

CLIFFORD CHANCE LLP

**INDEPENDENT REVIEW OF THE CENTRAL ALLEGATION MADE BY DR
LAWRENCE TOMLINSON IN *BANKS' LENDING PRACTICES: TREATMENT OF
BUSINESSES IN DISTRESS***

CONTENTS

Section	Page
1. Introduction.....	3
2. Summary of findings.....	4
3. Methodology	8
4. Lending to SMEs	12
5. The restructuring process.....	15
B&C Group.....	16
B&C Credit/CRM.....	17
SRM.....	18
Transfer to BRG.....	19
Assessment of viability within BRG.....	26
Restructuring within BRG	29
6. Additional revenue ("upsides").....	33
7. Exit from BRG.....	38
8. Sales to West Register	41
9. Financial incentives	45
APPENDIX 1 Terms of Reference	51
APPENDIX 2 Interviews Conducted.....	53
APPENDIX 3 Path of a customer from mainstream B&C to BRG.....	55
APPENDIX 4 SRM Watch Classification.....	56
APPENDIX 5 Glossary of Terms	57

1. INTRODUCTION

- 1.1 Clifford Chance LLP was engaged by The Royal Bank of Scotland plc ("**RBS**") to independently review the central allegation made by Dr Lawrence Tomlinson in a report entitled *Banks' Lending Practices: Treatment of Businesses in distress* (the "**Tomlinson Report**").
- 1.2 Clifford Chance was instructed to investigate the central, most serious, allegation made in the Tomlinson Report: that the bank, through its Global Restructuring Group ("**GRG**"), was guilty of '*systematic and institutional*' behaviour in artificially distressing otherwise viable businesses, putting its customers '*on a journey towards administration, receivership and liquidation*'. We describe this allegation as the "**Principal Allegation**".
- 1.3 We understand that the Principal Allegation and other allegations made in the Tomlinson Report will be considered separately by Skilled Persons appointed by the Financial Conduct Authority pursuant to section 166 of the Financial Services and Markets Act 2000.

Tomlinson Report

- 1.4 The Tomlinson Report makes a number of observations and allegations in support of the Principal Allegation concerning the bank's lending to and recovery of debts from small to medium sized enterprises ("**SMEs**")¹ as follows:
- 1.4.1 The bank operates a '*process by which businesses are assessed for their potential value*' in order to select viable SME customers as targets.
- 1.4.2 The bank's actions '*artificially distress*' the customer, triggering a transfer to the bank's business support division so that the bank can take control of that customer's assets. The bank uses a number of mechanisms to '*engineer*' a default, including:
- (a) the manipulation of property valuations, through which the bank '*significantly undervalues the business's assets and puts [it] into breach of [its] covenants*'; and
 - (b) the withdrawal or failure to renew existing facilities, including overdraft facilities and expiring term-loans.
- 1.4.3 Once under the management of the business support division, actions are taken which put the customer '*on a journey towards administration, receivership and liquidation*'.
- 1.4.4 GRG acts as a '*profit making centre*' for the bank, extracting the greatest amount of value possible from the bank's customers by:
- (a) imposing additional fees;

¹ For the purposes of our review, we focused on SMEs in the United Kingdom of Great Britain and Northern Ireland.

- (b) requiring further equity injections and personal guarantees to assist with the turnaround process, in circumstances where *'the bank has no intention of supporting or helping the business'*;
- (c) re-negotiating pre-existing facilities on terms priced so as to enable GRG to extract the greatest amount of value from the business to maximise its recovery; and
- (d) purchasing properties *'at cut prices'* from customers in Business Restructuring Group ("**BRG**") within GRG through the bank's property acquisition vehicle, West Register, in order to make an *'easy profit'*.

1.4.5 Our terms of reference are appended at Appendix 1. Clifford Chance engaged two other firms of solicitors to assist in the review. The firms that assisted were DMH Stallard LLP and TLT LLP. In preparing this report, we have had regard to:

- (a) the *RBS Independent Lending Review* by Sir Andrew Large (the "**Large Review**") which was published on 25 November following the release of the Summary and Recommendations of the Large Review on 1 November 2013;
- (b) Treasury Select Committee appearances by Sir Andrew Large and Dr Tomlinson; and
- (c) media reports following the publication of the Tomlinson Report.

2. **SUMMARY OF FINDINGS**

- 2.1 Since its inception, GRG has had two overarching objectives, to return customers to financial health and to protect the bank's position by minimising losses and maximising recoveries.
- 2.2 Given the focus of the Tomlinson Report, our review focused on BRG, the primary group within GRG that deals with SMEs, and West Register, the group within GRG that purchased properties.
- 2.3 Our review focused on customer complaints and a sample of customer files.² We interviewed 138 customers and reviewed 130 files.³ A substantial portion of our sample comprised customers who wished to complain about issues relating to the Principal Allegation. We intentionally compiled a sample of files that was more likely to identify facts adverse to the bank; these files were most likely to hold evidence of the Principal Allegation, if such evidence existed. As a result, it is likely that our sample is not representative of BRG cases generally. Accordingly, our findings should be viewed in this context and take into consideration the nature of the file sample.

² References to "customer" in this report are references to customers that we have interviewed and/or whose files we have reviewed.

³ As explained below, not all the files that we reviewed related to those customers whom we interviewed.

- 2.4 It is clear that, for many customers, the BRG handover and subsequent restructuring process are stressful and unpleasant, which is to be expected given the circumstances, and can make dealings between the customer and the bank fraught. Both in relation to the handover process and the restructuring process more generally, some customers complained that they experienced insensitive, rude or aggressive behaviour. The evidence on the files did not allow us to reach a conclusion as to customers' concerns about their interactions with the bank during the process or the behaviour of any individual at the bank. This is not surprising as these concerns are based on customers' interactions with relationship managers in meetings or over the telephone, and we are unable to verify such allegations about behaviour from written documents.
- 2.5 Our role was to review the files in so far as they were relevant to the Principal Allegation and not to resolve any individual complaints or any factual disputes that arose during the course of our review.
- 2.6 In carrying out our role, we were not restricted as to documents we could request from the bank and we were given access to any employees with whom we wished to speak. The bank co-operated with our review and provided us with 130 customer files, comprising 400,000 pages and 1,200 documents, including template customer communications, policies, minutes, management information packs, appraisal forms, watch list records, training materials and internal communications. We interviewed 45 employees.⁴
- 2.7 We set out below key questions arising from the Principal Allegation in bold, and our findings in relation to them.
- Does the bank operate a 'process by which businesses are assessed for their potential value' in order to select viable SME customers as targets?***
- 2.8 If the bank was guilty of '*systematic and institutional*' behaviour in targeting and then artificially distressing otherwise viable businesses, Specialised Relationship Management ("**SRM**"), which often would have had involvement with customers who were ultimately placed in BRG, would have played a central role in identifying customers and procuring their transfer to BRG. We did not find any evidence of this.
- 2.9 We have found no evidence that BRG proactively contacts the Business and Commercial group ("**B&C**") to discuss customers or initiate the transfer of a customer to the watch list or to BRG. Prior to a customer entering a "Watch process", BRG has limited access to customer information.
- 2.10 We did not see any evidence in our review of customer files, BRG management information packs, in our discussions with employees of the bank or otherwise, of BRG seeking to '*take*' cases through the Watch process.
- 2.11 We did not find evidence of West Register procuring the transfer of a customer to BRG.

⁴ We carried out 37 interviews, as some individuals were involved in multiple interviews and some interviews involved multiple individuals.

- 2.12 We found no evidence of West Register identifying properties which it wanted to acquire or procuring their acquisition.

Does the bank 'artificially distress' customers, triggering a transfer to BRG so that the bank can take control of customers' assets? Does the bank 'engineer' defaults?

- 2.13 The decision to transfer a customer to BRG is based on a list of triggers that result either in a mandatory transfer to BRG or mandatory referral to and discussion with BRG. An event of default is not necessarily required for a case to be transferred to BRG. Nor does an event of default necessarily result in a transfer to BRG.

- 2.14 We identified a number of cases where a customer had been transferred to BRG without an event of default having occurred. In these cases, the bank had significant concerns about the customer's financial position. We also identified a number of cases where transfer to BRG occurred as a result of an anticipated, as opposed to an actual, breach. In these cases, the bank was aware that there was little chance of repayment and that an event of default was almost certainly due to occur. We did not identify any files which fitted the description of the bank 'engineering' a default or 'artificially distressing' a customer.

Does the bank manipulate property valuations to 'significantly undervalue' customers' assets and put them into breach of their covenants?

- 2.15 The bank obtains external valuations to assess LTV covenant breaches. We saw no evidence on the files that we reviewed that the bank exerted undue influence on external valuers in order to procure a covenant breach. The bank carried out internal valuations for a different purpose: to assess whether or not one or more of the triggers for transfer to BRG occurred. We have seen no evidence that the bank deliberately manipulated valuations to procure a customer's transfer to BRG. In our review, we did not test the accuracy of the bank's valuation methodology.

Does the bank withdraw or fail to renew existing facilities including overdraft facilities and expiring term loans?

- 2.16 We identified cases where customers felt that the bank should not have withdrawn its overdraft. From our review of the files, it was clear that the bank believed that the customer was failing to deal with the signs of financial distress when it withdrew overdraft facilities and/or did not renew expiring term loans.

Once the customer is under the management of BRG, does BRG put the customer 'on a journey towards administration, receivership and liquidation'?

- 2.17 If the bank was guilty of 'systematic and institutional' behaviour in artificially distressing otherwise viable businesses, putting its customers 'on a journey towards administration, receivership and liquidation', we would not expect to see genuine efforts at restructuring the customers' businesses and finances, and endeavouring to return them to financial health. Even where BRG were ultimately unable to return the customer to the mainstream bank, this generally followed a period where the bank and the customer made serious attempts to achieve a restructuring.

- 2.18 In a substantial proportion of the cases where we could identify the relationship manager's initial assessment of viability and strategy the relationship manager's strategy was to return the customer to the mainstream bank or effect an otherwise viable exit (e.g., repayment or re-banking).
- 2.19 In our review of files, we observed a number of cases where the customer returned to the mainstream bank and we observed a number of cases where the customers successfully re-banked.
- 2.20 In some instances BRG provided additional funding in the absence of equity injections from the customer or a third-party.
- 2.21 In the case of customers that ultimately underwent an insolvency process or entered receivership, there was clear evidence on the files that we reviewed that the bank considered the customer to be suffering pre-existing financial distress sufficient to affect its viability.

Does GRG act as a 'profit making centre' for the bank, extracting the greatest amount of value possible from the bank's customers?

- 2.22 The performance indicators for BRG as a group, and relationship managers as individuals, reflect the two principal objectives of GRG: to return customers to financial health and to protect the bank's position by minimising losses and maximising recoveries.
- 2.23 Where the bank permits additional borrowing or reschedules/restructures existing debts for such a customer, the bank is not bound to continue providing the same rates that the customer obtained when its financial health was better and credit was generally cheaper.
- 2.24 The bank has no financial incentive to unnecessarily bring about the customer's insolvency by imposing unaffordable interest and fees. We found no examples where the bank deliberately charged interest and fees which it believed or knew that the customer could not afford.
- 2.25 Where customers contacted us to discuss their complaints, these generally included a complaint about the level of fees or other upsides.⁵ A number of complainants commented that they felt pricing of restructured facilities lacked transparency.
- 2.26 In reviewing the files, we found it difficult to understand how the bank calculated the fees which it proposed to customers in any particular case and therefore found it difficult to assess allegations of unfairness. This has led us to make a recommendation to the bank that we believe will assist with transparency on fees.

Does the bank require further equity injections and personal guarantees in circumstances where the bank has no intention of supporting or helping the business?

⁵ Within the banking sector, "upsides" is the term used to describe additional revenues derived from the customer by a bank, such as margin, arrangement fees, exit fees and other deferred fees.

- 2.27 We found no evidence that the bank sought additional equity, guarantees or other forms of security in circumstances where it intended to stop supporting any of these customers.

Does West Register purchase properties 'at cut prices' from customers in BRG in order to make an 'easy profit'?

- 2.28 We found no evidence that the bank '*low-balled*' bids to customers in the hope or expectation of acquiring properties at a low price.
- 2.29 West Register operates as a bidder of last resort or a fall-back option where the open market will not yield a better offer. We saw several cases where West Register's bid was substantially higher than the next highest bid. When West Register acquires a property in an open market sale (either directly from the customer or from an insolvency practitioner), it has by definition not purchased a property at a discounted price as the market value of a property is what the market is willing to pay.
- 2.30 Even if it could be said that West Register had purchased a property at below market value in an insolvency situation, it does not follow that the bank would make an '*easy profit*', as the Tomlinson Report states. Any perceived '*gain*' to West Register (being the difference in sale and purchase price of an asset) would be offset by any write-off made by the bank on the customer's loan.
- 2.31 We did not identify any complaints or files where a customer was '*forced into a corner*' or accepted '*conditions they otherwise would not*' when agreeing a consensual sale to West Register.
- 2.32 We did not observe examples within our sample of purchases of properties from SMEs which resulted in subsequent sales at a substantial profit to West Register (comparing the purchase price and sale price only).

3. METHODOLOGY

- 3.1 Our review focused on customer complaints and a sample of customer files. We interviewed 138 complainants and, where the complaint was within the scope of our review and the customer gave his or her consent, reviewed the attendant files. In addition, we constructed a further sample population of files having regard to the areas we considered most likely to hold evidence relating to the Principal Allegation, if such evidence existed. Reviewing files relating to complainants together with our sample population resulted in our having reviewed 130 files in total.

Review of customer complainants

- 3.2 Like the Tomlinson Report, our review is based largely on customer concerns and complaints. We understand that the Tomlinson Report draws on 20 complaints relating to the bank. The Tomlinson Report identifies certain themes which led him to conclude that GRG was guilty of '*systematic and institutional*' behaviour in artificially distressing otherwise viable businesses, putting them '*on a journey towards administration, receivership and liquidation*'. Some of the customers we have contacted have also spoken with Dr Tomlinson.

- 3.3 Following the announcement of our appointment, 104 customers contacted us asking to be included in our review. The bank referred 34 customers from whom it had complaints to us to include in our review. We sought to invite further customers to share their experiences of dealing with BRG by:
- 3.3.1 asking Dr Tomlinson to provide us with the names of bank customers which he considered relevant for our review;⁶
 - 3.3.2 asking the Department for Business, Innovation and Skills to encourage any SME customers who contacted BIS before or after the Tomlinson Report to contact us;
 - 3.3.3 contacting three law firms which represent SME clients who believe that they were victims of the practices alleged in the Tomlinson Report; and
 - 3.3.4 contacting a group called "RBS GRG Business Action Group" which was formed '*to collate evidence and research and pursue avenues for compensation for [its] members*'. We asked this group to share our details with any of their members who wished to be included in our review.
- 3.4 For each customer that we contacted, we undertook a "triaging" exercise in order to identify and exclude from our review those customers whose experiences were unlikely to be relevant to the Principal Allegation made in the Tomlinson Report. We excluded complaints that fell outside the scope of our review having regard to, amongst other things, the nature of the complaint and the time period to which they related. For example, customers whose complaints related to other banks, those whose complaints were unrelated to financially distressed companies (e.g., complaints about malfunctioning cash machines), those who wished to share positive experiences of BRG (on the basis that satisfied BRG customers would not assist us in determining whether or not other customers were artificially distressed). We excluded cases that referred to events prior to 2008 in order to limit our review to the financial crisis period.
- 3.5 The remainder of customers were contacted either by our firm, or by the law firms assisting us with our review (TLT and DMH Stallard). Collectively, we interviewed 138 customers, who told us about their experiences with BRG. These discussions lasted between 30 minutes and two and a half hours each. The purpose of the discussions was to establish whether the customer believed or suspected that they were or may have been affected by the practices described in the Tomlinson Report or similar practices. If so, we discussed the specific aspects of the bank's conduct they were concerned about. We requested their consent to retrieve their files from the bank and review them.
- 3.6 There were several customers whose concerns were manifestly irrelevant to our review (similarly to those described above at 3.4), and this only became clear in our discussions with them. For example, one customer's complaint dated back decades and had been the subject of multiple legal proceedings against a large number of

⁶ Dr Tomlinson encouraged customers to contact us, but he was unable to pass customers' details to us directly without customers' prior consent.

parties including the bank. Some customers did not consent to our retrieval of their file from the bank.

