

30 October 2017

Rt. Hon. Nicky Morgan MP
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Dear Nicky,

Thank you for your letter of Wednesday 25 October in which you asked me to set out the points that we do not agree with in the Interim Report published by the FCA on the 23 October and to clarify GRG's objectives versus those of RBS Restructuring. To assist the Committee in its work, I have taken your questions in order and summarised below the key points that we have made to the FCA during the course of the process.

It is in my view also important to put those points in the context of the findings that we do accept, and to make clear that we are now very much focused on putting things right for our customers through the automatic refund of complex fees and a complaints process overseen by retired High Court Judge, Sir William Blackburne. Regardless of our view, any relevant customer who feels they were treated inappropriately whilst in GRG should make use of the complaints process. In the event that a customer does not agree with the bank's determination, they can appeal to Sir William. The bank will adhere to any decision he makes.

We deeply regret the mistakes we have made in the past when dealing with some of our SME customers in GRG. That is why we were clear in our apology to those who went through what was a difficult experience as a result of the crisis, and to whom we did not provide the level of service and understanding that we should have done. We have made significant changes to how we work with customers in financial distress, both during and since the relevant period (2008 – 2013).

I welcomed the publication of the Financial Conduct Authority (FCA) Interim Report, which was also consistent with the summary conclusions published by the FCA in November 2016. I also welcomed the FCA's confirmation that the most serious allegations against the bank have not been upheld and that the steps we announced last November remain appropriate.

I will take each of the points in turn.

Accepted findings

We fully accept that that we did not, in all cases, fully comply with our own policies or always meet the standards of service that we set ourselves, and, notwithstanding that this was an exceptionally challenging time for the bank, we could have done better in managing our SME customers in financial distress. For customers, this manifested itself in the failings below, which the bank accepts were, during certain periods, widespread:

- a lack of clarity in some communications with customers as to the reasons for their transfer to GRG;
- in the identification of customer complaints and/or a failure to address them in an appropriate manner;
- in the documentation or explanations of rationale behind decisions relating to pricing following transfer to GRG; and,
- to manage the risk and perception of conflicts of interest in relation to the activities of West Register.

The bank has taken steps to address these failings. These include significant changes to the governance, mandate, operating model, policies and procedures for managing our SME customers in financial distress. They also include the automatic refund of complex fees and the complaints process overseen by Sir William.

The bank also notes and agrees with the clear findings that there is no evidence to support numerous serious allegations. The independent review did not find widespread or systematic inappropriate treatment of customers in the following areas:

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

In addition, we note the acknowledgement that:

- there was no evidence that the bank adopted an approach to internal valuations that would have systematically resulted in valuations that were too low, nor that the valuation was clearly incorrect on any individual case in the review sample; and,
- there was no clear causal link between any inappropriate actions of the bank and the insolvency of an otherwise viable business.

Areas of Difference

The bank has been fully and constructively engaged with the FCA since the outset of this process in 2014, and has provided detailed feedback at various stages.

The points set out below reflect concerns the bank expressed over the methodology and approach adopted by the Skilled Person, which departed from the approach set out in the FCA's Requirement Notice. These include the use of standards other than market comparators as well as a lack of consideration of customer impact.

1. Systematic

In line with the original allegations, the FCA Requirement Notice contains a specific definition of 'systematic': as *'an intentional and coordinated strategy'* to treat customers inappropriately. This important, defined term has, however, been redefined by the Skilled Person as a failure *'to address an inevitable and foreseeable consequence of a decision (whether by way of act or omission) that some other result would ensue'*.

The Skilled Person has not identified any instances of the bank displaying any actual, strategic intent to systematically mistreat customers. Rather the Skilled Person uses its own expanded and alternative definition of 'systematic' failings as the basis for its conclusions.

It is clear that the findings do not support a conclusion of 'systematic' inappropriate treatment of customers under the original definition.

As a result, we do not believe that the term 'systematic' is appropriate for what should, in many areas, be more appropriately described as weaknesses in controls.

2. Widespread inappropriate treatment

We clearly acknowledge that in some areas we could have done better for SME customers in GRG and that some of these shortcomings would have been widespread.

The bank does not agree that that the evidence relied upon by the Skilled Person substantiates the key finding that the bank is guilty of *'widespread inappropriate treatment of customers'*.

The Skilled Person focused on conduct in isolation from customer outcomes and assessed inappropriate treatment independent of identification of any customer detriment or causal link.

There is also no distinction drawn between process failings and conduct failings. Taken together, these approaches result in misleading conclusions likely to be misunderstood as suggesting that the bank was guilty of serious conduct failings and that these led to poor outcomes for customers.

