SUBMISSION FROM THE ROYAL BANK OF SCOTLAND

Thank you for inviting us to respond to the Final Report of the Independent Commission on Banking. While we welcome the opportunity from the Economy, Energy and Tourism Committee to give a preliminary reaction, it will take time for the full implications of the Commission’s recommendations to become clear. These will also be influenced by detailed rule-making, market developments and customer and competitor actions.

I should say at the outset that RBS supports the direction of international banking reform. In that regard we are generally supportive of the ICB’s focus on capital levels and progress towards an effective resolution regime, even though this will be costly for bank shareholders and potentially for their customers and the UK and Scottish economies. While we remain convinced that the Commission’s proposals on ring-fencing will not achieve the benefits intended, we recognise the clear determination that they should proceed.

RBS set out its arguments in full in its published submission to the ICB, but one point bears repeating: ring-fencing will not create a “safe” ring-fenced bank and a “risky” non-ring-fenced bank. Many aspects of EEA retail and commercial banking permitted within the proposed ring-fence entail considerable risk, while many prohibited activities are routine, low risk services to UK corporates and institutions. In RBS’s case, most of the losses incurred since the onset of the financial crisis have been ordinary commercial banking loan losses, not global markets losses.

While our view of ring-fencing has not changed, we realise the UK Government has endorsed the main recommendations of the report. We will therefore work closely with governments and legislators to carry out the reforms arising from the Commission’s report and to assist in the implementation of its recommendations. I hope that in this implementation governments will be cognisant that the incremental impact on financial stability of the ICB’s final proposals should be measured not against the world of banking regulation as it was in 2007 but against the new regulatory framework that will soon be in place. The Basel III reforms to capital and liquidity are in train. The FSA and Bank of England are working on Recovery and Resolution Plans with each bank. There will soon be a new supervisory architecture as well as international crisis management mechanisms such as bail-in measures to ensure that equity and debt investors, not taxpayers, bear the burden of recapitalising failing banks. It is against this backdrop that the design of a new UK ring-fence should take place.

The delicate juncture for the economy and for the international financial markets also needs recognition, as the ICB’s proposals, even if not implemented for some time, already form part of market and company analysis and decision-making.

The ICB’s proposals will entail significant costs not just to the RBS Group but to the UK banking industry and to the UK and Scottish economies as a whole. You will have seen a wide variety of analysts’ estimates confirming this
judgment. This will present a significant challenge to the value of the taxpayer’s holdings in UK banks. In future, in light of regulatory change, it is likely that there will be a lower contribution from the financial sector to the UK and Scottish economies than in the past or than would otherwise have been the case.

RBS Group is the only major banking group to be headquartered in Scotland and is one of the country’s largest companies, employing around 15,000 people. We inject around £600 million a year into the Scottish economy in wages and pensions alone and considerably more in contracts with third party suppliers. Our footprint in Scotland is significant. As it stands our main business lines in Scotland would be inside the ring-fence. They would be subject to higher capital costs with knock on implications for the cost of credit in the Scottish economy. The overall package of reforms are costly and some of those costs will be allocated to our Scottish activities not least through headquarter effects. That means that we may have to look again at how we reduce the costs of doing business. This is the best way to mitigate additional costs to our customers. In line with our long-standing policy, we will discuss the implications of any future cost programme with our colleagues, the Scottish Skills Taskforce and the Scottish Government.

As I said at the outset, RBS supports the direction of international banking reform. We also support the ICB’s recommendations relating to competition in the UK banking market. We think it unlikely, however, that the proposed UK ring-fence will add to financial stability in a cost-effective way.

Stephen Hester
Group Chief Executive
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