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CORPORATE & FINANCIAL WEEKLY DIGEST

Corporate & Financial Weekly Digest

March 16, 2012 by Edward Black

FSA Censures Bank of Scotland for Serious Systems Failures

On March 9, the UK Financial Services Authority (FSA) announced a public censure of Bank of Scotland plc in respect of failings of the bank's corporate division relating to sub-investment grade lending.

The FSA found that between January 2006 and December 2008, the bank had failed to comply with Principle 3 of the FSA's Principles for Businesses (adequate risk management systems). The bank's systems and controls were not appropriate to the high level of risk that its corporate division was taking as it pursued an aggressive growth strategy, focusing on high-risk sub-investment grade lending. The corporate division continued to pursue this strategy despite the worsening of market conditions in 2007. Rather than re-evaluating its business as conditions worsened, the division set out to increase its market share as other lenders began pulling out of the relevant market. The FSA found the following specific deficiencies:

- The bank's control framework provided insufficient challenge to the corporate division's strategy.
- The framework for managing credit risk across the relevant loan portfolio was deficient.
- The distribution framework did not operate effectively in reducing the risks in the portfolio.
- The process for the identification and management of transactions that showed signs of stress did not function effectively.

No financial penalty was imposed as there were exceptional circumstances – the fact that substantial taxpayer funds have been provided to the bank. The FSA stated that imposing a fine would mean that "the taxpayer would effectively pay twice for the same actions committed" by the bank. Accordingly, the FSA issued a public censure to ensure that details of the bank's "misconduct can be viewed by all and act as a lesson in risk management fallings."

In an accompanying press release, the FSA stated that it remains committed to producing a public report into the causes of the bank's overall failure. However, it considered that working on such a report at present could prejudice the outcome of ongoing enforcement actions against the bank. Accordingly, the FSA will commence its review and analysis work for the report only when relevant enforcement proceedings have been concluded.

For more information, click here.

Katten Muchin Rosenman LLP
Charlotte Chicago Irving London Los Angeles New York Washington, DC