1. Margin Credit – 10 Years of Lies

How Banks & the FCA covered up Swap credit risks and their effect on SME's solvency

S Middleton June 2023

BankConfidential

2.Legal 'Experts' keep getting it Wrong!

- **Paul Sinclair KC** – Statement in Perks v RBS – Made to dismiss evidence from his own witness Neil Graham that swap credit obligations could breach LTV:

'He did suggest, I think, that it might -- the contingent obligation could push a connection over a loan to value ratio covenant. That is wrong, in our submission. He just got that wrong… So we don't accept that the CLU had the impact that my learned friend suggests on the LTV calculations, and we don't accept that there is a duty on the bank to volunteer information about the CLU.'

- **Judge Jacobs** – Judgement in Perks v RBS

'A "contingent obligation" is an obligation, agreed to by a party, which arises when a particular contingency occurs. In the present case, there is no evidence that the "Contingent Obligation" (which is ultimately an estimate of the near worst-case risk to the Bank at a given time) creates any such obligation.'

'there is no evidence that it has any impact on the customer's ability to borrow under terms that have been agreed.'

'... there is no evidence that the Contingent Obligation has, or can have, the effect of putting the Partnership in breach of its loan agreement with the Bank.'

3. And Keep Getting it wrong!

- **J Swift KC** – Lessons Learned Report on IRHP Review

  <u>Statements on contingent liability</u>

- ***'Par 10 - The question of contingent liability was brought to the FCA's attention late in the process, and only properly surfaced during the implementation of the scheme.'***
- ***'It was not covered under FSMA nor the Principles and Rules made under it, and it was not addressed in the sales standards'***
- ***'Moreover, in practice the breadth of the sales standards relating to the disclosure of break costs would often have an equivalent effect, at least in establishing breach'***
- ***'11 – The Legal and Regulatory background meant there could have been no reasonable expectation on behalf of customers for such a requirement to appear in the sales standards'*** **[quoting cases from 2018 and 2020]**

4. Margin Credit or Similar Obligations – The Rules

- **PRE MIFID (Pre 11/2007) - Restrictions on lending to private customers**

COB 7.9.3R01/12/2001 - A *firm*, subject to the exceptions in *COB 7.9.5 R*, must not lend *money* or grant *credit* to a *private customer* (or arrange for any other person to do so) in the course of, or in connection with, its *designated investment* business unless: ...

(3) the *private customer* has given his **prior written consent to both the maximum amount of the loan or *credit*** and the amount or basis of any interest or *fees* to be levied in connection with the loan or *credit*.

- **POST MIFID (11/2007 on) - Providing a description of the nature and risks of designated investments**

COBS 14.3.2R01/11/2007*RP* - A *firm* must provide a *client* with a general description of the nature and risks of *designated investments*, taking into account, in particular, the *client's* categorisation as a *retail client*… That description must explain the nature ... As well as the risks in sufficient detail to enable the client to take investment decisions on an informed basis; and include;

- (c) the fact that **an investor might assume**, as a result of transactions in such *designated investments*, **financial commitments and other additional obligations, including contingent liabilities**, additional to the cost of acquiring the *designated investments*; and

- (d) **any margin requirements or similar obligations**, applicable to *designated investments* of that type.

5. The IRHP Review

- <u>**What the FCA Said**</u>

David de Souza – Lead Supervisor IRHP Review:

*‘**The IRHP review does of course consider** whether the banks sufficiently explained to the customer the risks of potential future (contingent) liabilities’*

- <u>**What KPMG Said**</u> – Internal Project Rosetta Files:

*‘The setting of any contingent liability is a credit risk function carried out as part of the operational process. The **process is not related to the sales standards agreed with the FCA** in respect of the past Review of IRHP’s.’*

WHY DID THE FCA LIE ABOUT THIS?

