fire sales – West Register. There are multiple accounts of West Register buying properties later down the line when the business has gone into insolvency at cut prices, When you look at the inaccuracy of the valuations of many of these assets, there is a potential for easy profit to be made from the cheap purchase of properties that later can be resold nearer the original valuation"*⁸⁸

"...there is a real potential for conflict of interests in the sale of assets out of the insolvency pot. RBS has a particularly precarious position given its West Register commercial portfolio under which it can make huge profits from the cheap purchase of assets from "distressed" businesses. A number of businesses felt that West Register has been interested in taking their property. Others have stated that that they believe their property was purposefully undervalued in order for the business to be distressed, enabling West Register to buy assets at a discount price."

*"A number of businesses complained about West Register's interest in their property and felt they had been forced into a corner where they had to accept conditions they otherwise would not"*⁸⁹
- iv. Given these two very distinct ways in which WR can appear, and given that each was dealt with by entirely separate teams, it is appropriate for us to treat them separately, although both entail, at some point, use of the West Register badge.
- v. In Chapter 5.1 (West Register Property Acquisitions) we consider the role of WR in property acquisitions. In the second we consider its role as owner of the interests secured from customers through Upside Instruments, and we review the role of SIG that negotiated those instruments.

⁸⁸ Tomlinson Report, page 7

⁸⁹ Tomlinson Report, page 14

- vi. We conclude that GRG failed to manage conflicts of interest inherent in the operation of these two WR functions and their close connections with GRG. Whilst both WR functions had the capability to be of assistance to both the Bank and the customer in certain circumstances, there was undue weight placed by GRG on the desirability of obtaining Upside Instruments and on the potential for WR to profit from obtaining assets from distressed customers.
- vii. However, we did not find evidence to suggest that when GRG acquired assets via its property arm, West Register, the price paid was clearly below the market price for that asset at the time.
- viii. Whilst RBS does not, at the end of the Relevant Period, appear to have made '*huge profits*' out of the process, and this was not (we conclude) the driver for transfers to GRG as some SMEs suspected, we have identified inappropriate treatment of customers as a result of the activities of WR. GRG's policies and practices in respect of WR gave rise to 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 WR. In our view, those failings gave rise to inappropriate treatment of customers that was widespread and systematic.

5.1 – West Register Property Acquisitions

Background

- 5.1.1. West Register was established in 1992. It was described by the Bank as *“the property arm of GRG”*. Its purpose was to acquire real estate assets representing the underlying security for distressed assets and defaulted credit facilities.
- 5.1.2. Although in June 2013 this area of GRG changed its name to Real Estate Asset Management (“REAM”) for ease we refer to it throughout this report as WR. There were separate arrangements in Great Britain (“WR(GB)”) and in Northern Ireland (“WRI”) (which was not established until April 2011).
- 5.1.3. RBS told us that during the Relevant Period:
- WR(GB) purchased 382 properties from a total of 166 SME customers, for a total purchase price of c. £218.75m;
 - From 2011 to the end of the Relevant Period, WRI purchased three properties from SME customers with a total acquisition value of £1.1m;
 - Of the properties purchased by WR(GB) from SME customers, 87% were purchased through either an administration, liquidation or receivership process. All of the properties purchased by WRI from SMEs were purchased through either an administration or receivership process; and
 - With *“one small exception”*, none of the property assets acquired from customers have realised proceeds in excess of the underlying customer's liabilities to the Bank.

The West Register Mission Statement

- 5.1.4. The first “Mission Statement” for the WR companies was set out in a short manual that deals with such issues as signing authorities within WR. It dates from January 2008:
- “By taking a medium/long term view, manage existing and selectively acquire assets with upside potential to avoid forced sales in the current market and hence obtain an orderly realisation of those assets so acquired. Otherwise, to act as vehicles for the acquisition of profitable property developments/investments on behalf of the Bank.”*
- 5.1.5. In the general GRG Aide Memoire dated August 2009, the following description of WR appears:
- “GRG Property Management Unit should be consulted wherever we need to have recourse to property security, or where the existence of property assets may be useful in a reconstruction. Our ability to acquire suitable assets into the West Register Companies is not only a reconstruction tool, but also a source of future profits.”*

5.1.6. By March 2011, the mission statement had become:

“to acquire property from distressed situations where taking ownership is determined to be the best way to maximise recovery and to create additional value through active asset management with a view to exiting when market conditions are more opportune.”

5.1.7. The focus changed again when WR as a unit of GRG changed its name to REAM in June 2013. The change of name was to *“reflect the growing focus on real estate management, irrespective of whether the Bank took direct legal ownership of the assets”*. However, that change in focus only applied to the final six months of our review and itself followed a number of internal reviews of its operations.

5.1.8. Thus, 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 ‘recovery objective’). The other was to hold assets and realise them at a later date (*“when market conditions are more opportune”*) when the bank would benefit from any uplift in value (the ‘future profit objective’).

5.1.9. It is against that background that we examined the policies that WR adopted, their application in practice as it emerged from our review of cases and the governance arrangements in place to monitor activities.

West Register policies

5.1.10. During the course of our Review, the Bank provided us with a number of policy and procedure manuals applicable to WR. Most are dated from 2011 onward.

5.1.11. Other than the 2008 manual, prior to 2011 there was no separate policy manual for West Register and its activities were covered by the general GRG Policy requirements. There was a short manual from 2008 but this dealt with operating procedures within the group of companies branded “West Register” and did not contain any relevant material.

5.1.12. This absence of bespoke policies and procedures for the earlier part of the Relevant Period appears to us to present a gap in governance and oversight.

5.1.13. From our review of the policies and procedures that did exist, and from our interviews with the current GRG management of WR/REAM, it is clear that for almost all of the Relevant Period WR was used to purchase properties from GRG in the following three scenarios:

- Firstly, where the customer was insolvent and the sale was undertaken as part of the insolvency or administration process. Here the sale would be undertaken by the insolvency practitioner who owed certain duties to third parties to secure the best price obtainable in the market conditions. The Bank told us that *“all disposals managed and subsequently sold by the administrator/receiver will be subject to either a full external marketing process or an independent professional valuation obtained by the receiver/insolvency practitioner. If the asset is suitable for a WR purchase a bid will be formulated and submitted directly to the*

administrator/receiver or their sales agent after approval from the Real Estate Investment Committee⁹⁰ has been obtained”;

- Secondly, an open market sale. The customer was still solvent and as part of a deleverage programme sold their assets on the open market. WR participated in the open market and interacted with the customer or their sales agent in the same way as any other potential purchaser; and
 - Lastly, a Consensual Sale – the customer had not been placed into an insolvency process and consented to selling the property to WR on arm's length terms without being placed on the open market. The GRG Relationship Manager would typically have commissioned an independent external valuation to assist this process.
- 5.1.14. In our discussions with GRG management within WR they stressed that WR never bid where the value of the property exceeded the quantum of the debt, and that while WR might bid for a property, in an insolvency situation the insolvency practitioner made the decision on which bid to accept.
- 5.1.15. In the 15 cases we observed where WR purchased an asset we found that it was always for an amount that was significantly less than the value of the outstanding debt.
- 5.1.16. In addition, almost all (13 of the cases) were purchased through an insolvency process (i.e. the Bank was not determining who would purchase the asset).
- 5.1.17. While this meant that WR may have been able to profit, the Bank, taken as a whole, was unlikely to. The following illustration demonstrates the position.

Illustration 2 (this is not a specific case)

Prior to 2008, the customer borrowed £900k to fund the purchase of land and associated development costs. At that time, it was estimated that the development would sell for £1m when it was completed.

The development was completed in early 2009, but following the downturn in the property markets, the value of the property had fallen to £700k.

The customer went into insolvency and a third party was appointed to run the insolvency. The asset was sold to WR for £700k. The Bank wrote off £200k.

- 5.1.18. In this scenario, which was similar to many of the cases we saw where WR acquired an asset, the Bank wrote off a significant sum of money. WR itself may have subsequently profited from the sale of the asset – if it was sold at a price above £700k. However, unless it sold for over the value of the debt that was outstanding (£900k) then the Bank, taken as a whole, was not making any profit.

⁹⁰ The Committee within WR that authorised all bids before being submitted by WR

Conflicts of interest

- 5.1.19. The existence of a vehicle owned and operated by the Bank and which acquired assets from businesses in financial difficulty gives rise to the potential for, and obvious perception of, a number of conflicts of interest.
- 5.1.20. In our view almost all of the criticism directed at WR by SME customers arises from those potential conflicts, or at least the perception of them. The division dealing on behalf of the Bank with the distressed business (GRG) also operated a unit for acquiring property from that SME business, following either a consensual sale or insolvency. That unit would retain the asset for a period, perhaps undertaking the completion or further development of the asset, and would seek to profit from capital appreciation in the future.
- 5.1.21. That WR had a “profit motive” is clear from the Aide Memoire and Mission Statement to which we have referred. This profit motive existed for the majority of the Relevant Period.
- 5.1.22. The Bank told us that the WR model existed to aid and maximise recoveries. In periods where the market for distressed assets lacked liquidity WR helped ensure that there was competition for assets so that ‘fire sales’ were avoided. In this way WR also minimised the immediate losses on sale of distressed assets by underpinning the market when assets were sold by insolvency practitioners. RBS told us that only around a quarter of WR bids were in the event accepted.
- 5.1.23. The “profit motive” related to income that would accrue at some point in the future. Whether a sale was consensual or part of an insolvency process, the Bank wrote down the value of any outstanding debt that could not be recovered. That write down affected the division of the Bank in which the loan had originated, but not GRG or WR. Any subsequent sale by WR would accrue to GRG/WR. Any proceeds over and above the agreed funding costs would therefore be profit attributed to GRG/WR. It is clear to us that this was the intention from the outset and it is mirrored in the mission statements and in the focus that WR received from GRG management.
- 5.1.24. The existence of some potential conflict in this model was recognised when detailed guidance was prepared by the legal department in February 2011 the aim of which was to “*examine, refresh and expand current guidelines...regarding information sharing with WR*”. The advice was issued under English law and subsequently appeared in the WR Policies and Procedures Manual issued in April 2011. We have not seen the full text of the earlier guidance to which this advice refers.
- 5.1.25. The advice of February 2011 notes that:
- “The type of situations which require WR involvement are expanding in scope and complexity and so it is important to ensure adequate safeguards and guidance are in place”.*

and it identifies the crux of the issue, in relation to the sharing of information, in the following way:

“...the ability of GRG to share information about the borrower or the charged asset(s) has to be carefully considered. This is also important because of the Bank's position as lender having access to confidential information about the customer and the charged asset(s) ...Reputational risk is also highly relevant to any sharing of information between GRG and WR given its potential to affect the price ultimately paid by WR”.

- 5.1.26. The advice dealt with, broadly, two situations. The first was where *“there are third parties with an economic interest in the sale”* or *“the charged asset(s) are particularly high profile or there is a perceived risk of litigation”*. For those cases, it was recommended that WR should be *“provided with no more information than any other bidders, or than a normal third party bidder would be provided with in the ordinary course ...nor should any third party advisor who has been involved for the Bank as a lender/charge-holder provide advice or guidance ...to WR in such circumstances.”*
- 5.1.27. The second situation was where *“there are clearly no third parties with an economic interest in the sale”*. In such a case the Bank could take a more *“pragmatic line and GRG may share some additional information with WR which may not ordinarily be provided to bidders”* and this was subject to some detailed guidance.
- 5.1.28. The April 2011 manual updated the February 2011 legal advice by providing that in situations where third parties might have an economic interest a full marketing process would be required, but no such exercise would be necessary where there *“are clearly no third parties with an economic interest in the charged asset(s)”*. The Policy manual published in 2012 was to substantially the same effect. It was these policies that applied for most of the Relevant Period, certainly from April 2011.
- 5.1.29. We do not take issue with the advice and subsequent policy so far as it concerned the legal position in relation to third parties. However, it does not address the position where WR may be able to influence GRG or indeed RBS strategy at an earlier stage, i.e. the stage at which the possibility of an asset being “identified” as being of future value to the Bank could be discussed between GRG and WR.
- 5.1.30. The failure to identify this risk, and address it by putting in place a more appropriate governance and policy framework (which we address in the following section), led to a position where WR was seen by GRG staff very much as an integral part of GRG and fostered an environment which gave rise to wider perceptions of conflicts of interest.
- 5.1.31. A new Policy and Procedures manual was issued in November 2013, but it was at the very end of the Relevant Period and unlikely to have had any impact on the cases in our sample. However, it does show an appreciation of the issues that had been identified by the Bank's GIA Department in a report that we discuss below and also recognises the much broader risks posed by WR operations, albeit that these were, in our view, evident from the outset.
- 5.1.32. Chapter 21 of the revised WR manual of November 2013 is headed “Conduct” and the first section relates to “Information Sharing”. While it adheres to the earlier legal

advice, we note that there appears to be a greater appreciation of the risks inherent in the sharing of information and being involved in the development of strategy:

“There is a risk of perceived or actual conflicts of interest if an Asset Manager (AM) becomes privy to information, not available to the rest of the market, and later becomes involved in the formulation of a bid to purchase the asset on behalf of the West Register entities. The following scenarios will have potential to give rise to conflicts:

- *After considering and [sic] Asset Management proposition, it is decided ownership through the West Register vehicle will realise maximum recovery and a bid is formulated*
- *Upon exiting a period of Asset Management, the West Register vehicle is required to formulate a bid in order to underpin the market*
- *An RM approaches an AM directly to formulate a bid on behalf of the West Register entities (the decision to sell has already been taken)”*

*“The REAM operating model has been designed to manage this conflict. Providing AMs and Bid Managers (BMs) observe the Conflicts Management Process and West Register Information Sharing Policy (where relevant), AMs should not be discouraged from discussing real estate issues with RMs. During the normal course of business RMs and AMs will operate on the same side of the information barrier; only when a bid from a West Register entity is required will conflict have potential to arise. **Therefore, each time an AM becomes involved with a case, with a view to explore or enact and[sic – an] Asset Management Structure, the AM will compromise themselves from later becoming involved in the formulation of a West Register bid.**” [our emphasis]*

- 5.1.33. This element, which is central to the Tomlinson allegations, is absent from the earlier guidance. It shows a greater appreciation of the wider risks that we have identified. However, it still refers to discussions between WR and GRG as being permissible. We regard that as still being inappropriate.
- 5.1.34. We consider such early discussions carry the very real risk that WR may influence the strategy pursued by GRG in furtherance of the WR future profit objective. And even if that risk does not itself materialise, those discussions carry the obvious risk of the perception that improper influence has occurred.

Governance arrangements

- 5.1.35. We have carefully considered the various committee structures that existed during the Relevant Period. We identified that during the Relevant Period there was inadequate separation of operational functions relating to WR and the mechanisms that ought to have acted as a balance to them. Put simply, the same body of people who had responsibility for operational matters relating to WR also assessed the risk of them from both the compliance and the regulatory perspective, which, in our view, was inappropriate. Thus the Asset Purchase Proposition Committee which was responsible for *“the approval of all property acquisitions, disposals and increases to facility limits by West Register Property and its subsidiaries and analysing weekly M.I. at a portfolio level”* had among its membership the Head of GRG UK, Head of Finance GRG and the

Head of Risk GRG. Other members of the Committee had operational functions dealing with cases, but were, at the same time, also members of Committees that made decisions on the sale of assets.

5.1.36. We have concluded that there was a material risk that the separation of responsibilities implied by the committee structure simply did not operate in practice. There was extensive cross-membership with senior GRG staff sitting in multiple roles across the committees and there was an absence of any significant input into decision making from persons outside GRG. We note that in an Audit Report dated June 2013 GIA reached a similar conclusion. GIA assessed the governance controls of GRG management's then proposal to roll out a revised global WR real estate asset management operating model. The report identified a significant weakness in WR's governance and oversight model and noted that the WR governance framework required strengthening *"in order to provide effective management and oversight across the asset portfolio to reduce the risk of the reputational and conduct risk associated with WR assets"*.

5.1.37. Other findings from the Audit were reported as follows:

- The Global Head of WR Property, The Head of West Register (GB) Property and the Head of WR Germany were members on both the Asset Purchase Proposition Committee ("APP") as well as the SCR Panel. This could give rise to a perceived conflict of interest if the same members sit and agree decisions on both the APP and SCR for the same case. This increased the risk that WR management was privy to historical transactional information over and above that which was normally restricted to WR management for the purpose of tabling purchase price bids;
- For decisions taken by the APP for the acquisition of a property, it was noted that the APP members only consisted of GRG members. This increased a perceived risk that decisions taken by the APP do not have an independent view outside GRG;
- The GRG Strategic Property Group Committee ("SPGC") members consisted of GRG and Non GRG members. While allowable under the terms of reference, it was noted that no one outside of GRG had attended the SPGC for the two quarters prior to the audit; and
- WR did not maintain a conflicts register to record any conflict risks that may exist for each of the staff members within WR.

5.1.38. Given the nature of the operations that WR was undertaking, and the foreseeable perception of conflicts that customers were likely to have, this failure to have in place a meaningful division between the operational function on the one hand and the measure and balance of the risk of those operations on the other was fundamental. It resulted in an absence of appropriate oversight in a sensitive part of GRG's operations.

The position 'on the ground'

- 5.1.39. We have identified areas of concern that arise from the closeness of WR to the frontline staff within GRG. This closeness is apparent both from material that was disclosed to us during the course of our policy and procedures review and from our review of the cases.

Regional Reviews

- 5.1.40. The Bank disclosed to us the outcomes of a series of reviews undertaken by the GRG Strategic Delivery Unit ("GRG SDU") at a number of the regional offices during the course of 2011/2012. An initial review was carried out on the loan book for one regional office and a report was completed in February 2011.
- 5.1.41. This report stated that the *"purpose of this exercise is to identify [X Office] managed residential assets that are likely candidates for consideration and potentially acquisition by West Register Properties (WRP)"*. The review took a sample size of 99 residential property connections and assessed what key parameters WR *"would use to segment the portfolio to assess assets of interest"*. The identification criteria focussed upon by WR comprised:
- Assets with an LTV greater than 100% and a net interest cover ratio of less than 1;
 - All other assets (regardless of LTV) with net interest cover ratio of less than 1;
 - All assets with LTV greater than 100%.
- 5.1.42. The GRG SDU recommended that two additional criteria be considered:
- Assets with LTV between 85% and 100% and interest coverage ratio of greater than 1 times, given the high LTV and likelihood of covenant breach/default;
 - All non-cash paying assets regardless of LTV and interest cost ratio.
- 5.1.43. Utilising these metrics, it was determined that c. 97% of the portfolio should be considered for referral to WR. The GRG SDU concluded that *"formalising criteria for referrals and agreeing policies and procedures upfront related to such referrals should be considered"*.
- 5.1.44. The following was also noted in an internal memo dated 18 March 2011, where the subject matter was "[X Office] Review";
- "[Staff Initials] provided us with most recent SCRs which we reviewed to ascertain whether the interests of the bank would be best served by exiting the position with WR providing a potential exit preferably through a consensual deal or on the back of an insolvency process."*
- 5.1.45. The outcome of the review at [X Office] was considered at the meeting of the GRG Management Committee on 7 March 2011. The minute is concise; it simply records:
- "Note to use [X Office] Portfolio Review as a prototype to get properties into West Register"*
- 5.1.46. The reviews at other Regional offices followed, and reports were prepared on each. The papers we have seen show that those conducting the reviews looked at individual cases

that were already under GRG control and considered whether assets held as security in various GRG loan portfolios were suitable for WR purchase. Discussions were held with individual GRG Relationship Managers about cases. In relation to some of those cases WR had identified that it might itself be able to provide a solution by acquiring a particular property.

5.1.47. The Bank has explained this exercise on the basis that it was required:

- *“to address concerns regarding BRG’s growing concentration of highly distressed, capital intensive residential asset related loans which were without any obvious means of appropriate resolution;*
- *to assess whether BRG could utilise the resource in West Register to better effect to ensure that all appropriate options for resolution were being considered for the benefit of customers and the bank; and*
- *to support the bank’s then extant APS obligations”.*

5.1.48. Whatever the intention behind the reviews, they were a means by which GRG Relationship Managers could learn about how WR operated, and the situations in which it might provide a solution to the issues on a case from a Bank perspective. The reviews also helped to develop a greater dependency on, and closeness to, WR on the part of GRG Relationship Managers than appeared to us to be either necessary or appropriate. This in turn increased the risk that WR would be consulted at an earlier stage about its appetite for an asset purchase, even as part of the formulation of the Bank’s initial strategy on individual GRG cases.

5.1.49. This was confirmed to us during the course of our discussions with a GRG Relationship Manager. In dealing with WR we were told:

“...it was quite common for our contact in West Register to sit down with us and we’d review portfolios in terms of what might be on the horizon”.

5.1.50. The existence of WR appears on occasion to have been seen as providing an easier solution to distressed SME cases for the Relationship Manager while being identified as a future source of profit to WR.

West Register in individual cases

5.1.51. We found that WR had, at some point, been involved in 60 of the cases that we reviewed, and that involvement resulted in a purchase of assets by WR in 15 of them.

Fig. 22: West Register involvement

Issue	Number of cases	% all cases
Cases where we identified some involvement by West Register in the case	60	29%
Cases where West Register bid on a property but the offer was rejected or the asset was sold to someone else	12	6%
Cases where West Register purchased one or more assets	15	7%

5.1.52. The purchase position is shown in the following table:

Fig. 23: West Register purchases

Issue		Number of cases	% of cases
Number of cases (and assets) where there was a purchase by West Register		15 (131 assets)	7%
Types of West Register sale	Insolvency	13	87%
	Consensual	2	13%
Asset type purchased by West Register	Property	15	100%
	Other	0	0%

5.1.53. We reviewed each of the cases involving WR carefully. We were satisfied that:

- There was no evidence that the intent to purchase those assets had been formed prior to the transfer of the customer to GRG;
- On each occasion the price paid by WR was below the level of the debt held by the Bank at that point – in other words the purchase crystallised a loss for the Bank; and
- In no case did the evidence available to us suggest that a successful bid by WR was clearly below market prices for the asset at that time.

5.1.54. We did however note that in at least six cases WR was actively involved in the development of GRG strategy prior to a purchase, for example discussing issues such as whether or not property should be let.

5.1.55. Whilst we did identify cases where the involvement of WR was part of a wider picture of the Bank's actions that we judged likely gave rise to material financial distress, we did

not identify any case where the purchase price paid by WR (as opposed to by another person) alone gave rise to a financial loss to the customer.

- 5.1.56. Most of the WR purchases were set in the context of a business where an insolvency practitioner had been appointed. In only two of them were the sales “consensual”. In both of these “consensual” cases there was an issue as to the extent to which the customers felt they had any real alternative but to agree to a sale to West Register. One example of this is set out below.