First-level review

- 3.7 The bank provided us with 51 files at our request. These related to the 138 complaints we received after we excluded those that fell outside our scope as set out in 3.4 and 3.6 above.
- 3.8 In many instances, the complainant provided further information and documents directly to us.
- 3.9 We also reviewed a sample of other files dealt with by BRG. These files were selected from the following sources:
- 3.9.1 **Disputes with BRG customers where the bank settled the claim without going to court.**⁷ We included this sample in our review at the suggestion of Dr Tomlinson. Only two of these customers consented to being included in our review.
- 3.9.2 **Acquisitions of SME properties by West Register.** We selected a sample of 42 West Register files representing a quarter of all SME customers whose properties were purchased by West Register in the period 2008 to 2013. We selected this sample from a list of all acquisitions from SME customers in this period. We ensured that our review covered an even distribution of cases by date, across a range of BRG regional offices, a spread of purchases directly from the customer (consensual sales) and from insolvency practitioners and a range of properties, from high value properties (such as hotels) to residential properties. We targeted acquisitions which resulted in a subsequent sale by West Register and cases where the value of the property in West Register's system appeared to have increased, or remained close to the acquisition value (i.e., we sought to avoid cases where West Register purchased the property and its value appeared subsequently to have fallen).
- 3.9.3 **Equity participations.** We selected 15 files for review from this population. There were relatively few equity participations relating to BRG customers. We selected a range of cases by date, targeting those where the bank secured substantial equity participation.
- 3.9.4 **Property Participation Fee Agreements ("PPFAs").** There was a large number of PPFAs. We selected 15 files for review from this population, targeting those where the bank secured a large participation in the value of customers' real estate assets.
- 3.9.5 **Other cases.** We identified a number of cases from other sources over the course of our review. We selected five such files for review.
- 3.10 For each of these sample categories, a file request was sent to the bank. To obtain these documents, the bank first contacted the relationship managers and requested

⁷ There were 18 such cases.

originals of all their customer files. Any hard copies were photocopied and returned to the relationship managers. Electronic files would be uploaded to a secure shared drive and access was granted to Clifford Chance. The relationship managers' files were supplemented with print-offs from the bank's electronic relationship management system ("**RMPS**"), which contained credit submissions and provisions. Complaint files were obtained from the bank's central complaints team. Strategy and Credit Review papers were obtained from a database/shared drive where they had been stored. West Register files were obtained from West Register. PPFAs and equity documentation was obtained from the Strategic Investment Group ("**SIG**"), the group within the bank that deals with equity participations, PPFAs and other non-cash upsides.

- 3.11 We reviewed 216 boxes of documents containing 130 customer files. The customer files we reviewed varied in length, with some files consisting of as little as 100 pages and others consisting of around 18,000 pages. These files consisted of over 400,000 pages in total. Most contained internal correspondence between employees of BRG and other areas of the bank; correspondence between the bank, the customer and third parties; copies of property valuations, independent business reviews and internal assessments of the customers' financial positions; and copies of facility agreements and related documents. Some files contained details of complaints which had previously been made by customers. We did not retrieve and review all electronic communications for each file. Our intention, in the time available, was not to comprehensively review all the material relating to each case, but to obtain sufficient information, including through reviewing electronic communications and other material in the files provided to us by the bank, to be able to assess issues which could relate to the Principal Allegation.
- 3.12 Clifford Chance worked with DMH Stallard and TLT on the first-level review of these files. For each file, we completed a standardised case analysis form, which identified the circumstances relating to a customer's experience with the bank and provided detail on key areas relating to the Principal Allegation. We also created a chronology for each customer file, listing documents that were important, missing or required further clarification. In some cases we requested and received additional documents from the bank. In other cases we interviewed relationship managers directly.
- 3.13 Whilst the files did not provide a complete record of the bank's dealings with the customer, they provided a contemporaneous record of the bank's perception of the customer, the reasons for its decision to transfer the customer into BRG, the restructuring strategy it sought to pursue and the progress and result of the restructuring process.
- 3.14 On the basis of the first-level file review, we assigned a relevance rating to each file, which indicated how closely connected the file was to elements of the Principal Allegation.

Second-level review

- 3.15 After the completion of the file review case analysis forms, Clifford Chance conducted a second-level review. The purpose of this was to identify matters that were potentially relevant to the Principal Allegation from the results of the initial

review. In a number of cases our assessment of file relevance ratings altered as we gained a fuller picture of the case and its relevance to specific elements of the Principal Allegation.

- 3.16 We conducted the second-level review with the aim of collating information about key stages of the customers' journeys through the bank. We divided this information into three stages: transfer to BRG, restructuring of the terms of lending and exit from BRG. The data obtained from this review informed the relevant sections of this report.

Interviews

- 3.17 GRG provided us with a high level briefing of GRG's role, business model and corporate structure. We also requested and received briefings from employees familiar with two technical areas: the bank's pricing calculators and the Asset Protection Scheme.
- 3.18 Clifford Chance and the firms assisting us also conducted 37 interviews with the bank's employees.⁸ Interviews generally lasted around two hours each, but several were much longer. The purpose of these discussions was to establish information concerning how policies, procedures and practices relevant to the Principal Allegation operated within the bank in the period 2008 to 2013.
- 3.19 A number of interviews relating to specific files were carried out with employees of the bank who were identified during the file review process. A list of interviews is appended as APPENDIX 2.

Whistleblowers

- 3.20 During a meeting with BRG managers at the bank's offices in London on 8 January 2014, we encouraged employees of the bank to submit any relevant information to Clifford Chance by e-mail. We offered anonymity to anyone who contacted us in this way. We also made interviewees aware of the e-mail address. We received one e-mail from a current employee at the bank, who suggested that we include a particular customer in our review because the employee believed that the customer had been treated unfairly by the bank. We included this customer in our interview process.

Information and documents

- 3.21 Apart from the customer files which were uploaded onto the mentioned secure shared drive, a large number of other documents were provided to us at our request. These include template customer communications, policies, minutes, management information packs, appraisal forms, watch list records, training materials and internal communications. We received approximately 1,200 such documents.

4. LENDING TO SMES

- 4.1 This section provides an overview of the parts of the bank that are relevant to the Principal Allegation, in particular those divisions that are active in the SME market.

⁸ We interviewed 45 employees, as some individuals were involved in multiple interviews and some interviews involved multiple individuals.

- 4.2 The focus of the Tomlinson Report is on SMEs. There is no standard definition of an SME. The European Commission maintains a working definition:
- 4.2.1 Enterprises with less than 250 employees with a turnover of €50m or less or a balance sheet total of €43m or less constitute a "medium-sized" enterprise.
- 4.2.2 Enterprises with less than 50 employees with a turnover of €10m or less or a balance sheet total of €10m or less constitute a "small" enterprise.
- 4.3 The Large Review defined SMEs as customers with an annual turnover of less than £25m. In 2008, the bank's share of lending was 40% of all lending to SMEs by major high street banks. It was the largest lender to SMEs in the UK.⁹ According to the Large Report, the bank's stock of lending to SMEs was £55bn at the market peak. The bank's stock of lending to SMEs has since reduced to £38bn and its share of lending is now 33% of major high street banks. However, the bank remains the biggest lender in the SME market, with the largest customer and borrower base.
- 4.4 The bank manages its relationships with SME borrowers primarily through B&C, which sits within the bank's Corporate Banking Division ("**CBD**"). For the purposes of our review, B&C's primary relevance is that most of the SME customers in the bank's restructuring group were previously managed in B&C, which would have been involved in the handover of customers to BRG.
- 4.5 GRG is the group within the bank that is responsible for dealing with financially distressed business customers. It operates across the Americas, the UK, Europe, Middle East, Africa and the Asia-Pacific region. It deals with a portfolio of debt of approximately £45bn and covers a wide range of the bank's business divisions (including Markets & International Banking, CBD and Non-Core Division). It deals with more than 10,000 cases and employs over 1,000 people.
- 4.6 GRG's mandate is set out in a memorandum dated 9 December 2008, which was published when its predecessor, the Specialised Lending Services ("**SLS**") division, was renamed the Global Restructuring Group. The memorandum states:
- 'Any material event which has a negative impact on the customer should result in a transfer to GRG. Typically, this will be characterised by a significant deterioration in some aspect of the customer's activity, such as trading, where a breach of covenant is likely or where a customer has missed or is expected to miss a contractual payment to anyone. 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.'*
- 4.7 GRG has two overarching objectives: to return customers to financial health and to protect the bank's position by minimising losses and maximising recoveries. When GRG was created, it described its '*main thrust of activities*' as '*rejuvenating and restoring customers to the business, rather than, as sometimes perceived, simply*

⁹ The Large Review, p. 25.

recovery from failed customers'. However, GRG also has a responsibility to protect the bank's capital and profitability, with associated financial objectives.

- 4.8 GRG has separate groups dealing with the management of real estate (which includes the group formerly known as West Register); equity and property participations and other non-cash upsides (SIG); and management of corporate exposures in the UK ("**GRG UK**"). GRG UK currently employs around 300 people. It includes:
- 4.8.1 UK Corporates, which deals with the restructuring of listed companies, syndicated loans and customers with in excess of £20m in borrowings;
 - 4.8.2 Special Situations, which manages professional negligence claims against professional service providers to the bank;
 - 4.8.3 Divested, which manages distressed business loans in those parts of the bank that will be divested when the Williams & Glyn challenger bank is created;
 - 4.8.4 Recoveries & Litigation, which is responsible for insolvencies and receiverships; and
 - 4.8.5 BRG, which is described below.
- 4.9 Our review focused primarily on BRG.¹⁰ BRG is the division of GRG that principally deals with SMEs. It manages the bank's relationship with financially distressed borrowers where borrowings total between £1m and £20m.¹¹
- 4.10 The term "SME" is a reasonable shorthand description of customers dealt with by BRG, taking account of their size. These customers are not necessarily SMEs in the sense that the term is sometimes used. They include everything from sole traders and small-scale property owners (e.g., individuals or families who borrowed in excess of £1m to acquire small portfolios of buy-to-let residential properties or to develop a single property for onward sale) to larger, more complex businesses (e.g., factories and manufacturers, care homes, small hotel chains, industrial, residential or office property developers and road haulage companies).
- 4.11 From 2008 to 2013, BRG's caseload grew from 1,735 customers in 2008 to a peak of 5,043 customers in 2011. The number of cases in BRG has fallen from 2011, reaching 4,302 in December 2013. Turnover of cases was substantial. Each year from 2008 to 2013, BRG accepted between 1,200 and 2,600 new cases and between 700 and 2,000 customers exited BRG.
- 4.12 BRG's portfolio represents around half of the GRG debt portfolio by number. BRG handles a portfolio of debt totalling over £5bn, around 60% of which relates directly to commercial real estate. Much of the remainder of BRG's portfolio relates indirectly to real estate; it includes hotels and restaurants, care homes, construction companies and road haulage businesses servicing the construction sector. As a result,

¹⁰ For the purposes of our report, references to BRG include Divested.

¹¹ Larger financially distressed customers, including listed companies, were dealt with in UK Corporates within GRG, described above. Smaller financially distressed customers, with borrowings less than £1m, were dealt with by a separate credit function within GRG called the Strategy Management Unit.

BRG is particularly exposed to the property lending market, which was hard-hit in the financial crisis.

- 4.13 BRG operates across seven regions in the UK: London, Birmingham, Bristol, Cambridge, Edinburgh, Leeds and Manchester. Its largest regional office is in London, with 34 employees. The smallest BRG regional office is in Cambridge, with five employees. For each region, there is a Regional Head¹² and a combination of Corporate Directors, relationship managers and support staff. BRG employs around 130 employees, representing just over half of the workforce in GRG UK and around 10% of GRG's global headcount.
- 4.14 Our review also covers other parts of GRG that deal with SME customers and parts of the bank that would have dealt with these customers before their transfer to BRG. In particular, we focus on the division of GRG that acquires properties from customers. This group was previously known as West Register and is distinct from BRG. In June 2013, West Register was consolidated into Real Estate Asset Management ("**REAM**"). For the sake of simplicity, we will refer to it as West Register. We also focus on Recoveries and Litigation, which is responsible for those customers either in an insolvency process or where a receiver has been appointed.
- 4.15 West Register was established in 1992. Its function is to acquire real estate from financially distressed or defaulted customers of the bank and to manage and sell these properties in order to maximise the bank's recovery. The properties are acquired by one of the bank's West Register private limited companies. West Register actively manages properties by letting empty properties, obtaining planning permission and/or developing properties prior to their sale. It acquires properties in one of three ways:
- 4.15.1 from an insolvency practitioner or receiver;
 - 4.15.2 in an open market sale from a customer seeking to reduce its debts; or
 - 4.15.3 following an agreement with a customer which is not in an insolvency process or receivership, and which agrees to sell the property to West Register.
- 4.16 In December 2012, West Register's UK property portfolio was valued at £929m. Property acquired from the bank's UK SME customers totalled approximately £400m, less than half the overall portfolio. Between 2008 and 2013, West Register made acquisitions from 166 SME customers¹³ at an average of approximately 50% of the original loan value at the date of the transfer to GRG.

5. THE RESTRUCTURING PROCESS

- 5.1 In this section we describe the passage of a customer from the mainstream bank to BRG. We cover the factors within the mainstream bank that could lead to a transfer to BRG, the process by which the mainstream bank identifies and monitors financially stressed customers, and the process by which customers are transferred to BRG. We

¹² There are two Regional Heads of BRG in London.

¹³ In March 2009, the bank changed its method for recording acquisitions made by West Register. Accordingly, these figures may not include all customers from which properties were acquired prior to March 2009 and may include customers from which properties were purchased prior to 2008.

describe the handover process from the mainstream bank to BRG. We set out the process that BRG typically follows: assessing the customer's viability and developing a strategy to return the customer to financial health while protecting the bank's position. We describe the ways in which BRG goes about the restructuring process. We then turn to the various ways in which customers exit BRG.

- 5.2 At each point in the process, we refer to the criticisms explicitly or implicitly made in the Tomlinson Report and assess whether the results of our review support or contradict these criticisms.

B&C Group

- 5.3 As described in the previous section, the bank manages its relationships with SME borrowers within the mainstream bank, primarily through the B&C group.

Lending policies

- 5.4 The Large Review states that, in the run-up to the financial crisis, '*[b]anks lent without sufficient discipline and SMEs were able to borrow cheaply and easily instead of raising equity.*'¹⁴ B&C's lending to customers is governed by the bank's group policy. Lending criteria within CBD are governed by a large number of sector-specific policies and guidelines. These policies are subject to regular review and respond to market dynamics and changes in the bank's lending appetite.
- 5.5 The lending policies set out the bank's credit risk¹⁵ appetite and lending parameters in detail. We reviewed the policies from three of the 49 commercial sectors as a sample: residential property investment, care homes for the elderly, and hotels and guesthouses. The policies were updated several times between 2008 and 2013. They include:
- 5.5.1 general statements about the bank's lending appetite (e.g., positive, cautious or negative);
 - 5.5.2 '*key drivers*' that inform appetite for individual transactions and specify areas to be assessed when making lending decisions; and
 - 5.5.3 general lending parameters that govern how facilities should be structured.
- 5.6 Going into the financial crisis, the bank was substantially exposed to the commercial real estate sector. The Large Review records that in 2008, the bank's share of overall lending to the commercial real estate sector was 46%. This figure has fallen to 35% since 2008.
- 5.7 Following the drop in the value of real estate at the end of 2008, it became more difficult for customers to sell developments that were financed with short term interest-only repayment loans. This precipitated the transfer of many commercial real estate developers to BRG, while also reducing the demand for lending on new

¹⁴ Large Review, p 12.

¹⁵ Credit risk is the risk that a bank borrower or counterparty will fail to meet its contractual obligations to the bank.

developments. At the same time, B&C's appetite for lending to commercial real estate developers changed. These changes had two principal effects on B&C's lending to the real estate sector. There was a 'run-off' of B&C's commercial real estate book whereby loans that were repaid were not replaced by new lending. Those customers that could not repay their loans, or whose financial position deteriorated, were transferred to BRG.