6. Weasel Words

- **CONTINGENT LIABILITY (CLU)**

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BANKS INTERNAL LIABILITY

RBS internal Email - The CLU (contingent liability) is a dynamic number which represents where the bank believes the mark to market value could potentially move over the term of the trade

- **CONTINGENT OBLIGATION**

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CUSTOMERS DIRECT LIABILITY

RBS Internal Email – We strongly recommend that you build in a 15-20% fluctuation when requesting your limit as this avoids the need to revert to credit for increases.

BANK INTERNAL CREDIT RISK = HIGHER CUSTOMER CREDIT LIABILITY

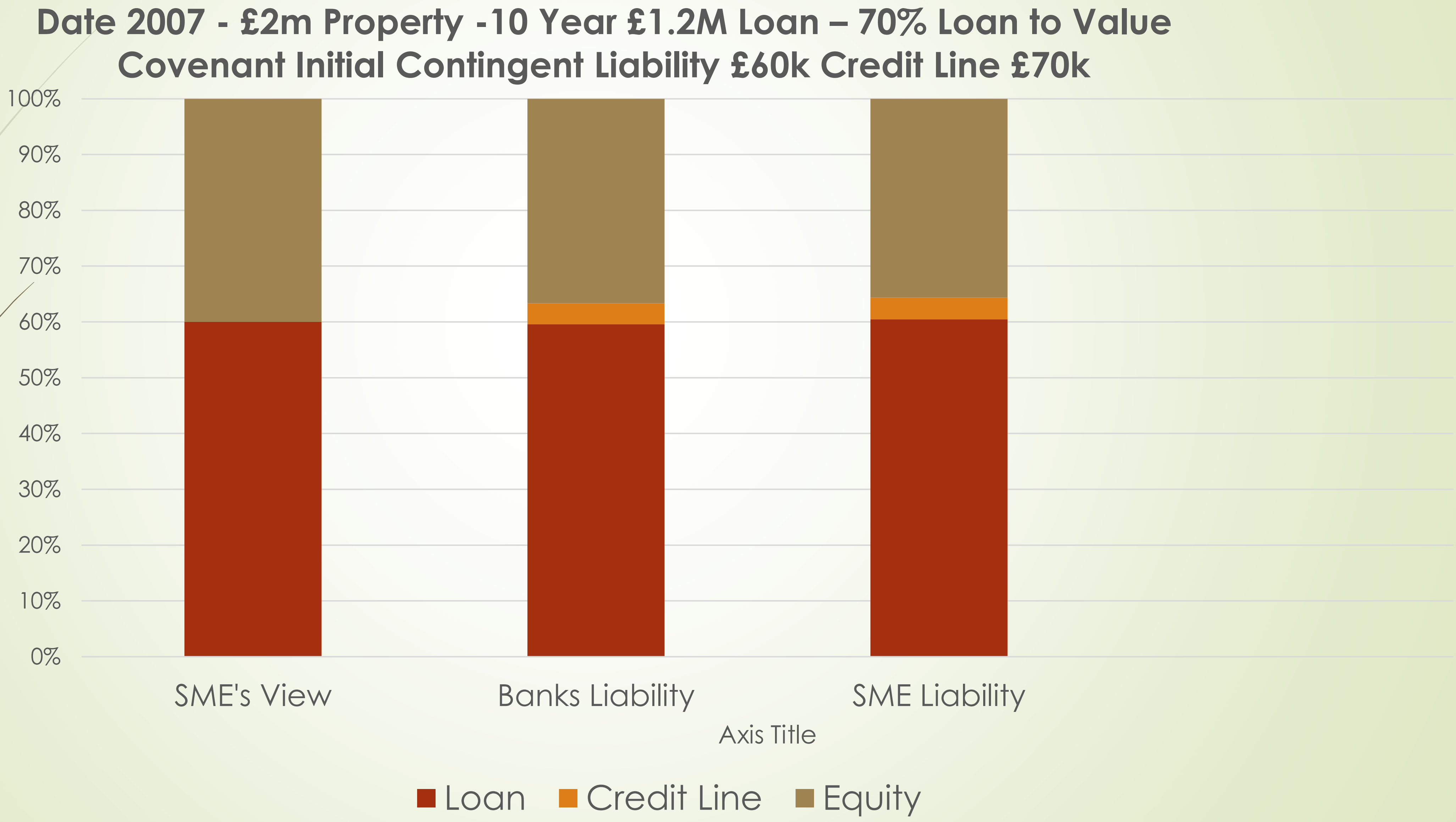
7. How Margin Credit Rules were broken

- Bank calculated customers potential losses on the swap/fixed rate loan.
