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DEBATE PACK

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Treatment of SMEs by RBS Global Restructuring Group

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Summary

This backbench business debate is sponsored by Clive Lewis. It has been called to highlight the treatment of small firms that happened to be referred to the Global Restructuring Group – a division of RBS - which dealt with small companies that were in financial difficulty. Many such firms feel that they were treated very poorly and their businesses suffered often fatal consequences at the hands of a group which had conflicted incentives. There has been a very lengthy period of enquiry, at least four separate investigations by different bodies, into what happened, including one on behalf of the FCA by a 'skilled person' Promontory. The FCA's final summary of the Skilled Person's Report was published on the morning of 28 November 2017. Elements of the Interim Report had been contested by RBS.

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1. Background

The Global Restructuring Group (GRG) was a division of the Royal Bank of Scotland (and NatWest). Its specialist role was to deal with the affairs of small and medium sized firms (SMEs) referred to it because the firm was in financial trouble. The options open to GRG ranged from restructuring the companies and bringing them back to health, or managing the cessation of business to best protect the bank's interests – normally loans made to the firm before it got into trouble. A legal website notes:

> NatWest and RBS's Global Restructuring Group, was a business support unit (BSU) for troubled businesses set up in the early nineties by Derek Sach and was formerly known as Specialised Lending Services. Following the credit crunch, GRG took control of 16,000 SME customers with £65 billion of assets via 'Project Dash for Cash'. Following allegations of misfeasance, GRG was reportedly disbanded in August 2014.[1]

In the aftermath of the financial crisis, when all banks were required to rebuild their capital reserves, it is alleged that the main focus of the GRG was to liquidate companies rather than to support them through further lending.

It is not uncommon that a company 'in trouble' may often not be able to generate profit or support further borrowing, but it might have assets (land, premises, machinery etc) with significant value which could be realised if the business ended. The main charge against the GRG is that it prioritised realisation of assets over other outcomes.

This is not the first time that a large group of SMEs have been jointly affected by the actions of their bank. Recently there has been the mis-selling of interest rate 'swaps' (see Library Note for more details). Other SMEs have complained about 'tailored business loans' sold by the Clydesdale bank.

1.1 Impact on small firms

The allegation, in short, is that companies that might have been viable in the long or medium term were put into the GRG where there was no attempt to rescue them, but rather to extract value during the insolvency procedure for the bank. The Tomlinson Report (see below) examined numerous case studies of firms consigned to GRG. He found:

> Much evidence was received about the practices of RBS' turnaround division, Global Restructuring Group (GRG) which typifies this behaviour. Once in this part of the bank, the business is trapped with no ability to move or opportunity to trade out of the position – they are forced to stand by and watch an otherwise successful business be sunk by the decisions of the bank. The

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> bank extracts maximum revenue from the business, beyond what can be considered reasonable and to such an extent that it is the key contributing factor to the business' financial deterioration.
>
> This is not an open and transparent process, nor is it a proportionate response from the bank. During the process businesses are completely in the dark as to what is happening around them until it is too late. Most worryingly, the businesses affected are often perfectly viable and but for the action of the bank, would have been able to positively contribute to UK growth.

It found:

> There are very few examples of businesses entering GRG and moving back out into local management.
>
> […]
>
> GRG artificially distresses otherwise viable businesses. Through such actions GRG places businesses on a journey towards administration, receivership and liquidation.
>
> 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.

He noted that there was an oft used path for committing companies to the GRG, namely engineering breaches of loan to value agreements. Continued bank funding was dependent on the company's assets being worth a set value. Tomlinson found that GRG intervened in the valuation of assets, triggered 'default' and the consequences that followed. With respect to valuations he found:

> The following are just a few examples of the many cases of reduction in valuation of assets that received:
>
> - A two thirds reduction in valuation in 2 months, during which the business' RBS Relationship Manager informed them that, "*no one has ever been sued for undervaluing a property*".
> - A revaluation, in the same month, by the same valuers, reduced the valuation of the asset by £1.3m (over 17%) due to the new instructions given to the valuer by the bank.
> - A desktop valuation (having never visited the property) reduced the value of the asset from £5m to £1.6m in 2 years. This allowed the bank to renegotiate its terms and significantly increase their margins.
>
> The evidence also brought to light many examples of revaluations being done on desk top calculations where the property is not even visited and there are mistakes in the documentation.