- 5.8 Within the bank, the relatively benign pre-crisis approach to commercial property lending included fewer and less strict covenants and greater availability of interest-only loans. As the bank's credit policies tightened following the onset of the financial crisis, the bank's guidance specified a range of tests in order to determine whether a customer remained within the bank's credit risk appetite.
- 5.9 The result of the tightening of the bank's credit policies was that, over time, customers who had previously been able to secure lending without much difficulty found that they were outside the bank's lending policies. As long as the customer did not default on its contractual obligations, this would not necessarily have had any impact on the customer. However, if the customer's loan came up for renewal, or if the customer defaulted on its loan obligations, it might find itself unable to obtain lending on terms similar to those that had been available in the previously benign market.
- 5.10 This particularly affected commercial real estate developers because they tended to have shorter term loans, which meant that many commercial real estate development loans came up for repayment/renewal in the period 2008 to 2013. Where distressed loans or expiring facilities fell outside the bank's lending criteria, B&C was required to refer the lending to their credit department for review. Any increase in lending would have to be approved by B&C Credit in accordance with the bank's tighter lending policies and existing lending had to be managed back within the bank's credit policies.

B&C Credit/CRM

- 5.11 B&C Credit includes both mainstream credit teams and a unit called Credit Risk Management ("**CRM**"). Both groups are part of the bank's credit department, which is a risk management function rather than a customer-facing function, ultimately reporting to the bank's Chief Risk Officer.
- 5.12 CRM is responsible for credit risk management of higher-risk loans within B&C, which are referred to CRM from B&C Credit. CRM manages the bank's credit risk in relation to B&C customers who are experiencing early signs of financial stress, but who are not so financially distressed that they are transferred to BRG. These customers may be exhibiting signs of financial stress such as breaches of covenant, the loss of a key client, a drop in turnover, heavy reliance on their overdraft with or without a high level of excesses on the overdraft, or a sudden deterioration in its financial position or outlook. If CRM takes over the credit risk management of the customer, it will be subject to more frequent credit scrutiny. This would not typically be disclosed to the customer, although the B&C relationship manager could of course discuss the causes and effects of financial stress with the customer.
- 5.13 As part of its role, CRM identified and, along with B&C relationship managers, referred financially stressed customers to B&C's Specialised Relationship

Management team ("SRM") and financially distressed customers to BRG, as appropriate.

SRM

- 5.14 SRM was created in 2008 as a relationship team for financially stressed B&C customers. As at December 2013, SRM managed 8,606 customers in the UK. The rationale behind SRM's creation was twofold. First, it was set up to support financially stressed customers by transferring relationship management to B&C's most experienced relationship managers. Secondly, deploying experienced relationship managers to this unit helped the bank deal with the rapid rise in impairments in 2008, which are more resource-intensive for the bank to manage. Relationship managers within SRM typically have a smaller portfolio of customers than their mainstream B&C counterparts, usually managing between 30 and 40 customers each. In contrast, relationship managers in the mainstream bank typically manage 45 to 80 SME customers. The bank aims to return SRM customers to the mainstream B&C relationship management team within two to three years.
- 5.15 The Tomlinson Report does not refer to SRM. It does, however, refer to a whistleblower formerly employed at the bank who described how financially viable but financially stressed customers would be '*offered to GRG*' by the mainstream bank.¹⁶ For the purposes of our review, SRM is relevant because customers who were ultimately placed in BRG often passed through it.¹⁷ If the bank was guilty of '*systematic and institutional*' behaviour in artificially distressing otherwise viable businesses, SRM would have played a central role in identifying these customers and procuring their transfer to BRG. We did not find any evidence of this.
- 5.16 The existence of a group like SRM within the bank is not unusual. Banks generally recognise the need to have systems in place to identify and manage deteriorating credits and to provide early remedial action.¹⁸ The statistics suggest that SRM's role was in line with its aim as described above – to transfer customers back to the mainstream B&C relationship management team. A large proportion of customers exiting SRM were passed back to the mainstream B&C relationship management team. In 2009, 43% of cases which exited SRM returned to mainstream B&C relationship management and 1% did so by repaying their loans or re-banking. In 2011, 61% of cases which exited SRM returned to mainstream and 7% did so by repaying their loans or re-banking. By 2012, these figures had increased to 65% and 13% respectively.¹⁹

¹⁶ The whistleblower quoted on page six of the Tomlinson Report gives the example of a customer that is "*not in breach of its banking agreements but is say 10% down on budgeted performance*".

¹⁷ It was possible for customers to pass directly from mainstream B&C relationship management to BRG, but this tended to happen where an event occurred which was unforeseen by the bank. For example, if another creditor of the customer presented a winding up petition, or the customer's principal customer became insolvent or withdrew its business, a customer might pass directly from mainstream B&C relationship management to BRG.

¹⁸ See Principle 16 in the Principles for the Assessment of Banks' Management of Credit Risk (<https://www.bis.org/publ/bcbasc125.pdf>).

¹⁹ The remainder either stayed within SRM relationship management or were transferred into GRG.

Transfer to BRG

- 5.17 In this sub-section, we describe the process by which the mainstream bank identifies and monitors financially stressed customers and the process by which financially distressed customers are transferred to BRG. At Appendix 3, we attach a diagram of the path that a customer would follow if it was transferred from B&C to BRG. There are two principal routes by which an SME customer is transferred from B&C / SRM to BRG: through the "Watch process", a system designed to identify and manage potential problem cases, or by direct referral from B&C Credit/CRM.

Watch process

- 5.18 The Tomlinson Report refers to a whistleblower (an ex-employee of the bank) who stated:

'Each month relationship managers would submit the figures for their customers to the credit team in the bank. Should anything flag, it would be passed to the 'watch' committee. For example if a business is not in breach of its banking agreements but is say 10% down on budgeted performance, they will keep their eye on it. They may decide to offer it to GRG [...]. If GRG want to take it, and see some value from the business for the bank, it would then be passed directly to GRG and the relationship manager would be prevented from contacting the business at all going forward.'

- 5.19 A Watch process, or watch list, is a standard credit risk management tool in banks. Principle 16 of the Assessment of Banks' Management of Credit Risk issued by the Bank for International Settlements states that:

*'In order to facilitate early identification of changes in risk profiles, the bank's internal risk rating system should be responsive to indicators of potential or actual deterioration in credit risk. Credits with deteriorating ratings should be subject to additional oversight and monitoring, for example, through more frequent visits from credit officers and inclusion on a watch list that is regularly reviewed by senior management.'*²⁰

- 5.20 If a customer is displaying signs of financial stress, it is placed onto the bank's watch list. The primary responsibility for identifying these signs of financial stress rests with B&C relationship managers, who have a number of tools at their disposal including their annual review of customers, their access to the customer's management information and covenant monitoring.
- 5.21 We reviewed a sample of the bank's watch list papers between 2008 and 2012. The papers contain information organised into categories such as the watch priority (i.e., red, amber, or green), sector, relevant issue, review dates, proposed downgrades, funds in use and stressed loss. They also include a comments section for further information about the particular customer. Comments include details such as proposed strategy, current strategy and an explanation of the customer's position. This watch list is circulated to GRG and Credit on a regular basis. This list gives

²⁰ See <https://www.bis.org/publ/bcbssc125.pdf>.

BRG summary details of amber customers where there are indicators of potential or actual deterioration in the customer's position and credit risk.

- 5.22 In order to actively manage the customers within its portfolio, SRM chair two different types of Watch Forum: (a) territory watch, which occurs weekly (and where the review panel includes a representative from BRG, B&C Credit, a Territory Head from SRM and the SRM Head); and (b) national watch, for cases over £5m in value (where the review panel includes a representative from BRG, CRM Credit and a senior member of SRM).
- 5.23 The Watch Forum is a formal meeting with an agenda and recorded minutes. Papers are circulated a week ahead of the meeting. The Watch Forum reviews a summary of the customer's situation and discusses any issues that have arisen with the customer's SRM relationship manager. It operates as an advisory body. The Watch Forum process is governed by the bank's Group Credit Risk Policy, which requires divisions throughout the bank to adhere to a consistent monitoring process. At the bank, customers on the watch list are classified as being green, amber or red. The full classification system is set out in Appendix 4. Essentially, customers that are not in the Watch process are classified as green, customers on the Watch process are classified as amber (and sub-classified as amber improving, amber maintenance and amber active) and customers to be transferred to BRG are classified as red.²¹
- 5.24 From our discussions with individuals in Credit, we understand that there are a number of triggers that might justify an amber classification, including a breach of covenant, regular excesses on overdrafts, declining turnover, debt re-amortisation, and the fact that the customer was outside the bank's credit policy.
- 5.25 Decisions are made as a result of matters discussed at a Watch Forum, such as milestones that the customer should aim to meet or the return of a customer to mainstream B&C relationship management, with decision-making authority in relation to SRM's lending to these customers resting with CRM. The Watch Forum can propose the transfer of a customer to BRG, and the authority to make the primary decision rests with B&C Credit, subject to the right of BRG to override this decision. Panel members we have interviewed emphasised that it was rare for there to be disagreement between the members.
- 5.26 For the purposes of our review, the issue is whether the Watch Forum operated as an opportunity for BRG to 'take' cases from B&C as described in the Tomlinson Report. The Watch process involves senior representatives from BRG, B&C Credit/CRM and SRM. We note that if BRG had sought to 'take' cases from the watch list based on their revenue potential instead of the credit risk to the bank, it could not have done so without the knowledge of both senior B&C Credit and SRM representatives (i.e., without the involvement of people outside BRG). We did not see any evidence in our review of customer files, BRG management information packs, in our discussions with employees of the bank or otherwise, of BRG seeking to 'take' cases in this manner.

²¹ Customers already in default are classified as black and are likely to go straight to Recoveries & Litigation.

BRG's access to customer information prior to Watch or direct referral

- 5.27 There is no information barrier between BRG and B&C/SRM. BRG relationship managers have a certain degree of visibility over customer information through access to the RMPS, the tool that B&C relationship management employ to manage customer information.
- 5.28 However, we have found no evidence that BRG proactively contacts B&C to discuss customers or initiate the transfer of a customer to the watch list or to BRG. On occasion, B&C contacted BRG to discuss a customer, such as where an unusual event had occurred or to indicate that the customer would be placed on the watch list, but we have been told in interviews with individuals at the bank that in practice this was rare.

Direct referral - triggers for transfer to BRG

- 5.29 The decision to transfer a customer to BRG is based on a list of triggers that result either in a mandatory transfer to BRG or mandatory referral to and discussion with BRG. These triggers have remained largely unchanged since they were drafted in June 2009.
- 5.30 We have the following observations on the triggers for transferring files to BRG:
- 5.30.1 An event of default is not necessarily required for a case to be transferred to BRG. Nor does an event of default necessarily result in a transfer to BRG. In one instance, the customer's loan was restructured in B&C to include covenants requiring the disposal of property assets. The schedule for disposal of properties was extremely challenging for the customer. The customer was unable to meet the required targets. The customer breached the relevant covenant, but it was not transferred to BRG. Instead, the customer was transferred to SRM to be managed back to the mainstream bank.
- 5.30.2 We identified a number of other cases where a customer had been transferred to BRG without an event of default having occurred. These included where there was a marked drop in the customer's risk rating, where there were excesses on overdrafts or other miscellaneous signs of financial distress. In one example, a customer was transferred to BRG after incurring extensive legal costs as a consequence of losing litigation against a third party contractor resulting in the bank having significant concerns about the customer's financial position.
- 5.30.3 We identified a number of cases where transfer to BRG occurred as a result of an anticipated, as opposed to an actual, breach. In the majority of these cases, the anticipated breach was not the only trigger for transfer to BRG. In some cases, an anticipated breach was the sole trigger for transfer to BRG. For example, where a term facility was shortly to become due for full repayment and the bank was aware that there was little chance of repayment and that an event of default was almost certainly due to occur, the bank would transfer the file to BRG.

- 5.30.4 While some of the triggers are clear-cut, such as the existence of insolvency proceedings or litigation against the bank, others involve the exercise of judgment. One of the triggers, for example, is "a breakdown in the customer relationship". In the files we reviewed, this trigger applied where the bank had some reason to doubt the customer's good faith. For example, one customer misled the bank about whether his property development was complete, subsequently admitting to the bank that he had '*played*' the bank.
- 5.31 The Tomlinson Report describes instances where '*the distress or breach of banking arrangements [by the customer] is directly caused by a change in loan terms by the bank [...] or the significant undervaluation of an asset*'. In the context of commercial property companies, the Tomlinson Report states that one way in which the bank '*engineers*' the default of businesses is by revaluing the customer's property at an undervalue, thereby triggering breach of the LTV covenant in the customer's facility agreement.
- 5.32 We did not see any instances of an LTV breach being the event that precipitated transfer to BRG. In the files reviewed we saw incidents of the bank using internal valuations to assess whether customers met other triggers for transfer into BRG (e.g., to assess whether there was a security shortfall for the bank). Internal valuations were not carried out to the standard of the Red Book²², but they were undertaken according to set assumptions by qualified surveyors employed by the bank. We saw no evidence that the bank deliberately manipulated valuations to procure a customer's default or transfer to BRG. Where the bank discussed the internal valuation with the customer, a number of customers told us that they did not agree with the bank's internal valuation, which was sometimes undertaken on the assumption of a short marketing period. In our review, we did not test the accuracy of the bank's valuation methodology. As the Tomlinson Report observes, '*valuation is an art, not a science*'.²³ The alternative to the internal valuation was an external valuation, the cost of which would have been borne by the customer. We saw no evidence on the files that we reviewed that the bank exerted undue influence on external valuers in order to procure a covenant breach.
- 5.33 The Tomlinson Report states that the trigger point for a customer's move to the business support division '*is sometimes so insignificant, given the otherwise positive performance of the business, that the reaction by the bank can only be considered as utterly disproportionate at best and manipulative and conspiring at worst*'. A BRG Regional Head we interviewed at the bank explained that BRG would resist accepting a case if it did not agree that the customer was in financial distress. In one file we reviewed, the bank had concerns that the divorce between a care home owner and her partner was affecting their joint business. Credit expressed a preference for referral to BRG, which declined to become involved because there had been no credit impairment at that stage. The case was seen as a matter of '*problem management*' as there had been no defined financial underperformance.

²² The Red Book contains mandatory rules, best practice guidance and related commentary for all Royal Institute of Chartered Surveyors ("**RICS**") members undertaking asset valuations.

²³ The Tomlinson Report makes this observation in the context of saying that valuations are '*therefore easy [...] to be manipulated*'.

- 5.34 We did not identify any files which fitted the description of the bank '*engineering*' a default. We identified one file in which mainstream B&C relationship managers discussed the possibility of testing the value of security to ascertain if that would precipitate a modest restructuring by reducing the customer's debt, and thereby proactively managing a problem anticipated to occur on expiry of the customer's interest-only facility. They recognised that a breach of covenant would assist them in persuading the customer to reduce the bank's exposure through this restructuring process. However, the revaluation did not take place and the customer was transferred to SRM. In another case, the BRG relationship manager sought legal advice on whether or not she could rely on a failure to provide management information as an event of default as she believed that the customer was wrongly diverting rental income. Before the relationship manager took any action, the customer provided the management information.

Overdrafts

- 5.35 The Tomlinson Report refers to the potential for banks to obtain unfair leverage by removing facilities from customers in order to improve the bank's negotiating position:

'Whilst it may be reasonable for the banks to want to change facilities, or renegotiate terms and personal guarantees, there are instances where the bank is not acting fairly when doing so and the resulting outcome has severe consequences for the business. Essentially the business is pushed into a corner given the speed and lack of ability to move to a different lender. The business is thus forced to accept terms they otherwise would not.'

