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## FINAL NOTICE

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To: **Bank of Scotland plc**

Reference  
Number: **169628**

Address: **The Mound, Edinburgh, EH1 1YZ**

Date: **20 June 2019**

### **1. ACTION**

- 1.1. For the reasons given in this Final Notice, the Authority hereby imposes on Bank of Scotland plc ("BOS") a financial penalty of £45,500,000 pursuant to section 206 of the Act for contravening regulatory requirements between 3 May 2007 and 16 January 2009 ("the Relevant Period").
- 1.2. BOS agreed to resolve this matter and qualified for a 30% (stage 1) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £65,000,000 on BOS.

### **2. SUMMARY OF REASONS**

- 2.1. During the Relevant Period BOS failed to be open and cooperative with the Authority and failed to disclose information appropriately (in breach of Principle 11) in relation to BOS's suspicions that fraud may have taken place within its London and South East Regional Impaired Assets office headquartered in Reading ("IAR"). On 4 June 2010, the Authority appointed investigators to start looking at BOS's misconduct but, at the request of Thames Valley Police ("TVP"), the investigation was placed on hold on 21 August 2013 until after the criminal prosecution of relevant individuals had been completed. The Authority's investigation was therefore only restarted in February 2017.
- 2.2. A serious control breakdown was discovered in early 2007 by BOS in IAR. The Director of IAR in the region, Lynden Scourfield, had been sanctioning limits and additional lending facilities beyond the scope of his authority undetected for at least three years. The additional facilities had been provided to businesses that were in financial distress, and involved the use of turnaround consultants, Quayside Corporate Services Limited ("QCS").

- 2.3. By 3 May 2007, BOS had identified suspicious conduct, including suspicions of fraud. On a number of occasions during the Relevant Period, internal reports within BOS referred to the issues that had been identified as the 'Reading fraud'. However, it was not until July 2009, and after BOS became part of the merged Lloyds Banking Group ("LBG") on 16 January 2009, that BOS provided the Authority with full disclosure in relation to its suspicions and the report of the investigation that it had conducted.
- 2.4. It was later established, after investigation by TVP, that a fraud had occurred. In 2017, six individuals, including Mr Scourfield and another BOS employee, Mark Dobson, were convicted for the fraud involving QCS. Whilst during the Relevant Period BOS did not have access to all the evidence of fraud that subsequently resulted in the convictions, BOS had identified sufficient information that raised suspicions.
- 2.5. Pursuant to Principle 11 it is a fundamental obligation that a regulated firm must deal with its regulators in an open and cooperative way and disclose appropriately anything relating to the firm of which those regulators would reasonably expect notice. In addition, a specific rule (SUP 15.3.17R) requires a firm to notify the Authority immediately if the firm becomes aware that an employee may have committed a significant fraud against it. Further, near the start of the Relevant Period the Authority explicitly told BOS it expected to be updated about the control failings and any fraud that may have occurred, so BOS should also have considered any such potential fraud committed against IAR customers.
- 2.6. Whilst BOS did provide some limited information about the suspicious conduct it had identified to the Authority during the Relevant Period, it failed to be open and cooperative and did not disclose appropriately information when providing these communications. For example:
- (1) on 12 May 2007, after issues in IAR came to the attention of the press, BOS emailed the Authority describing the matter as a failure in controls. The email was followed shortly afterwards with a briefing from BOS by telephone;
  - (2) on 14 May 2007, the Authority specifically told BOS that it wished to be updated about the control failings and any fraud that may have occurred. BOS confirmed that it would ensure that the Authority was advised of developments, particularly around control failings and should any suggestion of fraud be identified. On three occasions in 2007 BOS informed the Authority that it had found no evidence of fraud. In fact, BOS had identified suspicious conduct suggesting an inappropriate and potentially corrupt relationship. As a result of these communications the Authority believed that BOS had been emphatic that there was no evidence that Mr Scourfield was acting fraudulently or corruptly and asked for some more details on BOS's reasons for this belief and the steps taken by BOS to investigate; and
  - (3) in response to this request, on 24 October 2007 BOS provided a brief summary of its investigation including that suspicious emails and an exit fee had been identified which appeared to be owed to BOS being re-directed to an account controlled by a director of QCS. However, BOS failed to provide all relevant details and did not disclose the report of its investigation into the issues. It was not until July 2009, after another request from the Authority, that full details were provided to the Authority.

- 2.7. The Authority considers the failings to be serious. Whilst BOS did not intend to breach Principle 11, it failed to give proper consideration to the need to disclose the suspicious information that it had identified to the Authority.
- 2.8. The failures of BOS were not due to the actions of any one individual or group of individuals. Instead, there was insufficient challenge, scrutiny or inquiry across the organisation which meant that an assessment of the information as a whole, which ought to have revealed its importance, was never performed. Moreover, there was no assessment or understanding of the impact that failing to give a full and complete picture to the Authority was likely to have.
- 2.9. The Authority considers the Firm's failings to be serious because:
- (1) the suspicions related to potentially serious misconduct. Following investigation by TVP, staff at BOS and QCS were convicted of serious criminal offences;
  - (2) BOS was aware before its first communication with the Authority in May 2007 that the impact of Mr Scourfield's misconduct was significant and would result in substantial losses to BOS. By June 2007, BOS had estimated the losses were approximately £50 million. It was later assessed that the total losses to BOS were £245 million;
  - (3) following the criminal convictions, LBG has estimated it will pay £115 million in compensation to customers who have been identified as being affected by the criminal behaviour. This compensation programme is currently subject to an independent quality assurance review (see further below);
  - (4) when issues arise, the Authority expects firms to conduct thorough investigations to understand what has transpired, and to make full inquiry into matters that raise suspicions of possible misconduct, particularly where there are suspicions of fraud. BOS did not disclose to the Authority that the investigation had been closed on 13 August 2007 despite there being a number of unanswered questions and despite the investigation team recommending that further investigative work should be conducted. It was agreed by BOS and the Authority in July 2009 that BOS's investigation report was *'woefully inadequate'*;
  - (5) the Authority specifically told BOS on 14 May 2007 that it wished to be updated about any fraud that may have occurred and BOS confirmed that it would ensure that the Authority was informed should any suggestion of fraud be identified. BOS had numerous opportunities to inform the Authority about all the information it had identified suggesting that there may have been a fraud, but did not do so. Whilst BOS provided a brief summary in October 2007, following a request by the Authority, the information was only finally disclosed in full at the request of Authority, after a period of around two years, in July 2009;
  - (6) full disclosure of the issues within IAR would have enabled the Authority at an earlier opportunity to properly assess BOS's response to the identification of the issues, changes to its procedures, its approach to the complaints received from customers and consideration of any losses either to BOS or its customers; and
  - (7) BOS did not report its suspicions to any other law enforcement agency such as the police, despite BOS being contacted by two police forces in 2008 about allegations of fraud. Instead it was the Authority that submitted a

Suspicious Activity Report ("SAR") in relation to relevant issues in June 2009. If BOS had communicated its suspicions appropriately to the Authority, as it should have done, the criminal misconduct could have been identified much earlier. This delay risked creating difficulties for TVP when obtaining and reviewing evidence years after the fraud had taken place and risked prejudicing the interests of justice.