- Bank manager applied to credit team for a credit line to cover known & potential losses usually at the same time as the loan.
- The Bank relied on the Loan Documents and All Monies Charge to secure this **additional undisclosed credit risk** against the customers and their assets.
- The credit line being a hard limit is part of the customers liabilities when calculating any Loan to Value covenants.
- When interest rates reduced and customers losses increased, the bank manager would keep applying for further credit in the customer's name without their approval.

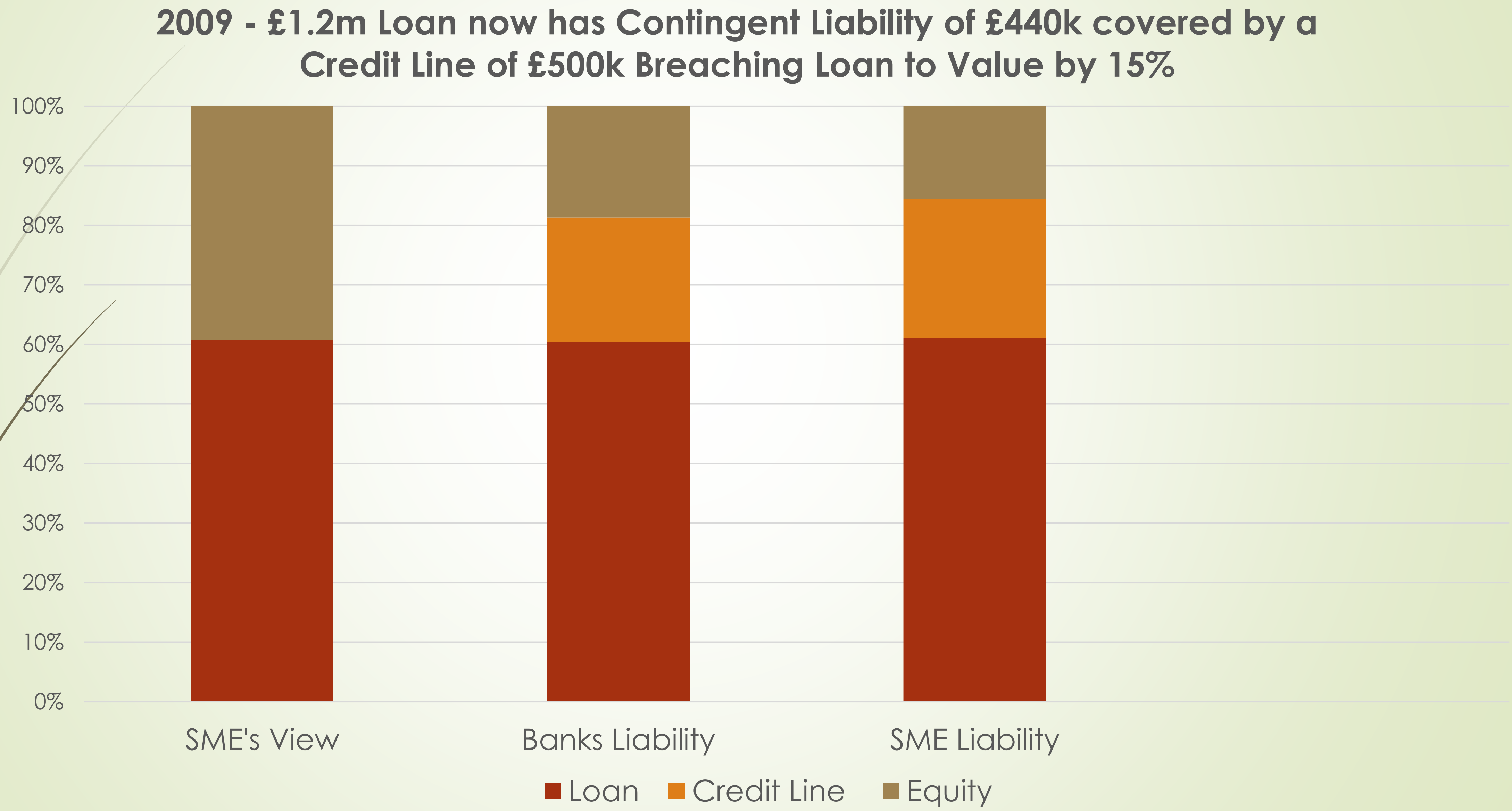
RBS WHISTLEBLOWER: *'EVERY CUSTOMER I SENT TO GRG FOR A LOAN TO VALUE BREACH WAS BECAUSE OF THE SWAP CREDIT LINES. WE WEREN'T ALLOWED TO TELL THE CUSTOMER THIS WAS THE CAUSE; WE WOULD HAVE TO FIND ANOTHER BREACH OR SAY GET AN UNDERVALUATION ON THEIR POROPERTY TO MANUFACTURE A SECURITY BREACH.*

