

Independent Lending Review

Terms of Reference

Introduction

Over the last four years, RBS/NatWest has significantly restructured its business, in response to the events and immediate impacts of the 2008 financial crisis. Changes include: the separation of the 'Rainbow' business in preparation for divestment; the creation of the Specialised Relationship Management unit to support customers who are beginning to feel cashflow/trading pressure; the creation of a Non Core Division to manage down exposure for selected assets; and the creation of a Real Estate Finance line of business within the Corporate Banking Division (CBD), to manage down the bank's exposure to the commercial real estate market.

However, along with other banks, RBS/NatWest has also faced lingering doubts about its willingness to lend sufficiently to UK SMEs. Some of the criticisms have focused on the lending standards RBS/NatWest has set itself, which are manifested both in the capital and 'risk appetite' that the bank makes available for SME lending and in the way that this is deployed via individual credit risk decisions.

Whilst RBS/NatWest will not return to the lending standards that were in place in the run up to the crisis of 2008 and must only grow its lending book safely and soundly, the bank does want to ensure that all of its key stakeholders understand and have confidence in both the lending standards it sets and the practices that its staff are using to deploy them.

RBS/NatWest has therefore appointed Sir Andrew Large, together with the management consultancy firm Oliver Wyman, to undertake an independent review of both its lending standards and the practices used to deploy them, for small and medium sized business lending.

RBS/NatWest will support the delivery of the review by providing access to individuals across the business, as well as to data and reports that are available and useful to the review itself.

The objective of the review will be to identify steps that RBS/NatWest can take to enhance its support to SMEs and the economic recovery whilst maintaining safe and sound lending practices. The review will also help to

promote a common understanding of the way in which the bank makes its judgements and decisions on SME lending.

Sir Andrew and Oliver Wyman will therefore be asked to capture the key findings from the review, as well as conclusions and recommendations, in a report that will be made public. RBS/NatWest reserves the right to review the contents of the report to ensure that customer privacy will not be compromised and that competitively sensitive information will not be made widely available through its publication. Beyond this, Sir Andrew and Oliver Wyman will be required to author the report on an independent and objective basis.

Objective

The objective of the review will be to identify steps that RBS/NatWest can take to enhance its support to SMEs and the economic recovery whilst maintaining safe and sound lending practices. The review will also help to promote a common understanding of the way in which the bank makes its judgements and decisions on SME lending.

The review will therefore provide an objective assessment of the lending standards and practices that RBS/NatWest uses in the SME market. This will cover the capital and risk appetite made available to this market, as well as the lending practices it deploys. As such, the review will:

- Assess RBS/NatWest's Risk Appetite and Capital Management frameworks and lending practices against common market practices, both to determine whether the approaches that RBS are using are in some way different or unique to those used by other banks
- Test the extent to which – in reality – RBS/NatWest has been willing to lend to SMEs and whether it is lending to those SMEs with conditions that are “reasonable” (i.e. unconstrained except by legitimate and necessary concerns related to prudence)
- Examine how RBS/NatWest's lending standards and the lending process through which they are deployed are perceived by the customers who have experienced them, including both those who have been successful and those who have been unsuccessful in their applications to borrow.
- Highlight any areas where RBS/NatWest could improve the way in which it sets its risk appetite within Corporate Banking Division and then deploys it through its lending practices, whilst maintaining appropriate lending standards and underwriting disciplines in order to grow SME lending safely and soundly.
- Consider the views of wider stakeholders – e.g. customers, relevant business federations and business associations, regulators and government – in assessing the elements above and drawing conclusions for the final report.