- 2.10. BOS received complaints from several IAR customers before, during and after the Relevant Period alleging concerns about the conduct of Mr Scourfield and QCS. When responding to complaints during the Relevant Period BOS did not consider that its own investigation had identified information which raised similar concerns, including suspicions of fraud, as the allegations raised by customers. As the corporate lending at the heart of the complaints is unregulated the Authority does not have jurisdiction to investigate and determine whether those complaints were assessed appropriately and has therefore made no findings in that regard.
- 2.11. Following the convictions of Mr Scourfield and others, LBG implemented a review of customers who may have been affected by the fraud. The review was conducted voluntarily by LBG, and is outside the Authority's remit as the corporate lending involved was unregulated.
- 2.12. LBG announced on 7 February 2017 that customer cases that are within the scope of the review include:
  - (1) those cases referred by the convicted former BOS employees to QCS;
  - (2) customer cases that involved or were managed by QCS; and
  - (3) all previous and any new customer complaints regarding the convicted former BOS employees and/or QCS as they relate to IAR.
- 2.13. LBG appointed an independent reviewer, Professor Russel Griggs, to review the information provided, with the assistance of legal and accountancy/insolvency advisers, and determine the appropriate amount of redress for customers ("the Griggs Review"). In addition to reviewing the records held by LBG, customers were asked to provide information about their personal experiences.
- 2.14. The number of businesses participating in the Griggs Review as at May 2019 was 71 which includes 191 directors of those businesses. All of those in the review have had an outcome communicated to them. The compensation offered ranges from £100,000 to in excess of £5 million. As at May 2019, the total compensation offered to customers is £93 million of which £71 million has been calculated as relating to distress and inconvenience. As at May 2019 98% of customers participating in the review have accepted the offers made. LBG has estimated that the total compensation amount to all customers (including those outside the review) could be up to £115 million.
- 2.15. It was announced on 18 December 2018 that LBG has commissioned an independent review to provide assurance that the Griggs Review methodology is delivering fair and reasonable outcomes for customers. The Assurance Review will be led by Sir Ross Cranston and LBG has committed to publish in full the findings of that review once it is completed.
- 2.16. A public censure was issued by the Authority against BOS on 9 March 2012 in relation to failings within the Corporate Division between January 2006 and March 2008. Those failings were in part illustrated by the control failings within IAR and are not the subject of this Notice.

- 2.17. The Authority hereby imposes on BOS a financial penalty of £45,500,000 pursuant to section 206 of the Act.

### **3. DEFINITIONS**

- 3.1. The definitions below are used in this Notice:

"the Act" means the Financial Services and Markets Act 2000

"the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority

"BOS" means Bank of Scotland plc. BOS was owned by HBOS and was the entity within the HBOS Group that was regulated by the Authority during the Relevant Period.

"CFCP Team" means the Corporate Financial Crime Prevention team within BOS. CFCP was the specialist team within the Corporate Division that was involved in undertaking investigations into suspected financial crimes.

the "Corporate Division" means the Corporate Banking Division of BOS

"GFCP" means HBOS Group Risk Financial Crime Prevention

"HBOS" means the Halifax Bank of Scotland plc

"HBOS Group" means the group of companies owned by Halifax Bank of Scotland plc, which included BOS

"IAR" means the impaired assets office for London and South of England region that was headquartered in Reading and had another office in Bishopsgate.

"LBG" means Lloyds Banking Group, a group of companies formed after Lloyds TSB Group plc acquired the HBOS Group after its failure in October 2008

"SAR" means Suspicious Activity Report

"SOCA" means Serious Organised Crime Agency

"Lloyds TSB" means Lloyds TSB Group plc

Senior Manager A, Senior Manager B, Senior Manager C, Senior Manager D, Senior Manager E, Senior Manager F, Senior Manager G, Senior Manager H and Senior Manager I are individuals who, using the term in the ordinary sense, were involved at different levels of management and oversight within BOS.

CFCP Team Member X held a position within the CFCP Team

"QCS" means Quayside Corporate Services Limited

"the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber)

"TVP" means Thames Valley Police

## **4. FACTS AND MATTERS**

### **Background**

- 4.1. Following the merger of the Halifax Group plc and Bank of Scotland in 2001, BOS became part of the merged group known as HBOS Group. BOS has been authorised by the Authority since 1 December 2001 to perform a number of regulated activities. Following the failure of the HBOS Group in October 2008 it was formally acquired by Lloyds TSB on 16 January 2009 and BOS became part of the merged LBG.
- 4.2. The Authority's investigation has focused on BOS's conduct before it became part of LBG. After the merger there were significant changes to the operation and management of BOS including a change in the key staff communicating with the Authority.

#### *The Authority's supervision of BOS*

- 4.3. During the Relevant Period, BOS was the subject of a 'close and continuous' supervisory relationship. This meant that BOS had been identified by the Authority as a high impact firm due to the risks it posed to the Authority's statutory objectives, therefore requiring close and continuous monitoring. Pursuant to Principle 11, like all regulated firms, BOS was required to be open and cooperative with the Authority and to disclose appropriately anything relating to BOS of which the Authority would reasonably expect notice. That duty included disclosing matters relating to the activity of IAR, notwithstanding that the corporate lending involved was not a regulated activity. The 'close and continuous' supervisory relationship meant that BOS had specific individual contacts at the Authority and frequent opportunities to disclose relevant matters.
- 4.4. Throughout the Relevant Period there were regular communications and meetings between BOS and the Authority to monitor the risks faced by the Corporate Division including the risks posed by the commercial lending managed within IAR. At the time, the Authority also had a formal process, known as ARROW (Advanced Risk Responsive Operating Framework), which would periodically assess the risks posed by firms such as BOS and require them to take specified actions to mitigate the risks identified. During the Relevant Period, the risk mitigation programme for BOS included actions relating to the Corporate Division even where the underlying activity was not regulated by the Authority.
- 4.5. Further, during the Relevant Period the Authority had a statutory objective to reduce the extent to which regulated firms could be used for a purpose connected to financial crime (this is now effectively subsumed into the Authority's integrity objective). In addition to Principle 11, the Authority had, and continues to have, a specific rule (SUP 15.3.7(2)R) requiring firms to notify the Authority immediately, in respect of both regulated and unregulated activities, on becoming aware that a fraud may have been committed on the firm and the fraud was significant. Further details of these provisions and related guidance are contained in Annex A to this Notice.

#### *BOS's approach to stressed corporate lending*

- 4.6. It was the responsibility of the relevant business area managing a transaction to identify any transactions, including corporate lending transactions, as stressed and to refer that transaction to, what was known prior to 2006 as, the High Risk teams. The High Risk teams would then carry out a detailed assessment of the transaction's credit risk, re-rating the transaction as required. Following that

assessment, the transaction would either be returned to the good book, classified as High Risk, classified as Impaired No Loss or classified as Impaired with Loss.