- 5.36 An overdraft is customarily an on-demand facility. A bank is entitled to demand repayment of on-demand or uncommitted facilities at any point, and will generally do so where it is concerned that the customer will be unable to repay. A bank will monitor a customer's usage of an overdraft facility to determine whether the customer is showing signs of financial distress (e.g., customers that have utilised most or all of their overdraft and have insufficient cash flow to pay down the balance from time to time). When the customer is showing signs of financial distress, the bank will seek to mitigate its credit risk by managing its exposure to on-demand or uncommitted facilities. The bank's options for reducing its exposure may be to reduce the customer's dependence on the overdraft, reducing or removing the uncommitted facilities, or warning a customer that these facilities will be removed if it does not take some remedial action.
- 5.37 Within the B&C division, a typical overdraft for an SME customer would have been between £10,000 and £3m between 2008 and 2013. The bank employees that we interviewed were acutely aware of the impact of withdrawing overdraft facilities. The withdrawal or reduction of an overdraft might well result in a customer being unable to meet its debts as they fall due, risking the viability of the customer.
- 5.38 We have the following observations on the withdrawal or reduction of overdrafts:
- 5.38.1 **Customers that are not in financial distress:** On the face of it, calling in the overdraft of a non-financially distressed customer that is in compliance with its contractual obligations is counterproductive for the bank and the customer. When asked whether the bank would ever call in its on-demand facilities

(including overdrafts) in order to meet the requirements of the bank's changing credit policies, an interviewee explained that the bank would not precipitate a financial crisis for its customers by using the on-demand mechanism in such a way. The bank was also plainly aware that calling in on-demand facilities in a precipitous manner would destroy customer relationships.

- 5.38.2 **Customers in financial distress:** As the Tomlinson Report acknowledges, it is sometimes reasonable for a bank to withdraw or change the terms of a customer's overdraft. The bank has no obligation to maintain loan facilities and has the right to withdraw or reduce an overdraft and may well exercise that right when it fears that the overdraft will not be repaid.
- 5.39 Viewed from the customer's perspective, this may seem unfair and unreasonable. The customer may feel that the bank is seeking to precipitate a cash flow crisis for the customer, notwithstanding the fact that the customer has not defaulted on its payment obligations. Customers may believe that their difficulties are short-term and that the outlook will improve with time. As the owner of the business, they stand to benefit if this happens (and they will naturally believe that the bank will benefit as well). The bank, on the other hand, has the objective of avoiding or minimising potential losses.
- 5.40 We identified a small number of cases which illustrate this difference in perspective. In one case, the customer had purchased an asset with the expectation of reselling it at a profit. It had an overdraft which it was fully utilising and sometimes exceeded the authorised limit, but it was not in default of its payment obligations. The bank became concerned about the customer's financial outlook and told the customer that it would not renew its overdraft, which precipitated its transfer to BRG. The bank believed that the customer was failing to deal with the signs of financial distress. The customer believed that its difficulties were not serious and in any event short-term. The customer was ultimately able to re-bank, but felt strongly that the bank's failure to renew its overdraft was unwarranted.
- 5.41 We observed, in a GRG training manual, which contained some guidance on negotiating upsides, a reference to using the on-demand nature of the overdraft as a point of leverage in negotiations of equity upsides when the customer is not in breach of its facilities but the business may be experiencing underperformance against expectations/forecasts. There is a line between seeking to manage the use of an overdraft by a customer showing signs of financial distress, which is standard credit stewardship practice and using the on-demand nature of an overdraft as a point of leverage. The circumstances in which it is appropriate for a bank to remove or to warn a customer that it will remove an overdraft are beyond the scope of this report. While we did not see any examples of relationship managers leveraging the bank's position in this way (as opposed to seeking to reduce its exposure to customers that the bank believed were showing signs of financial distress), the bank may wish to revisit the reference in its training materials to clarify this.²⁴

²⁴ The document comprised pre-reading for a training course covering GRG's approach to upsides, including the principles and calculation of risk pricing. We note that the document was over 50 pages long and that the text we have quoted is not representative of the document as a whole. We also reference this document in 7.4.

Handover procedure

- 5.42 When a case is transferred to BRG, there is an internal handover meeting between B&C and BRG. The Regional Head of BRG assigns the customer to a BRG relationship manager. The B&C relationship manager prepares a handover report in standard form which contains relevant customer referral details and background information.
- 5.43 The B&C relationship manager then arranges a handover meeting with the customer, where the BRG relationship manager is introduced to the customer. The BRG relationship manager provides the B&C relationship manager with a handover pack that included a pro-forma letter to be sent to the customer setting out the reasons for the transfer to BRG, the purpose of the handover meeting and the reason for BRG's attendance. BRG's aim according to the letter²⁵ is to *'work constructively with [the customer] to develop a strategy which addresses the Bank's concerns and, where possible ensures a turnaround or recovery plan is delivered'*. Alongside the letter, the customer receives a handover pack describing BRG in further detail.
- 5.44 The handover meeting typically takes place at the customer's premises. It provides an opportunity for the BRG relationship manager to introduce him or herself, to build a rapport and working relationship with the customer, to start to understand the customer's business and to try to address any concerns that the customer might have. The BRG relationship manager is generally accompanied by a senior colleague from BRG.
- 5.45 We understand that, once the handover meeting has taken place, the BRG relationship manager obtains the files from B&C and a further post handover letter is sent to the customer. This letter describes, in detail, the issues that have resulted in the transfer of the customer to BRG. The objective of BRG is reiterated: to return the customer to mainstream banking once the issues being faced have been overcome. The letter also requires the customer to provide BRG with management information and a business plan, and set out important information such as that there will be a monthly management fee charged (to reflect the 'intensive business review and management of the relationship for this time') and that a security review would be carried out.
- 5.46 In our interviews with customers, some complained about aspects of the handover process. Their complaints included the fact that they had not understood prior to the handover meeting that they were being transferred to BRG, that they did not understand why they were being transferred, that they had no choice in the matter and that the transfer from B&C to BRG (frequently via SRM) was disruptive.
- 5.47 Additionally, and both in relation to the handover process to BRG and the restructuring process more generally, some customers complained that they experienced insensitive, rude or aggressive behaviour. It is clear that, for many customers, the handover and subsequent restructuring process are stressful and unpleasant, which is expected given the circumstances, and can make dealings between the customer and the bank fraught. The evidence on the files did not allow us to reach a conclusion as to customers' concerns about the process or the behaviour

²⁵ We understand that the letters have been amended from time to time but have remained substantially the same throughout the relevant period.

of any individual at the bank. This is not surprising as these concerns were generally based on interactions between customers and relationship managers in meetings or over the telephone. We were unable to verify such allegations about behaviour from the documents on file.

Assessment of viability within BRG

Due diligence

- 5.48 Post-handover to BRG, the relationship manager begins by assessing the viability of the customer. As a first step, the BRG relationship manager undertakes due diligence to understand the extent and underlying causes of the customer's financial distress. The relationship manager is given information by the B&C relationship manager (including the bank's internal Watch papers and credit reports). The B&C relationship manager prepares a handover checklist to ensure that all relevant materials are passed to BRG. Financial and other management information may be (and generally is) requested directly from the customer. This often occurs before the customer handover meeting takes place. The information requested includes the customer's business plan as well as up-to-date management accounts, aged debtor and creditor listings and forecasts, where applicable.

Independent experts

- 5.49 The BRG relationship manager may obtain assistance from external consultants and experts, including sector experts, accountants and other business professionals. BRG has the authority to instruct an independent expert, B&C does not. The need for independent expertise may be one of the factors triggering the transfer to BRG. We note from our review of the files and our discussions with the bank's employees that, apart from solicitors undertaking security reviews, independent experts are not frequently engaged by BRG and those that are engaged typically have a limited remit. A full independent business review is rarely undertaken for SME customers.
- 5.50 Security reviews, whereby firms of solicitors assess the availability of the bank's security in return for a fixed fee (typically around £2,000), were standard practice in BRG. If the security structure is simple then the relevant BRG Regional Head can waive this requirement. Security reviews are undertaken because although the bank may have been satisfied with the security position at the outset of the banking relationship, the security may not still be enforceable. We understand that, pursuant to the terms of facility agreements in place, the cost of the security review is passed on to the customer.
- 5.51 During our conversations with customers, some concerns were raised in respect of both the scope and costs of reviews undertaken. This issue is not directly related to the Principal Allegation. We can see that there may be scope for disagreement between the bank and the customer about the necessity for a review and whether or not the review represented good value for the customer in certain circumstances.

Determining viability and strategy

- 5.52 The relationship manager then makes a determination of the customer's viability, based on a variety of factors, including (i) short-term liquidity analysis, (ii)

product/service demand and its sustainability, (iii) expected market evolution and competitive position of the business. Other factors taken into consideration include the capital structure of the customer and the breadth and quality of the management team. The relationship manager's assessment of the customer's viability is a subjective exercise albeit based on quantitative and qualitative elements.

- 5.53 The Principal Allegation suggests that BRG deliberately categorises customers as non-viable, in order to financially distress viable customers and put them '*on a journey towards administration, receivership and liquidation*'. In a substantial proportion of the cases where we could identify the relationship manager's initial assessment of viability and strategy, the relationship manager's strategy was to return the customer to the mainstream bank or effect an otherwise viable exit (e.g., repayment or re-banking). The remainder of cases where we could identify the relationship manager's initial assessment of viability and strategy were assessed as non-viable and were transferred to Recoveries and Litigation. On the files we reviewed, we saw no evidence of BRG relationship managers deliberately categorising customers as non-viable.

The Asset Protection Scheme

- 5.54 We sought to determine whether a relationship manager's strategy may have been influenced in circumstances where the customer's assets were subject to the Asset Protection Scheme ("**APS**"). The APS is a government scheme set up in 2009 to provide the bank with credit protection against £282bn worth of assets. The scheme was set up with Her Majesty's Treasury, and the Asset Protection Agency ("**APA**") was created to oversee the scheme. In accordance with the APS, the bank was required to manage certain assets in accordance with a number of detailed rules (the "**APS Rules**"). The APA played a part in the management of particular assets within the bank until the bank exited the scheme in October 2012.
- 5.55 Decisions involving assets covered under the APS were subject to a particular framework known as the Asset Management Objective ("**AMO**"). The AMO was to maximise the net present value of assets within the scheme. This involved minimising any losses and maximising any recoveries, in order to minimise the risk of loss to the APS (and ultimately, the UK taxpayer). The assets subject to the APS included some, but not all, loans from the bank to SME customers.
- 5.56 Where loans managed by BRG were subject to the APS, the strategy that BRG took in relation to the loans required an analysis of the effect of all the available options on the net present value of the loan in the bank's accounts. The bank was required to pursue the option that maximised the relevant asset's net present value, in accordance with the APS Rules.
- 5.57 Where a loan was subject to the APS, if a strategy such as forbearance (which may have been the option chosen by the bank in the absence of the APS) yielded a lower net present value than, for example, enforcing the bank's security, then the bank would have been compelled to enforce its security.
- 5.58 We were unable to determine the precise extent to which the APS impacted upon SME customers in BRG prior to its termination in 2012. In our discussions with interviewees, some told us that there was a sentiment on the part of the APA that the

bank sometimes took too long to refer cases to GRG. Additionally, we were told that, conceptually at least, the operation of the APS, in particular the net present value calculation, would have encouraged West Register to bid more and therefore acquire more property at an overvalue. However, any conceptual differences between the operation of the scheme and the bank's approach were usually resolved through discussions between the bank and the APA, with the bank by and large being able to pursue its business as usual strategy.

- 5.59 In our discussions with those who dealt with loans subject to the APS in this period, some believed that the APS had a substantial impact on the way in which the bank dealt with SME customers. Others believed that the APS had no discernible impact because it typically confirmed the approach that the bank would have taken in relation to the loan in any event. This could be explained by the fact that assets chosen for inclusion within the APS were divided into either "blind" or "sighted" assets.²⁶ If an asset was "blind", the APS management team was not involved in managing the asset and consequently the relationship manager would have no knowledge of whether or not a connection's assets fell within the APS. If an asset was "sighted", all the rules applicable under the APS would be applied to it and the relationship manager would know that it was within the APS. Therefore, some relationship managers would have known that their customer's assets were within the APS, while others would not have known. Generally speaking, "blind" assets were managed as they would usually have been.
- 5.60 We make two observations. To the extent that the APS had an impact on the way in which the bank dealt with SME customers, it is likely that the effect would have been to require the bank to adopt a conservative/defensive approach. If the APS had no discernible impact because it typically confirmed the approach that the bank would have taken in relation to the loan in any event, the bank cannot be criticised for adopting the course of action because it was bound by the APS Rules to adopt such a course.

Oversight processes

- 5.61 BRG operates a "four-eyes" approach to decision making. The BRG relationship manager cannot sanction his or her own arrangements with a customer.
- 5.61.1 **Credit:** Relationship managers determine the proposed strategy for a restructuring. Where a strategy requires a change to the customer's lending or facility terms, this must be approved by a credit sanctioner in accordance with the bank's credit policies. Credit sanctioners were, until October 2013, senior and experienced BRG employees. Since October 2013, credit-sanctioning has been transferred to an independent BRG credit team situated within GRG Risk. Subsequent credit reviews are undertaken periodically, with a formal annual review being the minimum requirement and the credit sanctioner determining the frequency of reporting. In high-risk cases, credit reviews can occur monthly.

²⁶ From the inception of the APS until July 2011, BRG was "sighted". From July 2011 onwards, most of its assets were "blind" and therefore would have been managed accordingly.

- 5.61.2 **SCRs:** Within 30 days of transfer into BRG, a customer's file will be subject to a Strategy and Credit Review ("SCR"). The purpose of the initial SCR is twofold: (i) consideration of the proposed strategy for a customer, including with respect to the suitability of the strategy proposed, and (ii) facilitation of the sharing of ideas between BRG relationship managers and BRG/GRG management. The SCR comprises a Chair and two other panel members who have had no prior involvement in the cases being presented at the SCR.

After the initial SCR, further SCRs are undertaken in respect of all BRG customers on a periodic basis: for customers with debt between £2m and £5m reviews would take place at least six monthly and for customers with debt below £2m reviews would take place at least annually. We understand that there may be circumstances when a relationship manager may seek to defer a case being presented to an SCR; however, we understand that this would be for specific reason and BRG relationship managers are not able to defer their cases more than once per review.

- 5.61.3 **Case reviews:** In addition to the formal SCRs, we understand that case reviews are undertaken regularly by BRG Regional Heads and Corporate Directors to ensure the appropriate strategy is being adopted. These act as informal opportunities for BRG relationship managers to discuss cases and strategy with their line managers.

Accordingly, checks and balances exist to ensure that strategies adopted by BRG relationship managers are subject to supervision and oversight. The effectiveness of the oversight is beyond the scope of our review, but its relevance for the purposes of our review is that there is at least a mechanism whereby relationship managers are subject to supervision and oversight. It is therefore difficult to envision a situation where a BRG relationship manager would be able to singly pursue a strategy that is fundamentally unfair to a customer without this being picked-up on review.

Restructuring within BRG

- 5.62 Once the viability of the customer is established and a strategy is chosen, the BRG relationship manager works with the customer to implement a restructuring plan. BRG has a number of tools at its disposal and is able to affect a restructuring in ways that would not be possible if the customer had remained within B&C relationship management. BRG is able to provide financial and non-financial support to customers, including advancing new money, providing forbearance, formal restructuring of terms outside of the bank's normal risk appetite and allowing temporary excesses on existing facilities.
- 5.63 If the bank was guilty of '*systematic and institutional*' behaviour in artificially distressing otherwise viable businesses, putting its customers '*on a journey towards administration, receivership and liquidation*', we would not expect to see genuine efforts at restructuring customers and endeavouring to return them to financial health. Even where BRG was ultimately unable to return the customer to the mainstream bank, this generally followed a period where the bank and the customer made serious attempts to achieve a restructuring to help address the customer's underlying financial issues.

Additional funding and security from the customer

5.64 The Tomlinson Report states:

'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.'

- 5.65 In the cases we have reviewed, customers often required additional funding. Examples include trading companies experiencing cash flow issues that required overdraft working capital facilities and property development companies experiencing cost overruns. Where new money is required, the bank seeks to establish whether or not the customer or the customer's principals are willing and able to make an equity injection into the business. As Dr Tomlinson states, such an equity injection demonstrates to the bank that the customer and its principals are committed to the business and believe in its future viability. The willingness and ability of the customer to introduce further equity is an important consideration in the bank's strategy. If the customer is unwilling to invest funds in the business then this may influence the bank's risk rating of the proposition. We have seen a number of references on files to this effect.
- 5.66 The bank will also encourage equity injections from other third-party sources. In one of the cases we reviewed, the bank introduced a third party investor to a customer requiring additional new money to support it during a period of growth and the customer obtained additional funding as a result. The customer avoided going into insolvency.
- 5.67 In addition to funding, the bank will often request additional security. The Tomlinson Report refers specifically to personal guarantees. In our review of the 130 files, we identified 19 cases where the bank requested additional personal or other guarantees. Of these files, 13 subsequently entered into some form of insolvency process. The bank did not request additional guarantees and, in quick succession, initiate an insolvency process. In the majority of these cases, the period between the provision of the guarantee and ultimate enforcement action was lengthy (typically, at least one year). We identified one case where enforcement action proceeded shortly after the provision of the guarantee. In that case, the customer suffered additional financial distress after the guarantee was provided, as a result of litigation unrelated to its dealings with the bank. We found no evidence that the bank intended to stop supporting any of these customers at the point where it sought additional equity, guarantees or other forms of security.
- 5.68 In the files that we reviewed, we saw many examples where the bank chose not to enforce personal guarantees.

