



DEBATE PACK

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Debate on redress for victims of banking misconduct and the FCA

By Timothy Edmonds

Summary

This backbench business debate is sponsored by Mr Martin Whitfield. It follows recent debates that have highlighted the treatment of small firms which were referred to the Global Restructuring Group – a division of the Royal Bank of Scotland - which dealt with small companies that were in financial difficulty. The debate will look at the broader issues around how small firms' interests might best be protected.

Many such firms feel that they are treated very poorly and their businesses suffered often fatal consequences at the hands of the banks which, they argue, may have conflicted incentives. With respect to the original RBS Group, 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 published a summary of the Skilled Person's Report in November 2017 and the Treasury Committee published the full, final, Report in February 2018.

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1. Background to the RBS (GRG) complaint

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 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."

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

² [FCA Letter](#) to Treasury Select Committee 28 November 2017

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.

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

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*](#)

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.

Section 166 Report

The FCA had been under pressure to release the whole Report for a considerable time. That it had not, it put down to the legal framework that surrounded the investigation and the possibility of legal challenge if it had. It made a statement on its treatment and publication of the Report in December 2017 and defended its conclusion 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

Following the previous GRG debate held in January 2018, which can be found [here](#), the Treasury Committee set the FCA a deadline to publish the skilled persons' report (Section 166) in full. The FCA decided not to do that but sent it instead to the Treasury Committee which published it (unredacted) immediately.

Commenting on its publication, the Committee's Chair, Mrs Morgan, said:

The findings in the report are disgraceful. The overarching priority at all levels of GRG was not the health and strength of customers, but the generation of income for RBS, through made-up fees, high interest rates, and the acquisition of equity and property.

The Committee has not taken the decision to publish lightly. Normally, reports prepared under section 166 are confidential, but there is overwhelming public interest in bringing transparency to what happened at GRG, given the earlier leak of the report, and in ensuring that everyone can see, and know that they are seeing, an authentic and verified copy of Promontory's original report.⁶

The full final Report can be found [here](#).

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](#)

⁵ [FCA Website](#)

⁶ Treasury Committee [Website](#); February 2018

2. Future Reforms

Some compensation issues remain unresolved and whilst not all of the conclusions presented in the FCA and other Reports are endorsed by all sides, the bulk of the investigative work into what happened is now complete.

The All-Party Group on Fair Business Banking, formed to support affected businesses, believe that there is scope for a full public enquiry to come on top of the FCA and skilled person's Review.

More generally they have proposals which they think would help prevent future poor treatment by banks of their business customers. Principal amongst these is for a better dispute resolution procedure. It is argued that there is some sort of regulatory space between what the Financial Ombudsman (FO) can supply and the normal processes of the courts. Not all firms have faith in the ability of the FO to deal with complex issues and its remit is limited in any case to cases where compensation is less than £150,000. An [undercover Report by Channel 4](#), 'discovered' failings of training and expertise amongst FO staff which might have meant that more complex cases do not have a natural home in that organisation. As mentioned earlier in this Paper, Andrew Bailey has some sympathy for this.

On the other hand, when a problem is escalated to the court, businesses feel that multinational banks have legal resources which they cannot effectively compete with. Whilst, there is fairly common acceptance that there is a 'redress gap', how to fill it is less straight forward.

2.1 An expanded Financial Ombudsman?

Separately, in January 2018, the FCA consulted on widening access to the Financial Ombudsman Scheme for small businesses. The summary to the document states:

Small and medium sized enterprises (SMEs) are businesses employing under 250 staff, or with an annual turnover of under €50m. When things go wrong, some SMEs, particularly smaller businesses, struggle to resolve disputes with financial services firms through the courts and have few alternative routes to seek redress. We propose changing our rules to allow more SMEs to refer disputes to the Financial Ombudsman Service ('the Ombudsman').

Our proposals are not designed to cover all disputes involving SMEs. Disputes not covered include those involving SMEs above our proposed eligibility threshold for the Ombudsman, as well as disputes where redress sought would be significantly in excess of the Ombudsman's binding award limit of £150,000.

In general, larger SMEs will have the bargaining power, organisational resources and understanding of financial services to protect their interests in disputes with firms. We therefore believe the courts remain the most appropriate place for larger SMEs to resolve financial services disputes. However, given the diverse nature of the SME population we want to explore if there is

anything else that might be done for those businesses and disputes not addressed by our consultation (see above). This could include greater scope for voluntary codes.⁷

This would increase the number of firms who could use it without changing the sort of service it could offer significantly, which is what the APPG and those it represents would like. Indeed, the APPG appears to see reform of the FO as a distraction.

2.2 A Financial Tribunal?

There is some support for another resolution procedure outside of the Ombudsman.

The APPG has been calling for the setting up of a Financial Services Tribunal which (according to its briefing) would be:

- Transparent
- Accessible
- Has 'teeth' – including full powers of disclosure
- Expertise – those operating it are cynical and experts in dealing with complex financial disputes

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](#).

The issues to be resolved would need to be the funding of it – currently the Ombudsman is free to use for complainants – would a tribunal panel of (presumably well paid) experts be free too? Also, the closer a Tribunal gets in terms of process and ability to supply redress, the closer it replicates the courts which it seeks to replace. In such a case, would the banks be bound by its decisions or would that have powers, as in a court to appeal to a further settlement body.

⁷ FCA; [Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/7: SMEs as Users of Financial Services](#); January 2018

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