Case Extract 35

In this case the sale of the secured asset to WR was recorded by GRG as being consensual. However email correspondence on file suggests that information not available to other bidders was shared with West Register and that pressure was being put on both the GRG Relationship Managers to engage with West Register in the sale of the property and on the customer to accept West Register's bid. We noted that the sale had proceeded with some haste with the customer afforded little option.

In May 2011, an internal memo between [employee of GRG] and [employee of West Register] states: *"With our offer still not accepted, we were informed at the beginning of May that **pressure was being put onto the customer to accept our bid of £750,000 and were assured that should we remain at that level a deal could be struck.**"* [our emphasis]

The case had also been reviewed internally by the Credit Quality Assurance division which produced an initial report that raised some issues in relation to the timing of the sale to West Register. The following observations were removed from this report at the request of a senior manager who objected to references to the timing issues because *"...it is a subjective opinion, does not add anything material and potentially implies inappropriate liaison with WR (which was not the case and would be strongly refuted)..."* The report was amended to delete the reference to the closeness of the timing.

- 5.1.57. Our review also noted certain additional aspects that indicated that the relationship between WR and GRG was not arm's length, and these cases are consistent with the evidence that we saw in the previous section of this Chapter.
- 5.1.58. For example, we identified that in several regional offices WR staff sat close to the Relationship Managers handling individual cases. This was an issue that was referred to in the Audit Report of June 2013 which made the following finding in relation to the position at one office:
- "The location of the WR team in London was not segregated from the remainder of the GRG teams increasing the risk of sharing and communicating restricted information"*
- 5.1.59. During the course of our review we noted that this was also the case in at least three other offices.
- 5.1.60. We also observed occasions where emails passed between (1) GRG, (2) PAU and (3) WR but where the employee responding on behalf of PAU responded also on behalf of WR.

This “double hatting” of roles only served to further blur the lines between PAU and WR, as well as confuse the role of PAU which played a crucial role in respect of valuations at various stages of a customer's journey.

- 5.1.61. In 30 of the cases in our sample we made findings that information had been inappropriately shared by GRG with WR. Although much of this information sharing was not contrary to the advice given in February 2011, because no third-party interests were involved, we have nonetheless regarded it as inappropriate, either because we considered that the nature of the information shared was too extensive or because the sharing took place at a time when WR was able to (and in some cases did) influence GRG's strategy toward the customer. This area was not addressed by either the legal advice or the Policy manual of April 2011, although it was dealt with in part in the November 2013 manual.
- 5.1.62. The sharing of information between WR and GRG Relationship Managers and the positive emphasis it was given by GRG management (including but not limited to the reviews referred to above) gave rise to an environment where we consider it likely that many Relationship Managers saw WR as the easy solution to challenging turnaround cases. The question to WR: *‘might you be interested in this one?’* was a frequent early question for Relationship Managers dealing with property assets where the Bank's debt appeared to be significantly greater than likely market values. The answer was sometimes a major input into the development of strategy. In particular, if WR gave an indicative price where it might be interested, then this inevitably was seen as the backstop for alternative strategies for GRG. In contrast, if WR was not interested then the Relationship Manager could not rely on it to underpin the price following any insolvency and hence that option became less attractive.
- 5.1.63. We set out a few case studies which illustrate the close nature of the relationship between GRG and WR.

Case Extract 36

The strategy to be followed on the case, as approved by the SCR committee and detailed in the SCR paper, was *“RTS, Working capital required, West Register were consulted in relation to purchasing the property and subsequently SIG were involved in July quantification and validation; third party diligence on figures necessary and possible PPFA support of restructure of term debt.”*

Case Extract 37

Following transfer of the connection to GRG, credit noted that the *“strategy here is to exit via West Register who have been provided with the relevant details”*.

West Register subsequently prepared an Asset Purchase Paper with approval to bid for the customer's properties. This paper contained full details of all the customer's properties, including rent-roll, and other information that would not have been in the public domain at that time.

It was also noted during our review that the GRG Relationship Manager, the Property Advisory Unit valuer (who was a secondee from the firm appointed as property manager by the administrators) and the West Register asset manager worked in close proximity of one another and that the majority of interactions between these individuals would have been carried out in person.

- 5.1.64. This early involvement of WR in cases once transferred to GRG led us to conclude that it created a real risk of WR helping to “shape” GRG’s approach to its strategy on individual cases. The example that we give below is at the extreme end of what we found; it shows that WR was involved within days of a transfer to GRG and that WR had a major influence on the outcome for the customer.

Case Extract 38

The customer was in the course of completing a development that would be utilised for a trading enterprise.

WR staff were given access to the file at a very early stage (i.e. within a few days of the file being transferred to GRG). The WR staff were involved in discussions with GRG staff, the independent valuer commissioned to assess the value of the property and the independent accountants who were undertaking an Independent Business Review. WR was in a position to influence the thoughts of key people before a decision had been reached as to the strategy to be adopted in this case, and in our view did so.

To highlight this point a specific meeting was held between the valuer, GRG staff and WR staff 10 days after the account had been transferred to GRG. Minutes of the meeting recorded that the WR representative “talked down” the value given by the external valuer. The following is an extract from an email by the GRG staff member to his line manager immediately following this meeting: “if it’s down to me I would say let it remain shut, test the market and if offers are very low, then sell to WRRL [West Register]”

RBS subsequently decided not to support the customer who went into administration and West Register acquired the property.

- 5.1.65. The customer in this case told us that he felt that the very early involvement of WR following the transfer to GRG was evidence that he was deliberately targeted for transfer. We did not agree that this was the case; the transfer was appropriate given the financial position of the customer. However, by involving WR at a very early stage GRG opened itself up to criticism. In this case we did conclude that the early involvement of WR did influence the strategy adopted by the Bank toward the customer; the Bank followed the course set out in the email and did not give meaningful consideration to other options that were available and viable.

5.1.66. More typical of the cases we reviewed is the following example:

Case Extract 39

At the time of transfer to GRG the customer made a request to the Bank to convert his property to serviced apartments. He was requested to provide the Bank with a business plan and proposals to support this. The Bank's UK Problem Exposure Review Committee confirmed the strategy for the connection as *"these units should be bought by West Register and let. Strategy agreed"*. This decision seems to have been the key driver for the strategy on this case and all other proposals were dismissed. This committee included members of GRG management team and the Head of GRG, who was also a member of the Asset Purchase Proposition Committee, which decided which assets WR should acquire.

Correspondence from a third-party adviser to the Bank noted that *"This again offers an opportunity for West Register to purchase. Our valuation on paper shows a total valuation of [c. £6m] however as before, this will not be achieved in the current climate, post 'credit crunch'. £3,000,000 might be realisable in the current market. There is therefore an opportunity for West Register to purchase the block at £3,000,000....The game plan going forward would be: - (i) The property could be let as serviced apartments for a period of 5, 10, 15 or 20 years depending on West Registers' preference and then sold off on a piece meal basis following the expiry of any lease and once the market has recovered."*

The West Register acquisition strategy appears to have been determined prior to the conduct of any viability, financial or other assessments of the customer's proposal.

Our conclusions

- 5.1.67. We have considered carefully whether the existence of such a vehicle as WR is appropriate at all in the context of handling distressed SME customer accounts. Dealings with property are fraught with conflicts of interest and these are more pronounced when the party having conduct of, or significant influence over, the sale of a property is also an interested party in the acquisition of the same asset⁹¹.
- 5.1.68. We accept that in certain circumstances a vehicle such as WR may be of benefit to both the Bank and the customer. That may be the case where, for example, a property has a defect in its title, lacks adequate planning consents or is in an area where the market for properties of a particular kind is all but non-existent. Here, a vehicle like WR might provide a route to an earlier resolution of difficult cases, as well as assist customers who wished to exit from failed property investments, thereby reducing undue risk, and/or crystallising losses.
- 5.1.69. We have concluded 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

⁹¹ During our review, RBS told us that WR is in the process of being closed down as a result of the potentially damaging perception that the Bank had conflicts of interest when it purchased property as part of a restructuring process.

the design of its governance and its policies and procedures, the greatest care was needed to protect all parties, not least the Bank itself, against such conflicts of interest (and the foreseeable perceptions that inevitably arise from them) inherent in such an arrangement.

- 5.1.70. These perceptions were reflected in discussions that we have had with customers and several interest groups representing former customers who are aggrieved at the treatment that they received. WR was a particular focus for their concerns.
- 5.1.71. Many of them were left with the perception that their business was put into liquidation, and that WR acquired a property from the liquidator and would now make a profit on its sale. They regarded this as a profit denied to them, but which would have come their way if the Bank had not decided to terminate its support for them and decided instead to support its own subsidiary in, inherently, the same enterprise.
- 5.1.72. It is easy to understand the strength of feeling that such a situation can engender. The perception is one that is foreseeable and therefore required appropriate mechanisms to guard against it. We have borne that in mind when undertaking our review of this area, which is required by paragraphs 4.1.1(8) and 4.2.2(8) of the Requirement Notice.
- 5.1.73. It is clear that the Relevant Period was characterised by a weak governance framework coupled with loose and often misdirected policy guidance, which together led to a failure to identify and address the substantive conflicts of interest that arose.
- 5.1.74. We concluded that the overall relationship between GRG and WR 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 WR model (maximising immediate recoveries; future profit to the Bank) was never identified and therefore never managed.
- 5.1.75. This inappropriate relationship was compounded by the closeness between WR and GRG at every level:
- The governance committee structure failed to sufficiently separate the operational activity from the risks that such activity generated;
 - Common membership of GRG management committees appears to be the result of a failure to identify the true nature of the conflicts (real or perceived) that were likely to arise;
 - Observations made by the Management Committee in March 2011, and the review exercise to which they related (*"a prototype to get properties into West Register..."*) sent an inconsistent message and thus, in our view, would have contributed to confusion amongst Relationship Managers as to the role of West Register in the development of their case strategy;

- At the operational level, GRG Relationship Managers freely shared information with WR and were encouraged to do so;
 - In some offices the physical proximity of the two teams was a significant factor; and
 - We identified occasions when WR employees also considered themselves to represent PAU and were thus compromised in giving independent advice on individual cases.
- 5.1.76. From our review of the cases, where we identified some involvement by WR, we were satisfied that:
- There was no evidence that the intent to purchase assets had been formed prior to the transfer of the customer to GRG;
 - On each occasion the price paid by WR was below the level of the debt held by the Bank at that point – in other words the purchase crystallised a loss for the Bank; and
 - In no case did the evidence available to us suggest that a successful bid by WR was clearly below market prices for the asset at that time.
- 5.1.77. We did however note that in at least six cases WR was actively involved in the development of GRG strategy prior to a purchase, for example discussing issues such as whether or not property should be let.
- 5.1.78. Accordingly, while not disagreeing that WR **could** have a positive use for both the Bank and its customers, we find that the manner in which the WR model was implemented by RBS was inappropriate and severely flawed. Specifically we conclude that:
- The conflicts of interest policies and procedures relating to the management of conflicts of interest relating to WR were inappropriate throughout the Relevant Period; and
 - In handling individual cases GRG failed to manage conflicts of interest relating to WR appropriately.
- 5.1.79. Whilst we did identify cases where the involvement of WR was part of a wider picture of the Bank's actions that we judged likely gave rise to material financial distress, we did not identify any case where the purchase price paid by WR (as opposed to by another person) alone gave rise to a financial loss to the customer.
- 5.1.80. Nonetheless the failings we did identify 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 WR. 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.

5.1.81. We also view the inappropriate treatment of customers, resulting from failings in GRG to manage the conflicts of interest inherent in its design and operation of West Register, as systematic. We conclude this because:

- The establishment of GRG with a 'profit motive' required careful oversight, but GRG management did not appear to recognise the conflicts of interest (whether real or perceived) inherent in the structure it developed, nor did it put in place adequate or appropriate controls to manage those conflicts –we consider the way in which the West Register model was implemented was severely flawed;
- GRG management 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 clearly did become involved in the strategy for the handling of SME cases prior to administration/insolvency;
- 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;
- 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;
- The focus on West Register as a potential and profitable solution to cases for the Bank 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.

5.1.82. These were shortcomings that GRG's management were (or should have been) aware of during the Relevant Period, but insufficient steps were taken to correct the position.

5.2 – Strategic Investment Group

- 5.2.1. In the previous Chapter we considered the role of West Register as a purchaser of assets. In this Chapter we consider its role as the holder of Upside Instruments. Upside Instruments were negotiated on behalf of GRG by SIG. There is no direct reference in the Requirement Notice to the operations of SIG per se and nor was it usually evident to customers. However, given the role that it played in relation to Upside Instruments and its use of West Register branded companies to hold the Upside Instruments, we carefully considered its role in our review.

SIG's role

- 5.2.2. The role of SIG was described in the introduction to a report by GIA dated June 2011:

“Strategic Investment Group (SIG) is a unit of GRG whose responsibility is to manage the upside instruments that GRG negotiates as part of problem debt restructurings. SIG’s main upside instruments are equity participations (both listed and unlisted) and Property Participation Fee Agreements (PPFAs) and these are held by RBS Group companies. SIG’s objective is to maximise the investment returns by managing the upside instruments strategies and collecting income including dividends and fees when due. SIG is primarily UK based with all listed equities managed in London. SIG also operates in EMEA, Asia Pacific (APAC), Americas, Citizens Financial Group (CFG) and Ulster Bank which manage the unlisted equities, instruments and PPFA’s in these locations. Following the credit downturn, GRG’s problem debt book has grown exponentially, driving an increase in facility restructurings involving SIG. As a result, the SIG risk profile has increased due to the growth in the number of positions it is managing and additional overseas locations that it now operates from”.

- 5.2.3. We set out below our analysis of the arrangements that are referred to collectively as Upside Instruments.

- 5.2.4. In a Policies and Procedures Manual that dates from 2008 and which is expressed to apply to the WR companies, the following Mission Statement is set out.

“By taking a medium/long term view, manage existing and selectively acquire assets with upside potential to avoid forced sales in the current market and hence obtain an orderly realisation of those assets so acquired. Otherwise to act as vehicles for the acquisition of profitable property developments/investments on behalf of the Bank”.

- 5.2.5. The same manual sets out in greater detail the six main functions of SIG. The first of these is of particular significance because it recognises that the taking of “upsides” is far from a straightforward process:

“To provide a service to SLS [as GRG was known at the outset of the Relevant Period] Relationship Managers on the structuring, negotiation and documentation of complex deals where there is an opportunity for significant upside or where public companies are involved”.

- 5.2.6. A further and more detailed Policies and Procedures Manual for SIG was issued in January 2011. Its introductory section provides an “overview” of the function in substantially the same terms used in the GIA report:

“SIG Roles and Responsibilities

SIG is a business within Global Restructuring Group (“GRG”) which sits within the Restructuring and Risk Division of the RBS Group. It is the prime function of GRG to work closely with CM/The Bank’s distressed customer base and to undertake positive and active management of this problem-lending portfolio. On transfer of a connection to GRG a strategy is devised to:

- *work with the customer to facilitate changes that will maximise the potential for turnaround of their situation and return them to profitability,*
- *participate in the value creation of the turnaround situation and obtain levels of reward commensurate with risks undertaken,*
- *return accounts to their originating division/subsidiary in a ‘satisfactory’ condition or maximise debt recoveries/avoid additional losses;*
- *ensure key lessons learned are recycled back to the mainstream Bank businesses and credit functions.*

SIG is primarily a UK based business (with teams in London, Birmingham, Edinburgh, Leeds and Manchester) but also has representatives globally reflecting the global nature of GRG (EMEA, Asia Pacific, Ireland and Americas)...

...SIG’s key roles and responsibilities are as follows:

- *To assist GRG RMs in the taking of equity and other upsides (including Property Participation Fee Agreements) including negotiation of terms, structuring and documentation when these are required to secure a level of return commensurate with the level of risk.*
- *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.*
- *Investment of new capital using SIGs 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...”*

Upside Instruments

- 5.2.7. The Bank 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 of the current lending criteria or which were exhibiting signs of financial distress.

- 5.2.8. Upside Instruments were often used in circumstances where the customer faced cash flow difficulties and was unable to meet existing or proposed interest charges or fees; such instruments were seen by the Bank 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 Bank's 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.
- 5.2.9. The nature of that role for these "instruments" was highlighted in training that was given to all Relationship Managers within GRG. The course, known as *"Introduction to Upsides"* lasted for two days and was designed to train Relationship Managers on such issues as identifying when such a device might be of value, the nature of each kind of instrument, the procedures to be followed and to help Relationship Managers understand the principles of risk-based pricing.
- 5.2.10. The introductory section notes:
- "In the majority of our cases, the inability to generate sufficient cash is at the heart of the difficulties that the customer is experiencing, and a simple increase in interest margin or fee structure is thus unlikely to be a viable means of delivering the level of return that the Bank is justified in seeking in return for its continued support. As such more creative approaches to the generation of an "upside return" are often required, and again this is covered within the ITU course content."*
- 5.2.11. We understand 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 is thus 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.
- 5.2.12. Whilst we consider this approach to be reasonable in theory, the practice was somewhat different. We have seen examples of these instruments being used inappropriately. In particular, the use of EPAs was a significant factor in some of the cases where we have found that the Bank likely caused material financial distress to a customer.
- 5.2.13. Because each operates differently, we will take PPFAs and EPAs in turn.

About PPFAs

- 5.2.14. A PPFA is *"an agreement by which the Bank matches its risk and return by reference to the value/ increase in value of a property."*
- 5.2.15. PPFAs were typically used in the following circumstances:
- Where the property was the business e.g. Hotels, Nursing Homes, Pubs;
 - When a company did not have distributable reserves and these were unlikely to be created;
 - Where future survival was marginal but the company was asset rich;

- Sole Traders and Partnerships (where equity was not available);
- Where equity would be inappropriate for any other reason; and
- Where the Bank saw redevelopment potential in the property that could enhance the value of the Upside Instrument over time.

5.2.16. There were two types of PPFA:

- A Nil Base Value ("NBV") PPFA; and
- A Base Value ("BV") PPFA.

5.2.17. In the case of the NBV PPFA, the customer entered into an agreement under the terms of which the Bank took a fixed percentage of the total value of a property on the expiry of the agreement, typically 3 or 5 years after it was entered into. The measure of the Bank's reward for the risk it assumed was calculated by reference to the projected value of the property at the end of the agreement. The letter at Annex VII proposes a NBV PPFA.

5.2.18. In the case of a BV PPFA, the base value for the agreement was the current estimate of the value of the property at the time when the agreement was entered into. The Bank's return was thus more dependent upon an increase in the value of the property over the term of the agreement.

Illustration 3 (this is not a specific case)

Customer A has an existing loan of £1,250,000 for the purpose of buying a plot of land and developing it. Following the economic downturn the customer experiences financial difficulties and has a negative cash flow. Development works are not completed. The additional funding requirement to complete the development and market it is £60,000. The incomplete development at the time is valued at £900,000.

Valuation evidence suggests that once completed the property could sell for £1,500,000. The Bank agrees to support the customer and as a condition of that support requires a NBV PPFA of 5%. The customer agrees to this arrangement and signs a contract under the terms of which West Register will receive 5% of the value of the entire property on sale (in this example the likely outcome would be 5% of £1,500,000 i.e. £75,000).

If the agreement had been a BV PPFA and it had taken the value of the property at the time of the agreement as its starting point i.e. £900,000 then WR would receive the agreed percentage as set out in the agreement of the difference between the agreed base value and the final selling price. A BV PPFA rate of 12.5% would achieve the same nominal income for the Bank (£75,000) if the property is sold at £1,500,000.

5.2.19. Most of the PPFA's in our sample were NBV PPFA's.

5.2.20. As part of a PPFA the Bank also entered into a Deed of Priority, under the terms of which the legal charge that secures the initial lending is deferred until after the sum due under the PPFA has been paid. This can have a significant impact on the commercial

outcome to a customer who has given (or whose owner has given) a personal guarantee on the original loan, particularly if there is a shortfall.

- 5.2.21. There were 20 cases in our sample where a PPFA was entered into. We noted that in some cases customers were given a comparatively short time in which to decide whether to accept a PPFA and there were some cases where the explanation given to the customer on how the agreement operated in practice could have been fuller, although we recognise that the customer was always afforded the opportunity to take independent legal advice prior to entering into such an arrangement.
- 5.2.22. The main issue relating to these agreements – both PPFAs and EPAs – arose from the widespread practice of not explaining the rationale behind how the Bank calculated the return it was proposing as compensation for its perception of the increased risk. This is a matter that we address more fully in Chapter 4.4 (Pricing), although we also refer to it below.
- 5.2.23. Overall however we 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.

About EPAs

- 5.2.24. The Bank has defined an EPA as follows:

"Equity differs from debt in that it gives the holder a stake in the performance of the business. In most cases equity will provide a yield in the form of dividends and an upside from capital gain."

- *The Bank acquires EPAs as part of providing solutions for financially complex customers, (generally the larger UK SMEs and upwards).*
- *Equity discussions with all customers are carried out by the SIG team.*
- *When SIG acquires EPAs in companies it is very rare to take a controlling stake. In the SME market equity participation typically does not exceed 20% with standard documentation providing minority shareholder protections but not participative controls.*
- *It is Bank policy that SIG do not become involved in the day to day running of those companies but monitors and supports the implementation of a strategy that adds equity value to the business without increasing its credit risk. The aim is to achieve an optimal realisation for each EPA for the benefit of all shareholders."*

- 5.2.25. The customer entered into an EPA in a total of 15 cases in our sample, and in four of those cases the customer also entered into a PPFA. All were limited companies; an EPA did not lend itself to any other business structure.
- 5.2.26. Under the terms of an EPA, RBS took a percentage of the equity of the company in the form of shares. It was a common feature of these arrangements that the shares carried a preference dividend. Thus the Bank was entitled to a return on its investment by the payment 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.

- 5.2.27. The Bank often used these instruments when they 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.
- 5.2.28. The pricing of these mezzanine and equity elements was achieved using approved IRR models which calculated the rate of return on loans.
- 5.2.29. The IRR tool used by SIG was intended to evidence the balance between the risk and reward strategy that the Bank considered it was putting in place; but in most of the cases we have reviewed the Bank was unable to provide us with the final model to evidence this.
- 5.2.30. In our work on staff objectives we noted that there was an undue focus on Upside Instruments and that, in practice, they were seen by Relationship Managers as a means of obtaining income in the future. By setting targets, however loose in nature, it gave an inappropriate focus; Relationship Managers felt incentivised to obtain such "deals" which could result in inappropriate outcomes for customers. We saw the effect of this in practice. The following example of one of the cases in our sample shows how an SME was identified as being a candidate for an EPA.

