URGENT FOR READING IN ADVANCE OF 24TH JAN MEETING

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The Right Honourable Andrew Tyrie
Chairman of the Treasury Select Committee
House of Commons
London SW1 OAA

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By email to tyriea@parliament.uk , treascom@parliament.uk abbottj@parliament.uk

Dear Mr Tyrie,

The failure of the Royal Bank of Scotland: Financial Services Authority Board Report

I hope you will recall our meeting last year on Wednesday 2nd February 2011 and our subsequent correspondence about the banking crisis. In particular, I would like to refer you and the other members of the Committee to my letter to you dated 16th February 2011 about the FSA's investigative work in relation to RBS and HBOS and other important matters.

To re-introduce myself to you and the Committee: I am the person who was referred to by the media in 2009 as "The HBOS Whistleblower" after I gave detailed evidence to The Treasury Select Committee about being dismissed from my role as Head of Group Regulatory Risk at HBOS by Sir James Crosby after raising regulatory and risk management concerns to the HBOS Board about its aggressive strategy for sales growth. The publication of my evidence coincided with that high profile meeting of the Committee with the ex CEOs and Chairmen of RBS and HBOS on 10th February 2009.

I have been meaning to write to you and the Treasury Select Committee for some time about the FSA's report on RBS as well as their continuing work into HBOS including the alleged Bank of Scotland fraud being investigated by the Thames Valley Police. I would also like to raise some important points for consideration by you and the Committee into the latest proposals to reform the FRC which are clearly within the terms of reference of the Committee.

As it has turned out, I only discovered yesterday morning (21st January 2012) that the Committee would be meeting with Sir David Walker and Bill Knight on Tuesday 24th January 2012 to interview them about their role in conducting independent oversight of the FSA's RBS Report. As a result, I decided immediately to write this urgent letter to you and the Committee about that subject as I have some important points to raise with you and the Committee in relation to the work that Sir David Walker and Bill Knight carried out. I will deal with the other matters (i.e. HBOS, the Bank of Scotland fraud and the proposals to review the FRC), in a subsequent letter to you and the Committee.

As you know from my letter to you last year, I never thought that we would "get to the bottom of things" if the job of investigating what happened at RBS or HBOS was left in the hands of the FSA. In dealing with my reasons, my letter included the following points:-

"Even though the time may now have passed when it is politically possible to ensure a comprehensive, forensic and totally independent investigation of all the banks into the causes and implications of the banking crisis, ***it is absolutely imperative that we do not lose that opportunity in relation to RBS and HBOS*** *by allowing the current FSA investigations to proceed and to be "swept quietly under the carpet". Whatever the position generally, there was, and is,* ***no reason at all to hold back in the depth of our scrutiny of the banks we rescued directly and in which we hold substantial shareholdings****. In fact, there are extremely strong reasons to do exactly the opposite. This is probably our last opportunity to get to the bottom of what actually happened and find out who did or did not do what in RBS and HBOS, who did or did not do what in the FSA in supervising those banks. In doing so this will allow us to hold people to account where appropriate and to rebuild public policy on a firm foundation of facts and re-create trust in our financial sector.*

In relation to any of the current investigations being commissioned by the FSA into either RBS or HBOS, we should bypass the argument about rights of confidentiality as between the FSA and the firm and "edited reports". We need to return to square one. It was never appropriate, in the first instance, for the FSA to commission such investigations when it is clear that the FSA themselves had failed in their statutory and supervisory duties. The FSA have an inherent conflict of interest in carrying out any investigation into any aspect of the banking crisis without independent, transparent and detailed forensic / judicial oversight. The overriding inference from all the evidence is that the FSA failed in their statutory duties to maintain market confidence and protect consumers in the lead up to the banking crisis. In effect they have already admitted this. This means that any investigation into RBS or HBOS, properly carried out, may very well end up finding against not only the firm but the FSA as well. The firm itself would be likely to use a "Nuremberg-type" defence claiming that "the FSA let us do it, so it must have been OK". Indeed, there should have been an investigation of the FSA's actions / omissions and any investigation of RBS / HBOS or the banking crisis generally should have been conducted independently.