Additional funding from BRG

- 5.69 In some instances BRG provided additional funding in the absence of equity injections from the customer or a third-party. We saw examples of this where the bank was the principal financier of a property development, the development was experiencing cost overruns and the customer's principals were unable or unwilling to inject further equity into the project. In such circumstances, the bank assessed the amount of new funds that would be required to see the proposed development through to completion and compared the current value of the development and the potential future value of the development once completed. If the bank believed that supporting the development with additional funding would enable the customer to repay the bank or result in a lower loss to the bank, then the bank would grant additional funding.
- 5.70 Some complainants we spoke to felt that the bank unfairly withdrew lending facilities funding developments, leaving the business without sufficient funds to complete projects. In most cases where we observed the withdrawal of funds, the projects had experienced cost overruns, delays and other set-backs. In some cases, the customer had an expectation that the bank would continue to fund projects and that additional funding would be granted on similar terms to original lending without any additional return for the bank.
- 5.71 BRG lent over £100m of new money during the period of 2010 and 2012. The decision to lend additional funds does not lie solely with the relationship manager. Where the bank agrees to provide additional funding, the BRG relationship manager must submit a detailed credit report with a recommendation to lend new money and the terms of such lending to a credit sanctioner. The credit sanctioner reviews the proposition, including the security across the customer and the terms and conditions applied to the additional lending before accepting or declining the risk.

Forbearance

- 5.72 BRG has the authority to agree concessions for a customer outside of the previously agreed contractual terms. Since late 2012, GRG has tested samples of SME customers with borrowing less than £10m to identify the extent of forbearance provided. Acknowledging the limits of a small sample size, the test findings suggest that the percentage of forbearance provided to SME customers is consistent with the whole GRG portfolio and is given in between 17.4% and 29%²⁷ of cases. We saw many examples of BRG providing extensions to the maturity date of facilities, most frequently in the context of property development customers. On a number of the files we reviewed, property development companies were unable to sell completed developments before interest-only facilities expired. BRG relationship managers agreed to extend the maturity date of facilities so that the customer was able to meet its capital repayment obligations.
- 5.73 Other examples of forbearance observed on files include capital repayment holidays, the capitalisation of arrears including interest. In most cases, such forbearance was provided to alleviate immediate cash flow issues and the bank sought to achieve

²⁷ These figures include all BRG and Divested cases assessed for forbearance during 2013 with lending exposure greater than £3m.

upside through either higher interest margins or the application of deferred fees (in the form of exit fees or PPFAs).

- 5.74 Other forbearance measures do not relate to the customer's payment obligations under relevant loan facilities. Covenant waivers are one such example and include either the temporary or permanent waiver of financial covenants or the resetting of covenants in order to avoid a potential default or to cure an existing covenant breach. There are numerous examples of covenant waivers being applied in the files that we have reviewed. For example, a trading company that had breached its EBITDA covenant had the breach waived and the covenant reset to avoid future breaches.
- 5.75 Financial and property covenants can offer significant protection to the bank in so far as managing credit risk and the relationship between risk and reward are concerned. Breach of a financial covenant constitutes an event of default and provides the bank with an opportunity to demand repayment of the loan or otherwise re-negotiate the terms and conditions of the loan. We came across several examples in the files that we reviewed of financial covenants being reset to account for changes in the customer's business and/or cash-flow rather than those covenants being used to trigger an event of default.

Reduction of debt

- 5.76 In the files we reviewed, the sale of assets was a common feature of restructuring where the customer operated in the real estate sector. Some customer complainants told us that they were forced to sell assets too soon, to the detriment to the customer's business, and that insufficient consideration was given to the alternative approach of holding out for better market conditions. Clearly, there may be different views on whether it is in the interests of the customer and its creditors to hold on to a property in the hope or expectation of an improvement in the market, or whether it is better to sell the property to avoid a further decline in the value of the property (taking into consideration the nature of the property, its quality and its location).
- 5.77 The Tomlinson Report states that '*West Register's portfolio risks being a significant conflict of interest within the bank [...] there is a clear risk of a perception arising that the intention is to purposefully distress a business to put them in GRG and subsequently take their assets for the West Register*'. From the sample of files we reviewed, a relatively large number of customers agreed to sell property to West Register outside of a formal insolvency process. In a vast majority of these cases, the property was openly marketed with West Register putting forward the highest offer, which the customer then accepted. We found no evidence of BRG artificially distressing the customer in order for West Register to purchase assets. We also found no evidence that the bank '*low-balled*' bids to customers in the hope or expectation of acquiring properties at below market value.
- 5.78 In relation to trading companies, the BRG relationship manager (sometimes with the assistance of independent experts) sought to agree staged reductions in debt in order to deleverage the customer over time. We saw examples of this strategy in respect of trading companies that BRG perceived to be over-reliant on overdraft facilities (e.g., experiencing unauthorised excesses). Some trading company complainants told us that the level and timing of the reductions applied by the bank had an adverse affect on cash-flows at a time when the customer was already experiencing financial distress.

Furthermore, complainants told us that the deleveraging process potentially affected the viability of their businesses. These complaints raise similar issues as already discussed with respect to withdrawals of overdrafts. We deal with the question of affordability below.

6. ADDITIONAL REVENUE ("UPSIDES")

6.1 BRG's primary objectives are to return customers to financial health and to protect the bank's position. It protects the bank's position by minimising losses and by maximising recoveries. This section focuses on revenue generation by BRG.

6.2 BRG generates additional revenue (or "upsides") through a combination of:

6.2.1 additional interest on loans;

6.2.2 fees (arrangement fees, management fees, PPFAs and, prior to mid-2013, risk fees); and

6.2.3 the bank acquiring ownership of shares in the customer or other non-cash upsides.

6.3 The Tomlinson Report states:

'The business is often fined on entry into GRG or BSU for breaching [its] covenants. More often than not, [its] interest on the loans will also be increased. Whilst the bank may argue that this increase in interest reflects the greater risk the bank faces as a result of the business'[s] [u]nstable position, this is unhelpful for the business, making it increasingly hard for [it] to trade out of [its] difficult situation. It is also difficult to justify when empirically the business'[s] commercial performance is unchanged and [it has] not missed any payments to the bank. The term of the loan may also be shortened dramatically so the business is having to regularly pay set up fees.'

6.4 This passage in the Tomlinson Report identifies the obvious tension between the bank's position (higher risk justifies higher returns) and the customer's position (any additional payments to the bank affect the customer's ability to return to financial health and, in extreme cases, may threaten its survival).

6.5 In a restructuring situation, BRG seeks additional revenue from the customer intended to reflect the additional risk it faces and the additional management time spent on files. Where a customer has passed the point at which it can borrow further funds either from the bank (because any further lending would be outside its credit policies) or from another bank (for the same reason), the options for the customer to secure alternative funding are limited to borrowing at much higher rates from sub-prime lenders or selling an equity stake to a third party. Non-bank lenders to financially distressed borrowers and equity investors (where available) demand much higher returns than major banks.

6.6 Where the bank permits additional borrowing or reschedules/restructures existing debts for such a customer, the bank is not bound to continue providing the same rates that the customer obtained when its financial health was better and the bank's risk assessment of the customer was lower. Furthermore, as set out below, distressed loans

are more resource intensive for the bank to manage and require the bank to hold more regulatory capital. Additional revenue may offset the costs of committing this additional capital and resources as well as reflecting the price of risk and making a return for the bank.

- 6.7 The principles behind risk/return are reflected in GRG's 'Introduction to Upsides' training materials:

'Whilst GRG's primary role will always be to limit losses from the distressed assets that it manages, it will be seen that an equally important task is to ensure that we derive a return that, as an absolute minimum, is commensurate with the increased risk that we are committing to carry from a Balance Sheet perspective. Moreover, where the funding we provide has become akin to mezzanine or equity risk, the reward, in terms of lending and protections we negotiate ought to be reflective of the nature of our current exposure'.

- 6.8 Where customers contacted us to discuss their complaints, these generally included a complaint about the level of fees or other upsides. Broadly speaking there were three kinds of complaint:

- 6.8.1 **Affordability:** some customers felt that the additional interest on loans and fees imposed by BRG threatened their viability.
- 6.8.2 **Fairness:** some customers complained about the absolute level of upsides for BRG, which they saw as disproportionate and unfair, regardless of its effect on their viability.
- 6.8.3 **Rationale:** where the bank sought to justify fees based on of the additional expertise which BRG relationship managers were able to provide, some customers felt that they received very little benefit from BRG's expertise. As a result, they felt that these fees were a waste of their money.

Affordability

- 6.9 In cases where there is very little margin for error, it is quite possible that additional interest or fees, fair and reasonable though they may be from the bank's perspective, are unaffordable for the customer having regard to its financial position. It is very difficult in any given case to identify a point at which additional interest and fees become unaffordable for a customer and where the line should be drawn in any particular case. In some cases that will be obvious, but in many cases the threshold of affordability will be difficult to identify. Given how finely balanced this issue is in some cases, we do not discount the possibility that BRG gets the balance wrong from time to time. We also do not discount the possibility that customers sometimes downplay their ability to pay higher interest and fees, whether or not they are fair, in order to minimise their cost of borrowing.
- 6.10 Insofar as the Principal Allegation is concerned, we make the following observations:
- 6.10.1 The bank has no financial incentive to unnecessarily bring about the customer's insolvency by imposing unaffordable interest and fees. We found

no examples where the bank deliberately charged interest and fees which it believed or knew that the customer could not afford.

- 6.10.2 The evidence from the files, from our discussions with bank employees and from the documents we have reviewed shows that the bank is sensitive to issues of affordability. In June 2013, guidance was issued to all BRG relationship managers. Relationship managers were reminded to take care to ensure that customers' cash flow position is properly taken into account in all cases. To this end, the guidance explained that risk fees (upfront fees, which may be what the Tomlinson Report was referring to as a '*fine*' on entry into GRG) would no longer be charged. In all cases where a BRG relationship manager agrees changes to fees and interest margins they are required to undertake an appropriate affordability assessment.²⁸
- 6.10.3 BRG provides relationship managers with several options to achieve returns commensurate with risk in order to avoid bringing about the customer's insolvency. In a majority of cases that we reviewed, the bank deferred "upsides" by deferring fees (or negotiating equity participations). Training materials and the guidance referred to above stated that, in order to ensure BRG's risk return principles are observed, consideration should be given to the ability to use deferred fees, effect interest roll-up and agree PPFAs or equity participations.
- 6.10.4 The customer was generally provided with several options in any restructuring and we observed that the bank maintained a dialogue with customers throughout. On the whole, it was a two-way process.

Fairness (and transparency)

- 6.11 The fairness and reasonableness of any fee is a matter of opinion, which is generally inferred from the fact that commercial counterparties have agreed the fee between themselves in a competitive market. In a restructuring environment, the issue is complicated by the fact that bargaining power generally (but not always) rests with the bank, such that negotiations are or may be perceived as one-sided. Furthermore, the contrast between the cost of credit in the market pre-2008 and banks' willingness to lend in this period, compared with the position customers found themselves in after 2008 was often striking, leading customers to infer that the bank had '*turned on them*'.
- 6.12 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).
- 6.13 The bank has a system in place, supported by training, to assist relationship managers in determining appropriate returns. The level of upside that the bank seeks to achieve

²⁸ Most of our sample pre-dates this guidance.

is intended to reflect the level of risk that it faces. BRG determines the level of debt that no longer justifies conventional debt pricing and assesses what level of pricing should apply to the proportion of debt that is abnormal. To do this, the BRG relationship manager determines what proportion of the bank's risk is senior debt risk, mezzanine debt risk and equity risk. The bank's training materials help relationship managers to calculate upsides applying this framework, but the process is subjective, albeit based on quantitative and qualitative elements, requiring the exercise of judgment as to the determination of the level of risk, the return that is appropriate for different levels of risk and the appropriate structure for upsides (e.g., upfront payments, regular payments, back-ended fees, equity participations). We note that there is an 'asset calculator' which helps to set appropriate returns for senior debt, but mezzanine debt and equity are set according to broad guidelines.²⁹ There is also a pricing model to enable relationship managers to structure returns appropriately. There is a great deal of flexibility in the bank's pricing structures, which is to the benefit of customers in many ways, but this flexibility comes at the expense of simplicity and transparency.

- 6.14 A number of complainants commented that they felt pricing of restructured facilities lacked transparency and the range of different fees applied in BRG confused complainants. We understand that there are a number of ways that an upside can be achieved and that, because of the financially distressed nature of the customers that find themselves in BRG, more creative approaches to the generation of an upside return are often required. The bank's internal rate of return ("**IRR**") therefore can be achieved through a combination of arrangement fees, risk fees, deferred fees through equity/property participation and exit fees. Some customers found the rationale for the pricing structures difficult to follow. They said that the terms "mezzanine risk" and "equity risk" were not clearly explained to them. In our review of the files we observed these terms being used in correspondence without further explanation.
- 6.15 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.³⁰ The poll identified '*clarity of explanation of the bank's pricing*' as a priority area for improvement.
- 6.16 BRG has sought to encourage greater transparency in its pricing. In the June 2013 guidance to all BRG relationship managers, relationship managers were instructed to take care to ensure amounts are '*fair, reasonable, transparent and objectively justifiable and set using applicable pricing models*'. Few of our file reviews post-date the guidance.

²⁹ Mezzanine debt risk is priced to produce an internal rate of return of between 10% and 25% depending on the perception of the risk being carried and equity exposures are priced to achieve an IRR of in excess of 25% due to the substantial risk attached to such positions. The overall rate of return is calculated based on a composite of senior debt, mezzanine debt and equity, split across additional interest, fees and equity upsides. Please refer to https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32263/12-539-sme-access-external-finance.pdf for further explanation of mapping of risk and reward profile.

³⁰ Overall, we note that the poll is very positive by comparison with the Tomlinson Report and associated publicity, in the sense that there is positive and negative feedback and overall satisfaction ratings are generally high. We did not place any weight on that fact in our review, because a large number of broadly satisfied customers do not necessarily prevent the Principal Allegation from being true.

- 6.17 In order to assist relationship managers to comply with this guidance, we recommend that in all cases the bank consider providing the customer with an aggregate figure representing their cost of borrowing for each of the various options it provides. This will assist customers to assess the various options available to them. Customers can determine whether finance is available elsewhere on better terms. This will assist with transparency and will enable customers and the bank to have a discussion about the reasonableness of fees if that concern arises, which would help customers to understand the bank's rationale for seeking additional revenue. It will also assist Credit and supervisors to provide oversight in relation to the fairness and reasonableness of fees proposed by relationship managers.
- 6.18 We also recommend that the bank clarify oversight in relation to the fairness of fees. Some bank interviewees told us that the strategy review process provided oversight in relation to fees; others told us that credit oversaw the level of fees.
- 6.19 As to costs which the customer bears, we note that the possibility of incurring costs associated with security reviews, external consultants and monitoring fees are set out in the post customer-meeting letter for CBD B&C. We would recommend including additional language in that letter to cover the possibility of further property valuations, as a reminder to the customer, where the bank has this right under specific facility agreements.
- 6.20 A number of the files reviewed involved facilities that incurred break fees as a result of the agreed restructuring, for example, as a result of an associated interest rate-hedging product being terminated early. The Tomlinson Report makes reference to the misselling of interest rate-hedging products. The sale or misselling of interest rate-hedging products by the mainstream bank is beyond the scope of our review. These fees are a contractual component of the original lending facilities and do not form part of any BRG upside. We observe that, as these fees crystallise during the restructuring process, they may be misinterpreted as a cost imposed by BRG.

