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CORPORATE & FINANCIAL
WEEKLY DIGEST

Corporate & Financial Weekly Digest

December 16, 2011 by Edward Black

FSA Publishes Its Report on the Failure of RBS

On December 12, the UK Financial Services Authority (FSA) published its Report on the failure of the Royal Bank of Scotland (RBS) and the FSA's conduct in relation to it.

The Report considers: (i) why RBS failed and the complex combination of factors that led to RBS's failure; (ii) lessons to be learned with respect to bank management and the UK regulatory framework and supervision; and (iii) the FSA enforcement division's focus on certain areas of RBS's business and the reasons that led the enforcement division to conclude that it was not appropriate to bring enforcement proceedings.

The Report notes that although poor capital and liquidity regulation made it more likely that there would be a systemic crisis (and therefore set the context for the failure of RBS), and a "flawed supervisory approach" on the part of the FSA provided insufficient challenge to RBS, the ultimate responsibility for the bank's failure must lie with RBS's senior management and its governance and culture.

The FSA acknowledged that many aspects of its approach to the supervision of RBS and other systemically important firms in the pre-crisis period were inadequate. The Report admits that this reflected the fact that the FSA's overall bank regulatory philosophy and approach were flawed. There was insufficient focus on the core prudential issues of capital and liquidity, and inadequate attention given to key business risks and asset quality decisions. Too much reliance was placed on assessments that appropriate decision-making processes were in place, with insufficient challenge to management assumptions and judgments. A flawed concept of a "regulatory dividend" rewarded firms with less intensive supervision if they could demonstrate effective controls and displayed a degree of co-operation with the FSA that ought to have been a non-negotiable minimum. Reflecting this philosophy, insufficient resources were devoted to high impact banks and their investment banking activities. In addition, supervision teams were responsible for both prudential and conduct issues, which resulted in inadequate focus on key prudential concerns.

FSA chairman Lord Adair Turner said: "The Report describes a historic approach to supervision, and one that has been radically reformed since 2007. The FSA is a different organization now. We have more resources, better skills, a more intensive approach and far greater focus on capital, liquidity and asset quality. Many of the reforms required in response to the lessons highlighted in this Report have already been implemented."

For more information, click here.

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