THIS IS WHAT THE BANKS & FCA HAVE BEEN HIDING!

8. How this Affected the SME



9. How this Affected the SME



10. Credit Lines were real Exposures

RBS Credit Line on Files.PDF

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Ref	Facility Type	BS / Risk Holder	Decision	Reason	Limit	Interest	Fees	Review Date	Expiry Date/Term
A3	Overdraft	Natwest	Approved	Approved as proposed	20.000	B+1.00, B+5.00	0.300	30-Sep-14	
B2	Interest Rate Swap/Hedging	Natwest	Approved	Approved as proposed	3,474.000		0.000	30-Sep-14	01-Sep-38
B23	Loan	Natwest	Approved	Approved as proposed	5,268.691	GBPLI+1.00	0.000	30-Sep-14	02-Sep-34

Total	Existing Limit	Proposed Limit	Change(+/-)
Total facilities under review	8,762.691	8,762.691	0.000
Total facilities not under review	0.000	0.000	0.000
Total Direct Exposure for Connection	8,762.691	8,762.691	0.000
Total Group Settlement Risk	0.000	0.000	0.000

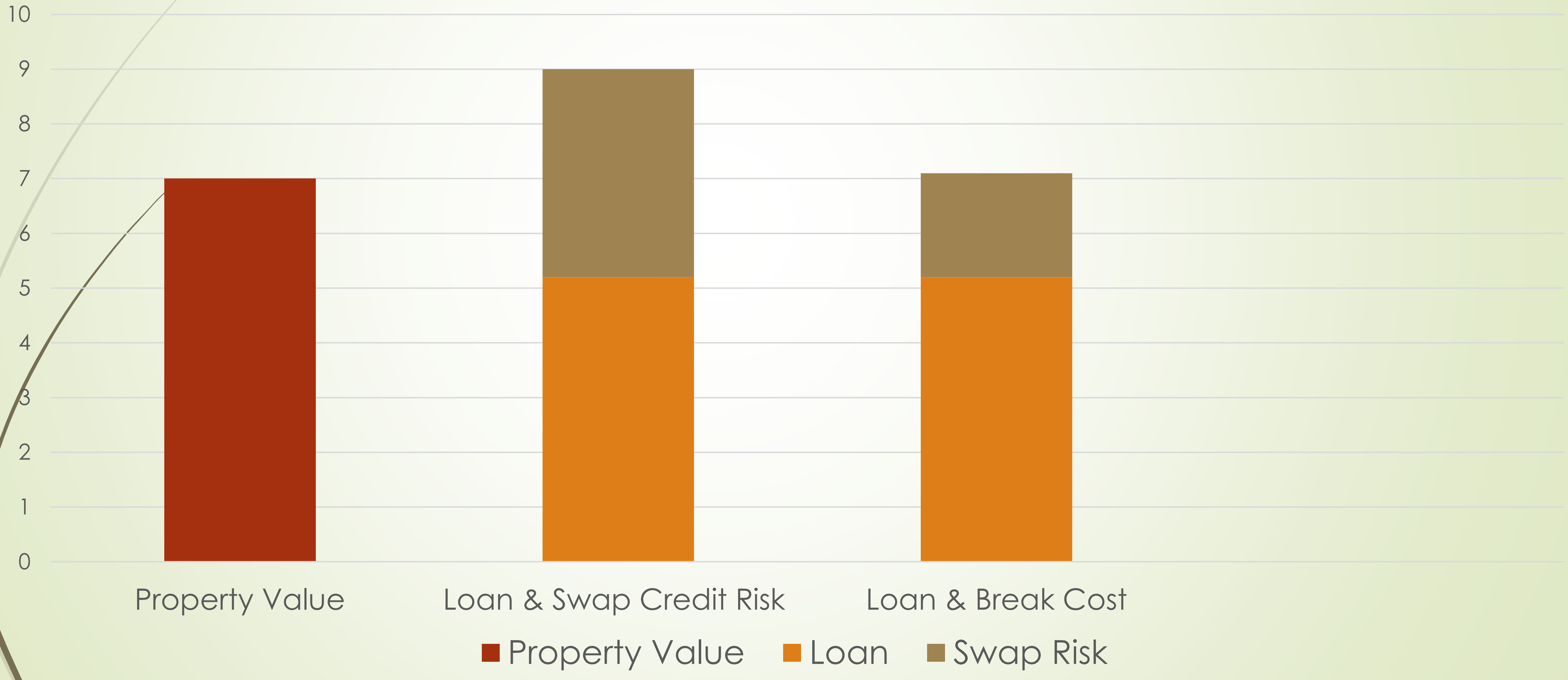
Connection Name: Kings Medical Practice- NWB

Core Bank Conditions of Sanction

Ref	Timing	Details	Date Met	Tracked	Copy	Status
A1	Post-drawdown	Annual Audited Financial required in 270 days of period end.		Y	N	EXISTING

11. Credit Line risk or Break Costs, which is the Larger?

Property Value **£7M** – Swap Credit Line **£3.8m** Swap break Cost **£1.9M**



12. What was the Incentive?

Swap and Fixed Rate Loan Credit Risks & Added Value/Commissions

Swap	Term (Yrs)	Initial Contingent Liability	Increased Contingent Liability	Date	Rate % (plus margin)	AV/Commission	Result
