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UK Individual Shareholders Society

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Press Release

RBS Report - Not a Total Whitewash, But....

ShareSoc (the UK Individual Shareholders Society) welcomes the long overdue publication of the FSA report on the failure of the Royal Bank of Scotland (RBS).

It does highlight many important issues, and we have summarised those in an Appendix to this press release. For example, it suggests that existing regulations are not tough enough to ensure proper stewardship of banks and suggests some changes (the report sees no prospect of penalties being imposed on the directors of RBS). But ShareSoc has have been saying this for some time, and about companies in general, not just banks. As our Manifesto states: **"The legal framework for companies should be changed to improve accountability**". ShareSoc would like to see a more extensive revision of the legal framework in which company directors operate to ensure they are accountable both to the law, and to shareholders. The penalties proposed in the report are inadequate in our view.

The FSA gets off relatively lightly, and the auditors to the company even more so. Their role and that of defective accounting standards that enabled RBS to conceal its true financial position are not even covered by the report.

Were shareholders misled by the prospectus in 2008?
One issue also not examined in the report, perhaps because it may be the subject of legal action, is the question of the accuracy of the prospectus for the massive rights issue in 2008. This was a key aspect of the affair that damaged many shareholders where they contributed more capital at a price which was extremely prejudicial to their financial interests – the share price has never recovered since and is unlikely to do so in any reasonable timescale following the £45bn bail-out by the Government.

Banking culture and how it should be changed
It is made evident in the report that the financial incentives given to the CEO, which focussed on increasing revenue, profits and leverage, contributed to the problem. Although the report suggests that this issue has already been tackled in the FSA's "Remuneration Code", we do not think this is going to really change the risk taking pursued in the financial sector. ShareSoc would like to see much more substantial reform to remuneration structures in public companies – see our recent submission on this issue: www.sharesoc.org/ShareSoc%20executive-remuneration%20response.pdf

In conclusion, the information in the report is useful in understanding what happened but the analysis is limited with significant omissions. It is disappointing that there are no major new recommendations in the report.

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Note any members of the press who wish to receive a complimentary copy of our informative monthly newsletter should send a request to sharesoc@btconnect.com . Our newsletters cover not just the affairs of our organisation but contain general financial news and commentary. Examples of our past newsletters are available on our web site.

About the UK Individual Shareholders Society (ShareSoc)

ShareSoc represents and supports individual investors who invest in the UK stock markets (and who own over 10% of the shares in UK public companies in aggregate). We are a mutual association controlled by our members with "not-for-profit" articles and incorporated as a company limited by guarantee. The organisation is financed by member subscriptions, donations from supporters and by its commercial activities. Associate Membership of ShareSoc is free and is open to everyone with an interest in stock market investment (go to www.sharesoc.org/membership.html to register). More information on ShareSoc can be obtained from our web site at www.sharesoc.org (our objects are fully defined on this page: www.sharesoc.org/objects.html).

Appendix – A Brief Analysis of the FSA Report on the Failure of RBS

Our review of the report by the Financial Services Authoriy (FSA) on the failure of the Royal Bank of Scotland is given below. The full report is present here: www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2011/rbs.shtml

The key points brought out in the report are:

1. Existing laws are not tough enough to ensure proper stewardship of companies by their directors, and penalise them when they fail. This is particularly a problem in banks, and even more so in those that are systemically important, as such failures can damage the wider economy and result in major charges on taxpayers.

2. Management failures contributed to the failure of RBS. That includes:

A – Inadequate due diligence on the ABN-AMRO acquisition.
B – The management choice of aggressive capital ratios and high leverage as a policy to achieve high returns for some years before the crisis.
C – Excessive dependence on short term money market funding.

This issue is covered in depth on page 220 of the report onwards. There seemed to be simply inadequate prudence partly encouraged by financial incentives given to the CEO which focussed on increasing revenue, profits and leverage (page 225).

3. There was no proper review of the ABN-AMRO takeover by the FSA. Indeed there is even a suggestion that they could not block it, although that is contradicted on page 181. But on page 182 it is confirmed they did not even consider the question of doing so.

4. The FSA is generally let off lightly by the report, where the "light-touch regulation" is seen as being a systemic problem that had developed over the years as a matter of policy, particularly as financial markets had generally been benign in that period. There was generally a "hands-off" supervisory approach.

5. The FSA had insufficient focus on liquidity and asset quality as opposed to capital ratios (although the latter have also been tightened very substantially since – RBS would have failed the current rules for example).

6. The ABN-AMRO acquisition was a step too far in terms of risk. This was the "*wrong price, the wrong way to pay, at the wrong time and the wrong deal* " (comments from the RBS Chairman as quoted in the report). It increased the company's exposure to CDOs substantially, particularly of lower quality ones.

7. Sub-prime mortgage credit losses (CDOs etc) were substantially damaging – more than apparently disclosed by RBS in its accounts or otherwise at the time it appears).

8. It was a crisis of liquidity as much as capital – as banks generally, but particularly RBS, became more dependent on short-term funding when eventually the market supplying that closed (this is in essence the same problem that affected Northern Rock and Bradford & Bingley – a simple "run" on a bank in essence but in the case of RBS, not of retail depositors but of other lenders to the bank).

9. Obviously the rights issue in 2008 was absolutely necessary to improve the liquidity position of RBS – but it does not comment on whether this was made clear in the prospectus.

10. An issue not examined is whether RBS management were aware of the problems in the ABN-AMRO acquisition at the time the prospectus was issued (and not disclosed therein).

11. The market was not aware of the liquidity position of RBS (see p.199) until October 2008. Comment: this is probably because there is no public reporting of this information and the accounts of banks, particularly those of RBS, have historically been very opaque.

12. The role of the auditors to RBS (in their annual reporting and their review of the prospectus) seems not to have been examined at all.