- 4.7. The High Risk teams that managed impaired assets specialised in providing strategic advice and assistance to corporate lending customers that were in financial difficulty. The aim of the management of these corporate customers was to either:
- (1) complete some form of insolvency process; or
  - (2) restructure the customer's lending and/or how the corporate customer operated to assist with a return to financial stability.
- 4.8. In mid-2006 the High Risk teams were restructured. The London and South of England High Risk Team, which for the purposes of this Notice is referred to as IAR, was moved into the 'Impaired Assets' reporting structure which encompassed a number of regional Impaired Assets offices.
- 4.9. IAR was headquartered in Reading. Additionally, there were staff based within the BOS Bishopsgate office in London that reported into the senior management of IAR who were based in Reading.
- 4.10. As at 1 March 2007, IAR was responsible for a portfolio of approximately 235 corporate customers with lending to a value of approximately £750 million. Where appropriate, BOS was required to make a provision in its financial statements for anticipated losses on the stressed transactions managed by the regional Impaired Assets offices, including IAR.
- 4.11. Commercial lending was, and still is, largely unregulated in the UK. As such the activity of IAR during the Relevant Period was not subject to specific rules imposed by the Authority. For example, conduct of business rules and complaints handling rules did not apply. However, as noted above, BOS was required to be open and cooperative with the Authority and disclose appropriately any matters relating to IAR of which the Authority would reasonably expect notice and specifically where a fraud may have been committed.

#### *The fraud*

- 4.12. In February 2017 six individuals were convicted for offences related to a fraud committed through IAR and were sentenced to a total of 47 years and 9 months. Two of those individuals, Lynden Scourfield and Mark Dobson, were employees of BOS working within IAR at the time that the fraud was committed. The Authority acknowledges that the weight of evidence that ultimately resulted in the convictions would not (and could not) have been available to BOS at the time.

#### *Lynden Scourfield*

- 4.13. Mr Scourfield was Director for London and South of England based within the Reading office of IAR. As at 1 March 2007, Mr Scourfield was the relationship manager of 25 business customers with a debt level of £274 million. There were at least a further 21 businesses whose relationship was managed by Mr Scourfield at some point between 2002 and 2007.
- 4.14. Mr Scourfield required many of the IAR business customers that he managed to appoint, and pay fees for, a firm of turnaround consultants called QCS (and related entities) as a condition of the customer receiving continued support from BOS. The involvement of QCS varied but typically individuals from QCS were appointed as

directors of the distressed businesses. For example, one individual connected to QCS was a director of approximately 45 companies, a substantial majority being business customers managed by IAR. This resulted in QCS having involvement in the decision-making over the strategy and finances of the businesses including the sale of the business to companies set up by QCS. In many cases inappropriate or overly optimistic turnaround plans were implemented by QCS which increased the risk of losses to both the business customers and to BOS.

- 4.15. As part of its proposed turnaround of the businesses, QCS would submit proposals for additional finance to BOS for approval by Mr Scourfield. QCS would purportedly use the lending to fund its turnaround strategies. In some cases the lending was granted beyond Mr Scourfield's authority to do so and beyond the ability of the customer to repay the lending. At the criminal trial it was shown that in return for his part in the fraud Mr Scourfield received money as well as gifts and hospitality from QCS including holidays and prostitutes.
- 4.16. TVP's investigation and the subsequent prosecutions established that the fraud started in around 2003. Following concerns being identified about his conduct, Mr Scourfield resigned from BOS on 27 April 2007. He was arrested in relation to the fraud on 29 September 2010.
- 4.17. Mr Scourfield pleaded guilty and was convicted of conspiracy to corrupt and fraudulent trading on 12 August 2016. On 2 February 2017, he was sentenced to 11 years and 3 months imprisonment.

*Mark Dobson*

- 4.18. At the time of the fraud Mr Dobson was an Associate Director based in the Bishopsgate office of IAR and he reported to Mr Scourfield.
- 4.19. The prosecution's case against Mr Dobson centred on the fact that between 2005 and 2006 during his employment at BOS he:
  - (1) allowed an amount of £152,750 to be paid to parties connected with QCS without the authority of the bank, the business customer or the administrator and in return Mr Dobson received a payment of £30,000; and
  - (2) wrote off interest owed by another business customer to make a gain for QCS.
- 4.20. Following the acquisition of BOS in 2009, Mr Dobson continued in employment at LBG. He was arrested in relation to the fraud in September 2011. LBG shortly after suspended Mr Dobson and commenced disciplinary proceedings against him in May 2012 and he was dismissed for gross misconduct in June 2012.
- 4.21. Mr Dobson was convicted of conspiracy to corrupt on 30 January 2017 and was sentenced to 4.5 years imprisonment.

*Compensation to customers*

- 4.22. As explained above, as at May 2019 all of the 71 businesses, and 191 directors of those businesses, participating in the customer redress review have had an outcome communicated to them. The total compensation offered to those customers is £93 million of which £71 million has been calculated as relating to distress and inconvenience. LBG has estimated that the total compensation amount to all customers (including those outside the review) could be up to £115 million. The full compensation to customers will not be confirmed until redress calculated



by the Griggs Review has been subject to an independent quality assurance review completed by Sir Ross Cranston.

#### *Losses to BOS*

- 4.23. It is difficult to quantify the extent of the loss to BOS which is directly attributable to the fraud. As the business customers were already under financial stress at the point that they entered the management of IAR it is possible that some of the losses to BOS may have been incurred irrespective of the fraud. Equally some of these losses may have been avoided if appropriate turnaround strategies had been implemented.
- 4.24. BOS assessed its losses from Mr Scourfield's portfolio as being due to:
- (1) increased lending to business customers that were already in financial difficulties;
  - (2) inappropriate strategies being pursued which increased the bank's risk exposure; and
  - (3) additional costs incurred when exiting the lending arrangements.
- 4.25. After reviewing the lending portfolio managed by Mr Scourfield, BOS identified that some of the lending was impaired such that losses would need to be provisioned for in its financial statements. Before provisions were recognised in its accounts, BOS's procedures involved a review by HBOS Group and approval by its auditors.
- 4.26. The level of provisions in BOS's financial statements grew over time such that:
- (1) in June 2007, an impairment charge for the whole of the Corporate Division was recorded as £234 million. Within that figure there was a provision of £76 million in relation to IAR cases. BOS considered that a more 'normalised' charge would have been £20-25 million such that Mr Scourfield's misconduct accounted for approximately £50 million in losses by this point; and
  - (2) by the end of 2007, BOS provisioned around £250 million in its accounts for 27 cases within the IAR portfolio (out of a total £602 million for the whole of the Corporate Division). Of this figure £245 million related to customers that were under the management of Mr Scourfield.

#### **Early allegations of misconduct were not escalated and/or investigated**

- 4.27. The Authority has identified that at least five business customers made allegations/complaints of misconduct against Mr Scourfield and/or individuals connected to QCS before suspicious conduct was identified by BOS in 2007. The Authority has not identified any evidence to suggest that these early allegations were escalated to senior management within the Corporate Division or HBOS Group. It is apparent from the below that many of the complaints were made directly to Mr Scourfield.
- 4.28. Reference to these complaints is included in this Notice for context only and the Authority has not made a finding in relation to BOS's handling of these complaints. As the complaints relate to unregulated business the Authority does not have jurisdiction to consider how BOS handled these complaints.