He found evidence of technical breaches of loan agreements – some approved by the bank – which led to companies being treated as cases for GRG:

> Every business which secures banking facilities will be required to sign a contract with the bank[…]. Not every covenant indicates that the business is in distress or that the businesses loan will be terminated as a result of a breach. They are merely intended to be

> flags in the system to give the bank the ability to monitor the business' performance and discuss potential issues.
>
> Evidence received as part of this reporting process suggests that in some instances, these covenants are being used to put the business into default and transfer them out of local management. In some cases, the breach could be as insignificant as being one day late in providing non-vital information on accounts. The business could be operating well, and there could be no change in profit or turnover, and the business up to date with all repayments, but the breach is used to trigger the move of the business out of local management.
>
> The use of covenants in this manner goes beyond what is expected by the business as the reaction of the bank is so utterly disproportionate.

Once committed to GRG the treatment of companies did not improve:

> Businesses across the country have a real fear of entering these divisions of the bank given the experience of others in their network. There are very few examples received as part of this evidence gathering process where the business has gone into GRG, in particular, and gone back into local management.
>
> We heard some shocking examples of business owners being confronted with last minute demands for information and money. In some instances this has even happened despite a tragic family bereavement. There are many examples of demands being made during or just before bank holidays, when it is extremely difficult for businesses to withdraw funds to pay the bank back.
>
> It is also exceedingly difficult for the business to find an alternative source of finance as once they are in BSU or GRG, they are classed as being distressed.

If a company was having cash problems before being committed, these could worsen fairly soon after:

> One business who submitted evidence demonstrated that in fees alone, their time in GRG had cost them £256,000. This is not to mention the detrimental impact it had on their operability or the costs of refinancing with another finance provider. Another informed that RBS made them pay an immediate sum of £40,000 to carry on with our current lending.

The 'skilled persons' Report by Promontory (see below) looked at the claims of harm made by Tomlinson based on a sample of cases. It found that it was too simplistic to say that all companies committed to GRG were viable. In fact it found that only "16% of the potentially viable cases in the representative sample (amounting to 11% of all cases) did experience inappropriate actions by RBS that, in all the circumstances of the case, were likely to have resulted in material financial distress (beyond that which the business would have experienced in any event)".

In a letter to the Treasury Committee after publication of the FCA's Final Summary of the Promontory Report (see below) Andrew Bailey commented on the assessment of 'harmed' companies:

"These [assessments] were not formal or enforceable determinations made by the Skilled Person, and RBS does not agree with these outputs from the Skilled Person's case review analysis.

The FCA discussed and agreed the process and methodology used by the Skilled Person to determine which of the four groups applied to each of the SME customers in the case review sample.

The Skilled Person made it clear to the FCA during the review that this process involved the exercise of professional judgement about what were often longstanding and complex bank/customer relationships. The Skilled Person's approach took into account that it was often a combination of circumstances and actions that gave rise to the most intense customer concerns. For practical purposes, it limited its consideration of the actions of RBS to the period the customer was in GRG, plus one year before the customer was transferred. The Skilled Person considered it necessary to distinguish between the overall level of distress experienced by the business and the circumstances that would in its view have existed, but for RBS's inappropriate actions. It therefore assessed whether inappropriate actions by RBS were likely to have given rise to material financial distress over the period over and above that which the business would have experienced were it not for those actions.

Each case was different and created its own challenges. A set of criteria, which might have worked for some cases, would not have worked for all of them."[2]

1.2 Compensation Scheme for GRG customers.

Customers of GRG were in a difficult position with respect to a route towards compensation. Most claims were in excess of the Financial Ombudsman's £150,000 limit. Neither was there access to the Financial Services Compensation Scheme because RBS was not in 'default'. Hence, the prospect for many small companies to gain compensation was to start potential costly legal proceedings.

In November 2016 RBS announced:

> In response to these accepted shortcomings, the bank implemented two steps in November, which the FCA has again confirmed are appropriate. These are:
>
> 1. A complaints process overseen by retired High Court Judge, Sir William Blackburne; and,
>
> 2. An automatic refund of complex fees for SMEs in the UK and ROI that were customers in GRG between 2008 and 2013.