It seems to me that the best way to resolve the problems described above would be for the Government, on the advice of the Treasury Select Committee, to order proper public judicial enquiries into RBS and HBOS. Of course, there is no reason that these enquiries cannot make use of the work already carried out under the investigations carried out by the FSA / PwC / EY. ***A worse alternative would be for the FSA and RBS / HBOS to agree for the work already carried out to be scrutinised by the appointment of a specialist QC or Judge to ensure that the terms of reference were appropriate, that the evidence gathered is sufficient and that the judgements made are appropriate.****"*

When we met, you asked me for my professional opinion on the best way forward to deal with the RBS and HBOS "investigations" and this was set out in the last paragraph quoted above. I always thought that if a public judicial enquiry was not possible that independent oversight should be carried out by a specialist QC or Judge. Notwithstanding this, The FSA decided, and the Committee agreed to the appointment of Bill Knight and Sir David Walker to carry out this work.

The formal terms of reference for their independent review are attached to this letter for ease of reference of those reading it.

The report is so long that it is almost impossible for any ordinary person "to get to grips" with it. Indeed, it is with great difficulty that a long term expert like me can do so.

There are, of course, numerous points that could be made on many aspects of the report but the area on which I wish to focus my comments relates to the decision not to take enforcement action as I consider this to be the most important aspect of the report and the work Sir David Walker and Bill Knight have carried out. However, before I deal with that thorny issue, I would like to make a number of important preliminary points all of which, of course, also have a general impact on the question of enforcement as well.

Preliminary points – Sir David Walker and Bill Knight have not completed their terms of reference and the FSA's work on the enforcement has been conflicted

- The terms of reference required Sir David Walker and Bill Knight "to review **and report on**". But there does not yet appear to be a report from them which means that they have not fulfilled their terms of reference.
- Such a report should, of course, be in writing and contain a detailed account of exactly what they did in conducting their review, their conclusions and their formal opinion as to whether the FSA's report is a "fair and balanced report etc" as required by the terms of reference.
- It should be noted that Appendix 2J at Page 346 of the report is not a description of what Sir David Walker and Bill Knight did but what the "Review Team". This is confusing because the Review Team is not Sir David Walker and Bill Knight (even though they were also supposed to be conducting a review) but, in fact, the FSA's own Review Team. Paragraph 22 makes the following clear:-

  *"Parts 1 and 2 had been produced by a separate **Review Team**, independent of executive management, led by Rosemary Hilary, the FSA's Director of Internal Audit. Part 3 had been prepared by the case team within the Enforcement and Financial Crime Division, led by William Amos (a Head of Department in that Division), which took forward the original investigation."*

- It is worrying that paragraph 25 states as follows:-

  "The specialist advisers offered comments on the Report at draft stage, which were considered by the Review Team in finalising the Report, and will report on it by way of evidence to the TSC."

  This suggests that the FSA believe that Sir David Walker and Bill Knight's "report" will be by way of "oral" evidence to the TSC. This would clearly be inadequate. A written report signed by Sir David Walker and Bill Knight must be required by the TSC so that it, too, can be subjected to careful and reflective oversight by the Committee, the press and the public at large.

- It is even more worrying that paragraph 23 states as follows:-

  "*On the basis of the quality assurance processes described above and its own discussions of key conclusions and judgements, the Board agreed to confirm to the specialist advisers that, in its opinion, the Report represents a fair and balanced summary of the evidence gathered by the FSA and by PwC during their review of the failure of RBS, that it fairly reflects the findings of the FSA's investigation and that it is a fair and balanced summary of the FSA's analysis of its regulatory and supervisory activities in the run-up to the failure of RBS."*

  This suggests (as is often the case with aspects of the Statutory Audit where "representations" by the client are relied on by the auditor) that Sir David Walker and Bill Knight's report and opinion will, essentially be based on the "self-serving" statements of the FSA to them that "....*the Report represents a fair and balanced summary of the evidence gathered by the FSA and by PwC during their review of the failure of RBS, that it fairly reflects the findings of the FSA's investigation and that it is a fair and balanced summary of the FSA's analysis of its regulatory and supervisory activities in the run-up to the failure of RBS"*

  It was never the intention of the TSC, in agreeing to their appointment, also to agree that Sir David Walker and Bill Knight should be permitted to rely on the FSA's representations in arriving at their own independent opinion without proper corroborative evidence. They were supposed to carry out their own detailed review work, draw their own conclusions and report accordingly.

