

Detailed Terms of Reference for the HBOS Review

A report by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) into the failure of HBOS plc (HBOS)

1. The Board of the Financial Services Authority (FSA) commissioned a report into the failure of HBOS. It was not appropriate to launch a wider review until the conclusion of certain enforcement proceedings. Those proceedings concluded in September 2012 and the FSA commenced its review of HBOS at that time. As preparation of the report has spanned the change in the structure of financial services regulation in the UK on 1 April 2013, the report will be jointly published by the FCA and PRA.
2. The **purpose** of the review is to:
 - a) explain and describe: why HBOS failed; the supervision of HBOS;
 - b) assess the FSA's enforcement investigations following the failure of HBOS, as set out in 4(f) below; and
 - c) inform a wider internal and public understanding of the causes of failure during the crisis (to the extent not already covered by the RBS report¹).
3. a) The review **period** will focus mainly on 1 January 2005 to 1 October 2008, the date when HBOS was in receipt of Emergency Liquidity Assistance (ELA) from the Bank of England. b) For the enforcement section of the review, the review period will be from 1 October 2008 to 12 September 2012, the date of the Final Notice given to Peter Cummings.
4. The review **scope** will:
 - a) summarise why HBOS failed;
 - b) assess HBOS' capital, asset quality and liquidity positions, as well as systemic vulnerabilities during the period;
 - c) assess management, governance and culture at HBOS at the time;
 - d) assess the key elements of the FSA's supervision of HBOS in the period;
 - e) address the issues set out in paragraphs 141(a) to (g) and (i) in the Parliamentary Commission on Banking Standards' Report into the failure of HBOS², paragraph 141(h) being addressed by paragraph 4(f) of these Terms;
 - f) assess the reasonableness of the scope of the FSA's enforcement investigations in relation to the failure of HBOS during the Review Period (i.e. October 2008 to

¹ Financial Services Authority Board Report entitled 'The failure of the Royal Bank of Scotland' December 2011

² Parliamentary Commission on Banking Standards report entitled 'An accident waiting to happen': The failure of HBOS' March 2013

September 2012), including offering an opinion, based on Andrew Green QC's review, as to whether the regulators should consider afresh whether any other former members of HBOS's senior management should be subject to an investigation with a view to prohibition proceedings³; and

- g) make any recommendations arising out of the above that have not already been covered in the previous reports, specifically Northern Rock⁴, The Turner Review⁵ and RBS.
5. The report will also include a high level analysis of the balance sheets of the Bank of Scotland and Halifax in 1998–2001, and of the merged HBOS balance sheet in 2001–2005, focusing on key prudential indicators such as capital and leverage ratios. It will not examine the particular causes and consequences of the Lloyds/HBOS merger itself, but will examine the quality of the HBOS loan book in 2008, considering both what was known before October 2008 and what subsequently came to light.
 6. It is anticipated that significant elements of relevant material have already been covered in detail in the RBS report. To the extent this is the case, the report will summarise and refer to this material within this report, which will, nevertheless, be a substantive report and will remain a standalone document.
 7. The **approach** and inputs to the review include:
 - a) analysis conducted by the FSA Prudential Business Unit/PRA's Supervisory Oversight Function. This function is responsible for reviewing the effectiveness of prudential supervision;
 - b) an assessment of management, governance and culture at HBOS supported by an external third party, Grant Thornton; and
 - c) placing reliance where appropriate on analysis already published within the RBS report, for example setting out the FSA's approach to supervision in the period.
 8. For the enforcement section, the assessment of the reasonableness of the FSA's enforcement investigations will be carried out by a team of independent Counsel led by Andrew Green QC, who will be the author of this part of the report.
 9. **Oversight** is provided by a dedicated steering committee comprising Board members of the PRA and FCA respectively. Separately, external independent reviewers have been agreed with the Treasury Committee⁶ to review the first 4 sections of the report (but not the enforcement section, which is being prepared separately). This approach will provide independent scrutiny and challenge to facilitate the production of a robust report.
 10. **Clearance and publication.** The aim is to publish the final report by the end of this year. This timescale incorporates the time needed by the external independent reviewers to complete their review, for Counsel to conduct their enforcement review and the Maxwellisation process, whereby the firm and any individuals subject to potential criticism

³ Thus addressing paragraph 141(h) of the PCBS report

⁴ Financial Services Authority report entitled 'The supervision of Northern Rock: a lessons learned review' March 2008

⁵ Financial Services Authority report entitled 'The Turner Review: A regulatory response to the global banking crisis' March 2009

⁶ <http://www.parliament.uk/documents/commons-committees/treasury/Terms%20of%20Reference%20HBOS%20review.pdf>
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are given an opportunity to make representations in response to the review's proposed findings. As the report will draw heavily on confidential information previously provided by HBOS and other relevant parties, their consent will also be legally required before publication of this information.

11. The Financial Services Act 2012 (FSA 2012) established the **future arrangements** for investigating regulatory failures. Under this approach, Her Majesty's Treasury will decide whether a firm failure is of a scale and nature which justifies the production of a public report, if the regulator has not already independently decided to produce one. The HBOS review is not being undertaken under FSA 2012. Ahead of that system being in place, the FSA's judgement was that the public's legitimate interest in understanding the key drivers of the 2008 financial crisis, would be served effectively by the publication of reports on RBS and HBOS, together with the earlier report which the FSA produced on Northern Rock and The Turner Review's report on the overall regulatory system.