Rationale

- 6.21 Where the bank sought to justify fees because of the additional expertise that BRG relationship managers were able to provide or greater resources were required to manage the customer relationship, some customers complained that they received very little benefit from BRG's expertise or additional resources. As a result, they felt that the fees were a waste of money. We recognise that, in some cases, BRG relationship managers brought considerable expertise to bear and that this helped a number of customers (and in some cases may well have saved customers' businesses). However, in some cases, there is little that the bank could do beyond providing financial assistance. Distressed debt is far more capital and resource intensive for the bank. We observe that the bank may have been better served in some cases by explaining that the monitoring fees in BRG represent part of the compensation for the greater resources required to manage the bank's exposure, with any "value-add" from relationship managers being a potential benefit. If the customer believes that they are paying for a professional service, they will measure the value of the fee against the service they receive. They may not appreciate that managing a financially distressed relationship carries additional costs for the bank.

- 6.22 We recognise that different restructuring options carry different risk and it is appropriate to apply different pricing for different restructuring options as a result. On a small number of the files that we reviewed, internal discussions show that the bank sought to encourage or incentivise a specific course of action by the customer through its pricing, such as an exit or a sale of assets to reduce the customer's debt. It is difficult for us to say that it is wrong in principle for the bank to use fees as a "lever" to persuade the customer to follow a particular course of action, or that it should not have done so in the circumstances of any particular case. We observe that the provision of options for the customer in any restructuring is an important part of the bank's defence against allegations of unfairness and/or abuse of bargaining power. Where the bank is providing an option and seeking simultaneously to deter the customer from choosing the option through its proposed pricing, the bank may feel it should err on the side of giving as many options as possible, but there is a risk that the bank's proposal could be misunderstood by customers as threatening or opportunistic.

7. EXIT FROM BRG

- 7.1 There are four principal ways in which customers could leave BRG: (1) repayment of the loan, (2) re-banking, (3) returning to the mainstream bank or (4) entering an insolvency process or receivership.

Re-banking

- 7.2 The BRG customer's inability to re-bank is an essential part of the Principal Allegation. Why would a viable customer permit itself to be put on a journey towards administration, receivership and insolvency if it had an alternative option? The Tomlinson Report states that defaults triggering the transfer to BRG:

'close all doors for the business. Once they are moved into GRG they are considered risky. With increased margins and fees, their cash flow will be impaired, again making their proposition look less attractive to a competitor bank... It is exceedingly difficult for the business to find an alternative source of finance, as once [it is] in [...] GRG, [it is] classed as being distressed.'

- 7.3 In our review, we observed several examples of customers successfully re-banking. Clearly not all customers were able to do so, but some customers chose (and managed) to re-bank. This finding is unlikely to be reflective of the overall proportion of BRG customers which re-banked in the period 2008 to 2013, as our sample deliberately targeted a disproportionately high number of cases where the customer underwent insolvency or receivership in order to allow us to address the Principal Allegation.
- 7.4 If the bank engineered defaults in order to extract maximum revenue from the customer, as alleged in the Tomlinson Report, one might expect to find evidence that the bank sought to prevent re-banking or obstructed the customer in the process. In our review of the files and documents, the bank did not seek to prevent customers from re-banking. In an internal training document dated August 2010, the bank described re-banking as follows: *'Re-banking is one of the options that a customer should always have and it is important that this option remains.'* The training goes on to describe re-banking as *'the natural consequence of a healthy and competitive banking market'*.

Return to Satisfactory

- 7.5 The process when customers leave BRG to return to the mainstream bank is known within the bank as "Return to Satisfactory" ("**RTS**"). The customer's inability to return to the mainstream bank is an essential part of the Principal Allegation. If BRG '*actively prevented businesses from turning around*' and '*put customers on a journey towards administration, receivership and insolvency*', as alleged in the Tomlinson Report, one would expect to find very few cases where the customer exited BRG and returned to the mainstream bank. The implication is that a transfer to BRG was generally terminal for SME customers.
- 7.6 The Tomlinson Report states that '*[t]here are very few examples received as part of the evidence gathering process where the business has gone into GRG, in particular, and gone back into local management*'.
- 7.7 In our review of files, we observed a number of cases where the customer returned to the mainstream bank.³¹ In many more cases, the BRG relationship manager's strategy for the customer, as set out in internal credit and strategy review documents overseen by senior managers in the Strategy and Credit Review process, was to return the customer to the mainstream bank. The strategy did not necessarily succeed in every case, but having the relationship manager's strategy set out in this way in internal documents appears to be inconsistent with '*systematic and institutional*' misconduct in '*actively preventing the business from turning around*' that the Tomlinson Report alleges.
- 7.8 The whistleblower referred to in the Tomlinson Report, and discussed earlier in this report, told Dr Tomlinson that he '*could not think of any occasion in which a business entered RBS' GRG and came back into local management*'. Based on the interviews we conducted, the files we reviewed and contemporaneous data in the form of management reports, the whistleblower's assertion is incorrect. The table below sets out the number of customers returned to satisfactory each year from 2008 to 2013.³²

	2008	2009	2010	2011	2012	2013
Number of BRG cases that Returned to Satisfactory	72	230	394	629	742	759

- 7.9 In excess of 2,800 SME customers were returned to the mainstream bank in the period 2008 to 2013. In our view this figure alone does not disprove the Principal Allegation, but it is an important piece of contextual information.

³¹ We would note that the proportion of customers in our review is unlikely to be representative of the overall proportion of BRG customers which were returned to the mainstream bank in the period 2008 to 2013, as, in order to address the Principal Allegation, our sampling methodology would have caught a disproportionately high number of cases where the customer underwent insolvency or receivership.

³² Figures provided by GRG.

- 7.10 A customer is able to RTS if it fits within the mainstream bank's credit policies, or is likely to do so within a reasonable timeframe. This process is the reverse of the process by which customers are transferred to BRG. The BRG relationship manager submits a formal request to a BRG credit sanctioner recommending that the customer return to the mainstream bank. If the BRG credit sanctioner agrees, the BRG relationship manager will contact B&C Credit to seek confirmation and, if B&C Credit approves, a B&C relationship manager will be assigned to the customer. The RTS process represents the bank's acceptance that a customer that returns to satisfactory is, or is expected in due course, to be back within the mainstream bank's lending criteria. Returning to the mainstream bank is a strong indicator of the customer's financial viability.
- 7.11 However, we would note that the customer may have undergone substantial restructuring in the intervening period. It may be a smaller business on exit from BRG, with lower revenues, fewer assets and lower headcount (albeit with less debt). Therefore, in our view, the RTS statistics alone do not disprove the Principal Allegation.

Insolvency or Receivership

- 7.12 As the Tomlinson Report states, '*[i]t is true that there will be many occasions where the business is struggling and it does need to go into business support and eventually insolvency*'. Within the bank, this process is run by a separate group in BRG, which is called Recoveries & Litigation. Any insolvency or recovery proceedings against the customer must be approved by both Recoveries & Litigation relationship managers and by GRG Credit.
- 7.13 In interviews, we were told that insolvency represents the worst outcome both for the customer and for the bank. The overall number of BRG cases that go into insolvency or receivership is less than 10% of all BRG cases in any given year.

	2010	2011	2012
Number of cases where insolvency practitioner appointed³³	442	402	408
Number of insolvency practitioner appointments as a % of BRG cases	9.7%	8%	8.8%

- 7.14 Relatively few of the complaints that we received (either directly or through the bank) came from customers that had undergone insolvency.³⁴ We reviewed a large number of files where the customer underwent insolvency or receivership by virtue of the fact that we received 42 files for review from a list of properties sold to West Register.

³³ This includes all GRG UK insolvency appointments, not just those for BRG. The number for BRG would therefore be lower. The former head of R&L estimated that around 90-95% of all cases in R&L came from BRG, so these figures are likely to be substantially correct.

³⁴ We draw no inference from this fact. Our review sought to identify viable customers. Non-viable customers would tend to undergo insolvency or receivership - the principals of these customers would be unlikely to complain about the end result. If any viable customers underwent insolvency or receivership, their principals might not complain for the reason that they ceased to have an economic interest in a company that goes into insolvency and therefore may not have any interest in complaining about the bank.

West Register purchases most of its properties from insolvency practitioners when the customer was in receivership or insolvency.

- 7.15 The Tomlinson Report states that '*some of the businesses that we heard from did not deserve to be pushed into administration*'. From our review of the files, where customers ultimately underwent an insolvency process or entered receivership, there was clear evidence that the bank considered the customer to be suffering pre-existing financial distress sufficient to affect its viability.

8. SALES TO WEST REGISTER

- 8.1 West Register has undergone various changes since it was first established in 1992. For many years, it was a small department comprising fewer than 10 individuals, who were responsible for providing advice, acquiring properties and managing property portfolios. The advisory branch of West Register was separated from West Register and moved to form part of BRG in mid to late 2010. In June 2013, Real Estate Asset Management was launched, consolidating the advisory and acquisition branches of the bank's property work into one unit.
- 8.2 The current West Register team consists of 43 real estate sector professionals with backgrounds in residential development, retail, hotels, commercial, planning and construction. Six members of the team are registered valuers and the majority are members or fellows of the Royal Institute of Chartered Surveyors (RICS). The team is split into five groups for management of assets: Residential Investment, Retail, General Commercial, Development and Residential Development.

Conflicts of interest

- 8.3 The Tomlinson Report states that '*West Register's portfolio risks being a significant conflict of interest within the Bank*', as it is a unit which both advises on, and bids for, properties of BRG customers. In our review we sought to understand the practical working relationship between West Register and BRG.
- 8.4 West Register recognises the risk of conflicts where it acts both as an adviser to BRG and as a bidder for properties of BRG's customers. To manage this risk, West Register has a conflicts management policy, a conflicts management procedure and an information sharing protocol in place to manage potential conflicts of interest and to limit West Register's access to information about customers in BRG and the properties they hold.
- 8.5 All West Register employees, whether involved in advising or bidding, are prohibited from accessing RMPS, the primary credit system used by both B&C and BRG relationship managers. West Register has limited access to information on REMIT, the bespoke system for recording and managing real estate assets. West Register also uses separate shared drives and does not have access to shared drives associated with other GRG teams. This ensures that all West Register employees who are approached by relationship managers for advice or in relation to a bid only have the information provided to them by the relationship manager about the property in question.
- 8.6 In its advisory capacity, West Register and BRG are encouraged to speak freely with one another as necessary. A BRG relationship manager may approach West Register

for advice at any stage of the restructuring process. BRG relationship managers may also approach West Register to suggest that West Register make the customer an offer for the property. When this happens, West Register brings in an individual who has not previously advised on the file (known within West Register as a Bid Manager), who reviews the property and arranges a valuation. If an employee of West Register has been involved in advising BRG on a particular customer, he or she is excluded from participating in West Register's bid team for a sale process involving that customer's property.

- 8.7 Where a Bid Manager is appointed, there are controls on the interaction between the Bid Manager, the BRG relationship manager and any West Register adviser who has previously dealt with the same property. In internal guidance circulated to West Register employees by RBS Legal in 2011, GRG set out procedures for relationship managers interacting with West Register. The level of information that a relationship manager may share with West Register in a bid situation is largely dependent on whether any third parties have an economic interest in the customer's property. An LTV threshold of 130% is used to ascertain whether a third party holds an economic interest. Where the threshold is met (i.e., where the bank is owed more than 130% of the value of the property), the 2011 guidance is relaxed so that certain information, such as tenants' data and valuation reports, can be shared with West Register. If not, this information may not be shared with West Register. We were told that, prior to the 2011 guidance, West Register only had access to information such as the outstanding debt and any provisions.
- 8.8 On an insolvency sale, West Register obtains its information from the insolvency practitioner's marketing brochure and generally receives the same information as other potential bidders. The e-mails that we have seen between relationship managers are usually no more than a few lines in length, briefly describing the property and either asking for advice or enquiring as to whether West Register would be interested in bidding for a property. Where available, the written communication we reviewed between BRG and West Register in relation to advisory matters was limited. Our review did not find any instances of West Register identifying properties which it wanted to acquire and then giving advice that would facilitate an eventual acquisition. The initial approach always came from the relationship manager. West Register did not always bid when invited to do so in a consensual closed market sale situation.
- 8.9 Nor did we find evidence of West Register procuring the transfer of a customer to BRG. Senior West Register employees sitting on the bank's oversight committees (such as the GRG Management Committee) would be aware of high level information relating to some customers going into BRG, but West Register is not involved in the decision to transfer them into BRG.
- 8.10 The sharing of information between a West Register advisor and Bid Manager on the same property is possible, notwithstanding the information barriers described above. There is no physical separation between the advisory team and the Bid Manager. We found no evidence of West Register identifying properties which it wanted to acquire or procuring their acquisition.

Purchases at below market value

- 8.11 The Tomlinson Report refers to the '*potential for easy profit to be made from the cheap purchase of properties that later can be resold nearer the original valuation*'. In order to explore this issue, we sought to understand the possible rationale for West Register to submit a bid at below market value. We also sought to assess the likelihood of the bank making a profit on a subsequent property disposal.
- 8.12 By way of context, between 2008 and 2013 West Register bought properties from a total of 166 BRG customers.³⁵ In December 2013, the total number of BRG cases totalled 4,302, although the cumulative total of cases passing through BRG from 2006-2013 was far higher than this. West Register therefore purchases a very small proportion of properties owned by BRG customers.
- 8.13 Before deciding to bid in a consensual situation, West Register considers whether it can add value to a property. If no value can be added, the bank's policy is that it is unnecessary for West Register to bid. For example, we saw e-mails where BRG asked West Register to make a bid. West Register replied that the property should be left within the existing ownership because West Register lacked the local knowledge to manage it more successfully than the customer.
- 8.14 From our interviews with West Register employees, our review of customer files and our review of the bank's documents, it is clear that West Register operates as a bidder of last resort or a fall-back option where the open market will not yield a better offer. An internal policy document states: '*[In] order to prevent opportunistic behaviour, West Register must be able to remain active and underpin the market as necessary*'. In a depressed market, there may be a shortage of bidders for a customer's property. Opportunistic buyers are able to purchase properties at below market value. This results in a loss to the customer (in a pre-insolvency situation) or creditors (in an insolvency situation). We saw several cases where West Register's bid was substantially higher than the next highest bid. In one case we reviewed, West Register's bid was £1.4m, significantly higher than the next highest bid of £857,000. In a few other cases, West Register's bid was approximately £100,000 more than the next highest bidder. In the absence of West Register's bid, these properties would have been sold at below market value, to the detriment of the customer and/or its creditors (including the bank).
- 8.15 We observed that West Register was content to allow third parties to acquire properties where their bids were higher than West Register's bid. West Register has a policy of only bidding once on a property. If another buyer puts in a higher bid than West Register, West Register's bid is not required to underpin the market. We observed this in practice. In one case, the customer was selling a portfolio of eight properties. There was interest from other bidders, but they were only concerned with certain parts of the property portfolio. The customer sold four of the properties to other parties. West Register purchased the remainder. In our review of customer files we identified three occasions where West Register acquired the property despite not being the highest bidder. In one of these cases the highest bidder was unable to

³⁵ In March 2009, the bank changed its method for recording acquisitions made by West Register. Accordingly, these figures may not include all customers from which properties were acquired prior to March 2009 and may include customers from which properties were purchased prior to 2008.

provide proof of funds to the seller. In the other two cases, the higher offers were subject to additional conditions or required planning consent.

- 8.16 The Tomlinson Report states that the bank's intention was to '*purposefully distress a business to put them in GRG and subsequently take their assets for the West Register, at discounted price*'. When West Register acquires a property in an open market sale (either directly from the customer or from an insolvency practitioner), it has by definition not purchased a property at a discounted price.
- 8.17 **Insolvency/receivership:** The majority of West Register acquisitions take place when an insolvency practitioner or receiver has been appointed.³⁶ From September 2008 to October 2013³⁷, 86% by value and 78% by number of properties purchased from SME customers of the bank were purchased after an insolvency practitioner or receiver was appointed. If West Register purchased a property at below market value in an insolvency situation, it does not follow that the bank will make an '*easy profit*', as the Tomlinson Report states. Any '*gain*' to West Register will be offset by a corresponding under-recovery on the customer's loan by BRG and B&C. The bank does not gain when West Register buys at below market value as at that stage the loss to the bank is crystallised. West Register must also maintain the property during the period between acquisition and disposal. To give a simplified example, assume a customer owes the bank £1m. Assume its property is worth less than £1m and it enters an insolvency process. Assume the property is worth approximately £500,000. Assume West Register buys it for £250,000 in the absence of a higher bidder. Viewed narrowly from the perspective of West Register, there is the potential for an '*easy profit*' if another buyer can be found. However, the bank will in the meantime have written off £750,000,³⁸ representing its debt less the purchase proceeds and its recovery of £250,000 will have come from West Register (i.e., the bank). Unless West Register can immediately sell the property for more than £1m, there is no profit at all.³⁹
- 8.18 **Consensual sales:** We refer to consensual sales directly to West Register (i.e., on a closed market), above at 5.77. The individuals with whom we spoke explained that it was rare for West Register to purchase properties directly from SMEs without the sales taking place on an open market. Consensual sales typically involved professional property investors seeking an exit from a particular project. In a small number of cases, the seller may have preferred a direct sale to West Register in order to keep the sale confidential. Of our sample of 42 West Register cases, only three were consensual sales.

