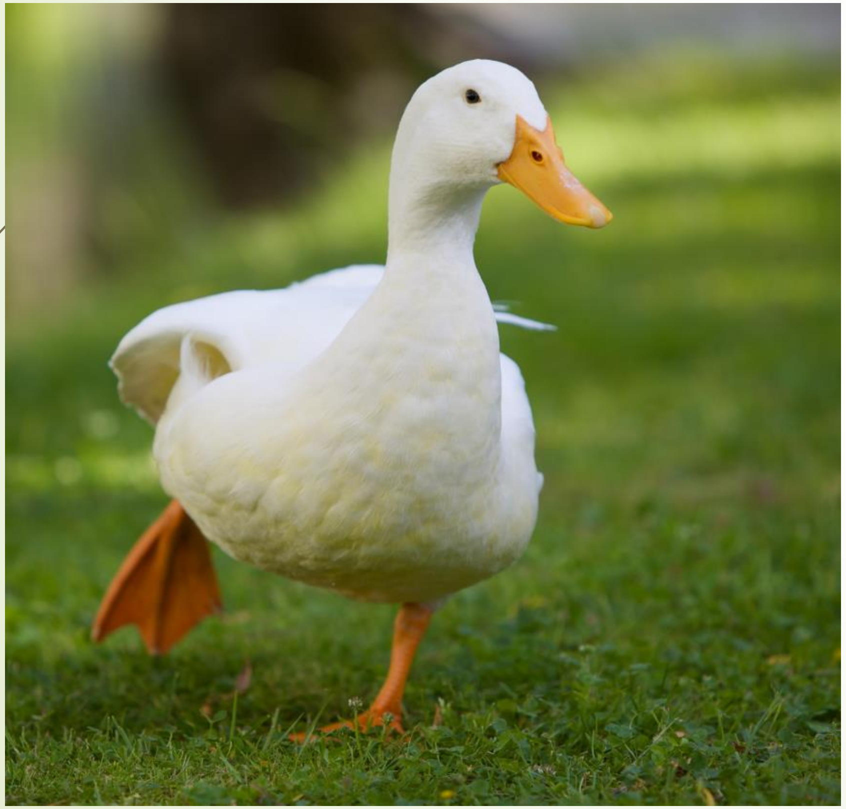
1. When is an Interest Rate Swap not a Swap?



The RBS Computer systems crash in 2012 - did it relate to Ulster bank SME's?

- S Middleton BankConfidential
- 27th April 2023

2. Interest Rate Swaps & Credit Lines (margin credit)

Swaps and ISDA contract deals lead to ongoing financial gains/losses that must be covered by cash or other security as agreed at the outset – **margin calls**

A forecast of increased losses will lead to a <u>margin call</u> for;

further cash or ***more security***

3. Swap Counterparty’s should Agree at Outset

- How much initial margin is required.
- Margin threshold/when margin calls will be made
- If cash is not available what security is acceptable
- How the other party can use secured assets (hypothecate)

- <u>What do the FCA Rules say </u>- COBS 14.3:

*‘A firm must provide a client with a general description of the nature and risks of designated investments ... **That description must**:*

***explain** the nature of the specific type of designated investment concerned, as well as **the risks particular to that specific type of designated investment**, in sufficient detail to enable the client to take investment decisions on an informed basis;’*

The risk descriptions must include the fact that there might additional obligations, including;

‘**margin requirements** or similar obligations’

4. Key Differences between Swaps and Fixed Rate Loans (FRL)

SWAP (Regulated)

- Has Standalone Trade to Fix the rate
- ISDA agreement
- Customer is Direct counterparty on trade
- Customer has the Credit Risk = credit line for margin credit
- Ongoing risk of rate fluctuation leads to direct credit risk and margin calls
- Standalone break costs
- Swap is a contract for differences (CFD) a derivative and investment and therefore regulated

- **ALL PROFIT UPFRONT**

Fixed Rate Loan (Unregulated)

- Loan Fix relies on internal indirect trade
- No ISDA Agreement
- Customer is indirectly exposed to third party trade
- Bank takes the credit risk, there would be no requirement for a credit line
- Rate fluctuation only poses risk if the customer breaks the loan
- Break costs embedded in Loan
- Fixed Rate Loan is a commercial loan which is fixed over a term not an investment and not regulated

- **PROFIT OVER THE TERM**

Spring 2012 = **FCA Force 9 banks to review Swap files and compensate mis-selling victims.**

The IRHP Review

5. FCA say FRL are not a Regulated Contract

2001-2012 Swap Sales – 30,000   Fixed Rate Loan Sales – 70,000

In relation to FRL's the FCA state to the Treasury Select Committee:

Clydesdale Bank plc ... sold both standalone IRHPs and loans with embedded swaps. These loans were sold under its 'Tailored Business Loan' (TBL) brand ... Between December 2001 and July 2012, the firm states that it provided **8,372** fixed-rate **Tailored Business Loans**

FCA Position - A CFD includes rights under a contract the purpose of which is to secure a profit or avoid a loss by reference to fluctuations in, for example, interest rates. **Where interest rate contracts are purchased separately to a variable rate loan which the client wishes to hedge, they are a form of CFD.**

A standalone interest rate hedging product will have **a separate ISDA** agreement quite separate to the loan.