  At this stage, there is no description anywhere in the report as to what Sir David Walker and Bill Knight's review actually entailed or who did it. Nor, as I point out above, is there any report of what they found, their conclusions and their formal opinion. This is just wrong.

- The mere fact that the FSA's own Review Team in relation to the most important aspect of this report (i.e. enforcement) was led William Amos who was a Head of Department in the same Division as the person who made the decisions (presumably Margaret Cole) and that Part 3 of the report was "prepared by the case team which took forward the original investigation" is the most worrying of all. See paragraph 23 quoted above:-

  "*Part 3* [the part on enforcement] *had been prepared by the case team within the Enforcement and Financial Crime Division, led by William Amos (a Head of Department in that Division), which took forward the original investigation."*

  When you add this to the fact that the terms of reference state, *"The reviewers will not be asked to express a legal point of view on the FSA's decisions as to whether to bring enforcement actions.",* there is a very serious problem of lack of independence and further conflict of interest in relation to the whole question of whether enforcement action should have been taken. This is for completely obvious reason that the very people who "took the original investigation forward" are in fact part of the FSA's own "Review Team" and that team is led by a person in the same department as the person who made the original

decision not to take enforcement action and Sir David Walker and Bill Knight have not been able to review the legal work on enforcement.

- I, therefore, re-iterate what I said in my letter to you last year:-

  "It was never appropriate, in the first instance, for the FSA to commission such investigations when it is clear that the FSA themselves had failed in their statutory and supervisory duties. The FSA have an inherent conflict of interest in carrying out any investigation into any aspect of the banking crisis without independent, transparent and detailed forensic / judicial oversight."

I will now move on to the more specific points I have in relation to the decisions not to take enforcement action.

More specific points relating to the FSA's decision not to take enforcement action against RBS or its Directors

Although, the FSA's report into RBS does have some useful material generally, it has been of no use whatsoever to the Committee or the general public in dealing with the thorniest issue of whether enforcement action should have been taken.

In fact, if anything, it has had the effect of blurring and obfuscating matters even more. This is because, by being so long and discursive (452 pages), the report gives the impression that the job has been done properly when, in fact, it has not.

There has still not been any truly independent review of whether enforcement action should have been taken and it is now abundantly clear (to anyone with a trained eye) from the report itself that the process adopted by the FSA itself has not been robust enough to give the assurance that should be required in a case of such critical public importance.

It is very important for the Committee to note that, although Sir David Walker and Bill Knight were not permitted by their terms of reference *"to express a legal point of view on the FSA's decisions as to whether to bring enforcement action.",* they were permitted to conduct a thorough review of the "completeness" and robustness of the FSA's process in arriving at such decisions e.g. who was involved, what did the minutes of meetings say, was their one or more independent legal opinions, who made the final decision etc. **There is no evidence in the report itself that this had been done and the lack of such a reference leads to the very strong inference that it was not done. It should have been.**

We are, therefore, yet again, left in the dark as to whether there should have been enforcement action and continue to have to rely on the FSA's own word reviewed only by themselves using the same team as did the original work.

In summary, the key specific points that I wish to make in relation to the whole question of enforcement and how it is dealt with in the FSAs report are as follows:-

- The enforcement investigation was too narrow in the first place; the reasons given are the time limit on taking enforcement action and the FSA's need to use resources efficiently. These are extraordinary excuses when the RBS fiasco cost the country £45 billion.