#### *Complaints from IAR customers in 2004*

4.29. During 2004, concerns were raised by two IAR customers about QCS and/or Mr Scourfield:

- (1) in January 2004, a customer alleged misconduct following the appointment of an individual from QCS in December 2003 as a non-executive. The customer repeated the complaint again in August 2004 both in a personal letter and in a letter from the customer's solicitors. The complaints were addressed to Mr Scourfield and there is no evidence that a response addressing these issues was sent to the customer. No information about the complaint was recorded on the BOS complaints system. In November 2004 the directors of the business were released from the personal guarantees they had given in relation to the lending on the condition that they did not bring any action against HBOS relating to the involvement of QCS or the monies paid to them; and
- (2) on 13 April 2004, solicitors acting on behalf of BOS wrote to a non-executive director of a business customer managed by Mr Scourfield. The letter referred to remarks made by the non-executive that Mr Scourfield '*...may have been compromised by drugs and girls provided by... [another company director]*'. The letter asked for an explanation of the remarks together with a retraction, apology and an undertaking not to repeat the comments. On 22 April 2004, solicitors acting for the non-executive responded stating that the comments were fully justified. The letter raised concerns that:
  - (a) the borrowings of the business from BOS had reached '*ludicrously high levels*';
  - (b) following Mr Scourfield extending finance to the business that Mr Scourfield had been rewarded by the business paying for Mr Scourfield's birthday party and entertaining him at a hotel; and
  - (c) there were conflicts of interest between BOS and the business due to Mr Scourfield's friendship with an individual connected to QCS.

4.30. There is no evidence that Mr Scourfield's conduct was investigated by BOS in 2004. The Authority has not identified any evidence to suggest that these allegations were escalated to senior management within the Corporate Division or HBOS Group at that time.

#### *Allegations from IAR customers in 2006*

4.31. During 2006, concerns were raised by three IAR customers about QCS and/or Mr Scourfield:

- (1) Around July/August 2006 a BOS staff member, who did not work in IAR, received an allegation from a customer about Mr Scourfield. The customer stated to the BOS staff member that Mr Scourfield was a '*crook*' and that he was '*being paid £3,000 a month by [a business customer]*'. The BOS staff member knew that Mr Scourfield had a large extension to his house and '*queried how this was funded*'. The BOS staff member was also aware there was a further allegation that an individual connected to QCS would ensure prostitutes were present when he socialised with Mr Scourfield. The BOS staff member was not aware of any other evidence to back up these allegations although the individual had observed that between 2004 to 2007

Mr Scourfield had '*developed a taste for the high life*'. The BOS staff member did not report these allegations to anyone at the time.

Later, during a Skilled Person review in 2010, the BOS staff member stated that they were terrified and did not report these concerns at the time as there was no whistleblowing policy in place and they did not have evidence to support the allegations. The BOS staff member has stated that IAR was informed of this allegation after 2007. The Authority has not identified any records to confirm what information was disclosed by the BOS staff member, who reviewed it and what action was taken. There is no evidence to suggest these allegations were investigated until the BOS staff member was interviewed during the Skilled Person review in 2010 (see paragraphs 4.169 to 4.173 for more information about this review).

- (2) A former shareholder in an IAR business customer contacted IAR on 14 July 2006 and 25 September 2006 raising concerns about QCS and BOS. The shareholder alleged that BOS and QCS had '*...together concocted some kind of "pre-pack" in which I am sure only the Bank's interests are cared for by the receiver to the exclusion of "unwanted" creditors*'.
- (3) On 30 October 2006, an IAR customer complained to Mr Scourfield about the fees charged by QCS which had amounted to over £14,000 during the course of ten weeks.

4.32. There is no evidence that Mr Scourfield's conduct was investigated by BOS in 2006. The Authority has not identified any evidence to suggest that these allegations were escalated to senior management within the Corporate Division or HBOS Group at that time.

#### **Peer review of IAR identifies suspicious conduct**

4.33. Due to a wider restructure the oversight of IAR was changed with effect from 1 July 2006. Towards the end of 2006, concerns were identified that the level of debt on Mr Scourfield's cases was increasing and the level of information reported about Mr Scourfield's portfolio was not as detailed as would be expected. As a result IAR implemented a review of a sample of IAR cases. The review focused on a sample of cases where the lending was over £1 million and had been managed either by Mr Scourfield or other members of staff within IAR. The review was conducted by staff from a different regional impaired assets office. This was the first time that a peer review of this nature had been conducted within IAR.

4.34. A report summarising the findings of the peer review was produced on 22 February 2007. The peer review identified concerns that:

- (1) the files to support the lending were limited or in some cases did not exist;
- (2) lending limits had not been approved in accordance with the procedures in place;
- (3) there was substantial credit exposure on many cases;
- (4) unusual strategies had been adopted, which exhibited increasing rather than decreasing risk, in particular on cases managed by Mr Scourfield. That included lending money without approval to permit companies that were already in financial difficulty to expand or acquire other business; and

- (5) the use of QCS as turnaround consultants in many cases was noted in the peer review and a second firm was noted as being used to a lesser extent.
- 4.35. The peer review report was escalated within the Corporate Division in March 2007. Although the existence of the controls issues was disclosed to the Authority in May 2007, the peer review report was not provided to the Authority at the time and was only provided, following a request by the Authority, on 29 October 2010.
- 4.36. When challenged about the credit sanctioning process applied to his cases, Mr Scourfield provided credit papers which he stated had been submitted for sanction in January 2006 and had been given verbal approval. On reviewing the papers, it was identified that there were events/information referred to in the papers which occurred after January 2006. By March 2007 this raised a concern within BOS that Mr Scourfield had prepared the papers after the event to cover up that the appropriate process had not been followed and that there had been verbal allegations that he had been 'on the take' in relation to some of his cases linked to QCS.
- 4.37. Mr Scourfield attended an informal meeting on 8 March 2007 within BOS to discuss the findings. A second meeting was arranged for 13 March 2007 but Mr Scourfield informed BOS that he was unwell and would be out of the office on sick leave.
- 4.38. Following Mr Scourfield's absence from the office, an additional business customer managed by Mr Scourfield was identified. The business had an exposure of £115 million, but its existence had never been reported by Mr Scourfield.
- 4.39. Mr Scourfield was suspended on 23 March 2007 pending completion of an investigation into the issues identified by the peer review. Mr Scourfield resigned with immediate effect on 27 April 2007.

#### **The Firm's May 2007 communication with the Authority**

- 4.40. From 3 May 2007, BOS had noted in internal records that there were suspicions and allegations about Mr Scourfield's conduct, including that he may have been involved in fraud and/or corruption. Despite that, BOS failed to be open with the Authority about its suspicions and did not disclose appropriately information during communications in May 2007, and thereafter in the Relevant Period.
- 4.41. Around March 2007 the Corporate Division started an investigation into the matters identified by the peer review. The scope of the investigation included consideration of:
- (1) the alleged failures to follow policy and procedure within IAR; and
  - (2) the potential for any of the alleged failures to have resulted in personal financial gain for any individuals within IAR.
- 4.42. BOS's Corporate Financial Crime Prevention team (CFCP Team) was engaged as part of the investigation as it had expertise in analysing email records and investigating potentially suspicious activity. The scope of the CFCP Team's work was to ascertain if there was evidence to suggest criminal behaviour including to establish if there was any evidence to indicate that Mr Scourfield had benefitted financially from the suspicious conduct that had been identified.
- 4.43. During March and April 2007, the investigation identified the following:

- (1) allegations were received from within IAR on 22 March 2007 that Mr Scourfield had received paid for holidays from QCS;
  - (2) the CFCP Team reviewed transactions from Mr Scourfield's savings account that was held with HBOS. It was identified on 22 March 2007 that Mr Scourfield's bank account, into which he received his salary, was not held with HBOS and could not be considered in detail during the investigation. The CFCP Team contacted fraud investigators from the bank in question to ask about the general movement of funds. The CFCP Team did not identify unusual activity from their enquiries;
  - (3) on 23 April 2007, the CFCP Team identified 'a few e-mails' between Mr Scourfield and an individual connected to QCS which 'suggest they were more than just business associates'. The CFCP Team stated at this point however there was no 'concrete evidence... to confirm any malpractice'; and
  - (4) an insolvency practitioner had raised concerns with IAR on 22 March 2007 about an exit fee that had been paid in December 2006. IAR raised these concerns with the CFCP Team on 24 April 2007 noting that '...the transaction does look a bit strange and worthy of investigation'. On 1 May 2007 the CFCP Team identified that the payment was 'a bit unusual' as the cheque had been categorised as 'cash out' and then a subsequent credit had been made to a suspense account as 'cash in'. It was identified on 9 May 2007 that the payment had been instructed by an individual connected to QCS.
- 4.44. By 31 March 2007 BOS had recognised that there were significant concerns with the lending portfolio managed by Mr Scourfield and had started to apply strategies to reduce its exposure to losses.
- 4.45. A BOS member of staff who had taken over responsibility for one of the business customers managed by Mr Scourfield, on reviewing papers in March to April 2007, noted that the business customer had provided loans to at least 36 other businesses that were linked to other IAR customers and QCS. The BOS member of staff was told by the business customer that Mr Scourfield had increased the lending limits for the business customer so it could be used as a funding vehicle when other IAR business customers could not get further funding from BOS. These concerns were shared within IAR on 19 April 2007.
- 4.46. On 3 May 2007, Senior Manager A wrote a briefing note explaining the control failures identified and that the failings would result in additional provisioning for bad debt being necessary. Although it is not clear if the briefing note was provided to anyone else within BOS, it is clear that BOS had started to suspect that Mr Scourfield's actions may have been for personal gain, consistent with the concerns and allegations already expressed within BOS that Mr Scourfield had been 'on the take' in matters linked to QCS. Senior Manager A however noted that BOS had been unable to substantiate the allegations that had been identified.
- 4.47. The 3 May 2007 briefing note refers to these suspicions about the motivation for Mr Scourfield's misconduct, including suspicions of fraudulent activity and concerns regarding an exit fee which appeared to be owed to BOS being re-directed to an account controlled by a director of QCS:

*'To date we have not uncovered anything that would point to Mr Scourfield's motivation for acting in the manner that he has. Our focus to date has been on identifying and stabilising the problems but it is difficult to believe that there are not underlying issues that would explain what would appear to be inexplicable. The relationship with [QCS] appears abnormally close and there are some verbal*

*allegations of presents/holidays being provided to Mr Scourfield. To date we have been unable to substantiate these. Similarly there appears to have been an exit fee due to the Bank (c. £152,000) that has been re-directed into an account controlled by [a director] of [QCS]. [CFCP Team] are investigating this aspect and we will clearly involve the Police should we be able to demonstrate criminality.'*

4.48. It was also stated in the 3 May 2007 briefing note that the failures had led to a '*substantial loss for [BOS]*'.

4.49. In accordance with SUP 15.3.17(2)R and Principle 11, BOS should have contacted the Authority immediately (i.e. on 3 May 2007) about its suspicions. Instead the first time that BOS contacted the Authority about the issues within IAR was on 12 May 2007. The notification from BOS was prompted by an expected article in the press the following day about Mr Scourfield. Senior Manager B informed the Authority by email that:

*'The article may indicate that he breached processes and acted outwith his authority and that he has lost the bank substantial amounts of money. The facts are his work was under scrutiny and he went of [sic] ill and as of last week he resigned. The sums lost will be nowhere like what [the article] may suggest or anything like it. I did not want you to read this cold. In the normal course [Senior Manager A] will be in touch with the detail.'*

4.50. The Authority has not identified a record, made by either BOS or the Authority, of any further detail provided by Senior Manager A to the Authority (notwithstanding the statement in the email above that detail would be provided and the reference in the email on 14 May 2007 set out below to a belief that the Authority had been updated).

4.51. On 13 May 2007, the Sunday Telegraph released an article entitled '*HBOS suspends "rogue banker"*'. The article alleged that the rogue banker had '*over-lent and kept advancing money to clients without authorisation*'.

4.52. Following BOS's notification to the Authority, on 14 May 2007, the Authority noted internally that '*HBOS informed us on 12<sup>th</sup> May. We are waiting to get further information. At the moment no fraud has been identified*'. Shortly afterwards, the Authority emailed Senior Manager A and stated:

*'I believe you have updated [individual from the Authority] about an employee from the high risk team. At this stage we will be taking no further action. Please can you keep me updated of any further developments, including any papers/communications reported to EXCO/board. We are particularly interested in the control failings and any fraud that may have occurred.'*

4.53. Senior Manager A responded the same day confirming that he had spoken to another individual at the Authority (see further details in paragraph 4.64(1)) stating that '*I shall ensure that you are advised of developments, particularly around control failings and should any suggestion of fraud arise/be identified*'.

4.54. Separately, following an update within BOS on 14 May 2007 about theft/fraud issues by staff members within a number of HBOS branches in its retail business that may appear in the press, Senior Manager C emailed Senior Manager I stating:

(1) '*Not a good few days but there we go...I assume you...are dotting i's and crossing t's to ensure the FSA have been told what is relevant. Given the weekend communication to the FSA on the Corporate Banking issue...its especially vital that this is covered off in a calm way*'; and

- (2) *'...not a good couple of days from a Risk perspective (following hot on the heels [sic] of the Corporate Banking investigation into the "rogue trader" in Reading) ...whilst the Retail issues may all be relatively small in isolation, they come on the back of a "poor run"... hence my determination that communication of the issues to the FSA are kept structured and clear.'*
- 4.55. Mr Dobson was interviewed about the cases that he managed, as part of BOS's investigation, on 17 May 2007. Mr Dobson was not asked any questions about the suspicious exit fee that had been identified.
- 4.56. The Executive Committee of HBOS was told by BOS on 21 May 2007 that *'An additional provision would...be required during the course of the year, (and probably, in part, by the half year) as a result of a weakness in control measures that had come to light following a recent change in structures. Further details were still coming to light as to the size of the potentially required provision, and a full review was taking place across the whole high risk book, looking at the control environment generally in that part of Corporate's business'*.
- 4.57. On 15 May 2007, Senior Manager A prepared a Credit Risk Paper which stated that work was ongoing to understand why controls did not trigger an earlier investigation for something that appeared to have been ongoing for two years. The paper was presented to the BOS Corporate Risk Control Committee on 22 May 2007. The draft minutes of that committee were later discussed at the HBOS Audit Committee on 6 June 2007. Following this meeting in July 2007 an agenda for the HBOS October Audit Committee meeting was drafted which included a discussion item *'Reading Fraud – update'*
- 4.58. On 18 May 2007, the CFCP Team updated Senior Manager D on the progress of the email review that:
- 'There are numerous e-mails from customers requesting either an increase to existing facilities or payment of wages/etc when over existing limit, with varying responses (if he indeed replies). There would also appear to be personal e-mail correspondence between Lynden Scourfield & [an individual connected to QCS]. For example, communications from [the individual] to Lynden saying phrases like "I'll always stick by you" and "Marry me", although can't see the context in which these statements were made. I've made copies of relevant e-mails and will get them up to you, but no smoking guns uncovered.'*
- 4.59. On 21 May 2007, Senior Manager D produced an internal report detailing the investigation that had been completed to date which was distributed within the Corporate Division, including Senior Manager A, and HR. The report notes that in addition to the analysis of the peer review a number of other issues had subsequently been raised, including the additional case managed by Mr Scourfield that had been identified. In that report it is noted that due to the *'unusual and unreported case management'* by Mr Scourfield, the CFCP Team had been asked to review whether Mr Scourfield *'benefitted financially in a fraudulent manner'* and that *'No evidence has yet been uncovered'*.
- 4.60. Senior Manager D also recommended that:
- (1) two individuals, including Mark Dobson, should be subject to a disciplinary process as they had admitted to breaches of policy. Following subsequent discussions with HR it was agreed on 18 December 2007 that no further formal action would be taken against either of the individuals; and