In contrast, [Tailored Business Loans] are not CFDs because the purpose of the loan is not to secure a profit or avoid a loss by reference to fluctuations in interest rates. Rather, the purpose of the loan from the customer's perspective is to borrow money on the specified terms in the loan, for example, relating to the interest rate payable on the loan

The TSC sent along their KC Jonathan Fisher who agreed with this stance and the conclusion was that:

The IRHP review does not extend to TBLs or other loans with embedded interest rate hedging features

6. Are Ulster Bank FRL's a Regulated Contract?

A Fixed Rate Loan Contract for Ulster Bank Limited (UBL) includes wording:

SWAP Facility F (Amount £50,000)

The Borrower has entered into a swap arrangement with the Bank based on current ISDA

Any breakage costs arising as a result of termination by the Borrower **either before or after the execution** of such an agreement shall be for the account of borrower

The Advisory Note States - Over the Counter (OTC) derivatives can provide significant benefits but may involve a variety of significant risks ... All OTC derivatives involve risks, which include ... the risk of counterparty. Entering into OTC derivatives can introduce significant liquidity risk.

- ☑ **STANDALONE TRADE**
- ☑ **ISDA AGREEMENT**
- ☑ **CUSTOMER IS COUNTERPARTY**
- ☑ **CUSTOMER HAS CREDIT RISK (MARGIN CREDIT)**
- ☑ **ONGOING CREDIT/LIQUIDITY RISK**

7. So why were Ulster Bank FRL Customers excluded from the IRHP Review?

- **Because they were told by their GRG managers that it was all an error...**

Sample of Statements repeatedly made to FRL customers when they asked to be entered into the Review;

- My understanding is that Fixed Rate loans such as yours do not fall into the remit of the FSA investigation.
- Any reference to a swap in your documents has only been made in error.
- To clarify you entered into a Fixed Interest Rate Loan agreement in November 2008. This did not constitute a swap.
- It is accepted that your previous relationship managers may have referred to this agreement as a swap facility in error however your agreement constituted a fixed rate loan.
- The references to derivatives on the Advisory Note is not correct, the wrong disclaimer was used in error.
- In regards to the reference of a Swap facility within your facility letters, while not being able to reference or discuss any other customer's complaints, I can categorically confirm that you have not been entered into a Swap facility by the Bank and any reference to this has been in error.

8. What products does the FCA's Flint KC Opinion on FRL's cover?

- Freedom of Information Act query 5th December 2019:

Q. Ulster Bank (UB) sold a number of products which they classed as Fixed Rate Loans, which however, are stated to be SWAPs in the loan documentation, did the FCA seek any specialist advice in relation to Hedge Products or Fixed Rate loan products sold by UB, in the same manner as they did with Clydesdale Tailored Business Loans.

FCA Response 18th February 2020 (emphasis added):

A. ***We obtained legal advice*** *on whether fixed rate loan products or similar fell within our regulatory remit,* ***which was not restricted to UB****. We also note that The Treasury Select Committee's Conduct and competition in SME lending considered this (see paragraph 138), and obtained its own advice from Jonathan Fisher QC which supported the FCA's view.*

So it is clear that the FCA or their advisers had studied the Ulster Bank FRL and decided it was not a regulated product and not eligible for the IRHP Review.

Or is it ...?

9. What Does the Flint KC Opinion cover?

22nd May review challenge response stated (emphasis added):

*'I have looked at the information that we have in relation to this question and have concluded that **the FCA's response could have been clearer**, <u>and may have led to an inaccurate impression.</u> The FCA did seek advice on whether loans with 'embedded' interest rate hedging features fell within our regulatory remit. However, **the FCA did not seek specific advice on Ulster Bank products.'***

70,000 FRL's sold of which only 8,000 were Clydesdale TBL's ... What about the other 62,000 contracts?