Andrew Bailey (CEO of the FCA) said in evidence to the Treasury Select Committee (31 October 2017), "They [RBS] have paid out or made offers of fee refunds of about £115million. That has been done. As of yesterday, they have received 954 complaints, I believe."

2 FCA Letter to Treasury Select Committee 28 November 2017

On its website, RBS said (as at October 2017) that:

> the bank has taken a number of steps to speed up the review rate, which should see half of the complaints received thus far dealt with by the end of 2017.

Welcome as the compensation scheme was, since many of the complaints were that sound businesses had been ruined, many company owners were also looking for compensation for 'consequential loss' rather than simply the fees they paid which put them out of business!

There is a separate 'consequential loss complaints scheme. By its nature this is a more complex procedure and the calculation of loss more difficult. Andrew Bailey at the same session, acknowledged the difficulties ("I do not underestimate the difficulty of the question of how to deal with consequential losses, which arises in corporate cases")

On a broader point Andrew Bailey addressed the question of the gap between the current capability of the Ombudsman and the effectiveness of ad hoc, 'voluntary' company compensation schemes. He was considering what new processes could be put in place to meet the needs of businesses that were more complex than individuals, but who did not have the resources of large companies to go to law:

> The second point I would make is that it just does not seem to be sensible that, every time one of these things happens, we have to set up something new. It would be much better if we had a standing scheme. We are planning to put out a consultation on this in the near future. I have to say to you there were two broad approaches here. Up until the summer, I was of the view that it would be more sensible, in one sense, to take the route you are going down of a formal system. That would require legislation.
>
> I have to tell you that I do not think that is going to happen, in the current situation, so we are going to go down the other route, which, by the way, can be made robust; do not let me suggest that this is inferior. The other route is to propose to extend the ombudsman scheme. That will have to tackle three issues. One is the scope of the ombudsman scheme, because currently it only covers what tend to be called micro-enterprises. Secondly, it will have to address the question of the award limit, because the limit is currently £150,000. Thirdly, and it goes back to your earlier point, it has to address the question of the ombudsman conducting arbitration or mediation. This is not the classic PPI where you deal with it after the event. Obviously firms need arbitration, not clearing up once the problem has crystallised.
>
> Q21**Stewart Hosie:** Whether it is a formal FSCS type scheme or a beefed up ombudsman scheme, either/or, there are various options you can have. There is a serious issue, particularly in the ombudsman route, which is the lack of skilled personnel to understand the complexity, even for small businesses, of the nature of break clauses, hedging and all of the other stuff we have seen in various of the other banking products.
>
> Absolutely, you are right there. This would be quite a fundamental change to the nature of the operation of the ombudsman, because these cases are also very bespoke, by their nature. I have talked to Caroline Wayman, who is the

> ombudsman, quite a bit about this and she is very well aware of this. That will be an important point addressed in this consultation. This is quite a change to the nature of the service that they provide.

There is some support for another resolution procedure. A debate in the House on 15 December 2016 proposed a Commercial Financial Dispute Resolution Platform – which would be some sort of impartial non- legal platform for small firm lending disputes which went beyond the capabilities of the Financial Ombudsman. The debate can be found here.

1.3 Investigation into the activities of the GRG.

There have been a significant number of investigations and subsequent Reports into the activities of RBS and the GRG.

In November 2013, at the request of the Coalition Government's Dr Vince Cable, Dr Lawrence Tomlinson, published a report *Banks' Lending Practices: Treatment of Businesses in distress*. This made serious allegations against RBS over the treatment of SME customers transferred to GRG. The previous section of this note gives examples.

In response to Tomlinson RBS appointed lawyers Clifford Chance to undertake a thorough and independent review of the central allegation made in that Report that the bank, through the GRG, systematically defrauded its small business customers. Clifford Chance concluded that there was no evidence to support this damaging and serious allegation.

In January 2014, the FCA appointed Promontory as a Skilled Person under section 166 of the *Financial Services and Markets Act 2000* to conduct an independent review of RBS's treatment of SME customers transferred to GRG between 2008 and 2013. Promontory, provided its final report to the FCA in September 2016 (the Skilled Person's Report). In November 2016 the FCA published a high level summary of the main findings and the key conclusions of the Report which were that there had been failures in customer treatment but did not find evidence to suggest that the more serious charge of the deliberately making firms insolvent for their asset value was proven.