Case Extract 40

In this case, where the Bank took an EPA, we noted a number of emails on file, which suggest that proposals had been circulated within the Bank focussed around a wider consideration of segments of the portfolio with equity or EPA potential. Among the emails were the following:

- An email which included a *"Shadow Equity Role Presentation"* on the role of *"Equity Shadow"* and incorporates comments on *"deal done targets"*, *" Need more equity deals = [name] to shadow more deals"*. *"Everyone is busy so extra resource should boost results. Delays equal missed opportunity"*
- An email sent by a member of SIG – attaching a spreadsheet which highlights portfolio reviews colour coded (traffic light system) for equity participation agreement. The spreadsheet states 'levers in place - customer receptive' as the key for those customers marked as green and each customer was highlighted as Red, Amber or Green. The customer under review by the Skilled Person was marked in green with the comment *"levers in place - customer receptive"*. In the Relationship Manager meeting conducted with the Skilled Person the SIG manager confirmed that the email related to customers where an EPA was considered appropriate.

EPA documentation

- 5.2.31. The Policy and Procedures Manual for SIG issued in January 2011 referred to standard documentation having been approved for use in cases within BRG.

- 5.2.32. This documentation generally comprised a Subscription Agreement and standardised Articles of Association that gave effect to some of the provisions in the Agreement.
- 5.2.33. The Subscription Agreement covered the following areas:
- Subscription: this set out the agreement as to the amount (and class) of shares to be allotted by the Company and subscribed by the remaining shareholders and/or WR. Commonly in the WR documentation, the shares to be subscribed by WR are Preferred Ordinary Shares thus according WR preferential treatment particularly on dividend payments;
 - Completion: at completion of the subscription, all monies are paid by the shareholders and WR is entered in the register of members;
 - Right to appoint Director and Observer: subject to certain rights and reservations; and
 - Financial Information: while WR is a member of the company, the company would be expected to provide WR with copies of all reports, balance sheet, profit and loss statement, and management accounts; notice of any offer made by any third party to acquire the shares; minutes of all meetings.
- 5.2.34. We have considered the documentation available on the cases that we have reviewed. We note that customers were advised to take legal advice, often within a short period, and we have noted that often those giving the advice to the customer were themselves unclear on certain issues, especially how the arrangement could be terminated, an issue on which the documentation and the letters generated at the time were silent. During the course of our review, in response to a complaint, the Bank accepted that, certainly in relation to that case, the position on the buy-back was not made clear but should have been.
- 5.2.35. In none of the cases in our sample where the customer did receive legal advice did the Bank agree to any changes to its standard documentation suggested by those advising customers.
- 5.2.36. The equity stake taken by the Bank did not have an express expiry date; it was left open to the parties to negotiate a value of the shares when either the Bank or the customer wished to end the arrangement.
- 5.2.37. In the policy manual of 2008 such arrangements are described as “complex”. We regard that as an accurate description, both of the documentation used and of the concept of debt for equity in the case of SMEs, certainly those at the smaller end of the scale.

Impact on customers

- 5.2.38. Whilst we saw only a small number of cases involving EPAs we were able to draw out some general observations about the impact these arrangements had on customers.
- 5.2.39. First, as the Bank itself accepted, the effect of these agreements was significant and provided the Bank with wide ranging rights in respect of the business. In the 2011 Manual the Bank refers to the documentation in the following way:

“The GRG standard equity documents include a number of “protective” as opposed to “participative” shareholder rights, designed to allow the Bank to “protect” the value of the shareholding negotiated as part of the restructure without having any impact or, as importantly for internal accounting and consolidation purposes, involvement in the day to to [sic] day running of the business. This includes the right to appoint a Director, but not an ability to control the Board of Directors.”

5.2.40. The Bank was understandably anxious to avoid it and any of its staff acting as a “Shadow Director” within the meaning given in the Companies Act 2006 because this would have given rise to certain statutory duties and potential liabilities and might have had unintended consequences. But in the cases that we reviewed, the effect on the company of entering into such an arrangement was seen very much by the customer as the Bank having a considerable say in how the business was run. In one example it resulted in the loss of control of the business to the family connected with it and a substantial watering down of their own equity stake in the company.

5.2.41. In Chapter 2.2 (About our investigation) we noted that many limited companies in our sample were either wholly owned by an owner manager or jointly owned with close family members or perhaps a business partner. While the Bank's primary relationship in law was to the limited company, the separation between the director/owner and company was in effect much more blurred.

5.2.42. In the training course “Introduction to Upsides” the Bank itself recognised the special position of family run companies in the context of whether there would ever be a market for the shares:

“When negotiating equity it is worth considering whether an exit is likely. Factors to consider include:

- *Family run businesses that have been owned by one family for generations are unlikely to be sold.”*

5.2.43. All the indications point against the suitability of EPAs for SMEs of the size in our sample. They were complex in terms of understanding the true extent to which rights were being transferred to the Bank and the nature of the documentation that customers were required to enter into. They also lacked clarity on such fundamental issues as the means by which the customer could exit the agreement and at what stage that could happen.

5.2.44. In an internal presentation dated December 2012, GRG itself referred to Upside Instruments as being inappropriate for smaller SMEs:

“For smaller SME customers (below £1m lending facilities) upside instruments are generally not considered appropriate. Any pricing changes are usually restricted to margins and/or fees”.

5.2.45. In the case of EPAs we are of the view that this set the bar too low; the complexity of an EPA rendered it unsuitable for use in cases unless the lending substantially exceeded £1m. An EPA might be of value and appropriate in the context of the larger customers within our sample – say those with debts over £10m or businesses that formed part of a

far larger group or otherwise had access to specialist support and advice – but for the overwhelming majority of cases EPAs were an inappropriate solution.

- 5.2.46. Given the complexity of the agreement it needed careful consideration by the SME. But the time available for consideration of the terms was often short. We observed the Bank adopt a two stage process where Heads of Terms were agreed typically in a matter of a few days before a final document was settled. We considered that this gave rise to risks to customers who did not have ready access to the specialist advice that was required to assess the impact of these terms. But in any event we noted that in practice customers felt, with considerable justification, that they had little option but to agree to the terms as the Bank presented them.
- 5.2.47. Second, we observed that the pricing associated with these arrangements was what we described as “opportunistic” – that is it appeared to us as assessed as much on the basis of what was the best deal SIG could negotiate, as from any considered analysis of the prices that it would be reasonable for the Bank to charge. Whilst the EPAs we observed were clearly risk investments – in that already financially distressed businesses were seeking additional funds – we assessed some of the pricing as appearing to be excessive.
- 5.2.48. The results of the EPA were, inevitably, diverse. In one case in our sample the SME had agreed to an EPA at a particularly challenging point in its history. It then benefited from an unexpected windfall arising from its response to a court case. As a result the value of the company increased significantly as did the value of the Bank's holdings. The negotiated sum paid by the business to buy out the EPA reflected that ‘windfall’. However as this was a genuine windfall we did not consider that of itself represented a material financial distress to the business, notwithstanding the very significant return the Bank earned in this case.
- 5.2.49. Linked with this was the difficulty of assessing the value of the arrangement where the SME recovered and wished to release itself from the Bank as its minority shareholder. The case files show how the Bank approached these discussions. There was in our view insufficient and inappropriate governance around these negotiations to ensure that the reasonable pursuit of a return to the Bank/GRG was not achieved through the unfair treatment of SME customers.
- 5.2.50. Third, we observed that EPAs gave rise to ongoing difficulties in the relationship between the Bank and its customer. Through its shareholding the Bank could and did intervene in issues including senior staffing, replacement of Directors and business strategy. Whilst these were rights established under the agreement, we were struck by the risks and conflicts involved in such detailed involvement where the business concerned was family owned or otherwise modest in scale. For the smaller SMEs we found this to be inappropriate.
- 5.2.51. Fourth, we noted, particularly early in the Relevant Period, a practice of GRG Relationship Managers contacting SIG to discuss potential opportunities. If SIG was attracted by the opportunity it appeared likely to us that this would have impacted the

wider strategy GRG adopted towards that customer. There was no governance evident in practice over such exchanges. The following illustrates the point:

Case Extract 41

Prior to the conduct of a handover meeting with the Customer, SIG indicated in an email 2009 *"...but subject to comfort this looks like a chunky equity deal to me, one for us to support where ever possible...the family look set to lose their shirts and there must be room to cut costs, the [car] Dealerships are a good name to have ...so there must be a deal to do"*.

- 5.2.52. Consideration of Upside Instruments formed an important component of our assessment of whether or not customers suffered from material financial distress.

Our conclusions

- 5.2.53. Upside Instruments were important parts of the GRG strategy, emphasised in objectives for staff at all levels. We conclude that whilst they had a valid role in the toolkit of a turnaround unit the focus given to them was disproportionate and inappropriate.
- 5.2.54. 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.
- 5.2.55. They were comparatively simple in nature. Whilst we have raised some findings concerning the way EPAs were entered into and how prices were calculated, we do not consider PPFAs to be inappropriate per se.
- 5.2.56. By contrast, EPAs are inherently more complex financial instruments; they required changes to a company's structure, had complex legal documentation, were open-ended and had no clear mechanism for determining value when terminated.
- 5.2.57. We have concluded that GRG/SIG failed to exercise adequate safeguards to ensure that the terms of EPAs were appropriate. We have observed opportunistic pricing both in setting the initial terms and in negotiation of the terms for a buy out of the EPA that appeared to us to be inappropriate in the context of SME customers.
- 5.2.58. The close association between SIG and the GRG Relationship Managers handling distressed customers gave rise to further 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 Relevant 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 the Bank. 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 or simply ignored.

- 5.2.59. We conclude that the application of EPAs gave rise to inappropriate treatment of customers. In the context of those customers with whom EPAs were agreed we have concluded that inappropriate treatment was widespread, albeit the number of SME customers actually subject to EPAs was relatively small.
- 5.2.60. Overall we have significant reservations about the applicability of EPAs to the SME customers we reviewed. EPAs might be of value and appropriate in the context of the larger customers within our sample – say those with debts over £10m or businesses that formed part of a far larger group or otherwise had access to specialist support and advice – but for the overwhelming majority of SME cases EPAs were an inappropriate solution. They should have been seen as the exception for the largest customers of BRG, rather than as a general objective.
- 5.2.61. We also view the inappropriate treatment of customers resulting from the focus on EPAs as systematic. We conclude this because:
- GRG management placed considerable emphasis on obtaining upsides – this was reflected in staff objectives, Management Information and training (as explained in Part 3 (How GRG operated)) and in its pricing policies (as explained in Chapter 4.4 (Pricing));
 - GRG did not put in place adequate controls over the circumstances in which EPAs would be applied and the terms associated with them;
 - 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').
- 5.2.62. These were shortcomings that GRG's management were (or ought to have been) aware of during the Relevant Period, but insufficient steps were taken to correct the position.

Part 6 – Customer outcomes

- i. Perhaps the most serious concerns raised in the Tomlinson Report were those which suggested: that GRG artificially distressed otherwise viable businesses; that through such actions GRG placed businesses on a journey towards administration, receivership and liquidation; and that GRG was incentivised to undervalue properties, which triggered insolvency and then allowed West Register to cheaply acquire such properties.
- ii. In addition, amongst the wide ranging complaints about their treatment, many customers were of the view that fundamentally the actions of RBS caused them financial distress and in some cases placed them on a journey towards insolvency. The issue of financial distress is perhaps the most contentious aspect of the review, and the area that was particularly complex to assess.
- iii. This Chapter sets out our approach to the assessment of whether it was likely that inappropriate actions caused financial distress. First, however, we consider what happened to the 5,900 SME customers who entered GRG during the Relevant Period.

6.1 – What happened to customers

- 6.1.1. We wanted to know what had happened to the SME customers referred to GRG. In evidence to the Treasury Select Committee, the Head of GRG emphasised GRG's record in helping businesses. He commented: *"We are very much about helping businesses. Our main focus is not only on restructuring their finances but helping them restructure their business, and this is happening on a large scale for these SMEs. During the period we handled something like 10,000. Less than 10% of them ended up in insolvency"*⁹²
- 6.1.2. The Large Report noted, *"It is important to note that despite the accusations from unhappy customers, over a half of all customers under relationship management of GRG are returned to normal relationship management within B&C, around a third refinance with another Bank or repay through asset disposals and only a minority (~10%) enter insolvency proceedings"*.⁹³
- 6.1.3. A factual question that arose during the course of our review was what was the outcome for the SME customers referred to GRG? Did they return to mainstream banking in large numbers, leave the Bank, or face insolvency and administration?
- 6.1.4. RBS's own data did not give straightforward answers to those questions – not least because RBS had not routinely produced data on SME cases as defined in the Requirement Notice. We worked with RBS to analyse its data to obtain a clearer picture of what occurred in respect of the SME group identified in the Requirement Notice. Validating the data was a significant exercise for both RBS and our team, requiring a number of assumptions to be made about how cases should best be recorded. For example RBS did not normally, in its reporting at the time, include separate data for Northern Ireland, as this was included in the figures for all of Ireland. In addition RBS's original data did not treat the various outcomes of "Exit", "RTS", "Remains in GRG", and "Appointment" as mutually exclusive and did not categorise outcomes under these four outcomes (which were specified by the Requirement Notice). We asked RBS to re-categorise its data to distinguish between those customers who faced a formal appointment process (under an insolvency or administration process) and those who had otherwise exited the banking relationship. RBS explained that this was not straightforward but it reviewed the data to produce more granular information for our review.
- 6.1.5. Following these initial adjustments, RBS's data can be summarised in the following table which shows the position at end December 2013 in relation to those SME customers within the scope of our review. This data was recognised as having a number of inconsistencies and data quality issues, in part caused by the need for manual interventions, by the Bank, to identify some fields.

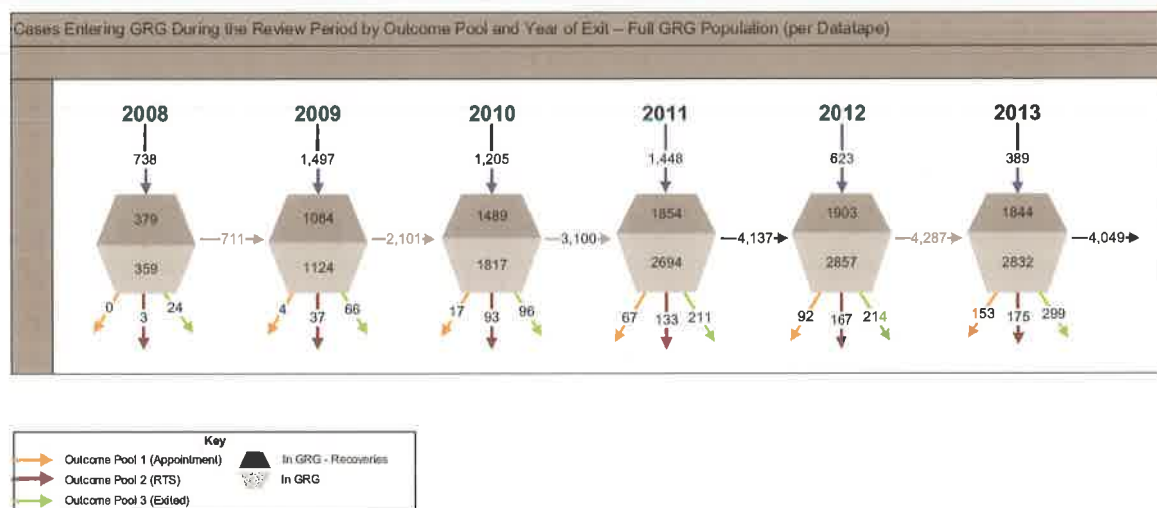
⁹² Treasury Select Committee: Oral Evidence SME Lending Chris Sullivan, Deputy Group Chief Executive, RBS, and Derek Sach, Head of GRG, RBS Q546, 17 June 2014

⁹³ Large Report, page 52

Fig. 24: Outcome for SME customers entering GRG during the Relevant Period

Outcome Pool	Cases	% all cases	% of those exiting GRG
Remains in GRG	4,049	69%	-
Return to Satisfactory	608	10%	33%
Exit Bank	910	15%	49%
Appointment	333	6%	18%
Total	5,900	100%	100%

6.1.6. The Case Flow Chart below gives more detail by setting out the various flows into and out of GRG during the Relevant Period in respect of SME customers based on RBS data.

Fig. 25: Case flow – SME cases entering and exiting GRG by year

6.1.7. On this basis, most customers who entered GRG are recorded as having not left it by the end of the Relevant Period. In fact, 4,049 customers remained in GRG, over two-thirds of the entire population, whilst 608 (or 10% of the entire group) were recorded as returning to satisfactory, and 910 (15%) had exited the Bank (or repaid their facilities). Just 333 (6%) had completed a formal appointment under an insolvency or administration process.

6.1.8. However, we do not consider this to be an appropriate representation of customer outcomes. We noted that a formal appointment process had been initiated in a further 1,033 cases (of the 4,049), but it appeared the process was not finally completed and so the customer record was "Remains in GRG". This could include, for example, customers where the formal processes of administration were in practice completed but RBS retained the customer record in GRG as it was pursuing the customer under a personal guarantee. But in the main, it reflected the time it takes to complete an insolvency process. We also noted that following the FCA action on Interest Rate Hedging

Products, a significant number of customer accounts were in effect frozen awaiting the outcome of their IRHP case.

- 6.1.9. Taking these 1,033 cases out of “Remains in GRG” and placing them into the “Appointment” outcome pool results in a significant change in the picture as is shown in the Table below.

Fig. 26: Outcome for SME customers entering GRG during the Relevant Period adjusting for cases where appointment process initiated but not completed

Outcome Pool	Cases	% all cases	% of those exiting GRG
Remains in GRG	3,016	51%	-
Return to Satisfactory	608	10%	21%
Exit Bank	910	15%	32%
Appointment	1,366	23%	46%
Total	5,900	100%	100%

- 6.1.10. Moreover, when we considered how the individual cases in our sample were recorded we noted that frequently the reality of the circumstances of the customer was not well captured by the RBS data⁹⁴. Some of the common issues we identified included:

- In most cases where an appointment had been initiated by the SME customer itself, or by a third party (such as HMRC or a trade creditor) then the outcome was recorded by RBS as “Exit”. Who initiated action seemed to us to be of limited relevance as to why a SME had reached those circumstances. Clearly the fact that RBS had initiated the process did not imply that RBS was necessarily to “blame” for the SME’s situation, but equally the fact that it was initiated by the customer or a third party did not necessarily absolve RBS of responsibility. And of course it also failed to reflect the reality of the outcome from a customer perspective.
- A further issue arose in the way in which RBS recorded the outcome for the different entities in a connection. We observed cases where RBS recorded a case as “RTS” because one part of the connection was returned to satisfactory, even though this component of the connection was not part of RBS’s material concerns at the time of transfer. We considered that the record should be set against the outcome for the primary component of the connection; that is the component that had driven RBS’s decision to transfer the case, rather than ancillary components that might be transferred for completeness, but were never in practice treated as being in financial distress.

⁹⁴ We have already noted the data issues that meant it was not straightforward for the Bank to present the data in the manner required by the Requirement Notice.

Case Extract 42

An experienced property developer with debts of around £2m experienced delays and difficulties in selling his latest development. His development company, together with a range of other smaller personal interests (including his self-invested pension trusts), were transferred to GRG as part of a 'connection'. Some two years later in the face of escalating fees the developer refinanced his main development business and exited the Bank. His personal arrangements (which we questioned the need to refer to GRG in the first place) then returned to the mainstream Bank.

RBS told us that it had recorded the case as 'RTS'. We disagreed, the primary entity that triggered the referral to GRG refinanced and the case should have been recorded as "Exit".

- 6.1.11. It was not practicable to redraw all the population data on the more realistic basis that we considered appropriate. We were, however, able to analyse the outcomes of the 207 cases that we considered, and compare them to the way that RBS first reported them to us. Of the cases that we reviewed, 47 were identified initially, by RBS, as being RTS cases (i.e. they were from the set of 608 RTS cases included in the population data). However, we found only 27 cases where we considered that genuine RTS had occurred within the Relevant Period. Similarly, we found 24 cases which we considered should be correctly categorised as Appointment, even though they were not identified as such in the population data. For our sample of cases, the impact is significant in reducing the number of cases justifiably described as "RTS" and increasing the proportion of cases that are recorded as "Appointment".
- 6.1.12. We cannot be certain about the extent of the change that our approach would make to RBS's figures presented in the previous tables. But it seems that the result would be a marked reduction in the RTS group for the entire population.

Our Conclusions

- 6.1.13. There are inevitably a number of ways of presenting the data covered in this Chapter. The approach adopted by RBS during the Relevant Period focused on the operational management needs of GRG. Our review was of a sub-set of the overall GRG group of customers – specifically those covered by the Requirement Notice – and focussed on customer outcomes rather than operational issues. We recognise that there remain alternative approaches to the presentation of the data in this Chapter, but are satisfied that the data presented here represents a fair account of what we found in relation to the SME customers covered by the Requirement Notice. At a minimum our work suggests that:
- The data included in the Large Report (as quoted above) of around a half of customers returning to the mainstream Bank appears not to reflect the reality for customers; and

- The MI that was being produced for GRG management during the Relevant Period did not enable GRG management to clearly understand and monitor actual outcomes from a customer perspective.
- 6.1.14. We have concluded that the way in which GRG measured and recorded the outcomes of the SME cases it handled gave a misleading impression from a customer perspective. We conclude that the number of cases that returned to mainstream banking was no more than one in ten of all cases entering GRG during the Relevant Period, and in reality may well have been a significantly lower proportion. Most cases remained in GRG at the end of the Relevant Period.
- 6.1.15. Whilst 6% had completed Appointment processes by the end of 2013 another significant group could be expected to face formal Appointment after the end of the Relevant Period. Another 17% were identified for recovery action. Overall we think it likely that, on the current trends, around a third of customers were destined to face insolvency and Appointment, albeit in many cases after the end of the Relevant Period.
- 6.1.16. This level of Appointment is in large part explained by the financial challenges that the SME businesses were already experiencing when they were transferred to GRG. Our assessment of our Representative Sample showed that 34% of those cases were clearly not viable at or around the point of transfer (see Chapter 6.2 (Distress assessment)).
- 6.1.17. But these numbers of themselves do little to validate (or repudiate) the most serious allegations made about GRG. Some of the customers referred to GRG were clearly not viable (as we describe in the next Chapter), including some that were referred to GRG by the mainstream Bank with the clear expectation and intention that formal recovery action was required. Whilst being in 'Recoveries' is an imperfect proxy for this group of customers, as is shown in the Flow Chart above, at any one time between a third and a half of SME customers in GRG were in 'Recoveries'.

6.2 – Distress assessment

- 6.2.1. This Chapter brings together the evidence that we gathered from our sample of cases and gives our conclusions on the extent to which the inappropriate actions of RBS are likely to have given rise to material financial distress.