- (2) an investigatory meeting should be held with a third individual to determine whether disciplinary action was appropriate. A meeting was held with the individual in June 2007 and steps were taken to initiate disciplinary action. However, the individual left the bank in September 2007 with no disciplinary action having been taken.
- 4.61. On 22 May 2007, the Corporate Risk Control Committee discussed a separate potential internal fraud, it was confirmed that investigations were in the early stage and that BOS had informed both law enforcement and the Authority at the time. A paper on internal fraud controls was presented to the Committee on the same day by Senior Manager E which summarised in relation to IAR that *'Ongoing investigation and initial findings highlight that whilst controls not adhered to, no personal gain has been proven'*.
- 4.62. An update was provided to the HBOS Board on 22 May 2007 about *'...a weakness in controls in the high risk area within Corporate, details of which were discussed. An additional provision would be required in the full year, the full scale of which was still being verified...would lead a thorough review of controls in this area. It was essential to demonstrate clear commitment in dealing with this issue, consistent with the FSA's view that the Group was clearly the "best" major bank with respect to transparency and openness'*.
- 4.63. On 24 May 2007, an individual, with connections to QCS, wrote to Senior Manager B that *'There are wider issues than Lynden & [individual connected to QCS] (at the end of the day [individual connected to QCS] while maybe oprating [sic] on the wrong side of grey got involved in messy cases having been introduced by BOS). Indications are more people involved inside and outside of the Bank...Don't think what I will tell you in due course will be good from a BOS perspective'*.
- 4.64. On 24 May 2007, Senior Manager C met with the Authority to discuss controls within the Corporate Division. The briefing notes prepared by BOS for the meeting refer to issues with controls within IAR and stated that *'there is no evidence (at this stage) that [Mr Scourfield] was engaged in fraudulent activity for personal gain, rather it was malpractice/non-compliance with due process, but this will be checked as part of our review'*. Following that meeting Senior Manager C emailed members of HBOS Group and BOS Corporate Division with a summary of the meeting which included:
- (1) *'I spent ten minutes taking [the Authority] through the detail of the Reading incident within Corporate. He had already had a good briefing from [Senior Manager A] and I don't think anything I told him was a surprise [sic] ...I stressed that [BOS] was now conducting an entirely independent review of Corporate processes with support from Internal Audit. He welcomed my candour but said he would like to be kept up to date with the work as it progresses. Clearly of most importance to the FSA is for us to come up with a clear structured explanation as to why it took three/four years for us to discover Scourfield's activities. Lastly, they're clearly surprised that his activities were never caught by any of our "10% random sampling pattern" portfolio reviews. In general, however, [the Authority] seemed very comfortable with our approach to the work and [the Authority] clearly felt that [BOS] had been very open'; and*
- (2) *'[The Authority] had noticed that over the last three to six months there had been an increase in the number of controls issues we had suffered. He mentioned the Reading incident and the run of incidents that we have had within Retail...I felt that [the Authority] was giving me a gentle warning and that he hoped this trend would soon turn around in a more positive direction.*



*Equally, he did stress that our proactive approach to informing the FSA of issues continued to stand us in very good stead.'*

- 4.65. On 26 May 2007 Senior Manager A emailed the Authority an update on the '*HBOS Reading rogue lender*' referring to another press article that was anticipated. Senior Manager A also provided an update on the review of the controls and concluded the email with '*For the avoidance of doubt we have not as yet uncovered any evidence of Fraud [sic]*'.
- 4.66. The communications from BOS to the Authority in May 2007 were not open and cooperative and did not disclose appropriately as it failed to disclose that BOS had suspicions, including that Mr Scourfield may have been involved in fraudulent activity, and the detail of those suspicions.

#### **The Firm's July 2007 communication with the Authority**

- 4.67. By the 26 May 2007, BOS was aware of the matters detailed in paragraphs 4.40 to 4.65 above including that:
- (1) concerning issues about the way that Mr Scourfield had managed his portfolio of cases had been identified;
  - (2) QCS had been appointed on many of the cases managed by Mr Scourfield and that emails suggested the relationship between Mr Scourfield and QCS was abnormally close and they were more than just business associates. There were also allegations within IAR that Mr Scourfield had received paid holidays from QCS and other suspicious conduct; and
  - (3) the Authority had expressly stated that it wanted to be updated by BOS on any fraud that may have occurred.
- 4.68. Despite this awareness BOS did not disclose to the Authority the information that it had identified giving rise to suspicions of misconduct, including suspicions of fraud and/or corruption. Further, communications to the Authority in July 2007 misleadingly stated that there was no evidence of fraud.
- 4.69. On 29 May 2007, CFCP Team Member X emailed Senior Manager D and copied in Senior Manager A to summarise the review that had been undertaken by the CFCP Team to date. In that update CFCP Team Member X stated that '*Nothing discovered that implicates [Mr Scourfield] in terms of criminal activity...Fees – Review ongoing, however to date one fee of £152,750 of concern.*' For the sake of clarity, the fact that CFCP Team Member X expressed the view that nothing had been discovered to implicate Mr Scourfield in criminal activity does not change the Authority's conclusion that earlier in May 2007 BOS had started to suspect Mr Scourfield may have engaged in criminal activity.
- 4.70. On 31 May 2007, Senior Manager A updated the Board of the Corporate Division. The minutes of that meeting record that it was stated '*Investigations were also ongoing to determine any potential fraud related activity...The FSA had also been kept fully in the loop.*'
- 4.71. On 1 June 2007, BOS's investigation identified emails referring to a holiday to Barbados taken by Mr Scourfield which appeared to have been arranged by individuals linked to QCS. In a meeting on 5 June 2007, Senior Manager A asked a member of IAR about these emails which suggested Mr Scourfield had accepted hospitality from QCS in the form of a holiday to Barbados, and another allegation that Mr Scourfield had travelled to Russia with representatives of QCS. It was noted

at the meeting that Mr Scourfield had not made IAR aware of the hospitality and it had not been approved.