³⁶ An insolvency practitioner owes fiduciary duties to the creditor. These duties may differ according to the type of insolvency proceedings. In a receivership, the primary duty of the insolvency practitioners is to the creditor who appointed him. In other insolvency procedures, this duty may extend to all creditors. In administrations and compulsory liquidation, the insolvency practitioner also acts as an officer of the court. This means that the insolvency practitioner has an obligation to act fairly in relation to all parties in the insolvency proceedings.

³⁷ In March 2009, the bank changed its method for recording acquisitions made by West Register. Accordingly, these figures may not include all customers from which properties were acquired prior to March 2009 and may include customers from which properties were purchased prior to 2008.

³⁸ This is assuming no other recoveries are made (e.g., third party guarantees).

³⁹ The example excludes costs of acquisition, rental income, etc.

- 8.19 There is a potential risk in any direct consensual sale that the seller may subsequently challenge the sale as unfair, particularly where the seller is in BRG and the bank therefore has additional leverage in any negotiation. We did not identify any complaints or files where a customer was not allowed to undertake a marketing process before selling a property to West Register. We did not see any guidance which described or encouraged such conduct. In our review of the bank's policies and guidance, we reviewed legal advice which reminded BRG employees of the legal importance of purchasing properties at fair value in a closed market.
- 8.20 We also found no evidence that the bank '*low-balled*' bids to customers in the hope or expectation of acquiring properties at an undervalue, as set out in 5.77. We did not observe examples of purchases of properties from SMEs which resulted in subsequent sales at a substantial profit to West Register. We were told that there has only been one case involving an SME's property where sale proceeds exceeded the customer's liabilities to the bank. In this case, we were told that the proceeds exceeded liabilities by £142,000, excluding the cost of carry, over-heads, maintenance costs, planning fees and write-off of debt on insolvency.
- 8.21 If West Register purchased the properties at below market value for an '*easy profit*', we would expect to see sales at a profit shortly after the acquisitions were made. We have compared the purchase price of properties acquired by West Register since 2010 with the Gross Asset Value, or the disposal value where a property has been sold, of each property as at December 2013. This comparison indicates that these properties, since acquisition, have increased in value by around 1% before taking into account any other costs associated with the acquisition and maintenance (including capital expenditure, SDLT, legal fees, agent fees and other acquisition costs).⁴⁰
- 8.22 West Register is still in the process of disposing of properties obtained during the slump in the market from 2008-2012. Depending on the state of the property market at the point of sale, there is a possibility that the bank may make a profit on the properties currently held by West Register by comparison with the purchase price. However, it is much less likely that the bank will make an overall profit having regard to write-offs on the underlying loans and any other costs associated with acquiring and maintaining the properties.
- 8.23 We were provided with the West Register profit and loss accounts for 2008-2013. These demonstrate that, when turnover and profit on disposals are offset against expenses and fair value adjustments on each property, West Register has made a cumulative loss of £111m.

9. FINANCIAL INCENTIVES

- 9.1 The Tomlinson Report refers to the practice of banks '*engineering a default to move businesses out of local management and into their turnaround divisions, generating revenue through fees, increased margins and devalued assets*'. We sought to determine whether the bank has a financial incentive to engineer a default in circumstances where the customer is willing and able to meet its repayment obligations.

⁴⁰ Once these costs are considered, the bank appears to have incurred a net loss of 10% of the purchase price of these properties.

- 9.2 GRG has two overarching objectives, to return customers to financial health and to protect the bank's position by minimising losses and maximising recoveries. As with any customer-facing business, these overarching objectives have to be kept in balance. In some cases, what is best for the customer will also be what is best for the bank and there will be no conflict between these objectives. In other cases, the objectives may come into conflict with one another. A bank has the right (and an obligation to its shareholders) to protect itself against losses.
- 9.3 As the Large Review states at page 11, assets and income managed by GRG remain on the balance sheet and P&L of the originating unit. The GRG P&L is constructed on the basis of management information. In other words, GRG's accounts are shadow accounts, produced on the basis of the P&L derived from loans under GRG's management. Whilst not determinative, on the face of it, this contradicts the Principal Allegation. GRG was not run as a separate "profit centre"; its P&L were accounted for in the accounts of the underlying business division (i.e., B&C). In BRG's management information, its performance was assessed by reference to a number of performance indicators, which changed over time. Even though P&L from customers in BRG was generally attributed to B&C, BRG sought to protect the bank's position (by minimising losses and maximising recoveries), alongside its objective of returning customers to financial health.
- 9.4 We examined these performance indicators at a group and at an individual level in order to assess whether they supported or undermined the Principal Allegation.
- 9.5 Since 2009, GRG's financial objectives have evolved from minimising losses and maximising recoveries to a greater emphasis on capital management by reducing Risk Weighted Assets ("**RWAs**") and exiting non-core assets. At a divisional level, GRG's key performance metrics include RWA capital reduction, reduction in expected losses, non-core asset reduction, contribution (see below), number of customers Returned to Satisfactory, businesses restructured and jobs preserved.
- 9.6 BRG's key performance indicators ("**KPIs**") are set out in monthly management information packs. We reviewed these packs across the period 2010 to 2013, together with limited management information from 2008. BRG's key performance indicators changed over time. Throughout the period, they included a combination of financial performance indicators and non-financial performance indicators. Some of these KPIs relate to portfolio issues (such as the overall size of BRG's exposure, number of cases overall, number of new cases, number of resolved cases, sectoral breakdown and trends and headcount).

Financial metrics

- 9.7 The bank recorded incremental income generated by BRG from fees, additional interest and "upsides" (revenue from the sale of equity stakes in businesses, PPFAs and other non-cash upsides). This incremental income (less direct costs) was described as "contribution". Contribution was monitored throughout the period 2008 to 2013 and features in the BRG management information packs, alongside non-financial performance indicators which are described below.⁴¹ The management

⁴¹ Over the period 2008 to 2013, BRG fees totalled £156m. BRG fees as a percentage of the BRG loan book are between 0.4% and 0.7% for the same period. These figures include an element of corporate cases.

information packs indicate that each regional office's financial performance was measured separately.

- 9.8 It is difficult to draw any inference from the management information on financial performance indicators in BRG. BRG measured its incremental revenue, but it also measured losses and provisions. The financial metrics, as set out in the monthly BRG management information packs, are not unduly focused on revenue generation within BRG.

Customers Returned to Satisfactory

- 9.9 The number of customers returned to satisfactory was monitored throughout the period 2008 to 2013 and features prominently in BRG's monthly management information packs.

RWA and Expected Loss

- 9.10 These objectives were applied to GRG from around 2010. All banks have to hold regulatory capital in order to be able to absorb unexpected losses. The amount of regulatory capital that a bank has to hold is determined having regard to the value and quality of its assets and its target ratios expressed through risk appetite. Credit RWAs are exposures that a bank enters into (such as loans), weighted according to the likelihood of default, the projected exposure at default and amount of loss on the exposure. As a bank's RWAs increase, absent a reduction in the bank's target capital ratio, the amount of capital that the bank will be required to hold will increase.
- 9.11 Expected loss is calculated based upon a bank's likely loss on default and the probability of default by the customer. The bank is required to deduct the difference between expected loss and provision on an exposure from its capital base. In the event of default an impairment provision will be raised, according to accounting principles, reflecting the expected loss on the exposure – this is deducted from capital.
- 9.12 The capital ratio of a bank is determined by dividing the regulatory capital (after deducting expected losses and provisions per 9.11 above) by the total RWA. The higher the RWA and expected loss deduction, the lower the ratio will be for the same amount of capital.
- 9.13 RWA and expected loss requirements would be likely to increase in the case of defaulted customers. A viable customer would have a lower Probability of Default ("PD") rating than a distressed customer.⁴² The RWA and expected losses are determined in part by the PD rating of a customer and, as set out above, these factors impact upon the bank's regulatory capital requirements. Everything else being equal, the better a customer's credit grading, the lower the regulatory capital that the bank is required to hold in respect of the customer's loan and therefore the greater the opportunity cost to the bank.⁴³

⁴² See below at 9.25 for a more detailed explanation of PD ratings.

⁴³ We note, by way of context, that from our review of the documents and from our discussions with GRG employees, the impact of SMEs on the bank's overall RWA figures and Expected Loss is relatively small. In 2013, BRG RWAs represented less than 10% (c. £5.375bn which excludes SMU cases and recoveries

- 9.14 Relationship managers are trained to recognise the correlation between customer credit quality and regulatory capital and the importance of effectively managing the bank's regulatory capital requirements. This would, on the face of it, run counter to relationship managers needlessly downgrading the credit of customers by creating unnecessary defaults.

Value add

- 9.15 In 2011, BRG began to record the value it added in monthly management information, using four metrics. First, it recorded the incremental contribution of BRG, reflecting additional income earned on cases net of expenses. Secondly, it recorded expected loss mitigation, reflecting the difference in expected loss case-by-case on entry to and exit from BRG, excluding write-offs and provisions. Third, it recorded the reduction in exposure case-by-case on entry to and exit from BRG. Finally, it measured the reduction in RWAs on cases exiting BRG. These metrics focus on cases exiting through the returned to satisfactory process or re-banking. Of relevance to the Principal Allegation is that cases where the customer was placed into insolvency or receivership did not count towards these four measures of added-value.

Appraisals

- 9.16 In interviews with GRG employees, we were told that individual performance assessment was based on a number of measures, but that individual relationship managers were not assigned any financial targets, because to do so could drive the wrong behaviour by relationship managers and it would in any event be unfair to relationship managers because the bank acknowledges that relationship managers are not able to select the cases they manage. We were told that the bank recognises that financial targets are a blunt tool for assessing relationship managers' performance because financial performance depends to a large extent on the customer's financial condition on entry into BRG. A relationship manager might perform very well in circumstances where the bank sustains a loss in any event, or might perform poorly in circumstances where the bank suffers no loss.
- 9.17 We reviewed a small sample of appraisals from relationship managers of varying seniority across the period 2008 to 2013. The appraisal forms were lengthy, with a number of *'key result areas'* by which relationship managers' performance was assessed. The appraisal forms changed over time. From 2008 to 2009 they measured a combination of financial contribution (with objectives including to *'contribute actively towards the department's financial targets'*), portfolio management, relationship management, teamwork and data maintenance. From 2010 onwards they measured a longer list of what were termed *'business goals'*: teamwork, compliance with policies, enhancing GRG's reputation (including service standards) and *'effective asset management and maximising sustainable fees as a component of minimising losses'*. Under this last goal, one of the objectives set out was to *'enhance revenue opportunities e.g. through upsides and obtaining appropriate fees on a timely basis'*. During 2012, these references were removed and a *'key role deliverable'* framed as *'quality of strategies to improve the bank's position and deals completed including an appropriate risk return'* was included.

dealt with by CMS Telford) of GRG's RWAs and around 5% of its Expected Loss. GRG's RWAs and Expected Loss figures are determined primarily by its large corporate exposures.

- 9.18 The relationship managers' financial contribution was clearly an important part of the performance assessment process and, within the relevant sections of the appraisal, the focus is almost entirely on BRG's revenue generation/loss avoidance objective. In free text blocks on the form, the appraiser estimated the relationship managers' individual revenue generation and highlighted cases where they had generated strong revenues. Relationship managers were encouraged to seek upsides (equity participations and PPFAs), but references are also made to a relationship manager's approach to ensuring that risk/reward is appropriately calculated and the need to treat customers fairly.
- 9.19 The section of the appraisal form dealing with portfolio management highlighted issues identified in relation to the management of customer files. In this section, the appraiser tended to focus on a combination of cases where the relationship manager avoided or minimised losses and cases where the outcome was favourable for the customer or other stakeholders. For example, the appraiser highlighted cases where the customer exited BRG and returned to satisfactory, or where the restructuring saved jobs. The appraiser provided feedback on the relationship managers' customer service and communication style (e.g., knowledge of his cases, ability to empathise, establish credibility and avoid confrontation). All relationship managers had a target of '*zero justified complaints*'.
- 9.20 A wide range of other objectives focused on the bank's processes and procedures, such as training attendance, knowledge of policies, file management. These form a large part of the appraisal form. They are not directly relevant to our review.
- 9.21 Overall, our impression from the appraisal forms that we reviewed is that relationship managers' performance assessment was balanced across a wide range of objectives, of which financial performance was an important objective, but on the face of the appraisals, not an overriding objective. All the objectives or goals were given equal prominence in the appraisal forms. The focus on revenue generation in the appraisal forms was balanced by the focus on other measures which brought benefits to customers.
- 9.22 The appraisal forms were detailed and lengthy. They provided a useful insight into the working practices of relationship managers in the self assessment sections of the form⁴⁴ and the oversight of relationship managers in the appraisers' section of the form. We saw nothing to suggest that relationship managers were encouraged to precipitate defaults, target asset-rich customers or procure the transfer of properties or businesses into the ownership of the bank.

Performance indicators - conclusion

- 9.23 The performance indicators for BRG as a group and relationship managers as individuals reflect the two principal objectives of GRG: to return customers to financial health and to protect the bank's position by minimising losses and maximising recoveries.

Accounting treatment

⁴⁴ We recognise that self assessments are to be treated with some caution given the natural tendency of any employee to portray themselves in a positive light when assessing their own performance.

- 9.24 When a customer defaults on its contractual obligations, certain financial consequences follow for the bank.
- 9.25 As described in section 9.13 above, the bank operates a credit grading system for customers, described as the Master Grading Scale ("**MGS**") which determines probability of default.⁴⁵ The credit grading system is not an industry standard scale; it is specific to the bank. The scale runs from MGS1 (or PD1) (representing the best credit quality) to MGS27 (or PD27) (customers in default). A financially healthy SME customer would typically fall mid-way along the scale. An SME customer undergoing heightened credit scrutiny and support from the SRM group would tend to fall around the MGS18 - MGS20 point mark. A rating of MGS24 is one of the triggers within the bank for a mandatory referral to BRG or discussion between the B&C division and BRG about the customer. From the data we observed, the MGS of customers upon entry into BRG was usually in a range from 21 to 27.
- 9.26 When a customer is in breach of its contractual obligations, the bank can elect to accelerate the loan and demand repayment, followed by enforcement action, or it can elect to charge default interest as set out in the contractual documentation, or it can elect to take no action against the customer (with or without some form of restructuring of the debt).
- 9.27 The bank must consider whether to make a provision in its accounts pursuant to IAS 39. A provision is effectively a loss in the bank's profit and loss account. If the bank is owed £1m, the debt is recorded as an asset in its balance sheet. If the loan is in default, a provision is made against the asset (i.e., its value is reduced in the profit and loss account). As between the bank and the customer, the loan is of course still repayable.
- 9.28 Viewed purely from the perspective of the bank's accounts, on the face of it, it would be counterintuitive to "engineer" a default by an otherwise viable customer. Absent a default, the customer's debt is an asset in the bank's accounts and interest and fees are treated as revenue. Following a default, the customer's debt is an impaired asset, and any subsequent repayments are treated as reducing the impairment provision.

⁴⁵ We would note that, on the materials we have seen, this term appears to be used interchangeably with the PD rating, with the rating scale of both being from 1 to 27 appearing to be the same.

APPENDIX 1 TERMS OF REFERENCE

Project Foreshore Terms of Reference

1. Purpose

This document sets out the terms of reference for a review by an external law firm (the "**Independent Review**") into the principal allegation (see paragraph 2 below) made by Lawrence Tomlinson in a report entitled *Banks' Lending Practices Review: Treatment of Businesses* (the "**Tomlinson Report**").