Purpose

- 6.2.2. The Requirement Notice required us to identify whether there was any inappropriate treatment of customers, and it specified a range of topics to be assessed. Specifically the Requirement Notice requires us to form a view on:

“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.”⁹⁵

- 6.2.3. This reflected what for many stakeholders is the key allegation in the Tomlinson Report, namely (as summarised in Annex D of the Requirement Notice) that:

“GRG artificially distresses otherwise viable businesses. Through such actions GRG places businesses on a journey towards administration, receivership and liquidation”; and

“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 the businesses towards insolvency.”⁹⁶

- 6.2.4. Given the complexities and significance of the judgments we needed to make in this area we established a methodology in advance for how we would approach the issues and the process we would adopt. This methodology was agreed with the FCA. We reviewed all 207 cases in our sample using this approach. As agreed between the FCA and RBS, we then notified RBS of our initial conclusions in respect of each case and RBS was given an opportunity to comment before we finalised our conclusions. We summarise the key points of our methodology and approach in the next section.

Methodology and approach

- 6.2.5. The approach we took to identifying distress (“the distress assessment”) built upon the work we had carried out in our initial case assessment. That initial assessment had drawn attention to a range of findings about the behaviours of GRG. The purpose of the distress assessment was to reach a view about whether the inappropriate actions we highlighted in our findings had distressed the businesses concerned.
- 6.2.6. In thinking about this question we noted that, whilst customers had on occasion drawn attention to an action by RBS that they considered to be ‘the final straw’, more often it was a combination of circumstances and actions that gave rise to the most intense customer concerns. We were conscious too that the individual actions of RBS might not

⁹⁵ Requirement Notice, paragraph 4.2.2(3)

⁹⁶ Requirement Notice: Annex D, paragraphs 14 and 15.

be viewed as inappropriate, but that when taken together in combination with other actions and the customer's circumstances the overall approach might be viewed as inappropriate and the impact severe. Accordingly, we were keen to ensure that our approach allowed us to consider the impact of a combination of events and circumstances by looking as holistically as possible at the relationship between RBS and its customer.

- 6.2.7. We decided to focus in this exercise on financial distress. We recognised that many customers reported significant personal stress and other impacts from their dealings with GRG. We do not underestimate the significance of such non-financial distress, but for the purpose of the distress assessment our consideration was limited to financial distress.
- 6.2.8. Although the Requirement Notice is careful to refer not just to GRG but also to RBS Group as a whole, we decided that for practical purposes we would limit our consideration of the actions of RBS to the period the customer was in GRG, plus one year before the customer was transferred. It is important to note that this timeline meant that the original lending and the initial sale/purchase of any IRHP were outside the scope of our assessment.
- 6.2.9. We also considered carefully how we should define financial distress for the purposes of this aspect of our work. The Requirement Notice refers simply to whether the actions of RBS "*distressed otherwise viable businesses*". We considered that it was necessary to distinguish between the overall level of distress experienced by the business and the circumstances that appear likely to have existed, but for RBS's inappropriate actions. In effect therefore, we assessed whether inappropriate actions by RBS are likely to have given rise to material financial distress over and above that which the business would have experienced were it not for those actions.
- 6.2.10. In keeping with this approach, we defined distress as meaning financial strain on a business, outside the extant pressures on a business arising from its inherent financial position, the prevailing economic environment etc. This could include increased losses, including loss of business opportunities or economic value, pressure from management time spent dealing with RBS's requirements and restrictions on trading capabilities. But it might also include the business sourcing additional cash injections or security (for example, personal guarantees). We also considered that distress could be caused if, for example, RBS decided not to exercise appropriate forbearance or restructure debt that would have relieved financial strain (i.e. it decided not to act).
- 6.2.11. We saw 'distress' as occurring along a spectrum. That is, inappropriate actions by RBS may have led to differing levels of 'distress', which were likely to have had increasingly significant impacts on the business. Distress might, at the mild end, be additional costs that put a strain on cash flow and limited the business's ability to respond to market conditions or at the higher end, put it on the edge of or into insolvency.
- 6.2.12. In practical terms, mapping RBS's actions to specific consequences was challenging given the limitations on the evidence available to us about all of the relevant circumstances of the customer at the time. We were also conscious that in different

cases what appeared to be similar decisions by RBS could in practice have widely different impacts given the individual circumstances of the business concerned. We took a cautious approach to the assessment of the likely consequences of Bank actions, but overall we were guided by what we considered to be the most likely nature and extent of the impacts we identified.

- 6.2.13. Our assessment was therefore very much focused on the individual facts and circumstances of each of the 207 cases. To help identify the primary themes from these assessments and to assist with a prima facie categorisation of the types of impact we observed we placed each of the cases into one of four Groups based on our consideration of the facts of that case. The Groups we identified are set out below.

Fig. 27: Distress assessment group characteristics

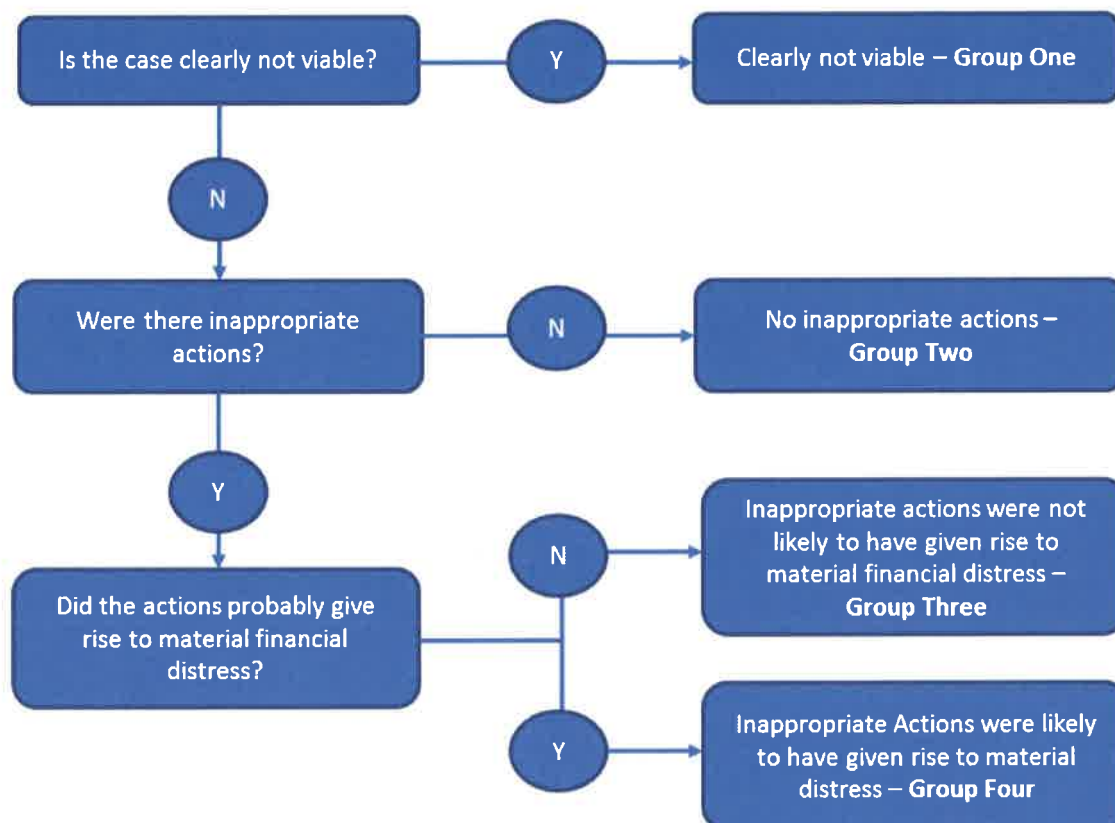
Group	Characteristics	Notes
One	Business clearly not viable	Those cases that are excluded from the methodology at stage one by virtue of our assessment that it is clear that the business would not have been viable on any reasonable scenario (irrespective of RBS's actions).
Two	No inappropriate actions identified	Our assessment suggests there were no inappropriate actions by RBS Group.
Three	Inappropriate actions were unlikely to have resulted in material distress to the business	We assess that the inappropriate actions by RBS Group were such that in all the circumstances of the case they were unlikely to have resulted in material financial distress to the business, beyond that which the business would have experienced in any event.
Four	Inappropriate actions were likely to have resulted in material distress to the business	We assess that the inappropriate actions of RBS Group were such that in all the circumstances of the case they were likely to have resulted in material financial distress to the business, beyond that which the business would have experienced in any event.

- 6.2.14. Accordingly, our methodology essentially required the consideration of three questions for each of the cases within the sample. These were:

- Was the connection 'clearly not viable'?
- Were there inappropriate actions by RBS?
- Was it likely that any inappropriate action (or combination of actions) led to material financial distress?

6.2.15. Our approach is summarised below:

Fig. 28: Distress assessment methodology summary



6.2.16. An element of judgment was required in relation to all of these questions. We did not have a set of criteria against which we determined the answers. Each case was different and created its own challenges. A strict set of criteria, which might have worked for some cases, would not have worked for them all. However, we did aim to be as consistent as possible in our decision-making. To assist in this process we formed a Distress Assessment Panel to consider each of the cases within the sample. This Panel consisted of senior members of the project team, and ensured that a range of skills, knowledge and relevant experience were brought to bear to the decision making on each case.

6.2.17. The Panel members considered all the relevant outputs of the original case assessment for each case, and discussed each of the cases so as to form a view on which Group each case should be placed into.

6.2.18. Many of the decisions that were taken were not straightforward, and the process benefited greatly from the robust discussion and debate that took place in the Panel.

6.2.19. As we assessed the cases, we found that similar (but not necessarily exactly the same) issues arose in some cases that required similar treatment; and conducting the assessment process allowed us to build up our knowledge. Once we had completed our assessment of all cases, we re-reviewed a selection of cases to ensure that we were treating them consistently, where appropriate, with other cases with similar features.

The basis of our assessments

6.2.20. In this section, we set out in more detail the basis of our assessment against each of the three key questions:

1. Was the connection “clearly not viable”?
2. Were there inappropriate actions by RBS?
3. Did any inappropriate action (or combination of actions) lead to material financial distress?

6.2.21. The assessment of distress was not carried out on any case until that case had been through the initial case review, and RBS had been afforded an opportunity to clarify any factual material arising from our initial findings. That is, the assessment of distress was the final step in the assessment of the case. That meant (as far as was possible) there was a set of facts for each case that had been through a thorough and rigorous process of review that incorporated (where appropriate) any changes necessary as a result of the Bank's corrections of fact following our initial review.

Was the connection clearly not viable?

6.2.23. The first stage of our methodology was to exclude from further consideration any case where it was clear that the connection would not have been viable on any reasonable scenario (irrespective of RBS's actions). We took a conservative view as to whether a connection was ‘potentially viable’⁹⁷ – and if the evidence was not clear that a connection was ‘clearly not viable’ then we classified it as being potentially viable.

6.2.24. While RBS had no definition of what it meant by viability, we came to the view that the approach that we adopted was consistent with GRG's stated objective as a turnaround division. In our consideration, it is reasonable to expect that a turnaround division might consider assisting those customers for whom there was some prospect of turnaround – even if it then determined that it was too difficult to achieve, or if it was ultimately in vain. This reflects the policy approach to turnaround issues we discuss in Chapter 4.2 (Turnaround).

6.2.25. In many cases, a connection involved a number of different elements. For example, a single connection may have consisted of a combination of limited companies, sole traders or partnerships, or personal debt of the business owner(s). In considering these cases, we had regard to whether individual elements within the connection were potentially viable. Where there was some element of viability, we generally considered the connection to be potentially viable – but our subsequent assessment of the case would take into account that some parts of the connection may not have been viable. There were a few cases where the only viable element within the connection was so insignificant that we did determine that the connection, taken as a whole, was clearly not viable.

⁹⁷ Strictly the group of cases that do not fall in Group One are cases that we judged to **not** be ‘clearly not viable’ – to avoid the double negative and aid communication we summarise this group as the ‘potentially viable’.

- 6.2.26. Our assessment of potential viability was conducted at or around the time of transfer to GRG – although in cases where RBS's actions before transfer may have had an impact then we considered the potential viability at that point. However, the information we had was imperfect, so we tended to use information from a period around the time of the transfer in making our assessment. Even then, in many cases, there was limited financial information on file with which to make an assessment.
- 6.2.27. This lack of information on file might occur, for example, because the key information on which viability depended related to the detail of the position between the customer and a third party. More generally, current and accurate information about a range of factors – not least the financial circumstances of the business at the time – was not always readily evidenced from the information held by RBS on the cases that we considered. The absence of viability assessments undertaken by GRG on cases meant that we could not be sure that RBS itself had considered the issues and that it, and we, had all the information necessary to make a reasoned assessment.
- 6.2.28. We were therefore careful to form our judgment without the benefit of hindsight. So the end result for the connection, potentially some years later, was not always a good indicator of our conclusion about viability. There were cases that we concluded were potentially viable that ended up in administration or insolvency at some point further down the track.
- 6.2.29. In some cases, we considered the actions of RBS following the transfer to GRG to be relevant to our assessment. For example, if RBS did not treat the customer as being clearly not viable, then we took that into account in our assessment and generally concluded that the case should not be included in Group One. Similarly, if RBS entered into long-term financial arrangements with the customer such as a PPFA we took that as an indication that RBS, at the time, at least considered the customer to be potentially viable.
- 6.2.30. Any meaningful process of viability assessment will also include a range of qualitative factors; including future market prospects, client levels of cooperation and the quality of management. In making our assessments we, where possible and appropriate, placed weight on third-party assessments made at the time. Otherwise we reached our own judgments having considered all the information available to us.
- 6.2.31. We therefore took into account the potential medium-term prospects for the connection and the performance of the connection across the business cycle. This was particularly relevant for trading cases that might, or might not, have been suffering from some short-term financial or trading issues. In these cases, assessments always involve some element of judgment, particularly with regard to whether the problems are likely to be short-term in nature or not. We therefore considered issues such as whether the market for the product may have changed, whether key purchasers had not renewed contracts, and the length of time the business had been successful previously.
- 6.2.32. In respect of property companies, cash considerations were not always primary. The medium-term viability of a property case (at the time under review) largely depended

on the actions that RBS itself might choose to take - for example to provide funds to build out a development or not - and thus cannot be assessed independently of those actions/inactions. In such cases we considered whether or not the property case represented a “*viable proposition*” for RBS, recognising that RBS might not always wish to decide to advance facilities even if the result was viable.

- 6.2.33. We approached viable proposition assessments cautiously. In particular, we made no assumption about the inevitability of the property market improving. Whilst customers often assumed such an improvement was ‘simply a matter of time’ there was in fact no reliable basis for forecasting when (or indeed if) the property market would recover sufficiently so as to enable capital and any outstanding interest to be repaid. We were therefore more likely to classify what were essentially speculative property developments as being clearly not viable – rather than assume that the property market would recover within a reasonable time period.
- 6.2.34. Finally, we recognised that the viability of a business will change, sometimes markedly, over time. Typically the businesses we were reviewing were under consideration by GRG for two or three years. Over that time the financial performance of the SME often altered significantly. Whilst our approach focused on a medium-term view it remains the case that businesses that are assessed as viable at one point in time can subsequently become clearly not viable following further events. For businesses that we considered potentially viable around the time of transfer, we noted any change of viability in the context of considering the impact of any inappropriate actions by RBS.
- 6.2.35. Where we determined that a case was ‘clearly not viable’ we placed the case into Group One. Given the focus on distress to **otherwise viable** businesses in the Requirement Notice, we removed cases that we assessed as clearly not viable from further consideration in this distress assessment process. For the balance of “potentially viable” cases we went on to consider whether or not there had been inappropriate actions by RBS and whether these gave rise to material distress.

Were there inappropriate actions by RBS?

- 6.2.36. During the initial review of the cases we had already identified inappropriate actions, as applicable, on each of the cases in our sample. As part of our distress assessment, we considered whether there were additional inappropriate actions that should be identified, and whether the inappropriate actions that had been identified remained valid in the light of any comments from the Bank or any new evidence it provided.
- 6.2.37. For those cases that we classified as potentially viable we considered whether there were any inappropriate actions in respect of those cases. Where there were no inappropriate actions we placed the case into Group Two.
- 6.2.38. The impact of the inappropriate actions by RBS that we observed varied widely. In some cases the findings we highlighted may not have had any direct impact on the customer, or the impact may have been modest. Typically, for example, poor transfer communication and poor complaint handling, whilst common findings across the sample, seldom if ever in our judgment could be said with confidence to have led to

material financial distress (although we did not rule out the possibility that they may have done so in some cases).

- 6.2.39. Conversely we did not assess as inappropriate some actions of RBS that clearly gave rise to material financial challenges for businesses. For example, we did not conclude that all margin or fee increases were inappropriate, even if they did give rise to financial challenges for the business. Nor did we conclude that it was inappropriate for RBS to require a business to re-bank or reduce its level of indebtedness. However, if increases were levied without consideration of the impact on the customer, or demands made to re-bank or reduce debt were associated with unrealistic timescales, then we were likely to assess that RBS had acted inappropriately.
- 6.2.40. We also considered carefully circumstances where it might reasonably be judged that RBS's failure to act represented an inappropriate action. This might occur, for example, where we identified a clear alternative strategy for the handling of the case that was reasonable and achievable, that RBS had not adopted.

Did inappropriate actions lead to material financial distress?

- 6.2.41. Where there were inappropriate actions evident in a case we then considered whether they were likely to have led to material financial distress. In assessing whether inappropriate actions of RBS were likely to have caused material financial distress, or not, we applied the following tests on the balance of probabilities:
- There would need to be some element of financial distress;
 - That financial distress, given the circumstances of the case, would need to be material for that customer; and
 - There would be a causal link between the inappropriate action(s) of RBS and the material financial distress experienced by the customer.
- 6.2.42. The inappropriate actions we observed gave rise to a range of financial impacts on customers and similar actions in different cases had very different consequences given the circumstances of the customer. All of the cases we considered involved a complex pattern of circumstances. Customers were invariably suffering from some form of pre-existing financial difficulty which inappropriate Bank actions may have exacerbated. RBS was but one part, albeit often the most significant part, of a wider picture of financial challenges facing the SME. Those circumstances interacted in ways that were not always clear to us looking back (and may not have been clear to RBS at the time).
- 6.2.43. In some cases we identified that a sudden withdrawal of overdraft facilities was unhelpful to the business. The impact this had was dependent on the precise way in which the reduction/withdrawal was carried out and the financial circumstances of the SME at the time. In some of these cases we were satisfied that the withdrawal had been a pragmatic way to protect RBS's interests in the face of a business that was clearly failing – RBS's actions may have hastened the demise of the business by a few days or even weeks but it had not been a step that materially altered the picture faced by the business or its owners.

- 6.2.44. In other cases the business could cope with the reduction because it had access to alternative funds from outside the business: the withdrawal was unhelpful but we did not consider it gave rise to material financial distress. In other circumstances, however, the impact could be more severe, either because restrictions on the SME's critical working capital meant that new business could not be entered into, or because alternative funds were clearly more expensive, or more fundamentally because the SME could not continue to trade without the facility.
- 6.2.45. The wider economic circumstances of the time were also important factors in all the cases that we saw. The values of property were significantly reduced, some businesses were losing customers, markets that had previously flourished were no longer sustainable, and third-party creditors were seeking repayment of the monies that were owed to them. These factors were dynamic and were all part of the customer journeys that we saw in the cases in our sample.
- 6.2.46. In these circumstances there were seldom clear-cut causal links between Bank actions and particular consequences. The approach we adopted was to identify what we considered to be the most likely explanation for the circumstances we observed.
- 6.2.47. In considering material financial distress (Group Four cases), our threshold was **not** that we had evidence that the inappropriate actions of RBS were likely to lead to insolvency or administration for the business – but rather that material financial distress was likely to have been caused. This might be limited to a material loss of income or profit or a material loss of ownership rights over the business (the latter for example might be judged to have occurred where an unnecessary Upside Instrument had been required of the business).
- 6.2.48. The materiality threshold was important because, without it, there would be no way of distinguishing those cases where financial distress was non-existent, or minor, and those cases where it may have had a significant impact. We did not however identify a quantum for financial distress in each case; nor did we specify a quantum for materiality. We considered materiality in the context of the customer at the time. Returning to the example of the overdraft withdrawal given above, where we determined that the withdrawal of the overdraft had probably led to a business not being able to operate effectively, it was not possible to identify what the actual impact was, in monetary terms. But this did not preclude us from determining that material financial distress was likely to have been caused.
- 6.2.49. Against this backdrop, the assessment of whether inappropriate actions of RBS caused financial distress, or not, was challenging. We typically saw the customer's circumstances solely through the lens of the interaction between the customer and RBS, and there were undoubtedly elements of cases that may have been relevant to any assessment which we did not have sight of. As such, it was not always clear exactly what event or action led to distress for the customer.
- 6.2.50. We therefore adopted a 'reasonable likelihood' test to assess whether inappropriate actions were likely to have led to material financial distress.

- 6.2.51. In summary, our assessment was predicated on a judgment that there was a reasonable likelihood that the inappropriate actions(s) of RBS led to financial distress that was, in our view, likely to be material in the context of the customer in question.

Our distress assessment results

- 6.2.52. We conducted a distress assessment in respect of the 207 cases that we reviewed. This assessment included both the Representative Sample of 178 cases and the 29 Tomlinson Cases.
- 6.2.53. Our first step was to remove from further analysis those cases that we judged to be clearly not viable. These Group One – clearly not viable – cases accounted for 34% of the Representative Sample. Of the remaining cases (117 cases) in the Representative Sample (those cases that were in our judgment potentially viable) all but 8% had some inappropriate actions in the handling of their case by RBS. In the majority of cases we assessed that, in all the circumstances of the case, it was not likely that those actions resulted in material financial distress (beyond that which the business would have experienced in any event). However, in our view, 16% of the potentially viable cases (11% of all cases) in our Representative Sample **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). The results are summarised in the following table.

Fig. 29: Distress Assessment – Potentially viable cases in the Representative Sample

Distress Assessment Group	Number of cases	Percentage
Two: No inappropriate actions	9	8%
Three: Inappropriate actions did not result in material distress	89	76%
Four: Inappropriate actions resulted in material distress	19	16%

- 6.2.54. The sample size of the Tomlinson Cases was considerably smaller and so caution should be exercised in comparing it with our larger Representative Sample. We were also conscious that the Tomlinson Cases were largely self-selecting and might not be representative of the wider experience of customers in GRG in respect of financial distress. With those caveats we noted that of the potentially viable group in the Tomlinson Cases, in our view, all but one experienced some inappropriate actions. Again in the majority of cases we concluded that, in our view, in all the circumstances of each case, those actions were unlikely to have resulted in material financial distress (beyond that which the business would have experienced in any event). Of the potentially viable group in the Tomlinson sample, we judge, in all the circumstances of each case, that 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).

Was this pattern typical across the Representative Sample?