- In any event, as I have said before, the FSA were conflicted at the time they actually made the decision not to take enforcement action by their own failures. If truth and justice were important, the matter should have been subjected (by referral from the TSC) to a full thorough public judicial inquiry in which RBS and its previous directors and executives could have been compelled to produce documentary evidence and give oral evidence under oath. This way there would have been complete transparency. After all, as we, the British Public, own 83% of RBS we should have been entitled to this.

- The initial enforcement investigation work should never have been carried out by PwC because they were also inherently conflicted because it is not in their commercial interest to support rigorous enforcement as it might make the firm against which they find or other firms wary of buying their services in the future. I also question whether PwC (or for that matter any of the other large firms of accountants) have the technical competence to carry out this type of forensic investigation which really needs legal (especially the law of evidence) and not accounting skills.

  The way the report reads about enforcement gives the reader the very clear sense that the FSA are writing it solely to justify their own view not to take enforcement action even though there are many examples given in the report itself of poor decisions for which ordinary people would say the inference is culpability of directors. We should also bear in mind that the FSA's own "self-serving statements" in this regard provide no comfort without proper independent corroboration. The weight that such self-serving statements carry is even less when you take into account the point I make above about the conflicts of those involved in the "Review Team" i.e. that "*Part 3* [the part on enforcement] *had been prepared by the case team within the Enforcement and Financial Crime Division, led by William Amos (a Head of Department in that Division), which took forward the original investigation."*

- More importantly, the report provides no opportunity for anyone publicly to scrutinise the FSA's decision or decision-making process not to take enforcement action as no-one has been allowed to see the full evidence due to confidentiality obligations under S348 FSMA 2000 (see paragraph 860 part 1 and 2) or had the opportunity to assess whether sufficient evidence was ever gathered in the first place by PwC. All we have to rely on, as I say, are the self-serving statements by the FSA themselves of the lack of culpability of the directors. Excluding from the terms of reference the right to Sir David Walker and Bill Knight *"to express a legal point of view on the FSA's decisions as to whether to bring enforcement action."* pretty much defeats the most important purpose / aspect of the work they could have done and very much supports the point that I made in my letter last year to you and the Committee that the work already carried out should, at the very

least, "....***<u>be scrutinised by the appointment of a specialist QC or Judge to ensure that the terms of reference were appropriate, that the evidence gathered is sufficient and that the judgements made are appropriate."</u>***

- Nor has there has been any publication in the report, of any of the key FSA materials supporting their decision not to take enforcement action e.g. minutes of meetings, opinions etc

- **<u>The most important point to make here is this</u>**: the only thing that the report, in fact, says about the decision making process adopted by the FSA is set out in paragraph 26 of Part 3 of the report:-

  "The decisions on whether to pursue enforcement action were discussed at the time at Head of Department and Director level in the Enforcement Division and at the FSA Executive Committee, and were reported to the FSA Board."

  So it is 100% clear from this single sentence that the decision on enforcement was made solely by the team doing the work in the enforcement department and then merely *"discussed at Head of Department and Director level in the Enforcement Division and at the FSA Executive Committee level"* and finally only just "reported" to the Board.

  This is a very convenient way of "distancing" the Heads of Department and Directors in the Enforcement Division AND the Executive Committee AND the Board of the FSA from the accountability for the actual decision to take enforcement action which, by clear inference, must have been taken solely by Margaret Cole or whoever else was leading the actual investigation.

  Surely, a decision of such critical public interest and importance should have been taken at least at FSA Board level and with the benefit of top level independent legal opinion?

- To be totally confident, in the FSA's decision in relation to enforcement, we **MUST** either be given access to the minutes and other working papers / reports which were subjected to FSA governance so that we can check that their process was a robust as they hold it out to be, or someone with the relevant competence, in whom the public can have real confidence must be able to review the papers privately and give a formal opinion on the matter. Sir David Walker and Bill Knight had the right to do this under their terms of reference - *(The reviewers may include observations about the completeness of the FSA's work.)* but do not appear to have done so.