- 4.72. On 8 June 2007, the CFCP Team met with GFCP to discuss the IAR investigation. Following that meeting GFCP noted that *'...it is evident that there are numerous connections between [individual connected to QCS/QCS] and various companies. The [individual connected to QCS] and LS link is clear from the Reading portfolio and in light of the e-mail evidence it supports the view that the bank's interests were not always taking priority.'*
- 4.73. Senior Manager B updated the Executive Committee of HBOS on 19 June 2007 that *'The position in relation to Reading continued to evolve. The financial consequences could deteriorate further over time'*. The issues in IAR were also referred to during a meeting of the HBOS Board of Directors on 26 June 2007 but no specific update was given.
- 4.74. On 27 June 2007, an individual wrote to Senior Manager B on behalf of the owner of QCS regarding concerns about how BOS was now managing the IAR customers where QCS was involved and that QCS had a claim for unpaid fees from BOS. The individual had previously written to Senior Manager B on 24 May 2007 (see paragraph 4.63). The 27 June 2007 letter stated *'As we have discussed, the modus operandi of [Mr Scourfield] and [an individual connected to QCS] are not in line with the way in which you and I would wish to conduct business. There is however, as far as I am aware no evidence of fraud'*.
- 4.75. In June 2007, an impairment charge for the whole of Corporate Division was recorded as £234 million. Within that figure there was a provision of £76 million in relation to IAR cases. BOS considered that, without the impact of the unauthorised lending, a more 'normal charge' would have been £20-25 million. The impact of the issues identified in IAR was estimated to be around £50 million.
- 4.76. On 3 July 2007, the CFCP Team provided a report to Senior Manager D summarising the work that had been undertaken. The report stated that:
- (1) *'... [Mr Scourfield's] known Bank [sic] accounts'* had been reviewed but *'No unusual activity apparent through these accounts'*;
  - (2) Mr Scourfield's laptop could not be forensically examined as no data was available and the hard drive had been disposed of;
  - (3) only 30 days' worth of Mr Scourfield's internal emails were held on back up servers and nothing material had been identified;
  - (4) Mr Scourfield's external emails for the period January 2004 to March 2007 were recovered for review and relevant emails *'worthy of further questions being raised'* included:
    - (a) an email in January 2005 regarding a trip to the USA where the tickets had been arranged by an individual from QCS and Mr Scourfield provided address details to be collected by limousine;
    - (b) emails in April and May 2005 relating to a trip to Barbados where the itinerary had been produced by an individual from QCS. It was noted in the report that the villa mentioned in the itinerary costs between \$3,000 to \$5,000 per night; and

- (c) an email chain between individuals from QCS and a contact in the USA with whom Mr Scourfield was arranging a transaction. The individual states *'I believe everything going forward – both social and business – should be kept confidential if you know what I mean'*;
- (5) one exit fee had been identified as potentially suspicious by an insolvency practitioner. A fee of £152,750 which was intended for BOS had instead been credited to a business banking account at the instruction of an individual connected to QCS. The funds were later paid to an offshore account that was linked to an individual from QCS. The CFCP Team concluded that *'...we see no business reason for this transaction to take place'*. The events surrounding this payment are described in more detail in paragraphs 4.182 to 4.187 below.
- 4.77. The report concluded that *'The majority of work has been undertaken and some areas (e.g. E-Mails and Exit Fee) require further answers that may only be able to be supplied by [Mr Scourfield]'*. Due to Mr Scourfield's resignation it was not possible for BOS to interview him in relation to the findings of the investigation.
- 4.78. On 5 July 2007, Senior Manager D issued an addendum to the 21 May 2007 investigation report which stated *'Nothing concrete has been discovered, albeit circumstantial evidence certainly would normally have led to questioning of [Mr Scourfield] around certain events/trips. Nothing in the findings implicates any other colleagues even circumstantially in any wrong doing. My recommendation would be for further forensic work to be instructed to seek to establish whether there is substance to any intuitive interpretation on the circumstantial evidence uncovered through this piece of work.'* There is no evidence that further investigatory work was undertaken by BOS despite Senior Manager D recommending that it should be undertaken.
- 4.79. By 20 July 2007, the CFCP Team noted that it had finished its investigation work and any remaining actions were being dealt with by Senior Manager D.
- 4.80. On 24 July 2007, the Authority had a number of close and continuous meetings with various members of staff at BOS on a range of topics. This included a meeting with Senior Manager A. Senior Manager A presented from a pack of PowerPoint slides to the Authority which included one summarising *'Incident at Reading'*. That summary stated:
- *'Control failures*
  - *No evidence of fraud*
  - *Significant losses*
  - *Group Risk Review'*
- 4.81. There was no further clarification in the written document that BOS had suspicions, including suspicions of fraud and/or corruption. BOS's note of the meeting records that what was discussed was *'Reading – no evidence of fraud – it resulted from management failure and some control weaknesses'*.
- 4.82. The communications in July 2007 were misleading as they stated there was no evidence of fraud at a time when in fact BOS had identified suspicious emails and an exit fee which appeared to be owed to BOS being re-directed to an account controlled by a director of QCS as well as allegations about Mr Scourfield's suspicious conduct from staff within IAR.

### **BOS's decision not to notify the police in 2007**

- 4.83. On several occasions during July and August 2007, BOS considered whether it was appropriate to report its suspicions regarding Mr Scourfield to the police but BOS concluded that it had insufficient evidence to do so.
- 4.84. On 27 July 2007:
- (1) the Authority was provided with a report that had been presented to the BOS Corporate Risk Control Committee the day before which summarised the key findings of a review by HBOS Group Credit, in conjunction with HBOS Group Financial Crime Prevention and HBOS Group Internal Audit, of the controls over credit limits within the Corporate Division. The review was separate to the investigation being conducted within the Corporate Division but it had been prompted by the identification of the weaknesses in controls within IAR. The report did not comment on the suspicious conduct. The minutes of the Corporate Risk Control Committee meeting state that *'the FSA had been made aware of the situation and would also now be provided with a copy of the review following its circulation to this Committee. Whilst no evidence of fraud had been detected, this continued to be investigated and advice would be taken as to whether the matter be referred to the police.'*; and
  - (2) it was noted at the HBOS Audit Committee that losses from twelve businesses within the IAR portfolio would lead to a loss of around £50 million in the first half of the year with further losses expected in the second half of the year. On 30 July 2007, Senior Manager F presented an update to the Audit Committee stating that *'whilst the investigation found no evidence of fraud or personal gain it remains difficult to understand any possible motivation for this behaviour'*.
- 4.85. On 31 July 2007, Senior Manager E contacted the Authority regarding a potential fraud that may have been perpetrated by a member of staff within BOS (the individual was not based within IAR). In that case the individual had resigned during a credit compliance review of his portfolio in March 2007. It was discovered around the same time that he had authorised suspicious payments and BOS informed the police.
- 4.86. Following from the 31 July 2007 email, on 6 August 2007, Senior Manager G emailed Senior Manager E and asked in relation to Mr Scourfield *'...what chance of getting Police interested even if evidence of any personal gain is lacking?'*. Senior Manager E responded *'At this stage, very little chance. From CFCP's perspective we have insubstantial evidence of criminal activity. I will be touching base with [Senior Manager D] on this, hopefully later today to get Credit Risk's latest position'*.
- 4.87. On 11 August 2007, the Daily Telegraph released an article entitled *'HBOS freezes rogue banker's accounts'*. The article included comments from a customer requesting that BOS *'remedy all the breaches and... investigate the anomalies in the account'*.
- 4.88. On 15 August 2007, the BOS Corporate Operational and Regulatory Risk Committee agree that a meeting with the police would be held regarding Mr Scourfield. This meeting did not occur.
- 4.89. BOS did not inform the Authority that it had decided not to report its suspicions to the police nor did BOS provide the Authority with any details of its consideration of

those suspicions at this time. The suspicious activity was first reported to SOCA by the Authority in June 2009.