- 6.2.55. We considered whether or not this pattern of findings was reasonably spread across all the categories of our Representative Sample, or whether there were groupings of poor (or good) outcomes. We reached the conclusion that property cases were less likely to experience material financial distress than other cases. However, we also noted that nearly a half of the property cases (48.6%) we assessed as clearly not viable (Group One), whereas just 24% of trading/other cases were assessed as clearly not viable.
- 6.2.56. The outcome is understandable given the circumstances of the time. Many of the property cases we saw involved the development of residential or commercial property for the purpose of sale upon completion. The fall in property prices early in the Relevant Period meant that, in a lot of these cases, the value of the property development was significantly less than had originally been expected, and certainly less than the credit facilities that had been extended. In addition, many of these cases were unlikely to have been able to generate sufficient rental income to pay ongoing interest – let alone make repayments of capital.
- 6.2.57. Of the 117 cases we assessed as potentially viable, in the Representative Sample, the breakdown was as follows:

Fig. 30: Breakdown of the viable cases in the Representative Sample

Distress Assessment Group	Property		Trading/Other	
Two: No inappropriate actions	4	11%	5	6%
Three: Inappropriate actions did not result in material distress	32	84%	57	72%
Four: Inappropriate actions resulted in material distress	2	5%	17	22%

- 6.2.58. There were no other features of the cases that appeared to us to give rise to other reliable distinctions between those cases more or less likely to be assessed as having experienced material financial distress. In particular we were satisfied that these results were not centred on one or two specific locations, or periods of time.
- 6.2.59. The only other criterion we have identified that gave rise to any clear pattern was whether we spoke with the customer or not. We spoke with customers in 46% of the Representative Sample. Of these, again excluding those that we considered to be clearly not viable, we assessed 25% as being likely to have experienced material financial distress (compared to 7% where we were not able to speak to the customer).
- 6.2.60. However, it is important to note that we found it more difficult to contact customers where the business had ceased to exist. This was more common for property cases, where we spoke with proportionally fewer customers and where we identified less material financial distress.

Further analysis

6.2.61. The following paragraphs provide further analysis and comment on the types of cases that we observed in each of the four distress assessment Groups.

Group One

6.2.62. The methodology was designed to meet the objective of the Requirement Notice – which specifically referred to distressing otherwise viable businesses. As such, we did not explicitly consider whether inappropriate actions distressed businesses that we assessed as being clearly not viable.

6.2.63. Unsurprisingly none of Group One cases returned to satisfactory. Many had clearly been transferred to GRG for recovery action. However the others remained in GRG, often for considerable periods – in some cases several years. Around 20% exited, mainly on the basis that the debt was repaid by the business owner from other resources. But overall a significant proportion of these Group One cases gave rise to an Appointment process (69%).

Fig. 31: Outcome group – clearly not viable customers

Group	RTS	Exit	Appointment	Remains in GRG
One	0	12	42	7

6.2.64. Whilst we assessed the cases as clearly not viable, this is not to say that we did not identify inappropriate actions in these cases. Indeed it appeared to us in several instances the customer would have had valid reasons for complaining about inappropriate treatment – but this inappropriate treatment did not in the event have any potential impact on the viability of the business. Typically the issues that we identified concerned the clarity of communications and pricing issues. In the words of the RBS internal Aide Memoire, these 'Dead on Arrival' cases faced Risk/Management Time fees or in the terms of the RBS "*Just Hit Budget*" document, these "*Basket cases*" could be "*Time Consuming but remunerative*".

6.2.65. The case examples below illustrate some of the features we observed in this Group of cases.

Case Extract 43 (Group One)

The Customer operated residential care homes. Over the course of a number of years, the principal care home received negative inspections, occupancy levels dropped and it experienced some financial difficulty and was loss making.

The customer was transferred initially to SRM which within 3 months recommended onward transfer to GRG. RBS sought fresh capital injections by the owners but these were not forthcoming.

The connection was transferred to GRG in full with reasons stated being trading losses, excesses, security shortfall and concern over the ability to service interest and ongoing viability. Following the transfer to GRG, the proposed GRG strategy was stated to be to

enable the connection to RTS. This was despite RBS's assessment that the business was not viable.

Whilst in GRG, RBS levied a number of fees and proposed a risk fee and made a number of PPFA proposals. The GRG Relationship Manager stated *"there is a strong probability that the risk fee at least will not ultimately be realisable and accordingly the above deal is preferable to on-going default with default margin but no risk fee"*.

The problems persisted for a further year and the SCR noted GRG Relationship Manager *"is currently negotiating a short term deal with bullet repayment/ratchet pricing to encourage exit given non-core status"*. A number of pricing changes, arrangement, management and monthly monitoring fees are apparent on file thereafter.

At the end of the Relevant Period the customer remained in GRG, although we understand shortly thereafter a liquidator was appointed – some four years after the transfer to GRG.

Case Extract 44 (Group One)

The Customer's trading business had been impacted by the smoking ban. It decided to diversify by converting the main business premises into flats and entering a new trading market. However, this new business failed when the company lost its main supply agreement.

The original facility letter in relation to the property conversion was approved and facility sanctioned based on the potential development value of the site following completion of the conversion.

There were a number of delays and cost-overruns, and the main contractor went into liquidation. RBS then appointed an independent consultant to undertake a review of the project. Based on their feedback RBS considered that the best option was to provide additional funds to complete the development and to look at the rental income to service interest until the flats were sold. Subsequently a new three year loan was agreed.

The development was eventually completed but no sales were completed over the next two years.

At that point the customer was transferred to GRG. Subsequently RBS became aware of the fact that the borrower had not filed accounts with Companies House for a number of years which would lead to a strike off notice. This, combined with the non-payment of interest on the facilities, triggered a move to GRG Recoveries.

We assessed that the Customer was clearly not viable. The demise of his original business and the loss of his main supply agreement on the second business venture, together with the problems experienced in selling the flats all suggested to us that there were no realistic prospects for this business surviving. It should be noted however that nonetheless a period of almost 5 years elapsed between the loss of the key supply

agreement and the ultimate appointment of a Receiver. During that time additional funds were extended by the Bank, guarantees taken and forbearance was provided.

- 6.2.66. As noted previously a significant proportion of the cases in Group One were property related cases.

Group Two – no inappropriate actions

- 6.2.67. There were few cases where we did not identify any inappropriate action on the part of RBS – just nine out of the 117 potentially viable cases in our Representative Sample (8%). These cases had a range of outcomes with three returning to mainstream banking.

Group Three – inappropriate actions did not give rise to material financial distress

- 6.2.68. This was the largest and most diverse group. Of the 89 cases in Group Three 36% were property businesses.

- 6.2.69. The range of treatment we observed by RBS varied widely. In some cases we had made few adverse findings in our initial case review, whilst in others our findings had been more extensive, including findings relating to:

- Poor turnaround practice;
- Poor valuation analysis;
- Inappropriate pricing, including the application of Upside Instruments; and
- The nature of West Register's involvement in the case.

- 6.2.70. We considered these cases with care to identify whether or not it was likely that such treatment by RBS had resulted in material financial distress.

- 6.2.71. There were three fundamental reasons why customers were placed in this Group – that is why we were satisfied, in all the circumstances of the relevant case, that inappropriate actions by RBS were **not** likely to have resulted in material financial distress:

- The nature of the inappropriate action was largely administrative in form and it appeared to us unlikely that it had led to any measurable financial distress. An example here would be poor transfer communication. Whilst this was common we found no case where, in all the circumstances, we could establish that it had likely led to financial distress;
- The financial impact of the inappropriate action did not appear material in the circumstances of the case. Examples here would be poor pricing or valuation practice, or a rapid reduction in facilities. Whilst we may have concluded that such actions gave rise to **some** financial distress, we concluded that the quantum was not likely to have been material in the context of the business concerned; or
- The customer was in a position to avoid the consequences of the inappropriate action and hence mitigate its material financial consequence. An example here would be where we saw threats to ratchet prices inappropriately, to withdraw facilities or to require Upside Instruments, but the customer had external funds that could be introduced (or it could re-bank) so as to repay debt and/or meet

other Bank requirements, hence avoiding the impact of the proposed action. Where we were satisfied that this mitigating action had not of itself resulted in material financial distress to the business such cases were assessed as Group Three. In this way cases with similar inappropriate actions to those in Group Four could be 'downgraded' because the customer was able to avoid the full impact of RBS's proposed approach.

- 6.2.72. The eventual outcome for Group Three cases was also mixed as is shown in the Table below, with 19 cases (21% of this Group) returning to satisfactory and the same number facing Appointment. The largest number of cases however exited RBS (37% of this Group).

Fig. 32: Outcome group three – inappropriate actions were not likely to have resulted in material financial distress

Group	RTS	Exit	Appointment	Remains in GRG
Three	19	33	19	18

- 6.2.73. The case extract below, whilst not typical of cases in Group Three, illustrates well the issues we had to deal with in making our assessment.

Case Extract 45 (Group Three)

The customer comprised a property development business which completed a retirement homes development project in October 2007. There were loans totalling c£5.2m against a property valuation of £8.15m. Interest was not covered and in early 2009, with lower valuations suggested, the business was transferred to GRG.

The customer proposed a rental strategy and units were let. In 2009/10 new terms were agreed which slightly increased and extended the loan for 2 years and provided for a PPFA with a floor of £300k. However, the deal appears not to have been fully accepted by the Bank and by February 2011 the Bank was urging the *"Relationship Manager to review ability to breach if necessary and restructure"* with similar remarks in September. At this point, valuations, including one by PAU at £4.9m (subsequently reduced by 10%) and an investment appraisal by an external valuer, indicated a value between £1.9m and £2.4m. As the end of the facility (August 2011) neared, West Register was approached by GRG and indicated its interest in bidding for the property.

In around June 2012 the customer bid £3m for the property, but following delays this was reduced to £2.1m which was rejected by the Bank (as was a subsequent upward adjustment). The connection was transferred to recoveries and receivers appointed in January 2013. The property was marketed and a bid made by an unconnected party which the Bank was recommended to accept by the Receiver in July. West Register then bid £3.038m which was accepted and the purchase completed in September 2013. The Bank pursued a PG for £290k lodged by the original owner of the business.

We concluded that the business was potentially viable when transferred to GRG.

In making our assessment of whether the Bank's actions were likely to have caused material financial distress we had regard to the inappropriate actions that we identified. These were:

- Valuations – insufficient work was carried out creating a risk of under valuing the properties;
- Conflict of interest – West Register - the extensive written and informal exchanges gave rise to a material risk of conflict, WR's role went beyond that of a backstop bidder on distressed properties and these conflicts were not considered or appropriately managed in this case;
- Pricing – there was no evidence of an explanation to the customer of the fees levied; and
- Turnaround Practice – the Bank had agreed a strategy for the renting of the units, but then adopted a different approach and dismissed various counter proposals by the customer.

We then turned to consider whether these actions were likely to have caused material financial distress to the business. We took into account the Bank's agreement to the customer's medium-term strategy of renting the properties to provide income to cover interest and potentially provide sufficient funds to start to repay capital. However, the evidence showed that the customer had only regarded that as being a short-term strategy.

We also noted that almost as soon as that agreement was settled the Bank considered that it unduly favoured the customer and sought to unpick it, but it was unable to do so, as the customer was not materially in breach of that agreement. However, the Bank subsequently acted when those restructured facilities came to be renewed.

We also noted that the Bank's action effectively triggered the receivership. We gave very careful consideration to the evidence available to us about the course of bidding facilitated by the Receiver.

We noted that West Register placed the then highest bid, but also that the option of West Register ownership had been actively discussed by officials within the Bank for a considerable period prior to and following Receivership. This case therefore had the hallmarks of the allegations reported by Dr Tomlinson.

The customer had remained in GRG for a considerable period but we also took into account that following the Receivership the Bank waived the floor to the PPFA.

In the circumstances we were unable to conclude that the inappropriate actions of the Bank were themselves the cause of the undoubted financial outcome. The development was the victim of the decline in property values and could not be sold at a price that would meet the amount of the outstanding borrowing. A sale was the most appropriate solution and there was nothing to suggest that West Register had paid a price that was below the true value. The amount offered by West Register was the highest bid that had been made at the time, and exceeded by some margin the

price offered by the customer (albeit at an earlier stage).

The case therefore fell within Group Three.

Group Four

- 6.2.74. We identified 19 cases as falling into Group Four – 16% of the potentially viable cases in our Representative Sample; that is, we considered that, in all the circumstances of the case, the inappropriate actions of RBS were likely to have resulted in material financial distress (beyond that which the business would have experienced in any event).
- 6.2.75. The proximate causes of the material distress we observed in both the Representative Sample and the Tomlinson Cases were case specific, but included:
- Sudden (or at least unduly rapid) requirements to reduce credit facility levels (for example the withdrawal of overdraft facilities);
 - Pricing increases that paid insufficient regard to the customer's circumstances and cash flow;
 - Upside Instruments that appeared to us to be unreasonable in all the circumstances; and
 - A general failure to consider wider turnaround options.
- 6.2.76. In a few cases we were satisfied that the threat of changes to terms was sufficient to place the customer in a position where it had to incur significant costs to either introduce funds from other sources, sell stock in hand at reduced prices, or more generally to re-bank and incur significant unplanned costs.
- 6.2.77. It is difficult to be certain about whether or not in any case the inappropriate actions of RBS played a part in the eventual failure of the business. The outcome of the Group Four cases in the Representative Sample is summarised below.

Fig. 33: Outcome group four – inappropriate actions were likely to have resulted in material financial distress

Group	RTS	Exit	Appointment	Remains in GRG
Four	3	4	9	3

- 6.2.78. The majority of the cases in Group Four were trading businesses (or trading property hybrids). Only two cases were property cases.
- 6.2.79. In two of the 19 cases the actions that were likely to have resulted in material financial distress were Bank actions taken prior to the transfer to GRG. However GRG did not address the problem or resolve it.
- 6.2.80. The following case extracts describe some of the scenarios we saw that resulted in us concluding that a case should be assessed as one where the inappropriate actions of RBS were likely to have resulted in material financial distress.

Case Extract 46 (Group Four)

This relatively unsophisticated customer directly, or through Trusts, had facilities that were used to fund property investments. By 2007 the connection had facilities of nearly £4m, £3.7m of which were priced at B+1.35% and had a tenure of 15 years. The loans were secured on properties originally valued at almost £6m and there were two swaps (IRHPs) running to 2010 and 2017 (notional amounts of £1.3m and £1m respectively).

The Bank (in early 2009) assessed that the value of the properties was such that it may breach the 70% LTV covenant. The facilities were restructured with a 12 month tenure (and some margin increases). Little progress was made on sales and the facilities were renewed for 6 months with a renewal fee. Further short-term facilities were not accepted by the customer and the case transferred to GRG in July 2011. In August GRG applied default interest of 4%. The customer had disputed the swaps sales and the case became part of the Bank's IRHP review. The connection remained in GRG at the end of the period.

We were satisfied that on transfer to GRG the customer remained viable.

In our initial review of the case we made findings on:

- Transfer – the customer was identified for transfer based on a desktop valuation that did not meet the contract requirement for valuation of the covenant. New short-term facilities and fee/margin increases led to a breakdown in relations and the transfer to GRG;
- Viability and turnaround – there was no appreciation of the impact of the swaps on the customer when the Bank restructured the facilities;
- Valuations – insufficient work was carried out and the customer was not given adequate opportunity to challenge desktop adjustments to yields;
- Pricing – increases were imposed with no explanation or analysis; and
- Complaints – customer complaints were largely disregarded.

After considering the Bank's responses to these findings, we were satisfied that the findings were appropriate.

In reaching our conclusions on the financial distress we noted that this was a relatively unsophisticated customer. There appeared to be no clear rationale for the original enquiries into the potential covenant breach; the desktop analysis was inadequate and fell short of what was required. The customer was not given a clear opportunity to challenge the Bank's new assessment and did not understand the impact this could have on his business.

The subsequent short tenure facilities and margin/pricing increases placed a material burden on the business and the Bank had failed to take adequate account of the impact of its actions on its customer – particularly in view of the impact of the long-term swaps on the customer. Whilst we recognised that exit may have been the preferred strategy of the Bank, in the circumstances of the case exit in the short term

was not a viable option for the customer. The Bank could and should have understood this and worked with the customer to find ways to address the issues. We were satisfied that in these circumstances the simple imposition of sales requirements together with increased fees and margins, set against renewals on increasingly short-term facilities represented a series of inappropriate actions that were likely to have given rise to material financial distress for the customer.

We also noted that poor complaint handling practice was likely to have exacerbated the issues from the customer's perspective.

Case Extract 47 (Group Four)

The customer was an owner managed manufacturer and distributor of specialised products that employed about 100 people. The business had interests in two European subsidiaries. In 2009 the group had a turnover of £27.7m with EBITDA of £1.8m. The business faced trading difficulties and, in 2009, had agreed increased facilities. It had also identified that an investment in new equipment would add to efficiency and profitability.

The original owner, who was from overseas, had died in 2005 leaving the business to his son who had no previous involvement in running the companies. One of the deceased's brothers had for some years acted as managing director and continued to do so. We regarded the customer as unsophisticated in their dealings with the Bank.

The Bank considered an IBR was required before additional lending could be agreed and the business was transferred to GRG in October 2010. At the time of transfer to GRG the facilities available to the customer were:

- £1.5m loan for 5 years;
- £200k overdraft facility;
- £3.2m RBSIF Invoice Discounting facility;
- £462k Asset Finance Facility.

A turnaround specialist (XXX) was introduced by the Bank to the business who subsequently was appointed as MD in December 2010. He remained in that role until 2012, but in June 2011 he appointed a Finance Director (YYY).

To fund investment in the new machinery a further facility of £500k was required.

In July 2011 the Bank agreed with the business a restructuring.

The terms were that, in consideration of supporting the existing facilities and granting an additional £500k loan the Bank would take an EPA which conferred on it Preferred Ordinary Shares equal to 40% of the value of the Company. The EPA also permitted the Bank to appoint a "special director" and there was no specified termination date nor were the criteria for determining the value of the shares in the event of termination specified.

The Bank also took a 30% PPFA for a 5 year term over a property valued at the time at £3m. This was a NBV PPFA. Accordingly, West Register would receive 30% of the value, whatever that might be when the PPFA ended.

The PPFA subsequently resulted in the suspension of certain creditor insurance because it was treated in the Company's accounts as a contingent liability due to it having a fixed expiry date.

The Bank also agreed that the company could retain the sale proceeds of certain assets held by the company in Europe.

In October 2011 the Bank introduced another third party (ZZZ) whom it appointed as the "special director". In due course XXX stepped down as Managing Director, his place being taken by ZZZ.

Later in 2012 the Bank agreed to lend an additional £750K. In exchange for this loan SIG required their EPA to increase to 70% (from 40% but retaining voting rights at 40%), the owner to reduce his shareholding to 5% (from 60%), with his PG to be extinguished and the Director's loans that totalled £387k to be equitised. The remaining 25% would be split between senior management (YYY & ZZZ: % tbc). The IRR was confirmed as 30%.

These terms were rejected; an adviser consulted by the owner identified an alternative source for further investment. That investment would be made by the owner of a similar business overseas. When it was suggested that the GRG Relationship Manager meet this new investor he replied internally by email that he: *"had no interest in meeting them with no desire to be anything other than completely dismissive of them in a polite and hospitable manner"*.

In the interim, the trading position improved and in early 2013 the customer looked to refinance away from RBS but first had to "buy out" the EPA.

An initial offer of £400k made in April 2013 was rejected by the Bank. Internal communications show that the Bank valued its shareholding at "£2m+".

The file contains an email passing internally between personnel in GRG/SIG in which one responds to the other that he would respond to the offer *"short and sweet, no rejection/no agreement/no counter offer. It's a bit like the Kissinger school of negotiation. Don't open the first three letters and then read the fourth"*.

Negotiations followed; the Bank rejected an offer of £1.5m made on behalf of the customer, and the customer rejected an offer made by the Bank at £2m. The position remained unresolved until after the close of the Relevant Period.

In the event, in 2014, the Bank accepted only £1 for the EPA, £100k for the PPFA and was repaid its lending of £4.8m as part of a management buy-out.

- 6.2.81. Consideration of Upside Instruments formed an important component in our assessment of whether or not customers suffered from material financial distress. In relation to this example, we concluded that such distress had been caused by the Bank's inappropriate actions. The terms for the provision of the required further funding were

excessive in all the circumstances and led to a marked reduction in the owner manager's equity share of the business. That pricing, together with the impact of the PPFA on the accounts and the ability to secure credit, plus the restrictions placed on the way the owner manager operated (through the effective imposition of Bank appointees to senior positions), resulted in a significant distortion of management effort and were likely to have given rise to material financial distress to the business.

- 6.2.82. We recognised that some additional return on lending was appropriate in this case given that further lending was provided, and the business represented an increased risk. Equally we considered that the value of the PPFA and the EPA were unresolved at the end of the Relevant Period. However with the Bank rejecting a £1.5m offer, we were satisfied that the financial impact on the business was clearly material.
- 6.2.83. We also noted that the overall costs incurred by the business from the charges for consultants/employees required or recommended by the Bank, together with additional professional fees were material in the context of this business.
- 6.2.84. The business remained in GRG for over three years and the position was unresolved at the end of the Relevant Period.

Case Extract 48 (Group Four)

This case concerned a business connection focused on care homes and a hotel with debts of around £1.8m in 2008. In August 2008 the Bank sanctioned new lending of £3.9m for a residential property portfolio. At around the same time the Mainstream Relationship Manager discussed a new loan of £950k in respect of the hotel to refinance the existing loan and to provide development funding. The customer acted on the verbal agreement. Following further information the Bank withdrew the finance offers. With cash pressures evident the connection was transferred to GRG in March 2009.

There were ongoing problems with MI and winding-up petitions from HMRC. The care homes received a poor CQC inspection. The Bank required an IBR to be carried out. The customer reduced debt following the sale of properties in September 2010. The Bank proposed new fees and actively encouraged repayment of the entire debt. The customer re-banked in March 2011.

We were satisfied that on transfer to GRG the customer remained viable.

In our review of the file we made findings on:

- Identification of the customer for transfer - the customer relied on the verbal confirmation that the Bank would provide funding, resulting in costs being incurred that led to cash flow problems. The Bank discounted the impact of its own role in these problems.
- Transparency of the transfer process – the Bank failed to explain adequately the transfer and role of GRG.
- Independent Business Reports – the customer did not receive a copy

of the draft report.

- Pricing – the Bank set a £10k/m fee for continued support (October 2010). The rationale for that fee was not adequately explained and appears questionable and to have been motivated by the desire to have a 'lever' to encourage exit.
- Complaints – the Bank's complaint process was not complied with.

We were satisfied that these findings remained valid. In particular, we considered carefully the information available to us surrounding the 'offer' in respect of the hotel and its subsequent 'withdrawal' by the Bank. On the balance of the evidence available to us we were satisfied that a clear verbal offer of funding had been made and that the customer, not unreasonably, acted in reliance of that offer.

We then addressed the issue of material financial distress.