I then asked:

Q. *i) Was Charles Flint QC's advice based on an analysis of the Clydesdale Yorkshire Banking Groups (CYBG) Tailored Business Loan (TBL) only?*

iii) If so, was Jonathan Fisher QC's opinion for the Treasury Select Committee (TSC) based purely on Mr Flint's analysis of the TBL product?

A. *'as points (i) and (iii) relate to advice received from Counsel, we are unable to disclose this to you. In respect of this information a claim to legal professional privilege (LPP) could be maintained in legal proceedings and, for the reasons set out in Annex A below, such information is exempt from disclosure under section 42 (Legal professional privilege) of FOIA'*

10. The Swift Review into the IRHP Review& the TBL Ruse

Q. Can I ask what the FCA intends to do in consideration of what may have been a substantial regulatory failure by the FCA in NI, where thousands of UB cases may it seems have been improperly excluded from the IRHP Review because the FCA did not investigate the products competently?

*A. there is an independent review into the FSA's and subsequently the FCA's implementation and oversight of the IRHP redress scheme ... **The review will consider, amongst other things, whether the criteria for eligibility to benefit from the scheme were appropriate**. Therefore it would not be appropriate for us to comment on your remarks copied above until the report from the review has been published.*

I met with the Swift team explained about the margin disclosure failures on IRHP sales and provided substantial evidence to the Swift Team, proving that the Ulster Bank FRL's linked to swap contracts and had swap credit lines, the result ...

The Swift report in 493 pages did not mention the Ulster Bank FRL issue once!

11. The Swift Report & TBL Ruse (FCA hiding their cons in plain sight)

- **Swifts Report states**

Tailored Business Loans

143. As discussed at Chapter 2, the FCA had concluded that the scope of the Scheme should be limited to stand-alone IRHPs, rather than include TBLs, given that they were outside the regulatory perimeter

Swift 'mistakenly' classes 62,000 FRL's that were not sold by Clydesdale Bank as TBL's, hardly reassuring in terms of accuracy and detail in his report

- FCA employees state to Swift:

*'the legal position is that **TBLs are embedded** -- that a loan with an embedded swap is outside of the FCA perimeter. And then if you have a loan with a separate swap, the swap is in the regulated perimeter.'*

Since at least 2013 the FCA have been using the ruse that all FRL's are TBL's to deny them regulatory status *... Why?*

a. ***Because the TBL products did not have swap credit lines***

b. ***To avoid the substantial risk to the NatWest Group if the Ulster Bank FRL fraud is exposed.***

12. Just How big a Risk was the Ulster Bank FRL Fraud?

In the IRHP Review the RBS Group refused compensation to many, replaced swaps with swaps where possible and paid virtually no compensation for consequential losses

Bank	Cat A	Cat B	Cat C
RBS	546	**9248**	936
Barclays	756	2638	74
HSBC	241	2456	1093
Lloyds	81	1681	222
AIB	0	484	55
Santander	1	145	25
Co-op	0	90	8
Clydesdale	25	178	15

Proportion of Customer receiving Full Tear Up or Redress

HSBC - 95.4%

RBS – 56.8%

13. The Potential Risk of Ulster Bank FRL's in the IRHP Review

Ulster Bank FRL percentage of cases due a Full Tear Up 100%

Ulster Bank FRL Percentage of cases where Consequential Losses would be Due 100%

WHY?

1. **The IRHP Review was set up between the Banks and FCA to avoid any mention of margin credit/credit lines.**
2. **The banks then refused to pay consequential losses by stating that causing damage to the SME victims when rates dropped was not foreseeable.**

IF YOU SELL AN INVESTMENT TO A CUSTOMER WHERE AT THE OUTSET YOU HAVE TO LEND THEM MONEY FOR EXPECTED LOSSES (AND YOUR PROFIT & COMMISSIONS) THE DAMAGE IS FORESEEABLE!

CREDIT LINES HAD TO REMAIN HIDDEN IN THE REVIEW PROCESS

The Ulster Bank Accounting fraud on these products if admitted would have exposed:

A. The real damage of undisclosed hardcore credit facilities.

B. The foreseeability of damage to the customers who bought these

14. Shall we tell them about Ulster Bank -

When did RBS Senior Executives find out about the Ulster Bank FRL's with swaps & when was it reported to the FCA?