The FCA published its final Summary of the Promontory Report on 28 November 2017. A summary can be found here.

The Review had found that there had been widespread problems caused by:

- a failure to comply with RBS's own policy in respect of communicating with customers around transfer, where the standard of much SME customer communication was poor and in some cases misleading (see section 2(d) below),
- a failure to support SME businesses in a manner consistent with good turnaround practice (see section 2(e)),

- placing an undue focus on pricing increases and debt reduction without due consideration to the longer term viability of customers (see section 2(g)),
- a failure to document or explain the rationale behind decisions relating to pricing following transfer to GRG (see section 2(g)),
- a failure to ensure that appropriate and robust valuations were made by staff, and carrying out internal valuations based upon insufficient or inadequate work, especially where significant decisions were based on such valuations (see section 2(h)),
- a failure by RBS to adopt adequate procedures concerning the relationship with customers and to ensure fair treatment of customers (see section 2(a)),
- a failure to identify customer complaints and handle those complaints fairly (see section 2(i)),
- a failure to handle the conflicts of interest inherent in the structure and operation of West Register, GRG's property arm (see section 2(m)), and
- a failure to exercise adequate safeguards to ensure that the terms of certain upside instruments, in particular EPAs, were appropriate (see section 2(m)).

However, it did not agree that there was "widespread or systematic inappropriate treatment of customers" which was the more serious charge against RBS and the GRG. Specifically:

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

> person) alone gave rise to a financial loss to the customer (see section 2(m)).[3]

Describing the impact of what happened:

> The independent review estimated that over a third of the 5900 SME customers transferred to GRG during the review period were not viable at or around the time of transfer and could be expected to face insolvency or administration regardless of RBS's actions. Of the potentially viable SME customers transferred to GRG, the independent review found that a minority of the representative sample (16%) had experienced inappropriate action by RBS which appeared likely to have caused material financial distress. However, due to the wider economic circumstances of the time, there were seldom clear-cut causal links between Bank actions and particular consequences.[4]

A recent commentary on the investigation can be found in the FCA's oral evidence to the Treasury Select Committee on 31 Oct 2017.

The FCA made this statement on its treatment and publication of the Report in December 2017:

> Recent disclosure of our Governance Committees meeting papers under the Freedom of Information Act has led to speculation about the reason that we did not publish the full Skilled Person's Report following the independent review of Royal Bank of Scotland's (RBS) treatment of small and medium-sized enterprise (SME) customers transferred to its Global Restructuring Group (GRG). It has been suggested that we chose not to publish the report because we were afraid of legal action being taken against us.
>
> It is normal practice in regulatory decision making to consider legal risks, which we did in this case. That included advice from external Counsel. It is usual practice for material risks identified in the FCA's Governance Committees to be reflected in Board papers and discussed at Board meetings to ensure robust oversight of FCA decision making. We, as a regulator, would expect the same rigour and standards of risk management from the firms that we regulate.
>
> We must work within the legal framework established by Parliament and the courts. Publishing the full skilled person's report would be unlawful without getting the necessary consents from all affected parties as the FCA would be acting in breach of statutory restrictions on the disclosure of confidential information if the full report is published without the consent of all parties to which its full content may relate. In addition, individuals are allowed the opportunity to see and comment on criticisms which are to be made of them in a published report (so called "Maxwellisation"). Likewise, we had to have regard to the possible effect of publication on our ongoing focused investigation.
>
> We have therefore not sought consent from the individuals or groups of individuals who are identified in the Skilled Person's

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

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

Report. Our experience of previous reviews carried out by the regulators is that that would be a complex and lengthy process and, where consents were not forthcoming, would likely result in only a heavily redacted version of the Skilled Persons' Report being publishable. The Specialist Advisers appointed by the Treasury Committee commented that they saw "considerable force" in the FCA's concern that it would potentially be unfair to publish relevant findings as to management knowledge, even in summary form, prior to consulting relevant individuals.

We therefore concluded that the best way forward was to publish an extended summary of the report. Our guiding principle in drafting the summary of the report has been to balance our desire to give as much information as possible to small businesses and the wider public about the contents of the report with our obligation as a public authority to act fairly towards the potentially affected parties who have legal rights. We are firmly of the view that the approach we took was fair and balanced, a view we have had confirmed by external independent Counsel. [5]

[5] FCA Website

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