We noted that many of the problems that the customer experienced appeared to stem from poor management of the business but noted that overall the business appeared to be able to cover the debt levels. Whilst a transfer to GRG was not unreasonable, given the winding-up petition, we considered that the problems the business experienced appeared to stem, at least in part, from the expenditure the customer incurred acting in reliance of the verbal offer made by the mainstream Relationship Manager.

We considered that at the time the Bank recognised that the Mainstream Relationship Manager had effectively committed the Bank to the lending and were not convinced by the suggestion that this offer had clearly been made on the basis of specific conditions that the customer failed to satisfy.

We looked at the pricing proposals made by the Bank and in particular the £10k monthly fee. Whilst this fee was initially accrued and subsequently waived by the Bank following a complaint by the customer, there was no satisfactory justification for this level of fee in the circumstances of this case. Whilst the customer had missed some payments he had also introduced funds to reduce debts. We concluded that the primary rationale for these prices was to encourage re-banking and noted that the Bank itself had recognised that the fees might have been difficult to justify.

Overall we considered that the customer's position was materially distressed by the way in which the Bank handled the oral agreement of the hotel related loan. On balance we were satisfied that the loan had been agreed to and accordingly the withdrawal of that offer meant that he was committed to meeting contracted payments with limited facilities. This led to the business's cash flow position worsening and required the owner to introduce funds. Even if it is not correct to consider the oral agreement as a binding offer, we considered that the Bank at least recognised and should have acted on the fact that the circumstances surrounding the loan were doubtful. At a minimum the Bank should have considered more carefully the steps it should therefore have taken to assist the customer.

Whilst the customer was given some time to re-bank, we considered that pricing at a

level that was difficult to justify was used to encourage re-banking.

Our conclusions

- 6.2.85. We concluded that 92% of potentially viable customers, in our Representative Sample, experienced some form of inappropriate action by RBS. In the majority of cases however we concluded that it was likely that that inappropriate action did **not** result in material financial distress.
- 6.2.86. In 16% of the potentially viable cases in our Representative Sample we concluded that the inappropriate actions **were** likely to have resulted in material financial distress. Not all of these cases concluded with the insolvency of the businesses concerned. However, in our view, the impacts we observed could reasonably be described in several cases as contributing to a journey towards administration, receivership and liquidation.
- 6.2.87. We noted that adverse outcomes were **more** likely in the case of trading based businesses (in the case of 22% of potentially viable trading/other businesses we concluded that material financial distress was likely to have been caused), and in respect of those cases referred to us by Dr Tomlinson (28%). Where we had been able to speak to the customer to widen our evidence base we also saw a higher incidence of material distress (25%).
- 6.2.88. We noted that adverse outcomes were **less** likely in property related cases in our Representative Sample (5% of the Representative Sample) and in cases where we had not been able to speak to the customer (7%).
- 6.2.89. The data set was too small to draw robust conclusions on whether there were differences based on factors such as the date of transfer or GRG region handling the case. However, we observed Group Four cases across a range of offices and time periods.
- 6.2.90. Accordingly, we concluded that the inappropriate actions⁹⁸ of RBS Group were likely to have caused material financial distress to otherwise viable businesses. We concluded that the material financial distress we observed were not the result of isolated poor decisions by GRG staff. The proximate causes were case specific, but included:
- Sudden (or at least unduly rapid) requirements to reduce credit facility levels (for example the withdrawal of overdraft facilities);
 - Pricing increases that paid insufficient regard to the customer's circumstances and cash flow;
 - Upside Instruments that appeared to us to be unreasonable in all the circumstances; and
 - A general failure to consider wider turnaround options and identify and implement appropriate alternatives where they existed.

⁹⁸ Some of which we concluded were widespread and/or systematic.

- 6.2.91.** Although the proximate cause of distress varied, the themes of treatment were widely observed in our sample of cases and did not just occur in respect of those cases where we found RBS's inappropriate actions were likely to have resulted in material financial distress.

Part 7 – Recommendations

- 7.1. Throughout this report, we have identified issues relating specifically to RBS, but we also believe that there are wider lessons for RBS and for the industry as a whole. In this Part we draw together specific recommendations for RBS and draw out some wider observations in the light of our findings.
- 7.2. The FCA has instigated a review of its own approach to SMEs as users of financial services⁹⁹ and we see our report and its recommendations as a contribution to that work. There are also important implications for other lenders, the professionals with whom they work, policy makers, and SME customers.

Recommendations for RBS

- 7.3. The conclusions we have reached in this report warrant a fundamental rethink by RBS of how it handles its SME customers in financial distress¹⁰⁰.
- 7.4. We recognise that some change was already being made at the end of the Relevant Period. But the terms of reference for Phase One meant that we did not review whether or not the lessons from these events have been learnt by RBS, or whether the wide-ranging changes that we consider to be necessary have been made and are embedded. As we did not review changes made by RBS after the end of the Relevant Period we recognise that some of the recommendations set out below may already have been addressed or their relevance superseded by subsequent events. But nonetheless they provide a framework within which future treatment of SME customers can be developed and provide an opportunity to address the weaknesses in governance and oversight, and indicators of poor culture in GRG that we have highlighted in this report.
- 7.5. **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.**
- 7.6. **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;

⁹⁹ FCA Discussion Paper DP15/7: 'Our approach to SMEs as users of financial services', November 2015

¹⁰⁰ In this Part our references to SME customers are intended to be understood more widely than the Requirement Notice definition used elsewhere in this report.

- 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;
- **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 unit¹⁰¹;
- **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.

7.7. Addressing these recommendations will help ensure that similar problems to those experienced in RBS's GRG during the Relevant Period do not occur in future. These

¹⁰¹ RBS has told us that West Register is in the process of being wound down and that assets held by West Register are to be sold.

recommendations do not, however, address the concerns and issues of those SMEs that were handled by GRG. We make two recommendations that are intended to address specific unfairness that we observed during the course of our review. These are:

- xxiii. Revisit the cases identified in our 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.

7.8. But those specific recommendations do not address the central findings of our review. We have identified a number of cases where we conclude that the actions of RBS are likely to have caused material financial distress to the customers affected and there are other cases where it seems clear that the customer will have suffered from some unfairness. It is understandable that there will be calls for RBS to compensate the customers affected.

7.9. As we have noted previously the extent and nature of financial distress vary considerably and are often hard to quantify with any precision. The circumstances of GRG customers often meant that the Bank had considerable discretion under the law, and those individuals who suffered may not have a straightforward legal position in any case, for example because the company was the Bank's customer, and they may no longer be the owners, or the company may have ceased to exist. The inappropriate actions we identify and their wide ranging consequences for customers were not caused by breaches of regulatory rules or principles. So the scope for regulatory action is limited.

7.10. Responsibility for responding to these issues and the distress GRG caused many of its customers rests with the Board of the RBS Group. We do not underestimate the challenges of any redress scheme. It would likely require independent, lengthy and complex mediation, operating outside the strict legal framework.

7.11. **Nevertheless 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.**

7.12. There are also some wider issues for RBS to consider. First the extent to which the issues we report here in respect of GRG were or in particular remain features of other units handling SME customers. **We recommend that RBS reviews the relevance of these findings more widely to its handling of SME customers.**

7.13. Second the terms of the Requirement Notice meant that we did not review the extent to which those in RBS outside GRG were aware of the issues. In any event it appears to us that there are wider lessons for RBS to consider in terms of how the events in GRG could have continued for so long apparently either unnoticed or unchallenged by others in the wider RBS Group.

Lessons for the wider market

- 7.14. The FCA has, as noted above, instigated a review of its own approach to SMEs as users of financial services. Our report and its recommendations can be viewed as a contribution to that work. Our findings highlight the diversity of SMEs and the inequality of bargaining power between less sophisticated SMEs and banks. They also underline the lack of protection available more widely to SMEs.
- 7.15. The case for standards – established either by regulation or by agreement – in relation to lending to SMEs is derived from the special features of the market, as described in the CMA/FCA Market Study and the wider CMA Retail Banking – SME market investigation¹⁰²: a sector with high concentration in lending, the lack of understanding of many SMEs as to the pricing of banking products including loans, and the paradox of simultaneous low levels of satisfaction and of switching among SME bank customers. As our work has shown, SME customers facing hardship may have even more limited choices. They will often have little realistic prospect of changing their banking arrangements – whatever their level of satisfaction or dissatisfaction with the services provided, and whatever the price of those services. This is particularly the case during periods of economic uncertainty.
- 7.16. The SMEs in our sample illustrate the variety of SMEs that banks have to deal with. They included some SMEs with a reasonable level of financial sophistication who had available to them expert advice; but they also included SMEs without access to independent advice, and with little financial experience. Even when a SME had some reasonable understanding of financial issues, this was not necessarily sufficient for the increased complexity of the issues which often arose once the SME was transferred to GRG, where the situation could be complicated both by general legal issues such as the different protections and treatments offered to limited companies and to sole traders, and by the complexity of the solutions which GRG on occasion brought forward. There were other important differences. Some were in effect sole traders or owner managers where the sickness of a key individual could have catastrophic consequences for the business. For some smaller customers the lending was closely intertwined with personal financial arrangements, so that when things went wrong in the business the consequences were personal as well as professional.
- 7.17. We have noted that GRG had few arrangements for drawing such distinctions in its customer base and for shaping its services and communications with an eye to these differing levels of capability. Indeed, it is not clear that RBS now accepts the need for this.
- 7.18. We believe that policies and practices for the SME sector need to be based at least in part on an appreciation of differing customer capabilities, if the SME customer is to be treated fairly. This is not readily defined by arbitrary limits such as amounts of debt or even turnover. But it will be relevant to take account of the stage in the banking

¹⁰² Banking services to small and medium-sized enterprises: A CMA and FCA market study, July 2014

relationship reached by the customer, to ensure that products, services and communications are appropriate for the needs of the SME customer.

- 7.19. The present regulatory protections for SME-related conduct are limited. Given the widespread inappropriate actions identified in this report in relation to lending activities, **we consider that the FCA should work with the government and other relevant parties to extend the protections available to SME customers.**
- 7.20. One option would be to extend the regulatory perimeter to bring SMEs within the scope of FCA's regulated activities, to ensure that regulatory action can be taken to guard against unfair treatment of customers and that the principles for business and standards of good governance and personal responsibility apply to this sector as they do to other parts of retail banking. However a higher priority may be to give SMEs avenues to challenge banks where they are treated unfairly. For example consideration should be given to extending the unfair contract terms protections to SMEs, and giving them greater access to the FOS.
- 7.21. Contracts with SMEs for the provision of credit facilities and other services can be markedly more complex than their retail market equivalents. In part this reflects limited protections for SMEs – in particular the Unfair Terms in Consumer Contracts Regulations (UTCCRs)¹⁰³.
- 7.22. As a result, SME contracts can give banks wide discretionary rights to vary terms that would not be compliant with unfair contract terms provisions in a retail setting. The lack of unfair contract terms protections, taken together with the restricted access to redress/dispute mediation for SMEs, can give rise to a risk of unfair treatment of customers. Whilst some discretion may be inevitable given the nature of the products involved, the ability of banks to change lending criteria, or to treat many loans as well as overdrafts as 'on demand', means that banks have a wide discretion that SMEs cannot readily plan against or challenge.
- 7.23. The Law Commission's recommendation¹⁰⁴ that Unfair Terms in Consumer Contracts provisions should be extended to at least some SME customers has not been progressed. Coupled with the restrictions on access to dispute resolution services, this can place SMEs at a material disadvantage.
- 7.24. A concern raised by many SME customers in our sample related to the absence of any serious consideration of their complaints. While RBS had a policy to respond to complaints in line with its requirements under regulatory rules, many SME customers were not micro-enterprises and as such complaints from them were not covered by DISP. That meant the Bank had no regulatory obligations to handle complaints promptly, to investigate them fairly or to consider the root causes of such complaints. And there was no obligation to record and report on those complaints or to publish information about them.

¹⁰³ Now part of the Consumer Rights Act 2015

¹⁰⁴ Unfair terms in contracts report, Law Commission, February 2005

- 7.25. For customers other than micro-enterprises there is no access to the FOS. The ability, alternatively, to litigate for most of these customers will be limited; litigation is notoriously slow and costly and detracts from the running of the business. FCA is committed to reviewing the scope of FOS following the report of the Banking Standards Commission. But the micro-enterprise definition is not the only barrier facing SMEs in their dealings with FOS. Even for micro-enterprises, the FOS award limit (£150,000), coupled with the inability to litigate for any additional compensation following a FOS decision, limits the relevance of FOS as a redress option.
- 7.26. **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.**
- 7.27. An alternative (or supplementary) approach would be to develop professional standards governing banks' lending to SMEs. The Lending Code applies to some SMEs, but only micro-enterprises. It includes some provisions on helping micro-enterprises who are experiencing financial difficulties and complaints handling. The Lending Code is monitored by the Lending Standards Board.
- 7.28. In relation to turnaround divisions the need for additional protection for SME customers is more acute. At present there are no generally recognised professional standards for turnaround or restructuring units in the UK, although various guides and codes exist which are seen as relevant. These include for restructuring the IMF Restructuring Guidelines, the 'London approach' and the INSOL Principles. Both the Insolvency Practitioners Association and the Institute for Turnaround publish codes of ethics, and the latter has recently published a 'Statement of Principles for the UK 'Business Support Units' of Banks'¹⁰⁵.
- 7.29. The principles cover issues we identified as part of our review, including provisions on treating customers sympathetically, communication, appropriate pricing and complaints handling. They have been endorsed by several banks. However, there is little transparency about what banks have done to ensure that they meet the principles, and it seems no independent monitoring of compliance with the principles. It is unlikely, therefore, to give customers confidence that this will make a difference to their treatment in future.
- 7.30. Both the Lending Code and the Institute for Turnaround Statement may have a useful role here. What is important is that any self-regulatory action has the confidence of both banks and customers and has demonstrably effective independent oversight and monitoring.
- 7.31. **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.**

¹⁰⁵ IFT Statement of Principles for the UK Business Support Units of Banks, 2014

- 7.32. The situation in RBS and GRG was particular to that organisation at that time. Nevertheless the themes raised in this report may have wider resonance as banks consider how they should further develop turnaround units. For example, a concern that was raised with us by some stakeholders was the nature of the relationship between lenders and various professional firms that support the turnaround or insolvency process.
- 7.33. Inevitably banks are a major user of accounting/insolvency, valuation and legal services. Given their scale and scope providers of these services will understandably wish to have strong and constructive relationships with banks. A complex pattern has emerged of links between individual suppliers and banks which, it is argued, includes frequent use of secondees from professional firms, complex and sometimes non-transparent fee and revenue agreements between advisers and individual banks, and questions around the control of sensitive information between the banks and their advisers.
- 7.34. Such issues can give rise to concerns about the availability of qualified third-party support with the relevant experience to support customers (given that most with experience will have extensive conflicts with the banks serving those customers). There is also a perception that customer perspectives will be ignored because of the commercial significance of meeting wider bank requirements where a bank is a major client of a specific adviser and that the professionals may be too ready to see the bank's point of view.
- 7.35. In the case of GRG we identified weaknesses in the management of potential conflicts of interest, in particular around the use of secondees. It was not surprising that many customers were left with the impression that third-party providers were too close to the Bank. But a more general comment is that, whether or not such behaviours take place, the absence of agreed standards can create a suspicion of inappropriate practice, particularly where clients are facing economic distress, even if this may not in fact exist.
- 7.36. **We suggest that banks should review how they interact with third-party providers, especially in relation to secondees.**
- 7.37. **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.**

Annex I – Requirement Notice

FCA RESTRICTED

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.

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Phase 1

The purpose of Phase 1 is to form a view of RBS Group's treatment of small and medium size enterprises ("SME") customers¹ referred to Global Restructuring Group² ("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 systematic³; 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.

¹ In this Requirement Notice, "SME customers" is given the meaning provided at Annex F.

² In this Requirement Notice, save where otherwise described, "Global Restructuring Group" means the units/business areas described at paragraph 1 of Annex F.

³ In this Requirement Notice, the use of the word "systematic" refers to an intentional and co-ordinated strategy.

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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 Emma Taggart at The Financial

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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 Emma Taggart at 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 Emma Taggart at 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 Emma Taggart at 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.

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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.

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FCA RESTRICTED**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

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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

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FCA RESTRICTED**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:

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- (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.

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- (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.

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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).

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- (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:

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- (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 parties^a.

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;

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

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(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 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 litigation⁵ 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.

⁵ "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

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- (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.

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.

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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

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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.

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FCA RESTRICTED**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.

FCA RESTRICTED**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

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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.

FCA RESTRICTED

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/procedures⁶ 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.

⁶ From the 'review period' – with particular regard to current versions in operation (where relevant).

FCA RESTRICTED**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);

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FCA RESTRICTED

- 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.

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FCA RESTRICTED**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 PERSONS 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: 13 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:

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

- a. Business Restructuring Group ("BRG");
- b. Strategic 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 customer" 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.

Annex II - Glossary

AMO	Asset Management Objective	The objective of the APS, which is to maximise the expected Net Present Value of the Protected Assets, including by minimising losses and potential losses and maximising recoveries and potential recoveries in respect thereof.
APA	Asset Protection Agency	An executive agency of the Government created in 2009 to implement the APS.
APS	Asset Protection Scheme	A Government insurance scheme created in 2009 during the financial crisis to protect banks against exceptional losses.
B&C	Business & Commercial Banking	Provides banking services to small and medium sized businesses with turnover up to £25 million.
BRG	Business Restructuring Group	Relationship and credit management of connections in GRG from £1million to £20million RBS group aggregate exposure
C&Q	Concerns & Queries	A computer system where complaints should be logged.
CCC	Customer Complaints Centre	A unit established in September 2010 for complaint handling that is managed by a dedicated team of case handlers.
CSS	Customer Satisfaction Survey	An independent satisfaction survey, undertaken annually by Ipsos MORI, on a random sample of 500 GRG customers.
Customers		Given the meaning set out in Chapter 2.2 (About our investigation).
DAP	Distress Assessment Panel	This Panel consisted of senior members of the project team, and ensured that a range of skills, knowledge and relevant experience was brought to bear to the decision making on each case.
EMEA	Europe, Middle East and Africa Region	

EPA	Equity Participation Agreement	Acquiring equity in a business, explained in more detail in Chapter 5.2 (Strategic Investment Group).
ExCo	GRG Executive Committee	Responsible for establishing the strategy and strategic objectives for GRG, including the setting of risk appetite; ensuring GRG is appropriately led and managed, in line with its sanctioned strategy and debating and authorising significant business and functional matters.
FCA	Financial Conduct Authority	Regulates financial firms providing services to consumers and maintains the integrity of the UK's financial markets. Formed as one of the successors to the Financial Services Authority (FSA).
FOS	Financial Ombudsman Service	An ombudsman established in 2001 as a result of the FSMA to help settle disputes between consumers and UK-based businesses providing financial services.
FSA	Financial Services Authority	See FCA.
FSMA	Financial Services and Markets Act 2000	
FTE	Full Time Employee	
GRG	Global Restructuring Group	Undertakes active management of the Bank's problem lending portfolio.
HMRC	Her Majesty's Revenue & Customs	A non-ministerial department of the UK Government responsible for the collection of taxes, the payment of some forms of state support, and the administration of other regulatory regimes.
GRG Management		Those managers who might reasonably have been expected to take responsibility for the oversight and control of the processes we discuss.
IBR	Independent Business Review	A business review carried out by an independent professional accountancy firm.

IRR	Internal Rate of Return	A calculation of the rate of return on loans.
Large Report		The 'Independent Lending Review of RBS and NatWest's lending standards and practices for UK SMEs published on 25 November 2013
LTV	Loan-to-value	A percentage figure derived by dividing a loan amount by the value of the asset(s) against which it is secured.
ManCo	GRG Management Committee	Responsible for ensuring the overall strategy of the ExCo is being delivered, including people resourcing and retention.
P&L	Profit & Loss	A financial statement that summarises revenue, costs and expenses over a specific period of time (usually one year).
PAU	Property Advisory Unit	A team in GRG (wound down in April 2012) that gave guidance on property valuations and property issues.
PD	Probability of Default	The likelihood of a customer failing to trade satisfactorily and to service financial obligations. It is calculated from the Risk Rating questions within the Risk Rating Screen and Audited Financial information (also known as MGS).
PIK	Payment in Kind	When a bond pays in kind, it means that the amount of principal owed to the bondholder is increased in lieu of paying interest.
PPFA	Property Participation Fee Agreement	A deferred variable fee arrangement whereby customers agree to pay a fee in the future calculated by reference to increase in the underlying property value.
RBS	Royal Bank of Scotland	Or "the Bank". The Royal Bank of Scotland Plc.
RBS Group		RBS, National Westminster Bank plc and certain related companies.
RBSIF	Royal Bank of Scotland Invoice Finance	Provides customers with factoring and invoice discounting products that assist customers with their cash flow management.

REAM	Real Estate Asset Management	See WR.
Relevant Period		1 January 2008 to 31 December 2013, as further defined in the Requirement Notice.
Representative Sample		A statistically representative sample of cases that satisfied the definition of an SME (agreed with the FCA for the purposes of this review). A total of 178 cases were reviewed under this category.
Requirement Notice		Or “the Notice”. The terms of reference for our review, set out in Annex I.
RICS	Royal Institution of Chartered Surveyors	An independent, representative professional body which regulates property professionals and surveyors in the United Kingdom and other sovereign nations.
RM	Relationship Manager	A Bank employee who manages (primarily) a customer's lending relationship but will also be accountable for other elements of the relationship, for example Anti-Money Laundering regulations.
RTS	Return to Satisfactory	The return of a case to a B&C Relationship Manager where the lending meets current B&C lending criteria (or otherwise agreed) and is trading satisfactorily.
RWA	Risk Weighted Assets	A measurement of credit risk, market risk and operational risk that helps to establish minimum capital requirements.
SCR	Strategy & Credit Review	Committees of senior and experienced GRG RMs and directors that review exposures periodically.
SIG	Strategic Investment Group	A separate unit within GRG which provides advice and support on negotiating and managing Upside Instruments in respect of lending which falls outside the Bank's normal risk profile.
SME	Small & Medium Enterprises	Given the meaning set out in the Requirement Notice.

SMU	Strategy Management Unit	Part of BRG but a credit only function for where RBS Group exposure is generally less than £1m.
SRM	Specialised Relationship Management	Provides a specialist credit focused relationship expertise to B&C Banking and Lombard. Part of B&C not GRG.
Systematic		Given the meaning set out in the Requirement Notice and in Chapter 2.2 (About our investigation).
TCF	Treating Customers Fairly	Treating Customers Fairly is an FCA initiative that aims to ensure fair outcomes for customers. It includes six customer outcomes that financial institutions have to adhere to.
Tomlinson Report		'Banks' Lending Practices: Treatment of Businesses in Distress' published on 25 November 2013.
Upside Instrument		See EPA and PPFA.
Widespread		Given the meaning set out in the Requirement Notice and in Chapter 2.2 (About our investigation).
WR	West Register	The vehicle used by RBS to acquire property assets from distressed situations; mandated to consider purchasing any property asset where the property loan is distressed, and where the property is being offered for sale. Now known as REAM.