- Who decided to exclude the FRL swap contracts from the Review process, perhaps the Chief Financial Officer **Charles McManus** or **Joe Molloy** head of the Irish GRG.
- Someone trained the customer facing staff to parrot the same phrases that '*Any reference to a swap in your documents has only been made in error.'*
- In May 2012 as the RBS Group prepared to undertake its Pilot Review for the IRHP Review, Phillip Hampton the RBS Chairman stated that Ulster Bank was 'the Group's single biggest headache'. The RBS Group had already to put £13 billion into Ulster Bank following the financial crisis.
- The Bank submitted plans to Government officials and regulators to shut up to 40 branches.
- The Head of the Ulster Banks workers Union stated that he believed the move was because banks regulated by authorities abroad found it easier to scale back operations.
- On July 15th 2012 Colm Heatley at Bloomberg announces: 'Ulster Bank Ltd told the Irish Government it wants to be regulated by the Bank of England instead of Ireland's central bank'

By 2012 RBS would have known about the Ulster Bank FRL problems & evidence would suggest that the FCA also knew.

15. The IT Glitch and a series of unfortunate coincidences!

A current Belfast High Court case alleges that the 2012 IT Glitch was caused because there was an attempt to put a 'Patch' on the Ulster Bank credit system, to remove the FRL credit lines.

Customers had been submitting Data Subject Access Requests and when seeing the credit lines on their files for the FRL's had been alleging fraud.

May 2012 – P Hampton RBS Chairman states Ulster Bank the Group's biggest problem.

June 2012 – RBS in discussions with FCA as to who will be included in the IRHP Review and Pilot scheme, Ulster Bank FRL customers are asking to be in the Pilot.

17th June 2012 – Systems update crashes the Ulster Bank and Natwest systems and part of RBS.

19th June 2012 – Charles McManus Ulster bank CFO and Joe Molloy Head of GRG leave citing personal reasons.

29th June 2012 – With systems still crashed and credit line evidence unavailable on FRL's RBS reach agreement with the FCA on the Review.

June 2012 – It is reported that there are over 100 IT technicians working on the Ulster Bank systems and manually inputting information that had been wiped off.

15th July 2012 – Ulster Bank Directors tell the central bank they want to be regulated by the Bank of England.

16. The IT Glitch and a series of unfortunate coincidences!

18th July 2012 – Systems come back online but some Fixed Rate Loan customers state their loans cannot be found or payments made. Relationship Management Platform (RMP) which records swap credit lines and the trading platform were worst affected.

Circa July 2012 – CA technologies who provide the RBS software confirm that they proactively contacted other customers to reassure them that *'it was a specific problem to the Ulster Bank Platform'.*

September 2012 – The FCA announce that they have instructed RBS to undertake a Section 166 investigation into the IT failure and subsequently PWC are appointed as the Skilled Person.

October 2012 – RBS are notified they will be called to provide to the Northern Ireland assembly's Committee for Enterprise, Trade and Investment.

5th October 2012 – Chief Administration Officer Ron Teerlink responsible for the IT oversight suddenly leaves for 'personal reasons', around the same time Tony Stennet who was directly responsible for the crashed systems leaves for 'personal reasons'.

12th October 2012 – Evidence Session at NI Assemble where W Higgins from RBS states *'we know the root cause and we have produced a report for the FSA'*. When asked to share the broad conclusions from his investigations Higgins states '*that is part of the investigations and I have signed a confidentiality clause with the FSA' and* refused to provide any detail on the Glitch cause.

WHICH LEAVES THE FCA AS THE ONLY PARTY WHO CAN REPORT THE CAUSE OF THE IT CRASH!

What did cause the IT Crash?

PWC S.166 Report – No public domain information available confirming when PWC's report was produced or its conclusions, whilst referencing that they instructed RBS to undertake a S.166 the FCA does not refer to the report or any its conclusion anywhere in their formal report.

FCA Report – Not produced until November 2014 around the time that the IRHP Review was expected to have ended. Confirms that the programme version 2 update on the batch scheduler had been tested for compatibility with version 1 and worked but then confirms:

*'They updated the batch scheduler programme from Version 1 to Version 2A. Version 2A contained a modification known as a **"patch".'***

They confirmed that Version 2A was never tested for compatibility and when they tried to back out the update this caused the crash. **There is no explanation as to what Patch A was. FCA concludes not testing Version 2A for compatibility was the cause.**

RBS Board – When dealing with the IT Failure in his Chairmans report in the 2012 accounts Phillip Hampton states:

'Whilst these failings show our continuing need to update our risk and control systems, they at times had a deeper cause. Some employees put their own interests well ahead of customers and shareholders, <u>ignoring the difference between right and wrong</u> ... It is a matter of great regret that the conduct and values of a very small number of people fell so far short of what we expect'