- There is not even any reference in the report as to whether the FSA Enforcement Department obtained at least one independent QC level legal opinion on the matter. Experts might even say that two should have been required. The inference to be drawn by not referring to an independent legal opinion in the report itself must be that there was not one.

- Notwithstanding all of this, in a case such as this, even if there was only a minimal chance of successful "prosecution" (and the evidence that we do see demonstrates this clearly), the FSA should, as a matter of public interest, have taken enforcement action. In that way, at least the decision as to guilt or otherwise would then have been made by a full Tribunal and to some extent more independent and transparent.

- We should bear in mind that the onus of proof in an FSA enforcement action is only "on a balance of probabilities" so it is very much easier to win a case in the FSA Tribunal than it would be in a criminal case where the onus of proof is "beyond reasonable doubt".

- In any event, what we do know is that, in relation to Johnny Cameron, the FSA did a deal with him not to take action; a deal which, no doubt, Cameron was happy to comply with because not working in banking again is probably exactly what he was going to do in any event. He would certainly have had the funds to "pursue other interests" whether paid or not! This was a truly extraordinary decision if you want to create a deterrent effect through your enforcement action.

To conclude, I would simply say, as I have said many times before that, in my view, the FSA were always conflicted through their own failures at the time they carried out the investigation and enforcement work and made their original decisions. Now, it seems clear that they are doing what they can to justify their original decisions but without any proper transparent scrutiny on which the public can rely.

It is now looking like we are never going to get truth and justice in relation to what happened at RBS? But I do hope and trust that, at least, in relation to the HBOS case, about which I have direct personal evidence of wrong-doing, that this will not be the case? After all, Ken Clarke, when he was shadow business secretary, told me that my evidence about HBOS demonstrated at least civil wrong-doing. I agree. And now he is the Justice Minister.

Finally, could I please ask you to ensure that this letter is copied to all members of the Committee in time for them to read it in advance of meeting on 24th January 2012 with Sir David Walker and Bill Knight.

Yours sincerely

Paul Moore

[Sent by email so not signed]

Cc: All members of the Treasury Select Committee

Jim Shannon MP

Independent Review of Financial Services Authority's report on The Royal Bank of Scotland—Terms of Reference

Sir David Walker and Bill Knight have been asked by the Treasury Committee to review the Financial Services Authority's report into The Royal Bank of Scotland. This report is being prepared for publication by the Authority at the request of the Committee.

The review of the report has the following terms of reference, to which the FSA has agreed:

- To review and report on the extent to which the FSA report is a fair and balanced summary of the evidence gathered by the FSA and PricewaterhouseCoopers during their review of the failure of RBS, and whether it fairly reflects the findings of the FSA's investigation.

- To review and report on whether the FSA's report is a fair and balanced summary of the Authority's own analysis of its regulatory and supervisory activities in the run up to the failure of RBS.

The FSA will take all reasonable steps to ensure that the review team has access to such documents and persons as they consider necessary to undertake this review.

As part of the reviewers' consideration of the FSA's work, the FSA will provide the reviewers with drafts of the report. If they consider it appropriate, the reviewers may invite the FSA to reconsider aspects of the report before it is published. Instances where the reviewers' work has led to significant and substantive alterations in the published report will be reported to the Committee. The reviewers will also report to the Committee instances where they have suggested alterations to the draft report which they have been unable to agree with the FSA.

The reviewers may include observations about the completeness of the FSA's work.

The reviewers will not be asked to express a legal point of view on the FSA's decisions as to whether to bring enforcement actions.

The reviewers will be able to raise with the Committee any matters related to their work that they think appropriate.

Evidence or advice given to the Committee will be subject to the procedures governing select committees. Such evidence or advice is subject to parliamentary privilege; it is confidential to the Committee and may only be published by the Committee.

The FSA will provide the reviewers with reasonable resources. The FSA will bear the cost of employing such advisers as the reviewers may require, including the cost of legal representation in any proceedings in which they are involved as defendant or plaintiff relating to the review. Those advisers will report to the reviewers. The FSA and its staff will provide the reviewers with all reasonable support and cooperation.