A significant number of shortcomings identified by the Skilled Person were process failings that did not, and indeed could not, have caused any customer detriment. By way of example, in the 118 findings in relation to pricing, the Interim Report states that they primarily related 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. Furthermore, the Skilled Person did not assess customer outcomes as part of its review.

3. Material Financial Distress

The report acknowledges that there was no clear causal link between any inappropriate actions of the bank and the insolvency of an otherwise viable business. However, one of the most significant findings in the report is that in a minority of the review sample (11% total, 16% of what the Skilled Person identified as potentially viable cases) the bank is likely to have caused material financial distress to customers.

We do not agree that the bank's actions caused material financial distress in these cases. In addition, we do not accept that there was any causal link between the actions of the bank and the insolvency of any of those businesses. The Skilled Person appears to classify an unquantified level of financial detriment as 'material financial distress', regardless of whether a customer has suffered any financial impact at all.

By way of example, seven of the nineteen cases identified by the Skilled Person, relate to pricing proposals which were either not implemented by the bank or not paid by the customer. As such, the customer's business cannot have suffered any financial detriment, let alone have become distressed.

4. Implications of the 'turnaround' findings

As acknowledged in the Interim Report, 'commercial lenders have no obligation to lend to a business customer on terms that they find unacceptable or to continue to lend on terms that are no longer being met by a business customer in default'.

The bank has serious concerns regarding the wider implications for both RBS and commercial lending generally in relation to certain findings and recommendations, particularly those relating to 'turnaround practice'. These concerns include, amongst others: the definition of a 'customer' and duties to third parties; the finding that the absence of extended forbearance or debt forgiveness may constitute unfair or inappropriate customer treatment; and an obligation to consider all potentially credible customer proposals in each case, notwithstanding the increased risks to lenders' advances or collateral and the contractual rights open to lenders in the event of default by borrowers.

The turnaround obligations inferred or implied by the Skilled Person do not, in fact, exist. If they did, they would profoundly change the credit risks that banks are prepared to take and would set a precedent that would undermine the certainty of contractual bargains. In reaching many of its conclusions, we consider that the Skilled Person has paid insufficient regard to the underlying contractual relationship between the bank as lender and the customer as borrower.

These findings appear to be at odds with a bank's contractual rights and prudential obligations and to the best of our knowledge do not reflect how the SME lending market operates in practice. Indeed, some of these findings and recommendations seem more suited to a consumer lending landscape than to a commercial one. As such they could have, if implemented as suggested, significant implications for SME lending and the flexibility afforded to SME customers in distress.

5. GRG relations with customers

The Interim Report found that RBS's relations with its customers were often insensitive, dismissive and sometimes unduly aggressive. Whilst it may have been the case that examples of such behaviour did occur, we have seen no evidence to support this assertion on a widespread basis. The bank was not afforded the opportunity to review the allegations made by those customers who were interviewed by the Skilled Person. We would have investigated any such claims of poor behaviour as we take them extremely seriously.

GRG staff had to deliver very difficult messages in what were extremely stressful situations. This is not an easy task and we are sorry that we did not always get it right. As a bank, we continue to embed our desired culture, values and standards, and our approach to customer treatment, including in Restructuring.

That is why the steps we announced in November 2016 were developed with the involvement of the FCA; should any customer feel they were treated inappropriately, they should make use of the complaints process.

In response to your second question requesting clarification of GRG's objectives I believe two separate points are being conflated. In our press notice of 23 October, the passage quoted is referring to the current mandate of RBS Restructuring, rather than what had been GRG's objectives.

'We recognise there has been debate around the perceived or potential conflict in GRG's objectives. To give greater clarity, the bank's Restructuring function has a single, clear purpose: To protect the bank's capital. Where practicable it will do this by working with commercial and corporate customers to support their turnaround and recovery strategies and enable a return to mainstream banking. It will always aim to recover capital in a fair and efficient manner.'

The Interim Report sets out that GRG historically had the following objectives:

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

I believe that this is consistent with the evidence previously supplied by RBS to the Committee. I have also enclosed a document that sets out the key changes made to RBS Restructuring that have been designed to improve our customers' experience.

In closing, I should like to be clear that we made mistakes in the past. This was at a time when customers were going through a traumatic and painful experience and RBS was experiencing an exceptionally challenging period. The culture, structure and way RBS operates today has changed fundamentally since the period under review. We have made significant changes to deal with the issues of the past, so that the bank can better support SME customers in financial difficulty whilst also protecting the bank's capital. Most importantly, however, for customers who were in GRG during 2008 -13 we have put in place two processes, with the agreement of the FCA, to assist customers who were affected: an automatic fee review for complex fees and an independent complaints process. I firmly believe that these are the right steps to take, and the FCA agrees they are appropriate. We are working hard to ensure a fair outcome for our customers as soon as we can.

Yours sincerely



Ross McEwan