2,100,000	5	114,000	188,000	11/2007	5.6	32,000	Lost all properties/business
2,000,000	10	267,000	550,000	11/2007	6	47,000	Transfer to GRG & Property sold
11,500,000	10	1,000,000	3,300,000	02/2008	5.2	180,000	Transfer to BSU, business failed, property sold
5,200,000	25	1,450,000	3,800,000	08/2008	5.24	335,000	Had to sell property to exit swap

13. Who benefitted from the Sale?

From: McGuigan, Jane
Sent: 29 November 2007 16:23
To: Mcclurg, Scott (Glw Commercial)
Subject: Income !!!!!!!

Angela has confirmed that deal has been done and her income was £32k so that's £16k for us ....hurray!!

About the only good news I've had today ....

Jane

14. Why Margin Credit at UBL had to Remain hidden!

1. Investigating the UBL fraudulent accounting arrangement in 2012/13 would have exposed the credit Line risks to all SME's with Swap's.
2. It would have evidenced that extortionate commissions were being hidden from the customers.
3. It would have established the foreseeability of the product not protecting an SME but rather causing credit risk/losses – this should have led to consequential loss redress in the IRHP Review.
4. It would have exposed the fact that tens of thousands of businesses were forced into GRG & insolvency because an undisclosed credit risk breached their LTV covenants.

- **FCA as the regulator of <u>all of the above behaviours</u> failed to protect Ulster Bank SME's and have colluded with NatWest Group, allowing them to avoid paying Billions in redress due to Irish SME's!**