Annex III – Our initial case findings

We made findings in our initial review of cases around thematic areas reflecting the issues raised by the Requirement Notice. A finding did not necessarily evidence that a case demonstrated fully the particular issues raised in the Notice (or the allegations made in the Tomlinson Report). Rather, we made findings where we identified actions by the Bank that appeared to us to be inappropriate. When grouped by theme, the breakdown for the 207 cases is as follows.

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%

Annex IV – Just Hit Budget

This annex reproduces a document produced by a GRG team leader and was widely circulated in at least one regional office in BRG in 2009/10.

Just Hit Budget!

Tactics:

1. Manage expectations

- Set the tone at the handover meeting.
- Handover presentation puts a marker down in the first 10 minutes.
- Fit the solution to the problem.
- Get sanction!

2. Maintain the momentum

- follow up with handover letter, ideally with a facility letter even if only for a short period.
- The ball should hardly ever be in our court – nag sanctioners.
- Anticipate delays – credit docs turnaround, flag up key equity points before the documentation is issued.
- Leverage upsides with high initial monthly fees that substantially reduce upon completion of the upside (██████████ was £9.5K now £750 with PPAs).

3. Deliver

- **30 day's notice:** Under standard Bank terms and conditions we can change terms and conditions with 30 days' written notice – hence post-handover letter. With a fresh facility letter, no notice period is required...as long as they sign!
- Monthly fees or else!
- Record each deal on RMP. If it's not on RMP, your deal does not exist.

Tips:

- **Use facility letters:** If they sign, they can't complain. Heads of Terms cannot be enforced.
- **Basket cases:** Time consuming but remunerative.
- **Perfect deals:** they don't exist – if GIRG NAME unhappy and customer's unhappy then you probably have the balance right.
- **Deal or no deal?** No deal, no way. Missed opportunities will mean missed bonuses. You can always revisit an earlier deal.
- **Handover debt:** if you formalise the handover debt: not new money but customer likely to sign the facility letter to confirm the new limit, avoids immediate excesses and locks in immediate income.
- **Be specific:** avoid round number fees - £5,300 sounds as if you have thought about it, £5K sounds like you haven't.
- **Rope:** Sometimes you need to let customers hang themselves. You have then gained their trust and they know what's coming when they fail to deliver.
- **Never:** Issue "until further notice" overdraft letters.

16 Ways to generate income:

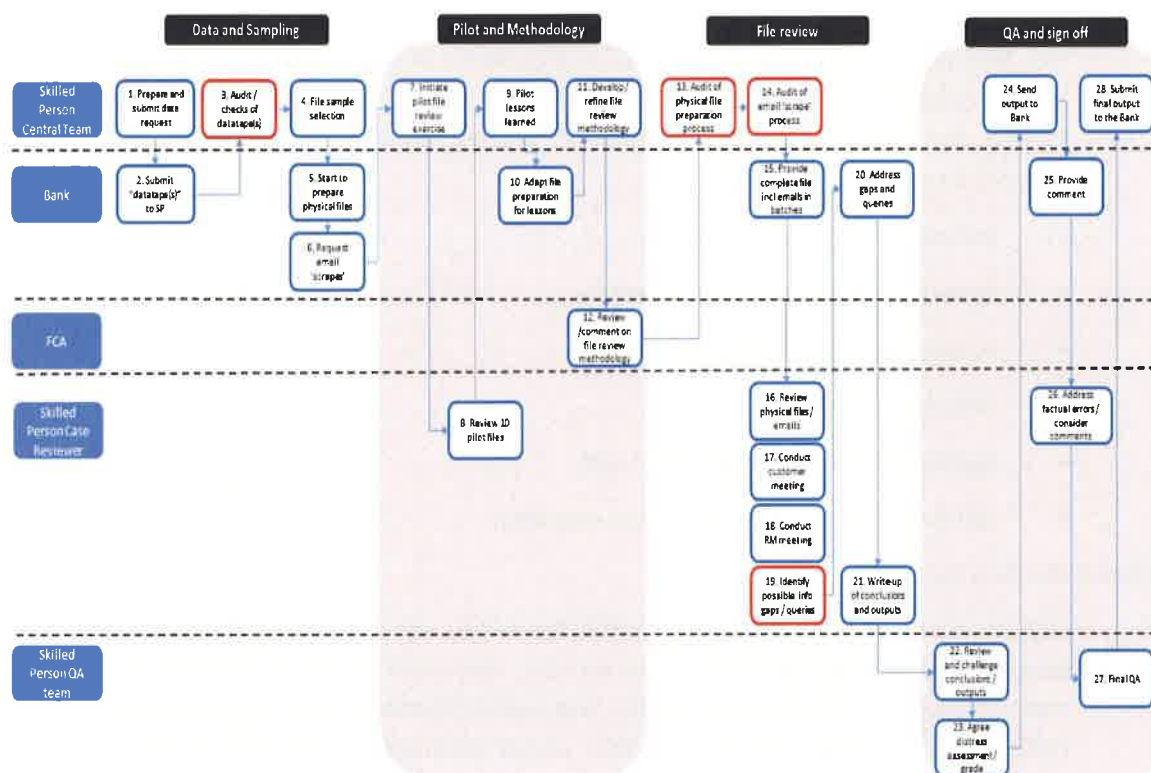
1. **Monthly fees:** minimum £500. Ideally on average we need c10% premium on our debt (current return will be <5%, mezz return should be about 15%). E.g. Debt £2m suggest £200K premium i.e. monthly fee £16K! They normally cannot afford this and you can then leverage an upside. Set up recurring income action on RMP. Diary note for when they expire.
2. **Exit fees:** Normally monthly 0.5% of all the balances to drive a re-finance. Consider ratcheting. Useful for property developments.
3. **Facility fees:** Aim for 2% but if doing a restructure aim much higher although may have to add to our debt.
4. **Redemption premiums/Other upsides:** Include in new loan facilities if significant (min. 10% premium) and deferred e.g. £50K in 6 months time then record as "other upside". Use with caution.
5. **Conditional Support Fees:** E.g. equity concluded by date X or fee £Y applies – helps deliver a deal or secure income if deal falls away.
6. **Default Interest Rates:** Check each loan facility prior to handover, formal notice of default required, refer to the paragraph, change back office and register the margin enhancement. Need to allow 3 days for them to remedy the breach.
7. **IIS:** Care – no margin enhancements and no fees, but if a refinance likely then you can claim back all the IIS! (████████ £600K). Also turns off Bankline, practically may have to have IIS only on loans.
8. **Excess fees:** Charge for any pre-notified excess.
9. **Non-receipt of MI:** Minimum £100 per month.
10. **Margin enhancement:** Minimum margin should be as per Bank matrix unless/until you agree an upside. Claim the margin until new limits formalised.
11. **New money:** With a new money action on RMP you can claim ALL the margin on the new money
12. **Royalty fees:** If equity going to have no value, consider a percentage of turnover (formal documentation available).
13. **Service charge:** We should have everyone on standard tariff. [STAFF] and [STAFF] can help.
14. **RBSIF:** You can claim one off "notional income" for the margin on RBSIF facilities if they drawdown and you introduce them. E.g. RBSIF drawdown with £1m funds in use limit at 3% margin – you get £30K income.
15. **GBM:** They should email us with income elements of SWAPs etc. when they enter them and when they redeem.
16. **Security fees:** Standard pricing per item per the standard Commercial Bank tariff to apply – on taking as well as on releasing.

Notes

Source: RBS. We have redacted customer identities and removed staff names.

Annex V – Methodology – case file review

- The following diagram illustrates the end-to-end case file review process at a high level. Broadly speaking the key steps can be grouped into four key pillars of work as depicted below. The diagram highlights key stages where we conducted audits and checks of Bank data and information.
- It also highlights the segregation of responsibilities within our team i.e. the central team, the case review team and the QA team.



Data and sampling

- The Requirement Notice stated *"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 and to be able to put those allegations in context..."*. *"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 Relevant Period, broken down by the number of cases in each Outcome Pool....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."*
- The Requirement Notice described four "outcome pools" as the basis for sample selection. These outcome pools were listed as follows:
 - Cases that resulted in insolvency;
 - Cases that returned to the main bank;

- Cases that exited RBS borrowings; and
- Cases that remain in GRG as at 01/01/2014.

Agreeing an SME definition

5. The initial FCA Requirement Notice refers to the inclusion of SME customers from GRG but did not provide a definition of SMEs. Neither does the Tomlinson Report. A definition of an SME was required to be agreed for the purposes of the conduct of the section 166 review. The initial Requirement Notice was amended to include a definition of an SME customer.
6. This SME definition specified that the full population of cases from which our sample has been drawn would include all cases classified as SMEs and managed across both RBS GB and RBS NI in the period from 1st January 2008 to 31st December 2013. It included all customers managed by:
 - Business Restructuring Group;
 - Strategic Relationship Management;
 - Strategic Management Unit;
 - GRG Recoveries;
 - Real Estate Asset Management; and
 - Northern Ireland (BRG Recoveries and SRM).

Agreeing the data set

7. The process of selecting a sample of cases for review was of critical importance to this assignment. We followed a structured process, supported by a best practice sampling methodology¹⁰⁶ to select a sample that was representative of the GRG population, of sufficient size to detect any abnormalities and of minimum bias. Broadly speaking, this included:
 - Preparing and submitting a data request to the Bank (i.e. customer data that we would need to allow us to select a representative sample);
 - Receiving the 'data tape' from the Bank (i.e. the customer data);
 - Carrying out a series of audit and quality checks on the 'data tape' provided by the Bank. This included running a number of queries on the data for logic errors, incorrect field populations (e.g. numbers in alpha fields), completeness checks and cross referencing the data received to the data request. In total the Bank submitted three versions of the data to us before we were satisfied that the quality of the data was adequate to allow us to select a sample of cases;

¹⁰⁶ This sampling methodology has been developed in compliance with UK National Audit Office guidelines (NAO - A Practical Guide to Sampling - Statistical and Technical Team).

- Stratifying/segmenting the data into the four FCA outcome pools and across other characteristics including core/non-core classification, regions (GB /NI) and year of entry to GRG; and
- Selecting the sample of cases for review.

Selecting the sample

8. We selected a sample of cases that satisfied the definition of an SME agreed for the purposes of the Review, following careful sampling design. A statistically representative sample allows the drawing of inferences about the whole population. In order for the analysis to be robust, each group must be homogenous and of a sufficient size to select a sample from. We were satisfied that the outcome pools met these criteria. Ultimately, the sample methodology aims to give us the confidence that if we find issues in 10% of our sample, this is likely to be representative of the population as a whole. Clearly, no estimate taken from a sample can be exact, and observations about the population has an attached margin of error. We targeted an average of $\pm 10\%$. We also targeted a confidence level of 90% (that is the likelihood that the results obtained from the sample lie within the associated precision).
9. On this basis, we determined a statistically representative sample across all four outcome pools would equate to 178 cases (of a total of 5,900 cases). Over time, and throughout the file review process, we identified data tape quality issues which resulted in a file being invalid for sampling purposes. In these cases, we replaced the case with another case with similar characteristics. In total, we replaced 20 cases.
10. An additional 29 cases were added to the sample representing customers that had complained directly to Dr Tomlinson (as agreed between us and the FCA), including a number that had formed part of the original Tomlinson Report. We agreed (with Dr Tomlinson) that we would not disclose the identities of these customers separately from those of the Representative Sample. The total sample of cases reviewed including these 29 cases was therefore 207.
11. In addition, throughout the review process, we received complaints directly from customers and through various channels (i.e. the FCA, Bully Banks, the Department of Business, Innovation and Skills). We undertook a 'triaging' exercise in order to identify those customers within the scope of our review. Where information was provided for cases in our sample, this information was also reviewed as part of the case file review.
12. We supplemented this core sample with a sample of 31 SRM cases for review. The original intention was to use this as a control group. However, we completed the reviews on eight of the cases in this sample (those being cases where customers had agreed to speak with us as part of the review). The results of these eight cases have not been included in this report, and were not included in our assessment of financial distress (see Chapter 6.2 (Distress Assessment) for more on financial distress). In the event, we determined that we did not require a control group for SRM.

File preparation by the Bank

13. We provided the Bank with an information request setting out what we would require on each case file.
14. On this basis and once the sample was selected, the Bank started to gather documentation and prepare the files. This included physical documentation gathering as well as 'scraping' the email files extracted from its servers by RBS based on 'custodians' (email addresses of RBS staff involved in the case) for the Relevant Period. Custodians included representatives from the mainstream Bank, SMU, SRM, GRG, West Register, credit sanctioners, administrative resources, Lombard and RBSIF staff. Key word logic was applied to the scraping e.g. customer name(s), business name(s), property address(es) etc. This was a significant exercise and was conducted on the Bank's behalf by a third-party specialist firm.

Pilot and methodology

15. Whilst the Bank was preparing the full set of files and 'scraping' email servers (using the third-party specialist firm), we designed the methodology for the review of each case file to ensure consistency of case file review and to provide guidance to the file testing team.
16. We then conducted a pilot exercise from February 2014 of the first 10 cases prepared by the Bank. The aim of the exercise was to test and refine the draft methodology and determine the adequacy of the file compilation process by RBS.
17. We shared the findings of the pilot with the FCA and the Bank, and RBS adapted the file preparation process accordingly.
18. An extract of the final methodology was shared with the Bank for information, and the full methodology was provided to the FCA for comment and review.
19. All cases were reviewed in accordance with this final methodology, which reflected the Bank's comments where appropriate and those of the FCA.

File review

20. The file review process comprised of the following steps:
 - **Review of the physical files provided by the Bank.** The files included various documents reflecting the relationship between the customer and Bank during the Relevant Period. For example it included loan agreements, credit papers, SCRs, pricing information, letters and emails, customer complaints, external IBR reports etc.
 - **Review of emails.** Once the third-party firm had 'scraped' the RBS email files, they were uploaded to a 'Viewpoint' extranet site. We had access to Viewpoint and reviewed all emails. This was a time consuming but important task.
 - **Customer interviews.** Once the sample was selected, we wrote out to all customers to request their participation in a meeting. The purpose of the meeting was to seek customer views on their treatment, clarify our

understanding of the file and emails and request any additional information that the customer was willing to provide. In 108 cases, a customer meeting was held. Meetings were conducted over the telephone for the most part and lasted approximately 2 hours. All meetings were formally recorded by a stenographer. In some cases, the customer provided additional documentation or clarification after the meeting.

- **Relationship Manager meeting.** In 169 cases, a meeting was held with the Relationship Manager(s) responsible for the case whilst it was in GRG. The purpose of the meeting was to secure the input of Relationship Managers in relation to the case, clarify our understanding of the file and any pertinent points raised by the customer and request additional information not found on file. Customers were often managed by a number of Relationship Managers whilst they were in GRG. In many instances, the original Relationship Manager was no longer with the Bank and was therefore unavailable for interview. In some cases where this was the case, we spoke to his/her manager or supervisor.
- **Identify possible information gaps/raise queries.** Throughout the process, we raised queries with the Bank. A written query process allowed us to raise case file specific or general queries on an ongoing basis. In total we raised over 1,000 such queries. Furthermore, having reviewed the file and met with the customer and the Relationship Manager, we checked whether the email scrape exercise conducted by the Bank had been adequate. In the event that we were not satisfied with the completion of the scrape, we raised a 'rescrape' request with the Bank. In a number of cases the Bank initiated their own 'rescrape'. In total 92 cases were rescraped and the results of the process was provided to us for review.
- **Write up conclusions and outputs.** On completion of the case file review, the case file reviewer formulated his/her conclusions on the case, prior to QA and submission to the Bank.

Audits of the Bank's information provision process

22. We conducted two audits of the Bank's information gathering processes during the summer of 2014:
 - The data scrape audit; and
 - The physical file preparation audit.
23. The purpose of these audits was to determine the extent to which we could rely on the robustness and completeness of the information provided to us. The results of the audits were shared with the Bank, and we made a series of recommendations in each instance. We asked the Bank to adapt its processes for both data scraping and physical file preparation.
24. In January 2015, the Bank carried out a spot check of the physical file preparation process as a result of our recommendation. These spot checks were conducted in four

locations, and we accompanied the Bank's teams in all cases. The Bank found new documentation in 23 cases.

25. The Table below provides more details on the pilot, spot checks and audits conducted.

Fig. 34: Steps taken to ensure the quality and completeness of information

Audit/Pilot	Approach	Key Findings	Key follow up actions
Pilot	<p>We asked the Bank to provide 10 pilot files to help us understand the structure and robustness of the Bank's files and refine our approach and methodology.</p> <p>The pilot took place between February and November 2014.</p>	<p>The pilot clarified what makes up a case file for the purposes of achieving the aims of our review. Key points were:</p> <ul style="list-style-type: none"> • There were important gaps; • Information was needed from multiple sources both electronic and physical hard copies; and • A review of email correspondence was needed to provide important insights and help close identified shortfalls. <p>The significance of issues identified meant that the pilot took much longer than anticipated.</p>	<p>Data scrape audit</p> <p>Physical file audit</p> <p>Memo outlining changes to be made to case files to RBS</p>

Data tape audit	<p>We asked RBS to produce a data tape listing the full population of customers defined as an SME (as defined for the purpose of the review). RBS produced a total of three data tapes. The sample was drawn from the third.</p> <p>We performed an audit of the data tapes to ensure that it was accurate and complete.</p>	<p>Data quality issues identified with initial versions of the data tapes.</p> <p>Reasonable assurance can be placed on the completeness and accuracy of the third data tape produced by RBS.</p>	<p>Resolution of issues identified during the audit of the first and second data tapes.</p>
Data scrape audits	<p>We reviewed the data scrape processes and associated controls from cradle to grave and formed an opinion based on substantive testing and walkthroughs of these.</p>	<p>We wrote to the Bank in July 2014 outlining 13 findings including absence of data, absence of West Register from scope, issues with key words, data sources, and data presentation, and issues around the review process.</p>	<p>Guidance on relevant/non-relevant emails</p> <p>Prescribed keywords for searches</p> <p>Scope extended to West Register</p> <p>Checks of rescrape process¹⁰⁷</p>

¹⁰⁷ RBS and their third party provider reviewed the emails provided under the re-scrape process and continued to identify issues in late 2015. The third party provider conducted an audit of its process but relied on RBS assurance that the data provided was complete. A small number of issues were however identified regarding the completeness of the data provided by RBS Technology Services. No audit of that process has been carried out.

Physical file audit	We undertook a detailed audit of the file preparation process being used to collate the physical case file being provided to us as part of our review. This included a review of the end-to-end process and a sample of case files.	Issues were identified in the following areas: <ul style="list-style-type: none"> • Reliance on the Relationship Manager to provide the required case information (which may give rise to a conflict); • Some completeness issues; • Need for more guidance for the staff responsible for identifying relevant information; and • Need for and recording of checks. 	Spot checks were performed on an ongoing basis. Revisited certain files from previous batches to search for further information
Spot checks	RBS conducted on-site spot checks in January 2015. We shadowed this process. Forty connections were selected across all batches (including the Pilot batch) and five offices.	464 additional documents were sourced from 23 of the 40 connections. There were checks of the modification date of electronically held documents. There was no instance of any amendment.	n/a

26. Throughout the review, new information was provided to us for 157 cases (73% of all cases). This new information was discovered through various channels such as the audits, meetings and query processes described above.

QA and sign off

27. Once the case file reviewer completed his/her case file review, the case was subject to a quality assessment (QA) review by a member of the QA team. We shared the facts and case file findings with the Bank and invited comments on any factual inaccuracies. In its response, the Bank commented on instances of factual inaccuracy and our judgments and in some cases provided new information that had been discovered.
28. The case reviewer addressed any factual inaccuracies, reviewed the new information provided by the Bank and considered other comments. The case was then subject to our QA processes and DAP assessment.

