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Case Study:
The Royal Bank of Scotland

RBS

The Royal Bank of Scotland

Strategy, Risk Oversight, Board dynamics, Board/CEO, Crisis management

The Case in Summary

One of the World's Top-10 banks at the beginning or 2007, RBS is now a mid-size UK-centered retail and commercial bank, still majority owned by the UK government. The financial crisis was of course in part responsible for the bank's downfall, but the ill-timed ABN-Amro deal was the trigger that led to the bank's implosion and nationalization.

This was not supposed to have been like that ! RBS had led in 2000, under its new CEO Fred Goodwin, one of the most successful bank deals of all times, with the £ 25 bn acquisition of NatWest. It then expanded aggressively during the first part of the 2000s, under the cheers of the markets, politicians and the press.

But the ABN-Amro acquisition was a deal too far, just as the financial crisis was erupting. Like all of its peers, RBS had ignored capital ratios, quality of loan portfolios and assets, and funding sources up until the financial crisis. The ABN-Amro deal compounded the weaknesses of RBS. Almost 10 years on, the bank is half its previous size and is still struggling to find its balance.

Governance Significance of this Case

This case raises interesting questions of:

- Strategy and strategy process
- Risk assessment (or lack thereof)
- Board dynamics
- Relationship with a dominant CEO
- The role of markets and of analysts
- In this particular sector, the role of regulators
- The role of "hurbis" and past deals in the decision-making

"The World's Worst Banker"

From
"European Banker of the Year"
2003

To
"The World's Worst Banker"
2008

The Background, Pre-ABN-Amro

- Spring 1998; Goodwin becomes Deputy CEO
- Spring to Fall 1999: Battle for NatWest agains Bank of Scotland
- February 2000, RBS acquires NatWest for £ 25 bn
- January 2001, Goodwin becomes CEO
- Spring 2004, RBS acquires CharterOne in the US for $ 10 bn, then a stake in Bank of China in 2005
- 2000 to 2004, RBS share price multiplied by 3 (+50% v. FTSE100)
- Spring 2006, Sir Tom McKillop (ex AstraZeneca) replaces Sir George Matthewson as Chairman
- In three years to June 2007, RBS's balance sheet multipled by 2

The ABN-Amro Battle

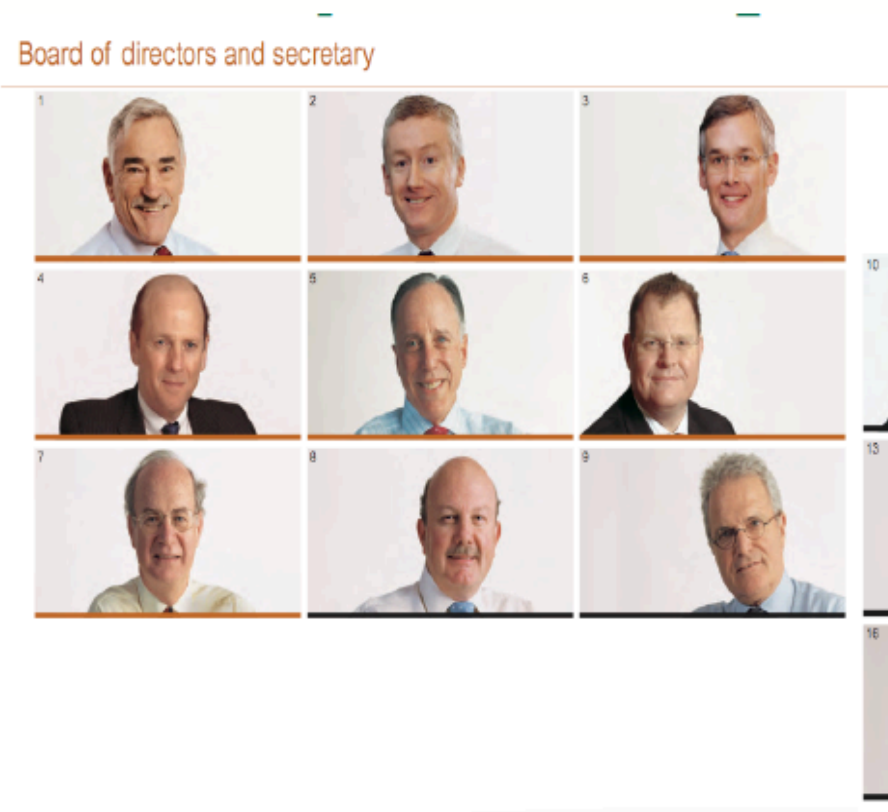
- February 2007, Activist Chris Holm (TCI) asks for « break-up » of ABN Amro
- Merril Lynch note explains value of « break-up »
- March 25, 2007, Barlcays and ABN Amro announce « exclusive negotiatons »
- April 23, 2007, Barclays and ABN Amro announce £ 66 bn merger
- April 25, 2007, Consortium (RBS, Santander, Fortis) announce £ 71 bn offer, formal on May 29
- August 9, 2007, BNPParibas closes three hedge funds
- ABN Amro Shareholder Meeting adopts TCI resolution that « maximisation of sharholder value » be the sole purpose of the choice
- October 10, 2007, Consortium offer becomes definitive.