<u>RBS STATE MISCONDUCT AND EMPLOYEE WRONGDOING</u>

The Real Effects on a FRL Customer – Mr A

- November 2007 contracted to a swap trade to fix interest rates for a £770k loan that does not draw down until 31st January 2008
- Loan document confirms a £50k swap credit line which Mr A does not understand
- As interest rates decrease in 2008 without Mr A's knowledge the swap credit line increases to £100k, then £150k until it peaks at £303,00 in March 2009
- MR A put under pressure to reduce borrowings as the Bank state they are not happy with the Loan to Value (LTV) risk, Mr A unaware of the swap credit line which is now at £267k
- Mr A Transferred into GRG because of security risk concerns on LTV
- May 2012 – Whilst trying to refinance Mr A is being put under constant pressure by GRG manager to put forward a business plan when that has been done.
- 25th May 2012 bank manager asks the market team for costs to break the FRL and is told:

  'in order for the swap facility to be crystallised that a break cost of £129k will be incurred.
- In June 2012 all payments have been made up to date on the loan.
- Systems crash 17th June 2012.
- June/July 2012 no payments can be made on the loan and bank staff confirm not to leave money for loan payment at the branch it cannot be allocated.

The Real Effects on a FRL Customer – Mr A

- August 2012 – Systems now working again but FRL does not show on the system and payment cannot be made.
- 12th September 2012 – GRG bank manager instructs the market team to break Mr A's swap without his knowledge.
- 13th September 2012 – GRG manager takes £119k from Mr A's loan account without any authorisation, transfers it into his current account and then again without authorisation pays it to NatWest Markets to cover the swap break cost. Mr A is not notified of this.
- 21st September – GRG manager served a demand for the loan repayment at £903,00 including the swap break cost and interest, at this point the FRL has not been broken and no default notice had been served. The demand states 'all facilities are repayable on demand' despite the fact the term loan has 5 years remaining.
- 24th September just 11 days after the GRG manager paid the swap break costs, Mr A asks the manager about entry into the IRHP Review and is told:

  'My understanding is that Fixed Rate loans such as yours do not fall into the remit of the FSA investigation.'

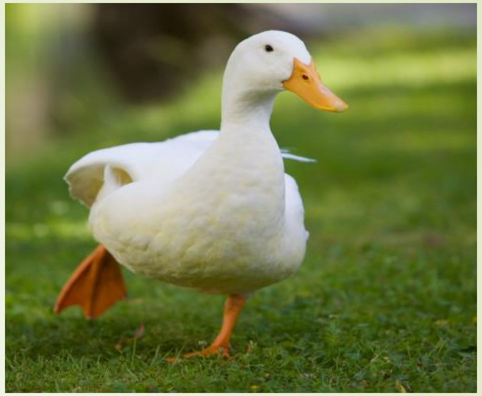
- 24th September 2012 – Mr A is sent to recoveries department for receivers to be appointed.

Ulster Bank becomes Non Core

When agreeing the Bail out in October 2008 and afterwards RBS agreed to substantially reduce its risk in areas such as construction, development, real estate, hospitality etc. it classified these areas as **Non Core** and ring fenced £342 billion of loans for this.

- <u>Almost all Ulster Bank Ltd customers in NI were targeted for Non Core.</u>
- Non Core customers were going to be placed in HM Treasury's **Asset Protection Scheme,** which was little more than a asset stripping outfit designed to extract as much profit as possible and transfer assets to the Banks own balance sheet via West Register & other vehicles.
- The Asset Protection Scheme was set to run for 3 years and planned to remove all £342 billion from RBS books byb2012.
- There is evidence that the HM Treasury arm the Asset Protection Agency blocked the bank from supporting customers to steal their assets for West Register.
- The Bank would not have expected many FRL customers to survive until the IRHP Review began but those that did posed a huge threat to the bank, the FCA and HM Treasury who had been the controlling mind of RBS when the Ulster Bank accounting fraud took place.
- **Surviving FRL victims could not be allowed into the IRHP Review as it would not only have exposed the accounting and regulatory fraud it would have brough focus onto the hidden swap credit lines and foreseeability for all swap victims!**

When is a swap not a swap?



- In this case:
- **WHEN THE FCA DECIDES TO, OR IS INSTRUCTED TO PROTECT HM TREASURY'S BEHAVIOUR AND RISK AT ALL COSTS!**
- The FCA either colluded with RBS or turned a blind eye to the serious fraud at Ulster Bank to protect RBS from compensation risk in NI and Ireland & the exposure of margin credit
- How was it hidden? 45 millions of ways to do this!
- £4.8 billion portfolio of loans including FRL's sold to Promontoria Aran for just £1.1 billion
- **SME's in NI and the Republic condemned to insolvency and despair to boost RBS balance sheet and cover up fraud in a UK state owned bank!**