Annex VI – Anonymised appraisal



Performance Management & Development Form

Form to be completed by end of January excluding review comments

NAME:	DIVISION: GRG BUSINESS UNIT: DEPARTMENT:
ROLE: Relationship Manager 1	LINE MANAGER: OTHER MANAGER:
REVIEW PERIOD From: To:	OBJECTIVES AGREED: Signed (Individual): Signed (Line Manager): Date:

Financial & KPI targets	Half year Target	Half year Actual	Full year Target	Full year actual
Income	£1,419k	£1,632k	£2,606k	£3,234k
Contribution	£1,062k	£1,312k	£1,947k	£2,580k

Personal Portfolio	As at	As at
Cases	24	25
New cases taken on	1	5
RTS cases	0	2
Total debt repaid	£3,015	£4,934
Total Income generated	£181.15k	£375k
Equity negotiated	0	0
PPAs negotiated	8	8
Other upsides negotiated	0	1

	Pod	Pod	Pod
Income	£1,293.20	£632.93	£1,232.02
Cases	49	37	54
New cases	17	15	21
RTS	6	0	8
PPA	15	0	13
Equity	0	0	0
Other	11	0	3
Debt repaid	£9,597	£8,692	£27,604



Section 1 - Objective Setting

Business Goal:	People Focused
Objective:	Identification and effective management of Talent within GRG Eg: Coaching, mentoring, promotion and sponsorship to leadership and training programmes, retention of 4+ rating staff. Specific responsibilities for [REDACTED]
Measures:	Observation, staff retention numbers, staff feedback
Due date:	Review six monthly
Objective:	Ensure timely and appropriate communication to teams Regular team meetings, deputising for the Regional Head
Measures:	Observation, attendance, staff feedback
Due date:	Review six monthly
Objective:	Team Development Ensure a review and appraisal is completed at least every 6 months for all team members. Ensure timely feedback is provided to aid ongoing personal development for team
Measures:	Check appraisal forms signed and held on staff files, staff feedback
Due date:	Review six monthly
Objective:	Effective management of under performers Ensure all those graded a 2 have action plans in place to address
Measures:	Strategy agreed with Regional Head / Head of BRG
Due date:	As strategy requires but reviewed 6 monthly as a minimum
Objective:	To ensure that all designated reportees receive performance worksheets using the BRG core KRAs and Competencies for their position
Measures:	Observation / production of completed sheets
Due date:	Review six monthly
Objective:	To assist with the creation and regular review of a PDP for each direct report for the effective development of their skills and competencies related to current and future jobs, including acting as mentor when appropriate.
Measures:	Completed and signed off PDPs held for all members of the team.
Due date:	Review six monthly
Objective:	To support and develop team members through robust sanctioning (within personal sanctioning limit) of proposals and encouragement towards best practice.
Measures:	Feedback, appraisal
Due date:	Ongoing
Objective:	Personal Development Ensure a Personal Development Plan (PDP) is in place and reviewed at least every 6 months
Measures:	Line manager to review PDP and discuss contents / objectives



Due date:	Review six monthly
Mid year Individual Summary:	
Mid year Manager Summary:	
End of year Individual Summary:	
End of year Manager Summary:	

Business Goal:	Maintaining the Licence to Operate
Objective:	Minimize Client Complaints
Measures:	Eg; zero "justified" client complaints reference to the C&Q report
Due date:	Review six monthly
Objective:	Compliance with the Asset Protection Scheme in good faith
Measures:	Feedback from APS
Due date:	Review six monthly
Objective:	Compliance with the Policy and Procedures manual and Credit Oversight Process Eg; ensure completion of the Regular Reading and Viewing modules in a timely manner, respond to any assurance testing observations to improve testing results. Includes compliance with Regular Reading & Viewing
Measures:	GIA reports / review of monitoring and control systems
Due date:	Review Six monthly
Objective:	Enhance Organisational Efficiency
Measures:	Eg; Attend a Work Out Session / Make suggestions for improvement in process
Due date:	Review Six monthly
Objective:	To maintain RMP and file record information for personal portfolio accurately and on a timely basis.
Measures:	Observation, compliance with requests, RMPS records
Due date:	Ongoing
Objective:	To ensure accurate Stressed Loss and Marked Provisions are maintained for each case within personal portfolio at all times.
Measures:	Tracking through RMPS, SCRs, Weekly reporting



Due date:	Ongoing
Objective:	Deal and file information to be recorded accurately and in a timely manner.
Measures:	Tracking through RMPs
Due date:	Ongoing
Objective:	To ensure that cases are managed in accordance with the Policy & Procedures Manual (All RMs)
Measures:	Observation, RMPs records, GIA
Due date:	Ongoing
Mid year Individual Summary:	
Mid year Manager Summary:	
End of year Individual Summary:	
End of year Manager Summary:	

Business Goal:	Execute Effective Asset Management and maximising sustainable fees as a component of minimising losses
Objective:	Regular review of Case Strategy - To recommend purposeful and achievable strategies with clear milestones for sanction at the appropriate level of management within BRG or Credit Committee, e.g., carry out initial and subsequent case reviews within the agreed timescales in accordance with the Policy & Procedures
Measures:	Observation/SCR reviews
Due date:	Ongoing
Objective:	Enhance revenue opportunities E.g. Through upsides and obtaining appropriate fees on a timely basis.
Measures:	Number of upsides achieved, fee income levels
Due date:	Ongoing
Objective:	Minimise losses for the bank and improve the Bank's position by establishing the most appropriate course of action for each case.
Measures:	Active management of Stressed Losses and Marked Provisions / SCR Review
Due date:	Ongoing
Objective:	Demonstrate an understanding of current issues/hot topics within Mid-Market Restructuring



Measures:	Feedback, presentations, communication, observation
Due date:	Ongoing
Objective:	To create strong relationships that ensure customer retention post RTS.
Measures:	Feedback, observation
Due date:	Ongoing
Mid year Individual Summary:	
Mid year Manager Summary:	
End of year Individual Summary:	
End of year Manager Summary:	

Business Goal:	Enhance our position at the leading edge of the global business and financial restructuring market
Objective:	Demonstration of "leadership" activity in the market
Measures:	Eg; Co-ordinate or host/present at a promotional or networking event
Due date:	Review annually
Objective:	To establish and maintain effective relationships both internally and externally to enhance GRG and personal reputation.
Measures:	Attend at least 12 networking events per year participate in presentations and meetings as appropriate.
Due date:	Review annually
Objective:	To maintain acceptable service standards at all times.
Measures:	Feedback, achieving zero 'justifiable' complaints, observation
Due date:	Ongoing
Mid year Individual Summary:	
Mid year Manager Summary:	



End of year Individual Summary:

Section 2 - Personal Development Plan (PDP)

Your Personal Development Plan covers your knowledge (technical, management etc.), skill (practical abilities) and behaviour (effective handling of people and situations). It should support the delivery of performance objectives as well as your career plans and build upon your strengths as well as address development areas.

<p>Identify key areas of strength:</p> <ul style="list-style-type: none"> ▪ Property cases – credit issues, structure, professionals, etc ▪ Knowledge of Bristol/Cardiff/Thames Valley Professionals ▪ Credit skills
<p>Identify key areas of development:</p> <ul style="list-style-type: none"> ▪ Recommendation trading company credit skills ▪ Internal networking ▪ Team management

Personal Development Objectives

What:	
Internal Networking	
How:	
<ul style="list-style-type: none"> ▪ Create opportunities to visit and work with BRG London, Recoveries, SIG, SRM, credit, etc ▪ Liaise/attend team meetings with [REDACTED] and his team ▪ Act as a point of contact for Property Deals, attend Watch Forums ▪ Introduce external network to BRG/other areas of the Bank ▪ Look for a mentor within the Bank ▪ Attend internal courses 	
Outcome:	
<ul style="list-style-type: none"> ▪ Greater knowledge of the various areas of the Bank and product offerings ▪ Greater confidence in explaining their roles to solve queries 	
Due Date:	Review quarterly

What:	Improve knowledge/skill on trading cases
How:	



<ul style="list-style-type: none"> Attend non-property professional meetings/courses Credit Skills 4+ Take on at least 5 non-property related cases. Work with a accountant secondee to refresh understanding of financials. Improve knowledge of RMP 	
Outcome:	
<ul style="list-style-type: none"> Provide greater guidance on trading cases Improved credit skills and in turn reduction in losses/greater returns 	
Due Date:	Review quarterly

What:	
Team management	
How:	
<ul style="list-style-type: none"> Attend management/team performance course Ensure direct reports [REDACTED], have PDPs and these are actively monitored. Assist in the development of the team and act as a point of focus to review and provide guidance on property related transactions. Gain feedback 	
Outcome:	
<ul style="list-style-type: none"> Maintain current open, honest culture Staff retention, promotion, increased confidence etc 	
Due Date:	Review quarterly

Section 3 – Performance Review

Everyone must have two face to face comprehensive reviews each year (mid-year and end of year) supported by monthly informal meetings.

Mid-year review: Individual's summary			
Mid-year review: Manager's summary			
Signature (Individual):		Date:	
Signature (Manager):		Date:	



End of year review : Individual's summary
End of year review : Manager's summary (including rationale for performance rating)

Signature (Individual):		Date:	
Signature (Manager):		Date:	

End of Year Performance Assessment

Performance Rating <i>(To complete: double click on the appropriate check box below and then click "checked" in the dialogue box that appears)</i>			
1. <input type="checkbox"/> Performance is acceptable and/or objectives not achieved and/or competence below level is not achieved.	2. <input type="checkbox"/> One or more key objectives not achieved and/or further competency development required for current role and/or individual's performance compares less favourable relative to peer group.	3. <input type="checkbox"/> Fully achieved key objectives throughout the year and all behaviours have been demonstrated at required level for each competency and performance is in line with the majority of peer group.	
4. <input type="checkbox"/> All objectives fully achieved and some have been exceeded throughout the year and all required behaviours demonstrated and consistently exceeded and performance compares more favourably relative to peer group.	5. <input type="checkbox"/> All objectives have been exceeded throughout the year and outstanding levels of the required behaviours are always demonstrated across the entire range of job competencies.	0. <input type="checkbox"/> This rating is used when an individual has been recruited to the Group during the final quarter of the performance year and the manager has insufficient time to elapse to allow a true assessment of performance.	
Signature (Individual):		Date:	
Signature (Manager):		Date:	

Annex VII – Example turnaround plan?



Our Ref: [REDACTED]
 Strictly Private & Confidential
 Directors
 [REDACTED]
 [REDACTED]
 [REDACTED]

Business Restructuring Group
 Vantage Point
 Woodwater Park
 Pynes Hill
 Exeter
 EX2 5FD

24th February 2010

Dear [REDACTED]
 [REDACTED]

We write further to a meeting on 8th March 2010 [REDACTED] and [REDACTED] following the Bank's letter of the 24th February which should be read in conjunction with this letter.

The Royal Bank of Scotland plc ('the Bank'). As discussed, the Company has outstanding indebtedness to the Bank (either direct or under guarantee) of the aggregate sum of £1,340,000 and is in default in respect of its liability to pay all or part of that indebtedness. The Bank holds certain security from the Company including a charge over the property known as [REDACTED] ('the Property'). We have been charging you an interest rate of 1.6 % per annum above the Bank's base rate on the basis that your liability to the Bank was fully secured. As we do not consider that your liability to the Bank remains fully secured, and the Bank has some concerns as to the ability of the Company to service its borrowings, any future lending by the Bank will need to carry a higher return to reflect the additional risk which the Bank is being asked to undertake.

Having discussed the matter with you, that the Company has the following options:

- (a) Refinance and pay the debt due to the Bank in full
- (b) Seeking the protection of an Insolvency process;
- (c) Asking the Bank to fund the unsecured / mezzanine element of the current loan. In order to do this, the Bank would require the following:

An agreement whereby the additional risk the Company is asking the Bank to undertake is met by the Company paying a percentage of the market value of the Property either at the end of a period of five years or on the earlier disposal of the Property. This would involve you entering into an agreement with the Bank's wholly owned subsidiary, West Register (Investments) Limited (West Register) which would be secured by a second charge on the Property granted to West Register.

Based on current information, we would envisage a fee of 15 %. For example this means that if the Property had a market value of £100,000 the fee payable would be £15,000.

Please note that the fee may vary over the period of the agreement according to the market value of the Property.

The Royal Bank of Scotland plc
 Registered in Scotland No 00512
 Registered Office: 38 B) Andrew Square
 Edinburgh EH2 2YB

Authorised and regulated by the
 Financial Services Authority

You would also have the ability to bring forward the date of the payment of the fee to the third anniversary. West Register would have the right to bring forward the date of payment of the fee where there is a change in the identity of the [majority] shareholders in the Company; or where the Company becomes insolvent or defaults on any of the facilities with the Bank. During the course of the agreement you would need the additional consent of West Register to make any alterations or change of use with respect to the property in the same way as you do now under the Bank's existing charge over the Property.

West Register reserves the right to request an independent valuation (at your own cost) prior to any agreement being entered into. Please also note that you will be responsible for the Bank's legal fees and all Land Registry and other fees (such as registration at Companies House) and other expenses incurred in the negotiation and preparation of this agreement.

Once you have had the opportunity of considering these options, we would be grateful if you could contact us to discuss further and we will, if necessary, instruct West Register to contact you. At this point if you have any queries relating to this arrangement you will be able to raise them.

Yours faithfully

.....
for and on behalf of
The Royal Bank of Scotland plc
[acting as agent for National Westminster Bank Plc]

Tel: [REDACTED]
E-Mail: [REDACTED] or [REDACTED]

Annex VIII – Requirement Notice mapping

This annex sets out in tabular form the main sections of the Requirement Notice that we are asked to comment on. It then points the reader to the Chapters of this report where we deal with the issues. For completeness, we also cover all those summary points set out in the Notice from the Tomlinson and Large reports and similarly set out where the reader will find material relevant to that allegation or comment. The numbering relates to the numbering of the relevant section/annex paragraph in the Notice.

Requirement Notice Reference	Where we address these issues
Section 4.1 - Policies and Procedures	
<i>Policy and Procedure Review</i>	
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.	<p>We discuss GRG Governance and oversight extensively in Chapter 3.2 (Governance and oversight). We draw out conclusions and recommendations in respect of Governance in Chapter 3.4 (Part 3 Conclusions).</p> <p>Relations with the rest of the RBS Group in respect of financial distressed SME customers are considered in Chapter 4.1 (Transfers to GRG).</p>
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.	<p>We set out RBS and GRG's approach and our assessment of it in Chapter 4.1 (Transfers to GRG).</p>
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.	<p>We comment on the approach adopted to customers returning to the mainstream Bank (Returning to Satisfactory) in Chapter 4.8 (Customers exiting GRG).</p>
4 Appropriateness of policies and procedures governing the relationship between Relationship Managers and SME customers in GRG.	<p>We assess the policies and procedures governing the relationship between Relationship Managers and customers in GRG in Chapter 4.6 (Customer experience and TCF), and in relation to complaints in Chapter 4.7</p>

(Complaints).		
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.	We discuss the costs imposed on businesses in Chapter 4.4 (Pricing). It is also a factor in Chapter 5.2 (Strategic Investment Group) – in respect of negotiation of Upside Instruments. The governance of pricing decisions is considered in those Chapters and in Chapters 3.2 (Governance and oversight) and 3.3 (Staff objectives).
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.	Transfer related issues are considered in Chapter 4.1 (Transfers to GRG), facilities in 4.3 (Facilities) (which also contains a section on Personal Guarantees).
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.	Our views on GRG complaint handling are set out in Chapter 4.7 (Complaints). It is also relevant to note aspects of our observations in Chapter 3.3 (Staff objectives).
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.	We consider conflicts of interest generally in Chapter 3.2 (Governance and oversight). Observations about particular conflicts of interest are set out in respect of REAM in Part 5 (West Register), and in respect of third parties including IBRs in Chapter 4.8 (Third Parties).
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.	We set out our observations on objectives and targets generally in Chapter 3.1 (GRG objectives and strategy), and on the impacts these had on staff that were relevant to SME customers in Chapter 3.3 (Staff objectives).

Section 4.2 - Customer Outcomes		
<i>Customer Outcomes</i>		
1	Whether RBS Group appropriately identified customers for transfer to GRG.	We set out our views on this issue in Chapter 4.1 (Transfers 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.	We discuss the transparency of the transfer process in to GRG in Chapter 4.1 (Transfers to GRG), and out of GRG in Chapter 4.8 (Customers exiting GRG). In both cases, this is primarily from the perspective of the customer concerned although we make brief reference to mainstream managers and their role.
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.	We discuss the background to this issue extensively in Part 4 (Activities of GRG) (see in particular Chapters 4.3 (Facilities), 4.4 (Pricing) and 4.5 (Valuations) (in respect of LTV issues)) and Part 5 (West Register) (specifically Chapter 5.2 (Strategic Investment Group) in relation to Upside Instruments) before reaching conclusions on financial distress in Chapter 6.2 (Distress assessment).
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.	We discuss the role of Third Parties in Chapter 4.8 (Third parties). Chapter 5.2 (Strategic Investment Group) is also relevant in relation to Bank appointed individuals. We consider preventing customers from taking action in Chapter 4.6 (Customer experience and TCF).
5	Whether the property valuation methodologies employed by GRG, deliberately or otherwise, undervalued properties.	We assess this issue in Chapter 4.5 (Valuations).
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.	We assess pricing issues in Chapter 4.4 (Pricing). Requests for information are considered in Chapter 4.6 (Customer experience and TCF).

7	Whether GRG requested personal guarantees and/or cash injections when it had already determined that it had no intention of supporting such businesses.	We discuss the role of Personal Guarantees and cash injections in Chapter 4.3 (Facilities).
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).	We consider conflicts of interest generally in Chapter 2.2 (Governance and oversight). Observations about particular conflicts of interest are set out in respect of REAM in Part 5 (West Register), and in respect of third parties including IBRs in Chapter 4.8 (Third parties).
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.	Our views on GRG complaint handling are set out in Chapter 4.7 (Complaints).

We had regard to the following issues as key points from the Tomlinson and Large reports (Requirement Notice Annex D)		
Tomlinson Report		
<i>Allegation</i>		
1	GRG is a profit centre for RBS, as opposed to a turnaround division aimed at improving business performance to recovery.	We discuss Profit Centre in Chapter 3.1 (GRG Objectives and Strategy). The implications for cases is covered through Parts 4 (Activities of GRG) and 5 (West Register), but see in particular Chapter 4.2 (Turnaround).
2	There are very few examples of businesses entering GRG and moving back out into local management.	We set out the data in Chapter 6.1 (What happened to customers). We address returning to local management in Chapter 4.8 (Customers exiting 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.	We consider the general picture in Chapter 4.1 (Transfers to GRG). It is also relevant to consider Part 5 (West Register) and the role of West Register (including SIG).
4	Businesses are assessed for transfer to GRG on the basis of the potential value to GRG and not their level of distress.	We consider the general picture in Chapter 4.1 (Transfers to GRG). It is also relevant to consider Part 5 (West Register) and the role of West Register (including SIG).

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.	We consider the general picture in Chapter 4.1 (Transfers to GRG). We were not able to assess reliably the nature of cases that were not transferred 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.	We consider the general picture in Chapter 4.1 (Transfers to GRG). But it is also relevant to consider Chapter 4.3 (Facilities), and 4.4 (Pricing). Chapter 4.5 (Valuations) includes relevant background material on how issues like LTV were assessed.
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.	We consider the general picture in Chapter 4.1 (Transfers to GRG). Our enquiries into actions of GRG mainstream prior to transfer were limited.
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.	We consider the general picture in Chapter 4.3 (Facilities).
9	Banks manipulate the financial position of businesses that are profitable but not generating any additional fees or profit for the bank.	We consider the issues around pricing practice in Chapter 4.4 (Pricing) (but also comment in the Chapters 3.3 (Staff objectives), 5.2 (Strategic Investment Group) (in respect of Upside Instruments) and 4.1 (Transfers to GRG).
10	If there was more transparency businesses would be better protected from the banks' opportunistic behaviour.	We address this point in our recommendations in Part 7 (Recommendations).
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.	The effects of IRHP are addressed in Chapter 4.2 (Turnaround).
12	The process of the default that triggers the move to GRG is inadequately explained to the customer.	We consider the general picture in Chapter 4.1 (Transfers to GRG). But the Chapters on Valuation, Facilities and Pricing are also relevant to the issue of transparency of explanations.

13	Relationship Managers are disciplined if they contact customers transferred to GRG.	RBS practice was that once a transfer to GRG was effected, the pre-existing mainstream Relationship Manager should no longer be in contact with the customer. We did not see that practice as inherently objectionable.
14	GRG artificially distresses otherwise viable businesses. Through such actions GRG places businesses on a journey towards administration, receivership and liquidation.	We discuss the background to this issue extensively in Part 4 (Activities of GRG) (see in particular Chapters 4.3 (Facilities), 4.4 (Pricing) and 4.5 (Valuations) (in respect of LTV issues)) and Part 5 (West Register) (specifically Chapter 5.2 in relation to Upside Instruments) before reaching conclusions on financial distress in Chapter 6.2 (Distress assessment).
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.	We discuss this issue in Chapter 4.2 (Turnaround).
16	Property valuation methodologies unquestionably undervalue properties.	We discuss this issue in Chapter 4.5 (Valuations).
17	GRG significantly undervalues the assets of businesses, with the consequence that this puts such businesses in breach of their covenants.	We discuss this issue in Chapter 4.5 (Valuations). Chapter 4.4 (Pricing) is also relevant to this assessment.
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.	The possibility of engineering defaults is covered in Chapter 4.1 (Transfers to GRG). It is also covered in Chapters 4.4 (Pricing) and 4.5 (Valuations).
19	There is an inherent conflict of interest with regard to the relationship between valuers employed by GRG and GRG's aims and objectives.	We discuss internal valuers in Chapter 4.5 (Valuations) and third parties in Chapter 4.8 (Third Parties). Part 5 (West Register) in respect of West Register is also relevant.
20	The valuers employed by GRG inappropriately act in the interest of the bank in their valuation of properties.	We discuss internal valuers in Chapter 4.5 (Valuations). Part 5 (West Register) in respect of West Register is also relevant.
21	GRG's property valuation methodology is based upon a fire sale of property, which is unfair.	We discuss valuation practice in Chapter 4.5 (Valuations).
22	GRG inappropriately revalues properties, undertaking insufficient work.	We discuss valuation practice in Chapter 4.5 (Valuations).
23	GRG is incentivised to undervalue properties, which triggers insolvency. West Register is then able to cheaply acquire such properties.	We discuss valuation practice in Chapter 4.5 (Valuations). Part 5 (West Register) in respect of West Register is also relevant (especially

		Chapter 5.1 (West Register Property Acquisitions)).
24	Otherwise viable businesses become increasingly distressed by the level of fees, bureaucracy and restrictions on trading capabilities.	Our overall assessment is set out in Chapter 6.2 (Distress Assessment). Preventing Customers from taking action is discussed in Chapter 4.6 (Customer experience and TCF).
25	Businesses are fined on entry into GRG for breaching their covenants.	We address this issue in Chapter 4.4 (Pricing).
26	Upon transfer to GRG interest on loans will be inappropriately/unfairly increased and the term of loan may be shortened dramatically.	We address this issue in the Chapters) 4.3 (Facilities) and 4.4 (Pricing).
27	Such changes are unjustified based upon the performance of the business.	We address this issue in the Chapters 4.3 (Facilities) and 4.4 (Pricing).
28	Businesses are not allowed to read Independent Bank Reviews which is unfair.	We address this issue in Chapter 4.8 (Third parties).
29	Businesses are not allowed to challenge Independent Bank Reviewers' conclusions, which is unfair.	We address this issue in Chapter 4.8 (Third parties). Chapter 4.2 (Turnaround) is also relevant.
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.	We address this issue in Chapter 4.8 (Third parties).
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.	Requests for Information is addressed in Chapter 4.6 (Customer Experience and TCF).
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.	We assess the impact of GRG including IBRs in Chapter 6.2 (Distress Assessment).
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.	We consider preventing customers from taking action in Chapter 4.6 (Customer Experience and TCF).
34	GRG asks for cash injections and/or security over loans through personal guarantees when it has no intention of supporting or	We consider cash injections in Chapter 4.3 (Facilities).

	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.	We consider these issues in Chapter 4.3 (Facilities).
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.	We observed no case involving a sale of debt or transfer of personal guarantees.
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.	We consider these issues in Chapter 4.8 (Third Parties).
38	Administrators of businesses in GRG do not act in an independent manner and as such they do [not] take appropriate action against other parties involved in the insolvency when these parties are acting unjustly/illegally.	We consider these issues in Chapter 4.8 (Third Parties), but the actions of Administrators post insolvency was not in our scope
39	GRG does not appropriately manage the potential conflict of interest presented by West Register's activities.	We consider these issues in Part 5 (West Register).
40	The complaints handling process for GRG customers is not working effectively.	We consider these issues in Chapter 4.7 (Complaints).
Large Report		
<i>Comment</i>		
1	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.	We discuss this issue in Part 3 (How GRG operated), and in particular in Chapter 3.2 (Governance and Oversight).
2	Due to different reporting lines B&C has limited ability to see or influence what happens to customers in GRG when they may	We note RBS practice was that once a transfer to GRG was effected, the pre-existing mainstream Relationship Manager should no

	be appropriate for future return to B&C.	longer be in contact with the customer. We did not see that practice as inherently objectionable. We discuss RTS in Chapter 4.8 (Customers Exiting GRG).
3	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.	We address the transparency of the Transfer process in Chapter 4.1 (Transfers to GRG).



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