Scope

The review will focus on lending to RBS/NatWest Business & Commercial customers in the UK, as currently housed within the Corporate Banking Division. The following limitations will apply:

- The review will not cover business lending to customers currently managed within the EU mandated divestment (i.e. “Rainbow”), Ulster Bank NI and Coutts portfolios
- The review will be limited to lending via overdrafts, term loans, trade finance, invoice finance (provided by RBS Invoice Finance) and asset finance products (provided by Lombard), as they relate to in scope UK CBD Business & Commercial customers
- The review will not consider market demand factors

Approach

The review will draw on the following sources of information:

- Interviews with management and staff within Corporate Banking Division
- Documentation relating to the Business & Commercial, Trade Finance, Lombard and Invoice Finance businesses and their lending activity, including (but not restricted to):
 - Management information reports
 - Policies and guidelines
 - Process maps, pricing discretions and credit approval frameworks
 - Project reports
 - Customer and staff survey templates and results
- Extracts from internal databases relating to the Business & Commercial, Trade Finance, Lombard and Invoice Finance credit portfolios and their lending activity, including (but not restricted to):
 - Application flow, over time
 - Customer and deal characteristics (e.g. risk, sector, price, term), over time
 - Overdraft, term loan, IF and Lombard portfolio data, over time
 - Samples of individual deal files, both underwritten and declined
 - Complaints and Business Hotline data
- External reports and datasets relating to the UK SME financing market, such as:
 - Bank of England and BBA data series
 - SME Finance Monitor data series
 - Trade association (e.g. FSB, CIB) reports
 - Academic papers and reports
- Primary research, undertaken specifically for the review, such as:

- Customer surveys
- Customer focus groups and/or interviews

RBS/NatWest expects the review to use these information sources (and others that may become apparent during the course of the work) to address the following areas:

- An assessment of the mechanisms RBS/NatWest uses to set, monitor and enforce its lending standards for SME lending today, and how they have evolved over the last five years. The assessment should take into consideration RBS/NatWest's actual experience and lessons learnt in the Business & Commercial business since the crisis of 2008, as well as comparisons with market practices.
- An analysis of Business & Commercial's capacity, appetite and ability to lend to UK SMEs.
- An analysis of volumes along the end-to-end lending process (i.e. from customer approach to draw down), to understand if there are opportunities that are being missed at different points along the end to end lending process.
- An historical analysis of how Business & Commercial's lending portfolio has evolved over the five years since the onset of the 2008 crisis.
- An assessment of how customers perceive the risk appetite of the bank, given their recent experiences.

RBS/NatWest also expects Sir Andrew and Oliver Wyman to engage with relevant external stakeholders (e.g. PRA, FCA, HMT, BIS, SME business associations) to ensure that they have had an opportunity to provide relevant information to the review.

Furthermore, RBS/NatWest expects a dedicated website to be established through which SME customers can provide their perspectives and experiences as an input into the independent review process.

Timescales

The exact date for the publication of the report will be dependent on the time taken to complete the review itself. However, broad expectations are as follows:

- July 2013: RBS/NatWest announces the commission of the independent review and makes this ToR public
- Summer 2013: detailed assessment of each area within scope of the review, as outlined above
- Autumn 2013: drafting of findings, conclusions and recommendations; completion of the report; release of the report via dedicated website

Governance

RBS/NatWest's intention is to commission a review which will be undertaken on a truly independent basis by industry experts, to ensure that its assessment of the lending standards the bank uses in the SME market is thorough, objective and unbiased. Sir Andrew Large and Oliver Wyman have therefore been engaged directly by the RBS Group Chairman.

RBS/NatWest believes that commissioning this review will be the best way both to promote a common understanding between the bank and its stakeholders, and to identify potential improvement opportunities for the bank to work on. RBS/NatWest will therefore ensure that Sir Andrew and Oliver Wyman are provided with the support they require to access documentation, reports and data they require, and to meet with relevant individuals within the Corporate Banking Division and RBS Group. RBS/NatWest will also establish a governance structure to ensure that:

- Data protection is adequately enforced
- Customer privacy is not compromised
- Competitively sensitive information is not made publicly available

Sir Andrew and Oliver Wyman will be required to author the report on an independent and objective basis.