The 2007 Results,
Denial or Incompetence ?

Sir Fred Goodwin, Group Chief Executive, said [2007 full year results]:
"It is tempting to think of the task before us in 2008 only in terms of the integration of ABN AMRO, and delivery of the substantial cost and revenue synergies. To do so, however, would overlook the real opportunities for the enlarged Group.

Whilst the future seems as difficult as ever to predict, it is clear that we enter 2008 with real momentum behind our organic growth, and with our product range, distribution capabilities and customer franchises materially enhanced. Coupled with our greater presence in the world's largest and fastest growing economies, there is much to be done, but a confidence that it will be, to the benefit of our shareholders, our customers and our staff."[46]

The Board



The Immediate Aftermath

- April 22, 2008, RBS announces £ 12 bn rights issue
- August 27, 2008, Hester appointed as non-exec Director
- October 13, 2008, UK Government takes 58% of RBS plus a £ 5 bn convertible, as rights issue fails to attracs enough investors
- October 13, 2008, Goodwin resigns and McKillop announces departure in March 2009 at next AGM
- November 1st, 2008, Hester takes over
- January 19, 2009, UK government converts and State ownership goes to 70% (later 82%). RBS pre-announces £ 8.5 bn of trading lossed and £ 20 bn write-offs (principally on ABN Amro). Share price drops 67% after a drop of 97% over the past 12 months.
- February 3, 2009, McKillop resigns, replaced by Philip Hampton.

And the Crisis goes on....

- December 2009, the Board threatens to resign on bonuses
- Hester's bonus cut repeatedly – Difficult realtion with main shareholder lead to his resignation in October 2013, remplaced by Ross McEwan
- Goodwin stripped of "knighthood" in 2012
- RBS fined mutiple times for mis-behavior on markets (Libor rigging, foreign exchange manipulation, mis-selling of sub-prime portgages, etc.)
- RBS fined for IT failures
- Trading lossed continue –forcing the bank continue down-sizing

....and on !

- Continuous asset sales – including cutting stake in US Citizen Financial Group to below 30% in 2015
- First satisfactory results since crisis only in 1H14
- Government starts privatization in August 2015, selling 5.2% (a £ 2bn tranche, out of the £ 45 bn it owns - at 330p v. 500p at bail-out)
- RBS is carrying on yet another 5-year restructuring plan
- The future: a mid-size UK retail and commercial bank

From one of the Top-10 Banks in the World to a UK-Centred retail and Commercial Bank

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The Inquiries

FSA.

The failure of the Royal Bank of Scotland

Financial Services Authority Board Report

www.fsa.gov.uk/rbs

December 2011

HM Treasury

RBS and the case for a bad bank:

the Government's Review

November 2013

The RBS Crisis: Causes

- 1. Capital: Weak capital position (no breach of Basel II, but would have been 2% under Basel III v. 4,5 to 9,5% required under Basel IV and over 10% today)
- 2. Liquidity: Over-reliance on wholesale funding, overnight funding and non-sterling funding (if LCR had been in place, ratio would have been 18% v. 100% required today)
- 3. Asset quality: significant losses on credit trading activites (eventually £18 bn) and impairment of loans (eventually £ 32.5 bn)

The RBS Crisis: Causes

- 4. Systemic Financial Crisis: With the collapse of Lemhan in September 2008, the rights issue of April 2008 turned out not to be enough
- 5. Regulatory failures: At no time did the regulators (in the UK, the Netherlands) raise any concerns
- 6. Governance and Culture: Board's mode of operation, CEO style, absence of focus on liquidity and capital, remuneration

The RBS Crisis: Causes

- 7. ABN Amro acquisition: Compounded all these weaknesses:
  - Short-term and non-£ funding
  - Credit trading and asset quality
  - Deal with 93% cash

The Role of the Board

. What were the flaws in the decision-making process ?

. Can the decision be justified from a risk perspective?

. What were the flaws in Board dynamics ?

. What was the role of the markets ? The analysts ?

. Was it a failure of strategy decision-making or of execution?

. What could have limited the down-sides ?

The term “governance” comes from the classical Greek “kubernetes”, the art of steering a ship. Governance, like sailing, is all about team work, effective communication, setting direction and strict monitoring, in ever changing conditions.

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