Playing the blame game at RBS

"YOU HAVE TO ASK YOURSELF, YOU WOULDN'T BRING FRED GOODWIN BACK TO SORT OUT THE BANKS, WHY WOULD YOU BRING [LABOUR] BACK TO SORT OUT THE ECONOMY?" – PRIME MINISTER DAVID CAMERON, PRIME MINISTER'S QUESTIONS 12 OCTOBER 2011

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Even David Cameron has problems with Sir Fred Goodwin, the former CEO of the Royal Bank of Scotland Group PLC. On Sir Fred's watch, the once famously conservative bank went on an acquisition spree, acquiring a number of banks and financial institutions, including Greenwich Capital Markets in the United States and, finally, the ill-fated takeover of ABN Amro. Both those entities, it turned out, had substantial sub-prime exposure – even while Sir Fred assured the investment community that "we don't do sub-prime".

So, in April 2008, RBS announced both a £5.9 billion write-down to account for sub-prime exposure, and a £12 billion rights offering – the biggest rights offering, at that time, in the history of Europe. It is now alleged, however, that the £5.9 billion write-down was in fact inadequate: it allegedly failed to take into consideration impairment of billions of pounds of goodwill that RBS had booked, much of it in connection with the ABN Amro acquisition. A write-down of such a greater magnitude would, of course, have made the RBS rights offering impossible. Instead, the rights offering was a stellar success.

In late 2008, RBS imploded, leading to a £20 billion governmental bail-out.

A lot of public pension schemes got burned by the RBS meltdown. A rights offering from a bank like RBS was viewed as the bluest of blue-chip investments; RBS was supposed be a safe "grandma" stock. No one suspected that bankers might act like risk-taking hedge-fund operators.

Attempts by UK public pension schemes to obtain redress in US courts were largely derailed by the United States Supreme Court's decision in Morrison v. National Australia Bank, 130 S. Ct. 2869 (2010), which severely limited the right of foreign investors to sue in US courts under US securities law for purchases made outside the US Indeed, the Government made a submission in the US RBS case asserting that even investors who purchased RBS ADSs on a US exchange should be forced to sue in the UK (where, the Government insisted, adequate remedies were available) rather than the US Redress might be sought in courts in the UK on a number of theories, particularly under Sections 90 and 90A of the Financial Services and Markets Act of 2000, as well as common-law claims such as fraud and negligent misrepresentation.

Meanwhile, Sir Fred and the RBS scandal continue to dominate the news. Just a few weeks ago, the BBC aired a documentary detailing the conduct leading up to the fall of RBS that received a good deal of coverage in the newspapers for including a videotape of Sir Fred's apology – described by one reporter as "grovelling" – to RBS investors at the last shareholders' meeting before he stepped down.

The Government appears to have come up with its own programme for avoiding responsibility for any liability imposed on RBS, Sir Fred, and other former RBS officers. This can be seen in the tortured history of the Financial Services Authority's report on the circumstances behind the fall of RBS.

In May 2009, the FSA engaged PricewaterhouseCoopers to perform an investigation into RBS and the circumstances leading up to the company's bailout by the UK government. PwC was a troublesome choice as an investigator, as it was

itself subject to criticism – and potential legal liability – for its alleged failures to detect management malfeasance in its audits of several other failed banks and financial institutions, and thus had reason to find no malfeasance here. The FSA nevertheless later characterised PwC's investigation as an "extensive" one that "looked specifically at the conduct of senior individuals" at RBS.

Last December, the FSA announced that PwC had concluded its investigation of the RBS meltdown, and that the investigation "confirmed that RBS made a series of bad decisions" – but that those decisions were "not the result of a lack of integrity by any individual" and it "did not identify any instances of fraud or dishonest activity by RBS senior individuals or a failure of governance on the part of the Board". The FSA concluded that it would not be bringing any charges against any of the parties involved, and did not believe any detailed public explanation was necessary. Indeed, the FSA took the position that it was legally prohibited from publishing a report containing its investigative findings without the permission of the subjects of the investigation (i.e., RBS and its senior officers).

The public reaction to this announcement was swift and harsh. For example, Britain's largest trade union, Unite, said the FSA "has demonstrated its weakness and inability to hold the sector to account" and called the conclusion "an outrage". Labour MP Michael Meacher wrote on his blog: "The FSA appears not just toothless, but gumless and jawless. Mismanagement on this gigantic scale cannot simply be written off with such Olympian insouciance." In response to the public and parliamentary outcry, the FSA promised a public report, to be issued last March.

That report was delayed when counsel to RBS and some of its individual former officers expressed concerns that the report, once issued, could subject them to further litigation. To allay the concerns of RBS and its former officers, the FSA appointed Sir David Walker, a long-time City banker, and prominent company attorney Bill Knight to "independently review" the FSA Report for fairness and accuracy prior to its release. This delayed the issuance of the report. At first, we were told, "indefinitely," then until October 2011, and now, we are told, until next year.

Meanwhile, FSA representatives have been telling anyone who would listen that the report will focus on demonstrating that much of the responsibility for RBS's failure lies at the feet of... the FSA. The FSA was a large contributor to the failure of RBS, the FSA tells us, by reason of its failure to adequately monitor the bank's activities (as well as the holes in the regulatory scheme in place at the time – now corrected, we are assured). Since the FSA can't be sued for inadequate regulation, that lets RBS (and the government) completely off the hook.

It does make one wonder where the redress for defrauded shareholders will come from, though. Private damage actions in the UK courts seem to provide the only real avenue for redress – provided the courts see through the FSA's attempt at obfuscation.

One final irony: owing to contractual indemnification rights he presumably has, Sir Fred – the individual whose primary role in the financial meltdown even David Cameron acknowledges – could be repaid out of the taxpayers' pockets for any liability and expenses he incurs as a result of his activities at RBS. Notwithstanding the FSA's purported findings, Parliament might want to reconsider whether such a result would comport with fairness, equity, and justice.