2. Scope

The Independent Review will be undertaken by Clifford Chance. Clifford Chance will review the most serious allegation made in the Tomlinson Report, namely that RBS, through its GRG division, was culpable of '*systematic and institutional*'⁴⁶ behaviour in artificially distressing otherwise viable UK SME businesses and through that putting businesses '*on a journey towards administration, receivership and liquidation*'⁴⁷ (the "**Principal Allegation**"). Clifford Chance will review the relevant policies and practices within RBS through conducting interviews and targeted documentation sampling and data analysis. Clifford Chance will make recommendations about steps, if any, that RBS should implement as a result of its review.

Clifford Chance in reviewing the Principal Allegation in the Tomlinson Report, will consider the recommendation at section 6, paragraph 3 (the "**Relevant Recommendation**") in the RBS Independent Lending Review by Sir Andrew Large (the "**Large Review**") '*a forensic inquiry to substantiate or refute serious accusations that have been made*'.

An initial project plan is appended to these Terms of Reference.

All the allegations in the Tomlinson Report (including the Principal Allegation) will separately be considered by a Skilled Person to be appointed by RBS at the request of the FCA. RBS and Clifford Chance will co-operate with that separate Skilled Person's review.

3. Reporting

Jon Pain, Group Head of Conduct and Regulatory Affairs will:

- oversee the Independent Review, and
- receive and consider advice from Clifford Chance on any issues identified during the Independent Review.

Jon Pain will be supported by the RBS Legal team. Clifford Chance will report to Jon Pain. Clifford Chance will not take instructions directly from any business group within RBS which

⁴⁶ Sections 3 and 4 (pages 5 and 6), section 5 (page 10) and section 6 (page 14) of the Tomlinson Report

⁴⁷ Section 3, sub-paragraph 1 of the Tomlinson Report

is referred to in the Tomlinson Report, unless the instructions are confirmed by Jon Pain, the Group General Counsel or the Group Deputy General Counsel.

Clifford Chance's Independent Review will remain confidential and will be subject to legal advice privilege and/or litigation privilege. RBS may choose to waive such privilege over the final Independent Review report (or an executive summary/key findings) if required.

Clifford Chance will report the results of its Independent Review to Jon Pain and will then present to the Chairman of the Board/CEO/Group Board/Board Risk Committee. The findings of the Independent Review will also be provided to the FCA.

4. **Resourcing**

The Independent Review will be conducted solely by Clifford Chance and will be coordinated by partner, Carlos Conceicao. All resourcing will be provided by Clifford Chance and any other legal service provider or professional services provider to whom Clifford Chance outsources work.

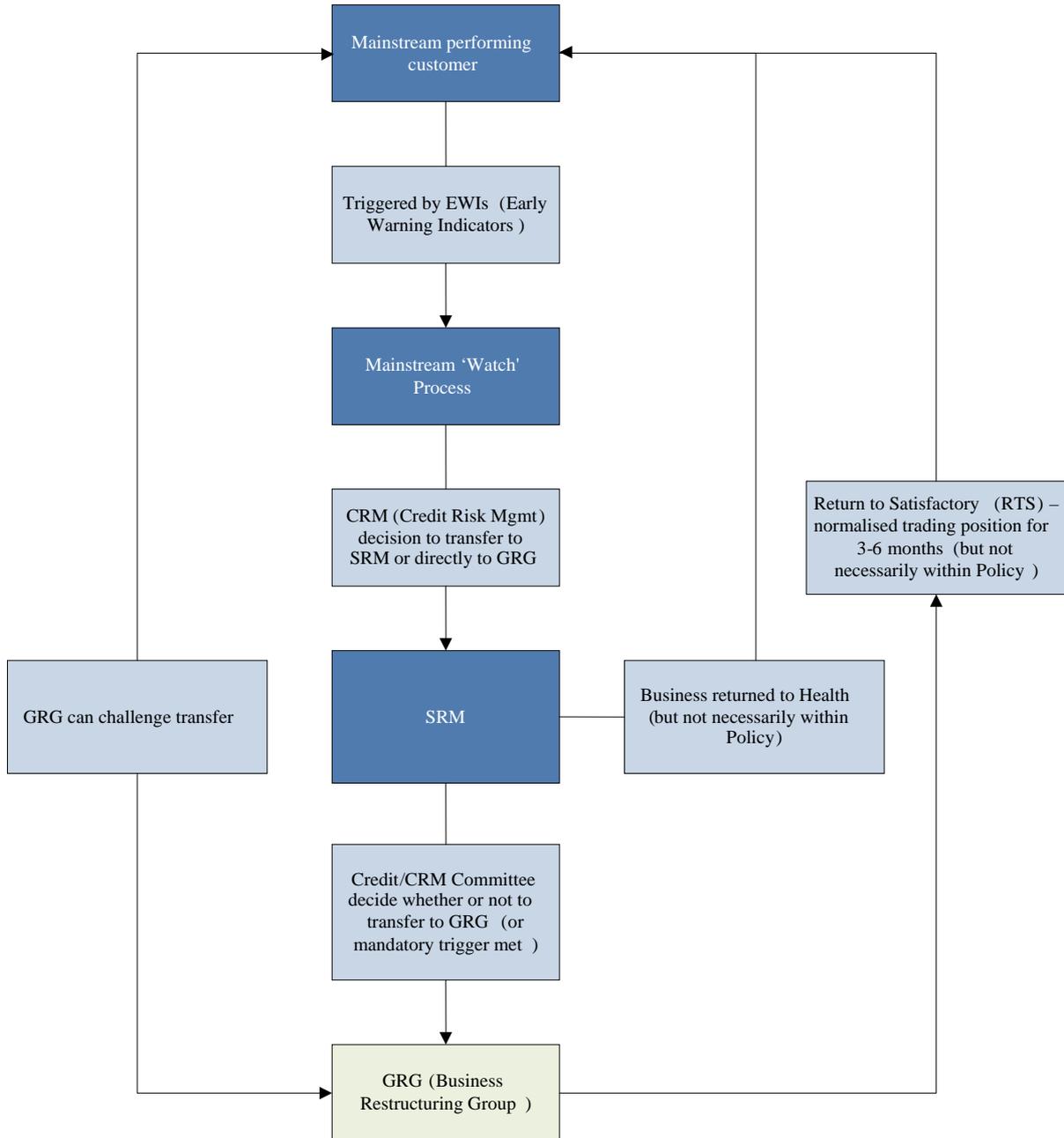
Clifford Chance undertakes work for the RBS GRG Division, in common with many firms on RBS's legal panel. Clifford Chance staff that have substantial ongoing or historical relationships with GRG will not be involved in the Independent Review. Clifford Chance will implement information barriers to ensure that it does not obtain confidential information which has been given to Clifford Chance in its capacity as legal advisers to GRG.

APPENDIX 2
INTERVIEWS CONDUCTED

Title and Division	Date of Interview
Head of GRG, UK & Americas	10 January 2014
Head of Business Restructuring Group, BRG	17 January 2014
Ex-Head of Recoveries and Litigation (Global), now Head of Recoveries and Litigation (Belfast)	20 January 2014
Chief Risk Officer, GRG	21 January 2014
Head of West Register UK, REAM	21 January 2014
Head of Specialised Relationship Management, Manchester and the North	23 January 2014
Regional Head of BRG, Manchester	23 January 2014
BRG Corporate Director, Manchester	23 January 2014
Regional Head of BRG, Birmingham	23 January 2014
Regional Head of Risk, Credit, Birmingham	23 January 2014
Head of Specialised Relationship Management, Midlands and the East	23 January 2014
Regional Head of BRG, London & South East (Real Estate Finance Companies)	31 January 2014
Global Director, REAM	31 January 2014
Head of Specialised Relationship Management, London and the South	4 February 2014
Regional Head of BRG, London & South East (Trading Companies)	5 February 2014
Managing Director for Commercial Banking, London and the South East	5 February 2014
Regional Head of B&C Risk, Edinburgh	13 February 2014
Director of Specialised Relationship Management, Bristol	13 February 2014
Head of BRG, Bristol	13 February 2014
Head of Credit, Bristol	13 February 2014

Title and Division	Date of Interview
Chief Finance and Administrative Officer, GRG	14 February 2014
Global Head of Property	17 February 2014
Managing Director for Business, Risk & Support	17 February 2014
Head of GRG (Divested)	18 February 2014
Head of BRG, Scotland	18 February 2014
Head of Specialised Relationship Management, Scotland	18 February 2014
Global Head of SIG, GRG	21 February 2014
Global Head, REAM	6 March 2014
Former Deputy Head of Asset Protection Scheme and Former Head of Risk and Compliance of APS, RBS	12 March 2014
Corporate Director and relationship manager, BRG (Divested Bank)	17 March 2014
Two relationship managers and credit sanctioner, BRG	18 March 2014
Relationship manager and credit sanctioner, BRG	18 March 2014
Regional Head of Restructuring, Head of Pre-Appointment Planning, Recoveries and Litigation and relationship manager, BRG	19 March 2014
Regional Head of BRG, Birmingham and two relationship managers, BRG	20 March 2014
Corporate Director and two relationship managers, BRG	20 March 2014
Global Head, GRG	21 March 2014
Ex- Chief Executive of Asset Protection Scheme, RBS	21 March 2014

**APPENDIX 3
PATH OF A CUSTOMER FROM MAINSTREAM B&C TO BRG**



APPENDIX 4
SRM WATCH CLASSIFICATION

SRM Watch Classification	
Green	Customers that were not in the Watch process where the performance and account conduct was considered satisfactory or where there had been a decision to return the customer back to the B&C relationship manager.
Amber – Improving	Customers where the strategy appeared to be working as a result of which, after a short period of monitoring and continued performance, it was anticipated that the customer would be removed from the Watch process.
Amber – Maintenance	Customers that had been identified as having a potential or defined weakness that required some attention but where GRG involvement would have been premature. 'Amber – Maintenance' also included customers where a strategy had been put in place but not implemented or proven to work.
Amber – Active	Customers that had been exhibiting well defined weaknesses that might have required GRG involvement within a three month period, unless prompt corrective action was taken or the strategy resulted in improvements.
Red	Customers that were exhibiting well defined weaknesses that resulted in transfer to GRG. There were exceptional customers where, with GRG agreement, Watch Red cases remained in SRM.

* From Watch Forum – Terms of Reference (Approved December 2012)

APPENDIX 5 GLOSSARY OF TERMS

Asset Management Objective (AMO)	The objective of the APS, which is to maximise the expected Net Present Value of any assets protected under the APS. It aims to minimise losses and potential losses and maximise recoveries and potential recoveries in respect of these assets.
Asset Protection Agency (APA)	An executive agency of the Government created in 2009 to implement the APS.
Asset Protection Scheme (APS)	A Government scheme created in 2009 during the financial crisis to protect banks against exceptional losses.
The Asset Protection Scheme Rules (APS Rules)	The rules governing the operation of the APS.
Business & Commercial (B&C)	The area of the bank which provides banking services to small and medium sized businesses with turnover of up to £25 million.
Bid Manager	The West Register employee assigned to review a property, arrange a valuation, and bid for it where appropriate.
Business Restructuring Group (BRG)	The division of GRG which deals with relationship and credit management of financially distressed borrowers with borrowings between £1m and £20m.
Corporate Banking Division (CBD)	The division within which B&C sits.
Credit Risk Management (CRM)	The bank's credit team for lower quality exposure, which would normally sanction cases managed by SRM prior to transfer to GRG.
Earnings before the deduction of interest, tax, depreciation and other amortised expenses (EBITDA)	A figure calculated by considering a business's earnings before interest payments, tax, depreciation, and amortization are subtracted. It can be used to indicate the operational profitability of a business.
Equity risk	the true risk capital in the business, normally funded by the shareholders. It is unsecured.
Expected loss	A calculation based on the bank's exposure to customers and the PD rating.
Gross Asset Value (GAV)	The sum of value of property a business owns.

Global Restructuring Group (GRG)	The group responsible for active management of the bank's problem business lending portfolio. Formerly known as Specialised Lending Services (SLS).
Global Restructuring Group (GRG UK)	The division of GRG which manages business exposures in the UK.
International Accounting Standards (IAS)	Accounting standards now known as International Financial Reporting Standards (IFRS) created by the International Accounting Standards Board (IASB) which is the independent, accounting standard-setting body of the IFRS Foundation.
Internal Rate of Return (IRR)	A model used to calculate the rate of return on loans.
Key Performance Indicators (KPI)	Information including financial and non-financial performance indicators, often relating to BRG's operational matters.
Large Review	The <i>RBS Independent Lending Review</i> by Sir Andrew Large, dated 25 November 2013
Loan to Value (LTV)	A percentage calculated by dividing the amount of a loan by the value of the asset(s) against which it is secured.
Mezzanine debt risk	The element of debt which is seldom fully secured against assets. Interest is normally substantially covered by current earnings, although some may be rolled up to preserve cash. This is usually repayable over a longer term than senior debt risk.
Probability of Default (PD)	The likelihood of a customer failing to trade satisfactorily and to service financial obligations. It is calculated from the bank's Risk Rating questions within the Risk Rating Screen and Audited Financial information.
Profit and Loss (P&L)	A financial statement that summarises revenue, costs and expenses over a specific period of time (usually one year).
Property Participation Fee Agreement (PPFA)	A deferred variable fee arrangement. Customers agree to pay a fee in the future calculated by reference to the underlying property value.

Principal Allegation	The allegation in the Tomlinson Report that the bank, through GRG, was guilty of ' <i>systematic and institutional</i> ' behaviour in artificially distressing otherwise viable businesses, putting its customers ' <i>on a journey towards administration, receivership and liquidation</i> '
Recoveries & Litigation (R&L)	A separate unit within GRG responsible for all insolvency appointments.
Real Estate Asset Management (REAM)	The vehicle launched in June 2013 to purchase property from financially distressed customers where taking ownership is determined to be the best way to maximise the bank's recovery. It also provides advice when requested to do so by a BRG relationship manager. It includes West Register.
REMIT	The bank's system for recording and managing real estate assets.
The Royal Bank of Scotland (RBS)	The bank which is the subject of this report.
Royal Institution of Chartered Surveyors (RICS)	An independent, representative professional body which regulates property professionals and surveyors in the United Kingdom and other sovereign nations.
Return to Satisfactory (RTS)	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.
RMPS	The electronic credit and relationship management system used by both B&C and BRG relationship managers.
Risk Weighted Assets (RWA)	A measurement of credit risk, market risk and operational risk that helps to establish minimum capital requirements.
Senior debt risk	The amount that a bank would currently lend to a customer. It normally means that borrowing is fully secured and interest and scheduled repayments are comfortably covered at all times by cash generated through operations.
Small & Medium Enterprises (SME)	The category of customers who were the subject of this report and of the Tomlinson Report. The European Commission defines them as enterprises with less than 50 employees, with a turnover of €10m or less, or a balance sheet total

of €10m or less. The Large Review defines them as customers with an annual turnover of less than £25m.

Specialised Lending Services (SLS)	The predecessor to GRG
Specialised Relationship Management (SRM)	A relationship team providing specialist credit-focused relationship expertise to B&C Banking and Lombard. It forms part of B&C, and its relationship managers deal with a smaller portfolio of customers than their mainstream B&C counterparts.
Strategy & Credit Review (SCR)	Committees of senior and experienced GRG relationship managers and directors that review exposures periodically and consider strategies for financially distressed customers.
Strategic Investment Group (SIG)	A separate unit within GRG which provides advice and support to GRG relationship managers on negotiating and managing equity participations, PPFAs and other non-cash upsides in respect of lending that falls outside the Bank's normal risk profile.
Strategy Management Unit (SMU)	A credit-only function dealing with cases where the bank's exposure is generally less than £1m. It is part of BRG. The Head of SMU reports to the Head of BRG.
Tomlinson Report	<i>Banks' Lending Practices: Treatment of Businesses in distress</i> , a report by Lawrence Tomlinson
Watch Forum	An advisory body which reviews customers who are considered to be a credit risk and discusses any issues that have arisen with the customer's SRM relationship manager.
West Register	The branch of GRG responsible for managing and acquiring real estate assets. It is separate from BRG. In June 2013, it became part of REAM.