### **Closure of the financial crime investigation**

- 4.90. On 13 August 2007, BOS closed its internal investigation into Mr Scourfield. The investigation was closed despite the recommendation by Senior Manager D in the 5 July 2007 addendum that further investigative work should be undertaken. During an interview with the Authority in 2018, Senior Manager H noted that Senior Manager A thought at the time that the suspicious conduct identified *'smelt to high heaven and he was frustrated that there'd been no evidence found'*.
- 4.91. Neither the decision to close the investigation nor the reasoning behind the decision were communicated to the Authority. BOS did not disclose its suspicions or details of its investigation to the Authority before the investigation was closed. Furthermore, BOS did not provide a copy of the investigation report to the Authority. The first time the Authority received a full copy of the report was on 9 July 2009.

### **Customer complaints to BOS in 2007**

- 4.92. During 2007, BOS received complaints relating to three business customers alleging misconduct by Mr Scourfield and/or QCS. Two of these businesses had made complaints before 2007 which, as noted earlier, had not been escalated/investigated. The complaints in 2007 were raised with a number of areas within BOS including IAR, Corporate Division and HBOS Group.
- 4.93. The allegations raised included that:
- (1) the level of charges by QCS and the prioritisation of the payment of QCS fees over other creditors of the businesses;
  - (2) payments had been made from their business accounts to QCS without their consent.
  - (3) the funds supplied by lending from BOS, and customers' payment of fees to QCS, had been used to fund the lifestyle of Mr Scourfield and individuals connected to QCS including holidays abroad and prostitutes; and
  - (4) £25,000 of a business customer's funds had been used by Mr Scourfield *'...and other Bank advisers for entertainment purposes and that one of the Bank's advisers was involved in a listed company who removed money from this Company. I can provide you with evidence of this from a lawyer who was involved in that situation'*.
- 4.94. In addition, during legal proceedings between BOS and the directors of an IAR customer about a separate matter relating to their residential mortgage, the directors made an application for a warrant of possession to be suspended on the basis of allegations of fraud that they had made against BOS. In deciding to suspend the warrant, on 5 October 2007, the judge commented that *'Well, I suppose I can and should take the view that in view of all that I have heard and the allegations that the [directors] raise, that they have been defrauded by the bank, the claimants here, in another matter, I can and do take the view that that probably will be resolved in their favour, that they will have a very substantial refund, and that that will give them the wherewithal to pay off the arrears within a reasonable time'*.

- 4.95. In considering the complaints made in respect of one business customer:
- (1) BOS initially suggested to the customer that they raise the matter directly with QCS;
  - (2) BOS noted internally that the issues raised by the customers were *'somewhat of a distraction'* as the complaints related to BOS's decision not to provide further funding. It was noted that the previous IAR member of staff who dealt with the customer had recommended that BOS should cease providing additional funding, given the financials of the business, but Mr Scourfield had *'...rejected...arguments and assumed ongoing responsibility for the relationship himself'*;
  - (3) on 25 April 2007, BOS responded to the customer stating that *'the contention that charges, interest and fees have been paid as "a direct result of mis-management of the account", will be investigated to enable a full reply on to be provided to [the customer]'*;
  - (4) on 15 May 2007, Senior Manager A met with the customers. Senior Manager A stated in the meeting that the Bank had examined the issues raised by the customers and was satisfied that they had been handled appropriately. Senior Manager A agreed that if any fees were charged by QCS after the customers asked for QCS's involvement to be terminated then the fees would be reimbursed. BOS however later contacted the customers on 15 November 2007 to state that they had provided no evidence that money had been debited from their accounts after they had asked for the services of QCS to be terminated; and
  - (5) on 31 July 2007, customers complained to the Corporate Division that their emails were being deleted without being read. The customers then complained again the next day that their complaint email had also been deleted without having been read. The complaint was also made again on 28 August 2007. Senior Manager A confirmed to the Authority that it was *'quite possible'* that some of the emails were deleted.
- 4.96. When considering these complaints, BOS failed to make the connection with, and take into account, the information that it had identified that raised suspicions about Mr Scourfield's conduct. Where responses were sent to customers that complained, BOS stated that if the customer had any substantive evidence of dishonesty of the individuals involved then it should be taken up with the appropriate authorities or provide the evidence to BOS. BOS stated that it did not have relevant knowledge of the matters complained about. Whilst the Authority acknowledges that the weight of evidence that ultimately resulted in Mr Scourfield's conviction would not have been available to BOS at the time, BOS did not give due consideration to the suspicious information that it had identified.
- 4.97. Despite these complaints, BOS did not review its decision to close its investigation and failed to put all the information together and report its suspicions to the Authority.

#### **The Firm's September 2007 communication with the Authority**

- 4.98. By the start of September 2007, BOS was aware of the matters detailed in paragraphs 4.93 to 4.97 above. Despite this awareness, BOS did not disclose to the Authority the fact of its suspicions or the information giving rise thereto. Further, a communication with the Authority on 28 September 2007 again misleadingly stated that no evidence of fraud had been found.

4.99. A report by BOS's auditors dated 4 September 2007 noted that further information which emerged in July 2007 regarding a few businesses, including some managed by IAR, indicated that the provision made in 30 June 2007 should have been increased by a further £50 million.

4.100. On 10 September 2007, BOS had a meeting with the Authority where questions were raised by the Authority regarding 'Reading (Corporate)'.

4.101. On 20 September 2007 BOS received a letter from a journalist referring to his investigation into Mr Scourfield which stated:

*'My initial findings suggest that the Reading branch had developed an unusually close relationship with a particular firm of consultants, who it has been requiring customers to use. Many BoS clients appointed this firm of consultants whose officers would often sit on their board of directors. Unfortunately, a surprisingly high proportion of your clients appear not to have benefitted from the input of these consultants and have gone to the wall. The BoS has run up bad debts and the bank's clients are concerned that the high consultancy fees they paid was not money well spent.'*

4.102. On 26 September 2007, BOS received another letter from the journalist providing the findings of his investigation into Mr Scourfield which stated:

*'As part of [the] investigation I have uncovered evidence of collusion between [Lynden Scourfield] and two executives... at Quayside Corporate Services, a consultancy offering advice on turnaround and recovery, to defraud the bank and its clients...*

*...The article will allege that loans by HBOS and supported by Mr Scourfield were not applied to assist your clients' recovery but to fund the excesses of your employee, Mr Scourfield, and the consultants he insisted should be appointed by your clients. In particular it will highlight how HBOS funds were used to fund overseas trips for Mr Scourfield and others and pay for prostitutes for Mr Scourfield and [an individual connected to QCS].'*

4.103. On 28 September 2007, Senior Manager F informed the Authority that BOS had been contacted by a journalist including in relation to 'alleged links between [Mr Scourfield] and one firm of consultants and accusations of personal gain and other salacious/criminal accusations against him and that firm'. Senior Manager F stated to the Authority:

*'We believe these [accusations] are probably driven by complaints from one customer who I understand has previously written to the Board concerning our treatment of them.'*

*These accusations were known about when our investigation was carried out and borne in mind when we reviewed payments etc to seek to identify whether there was any evidence to support fraud/personal gain. No evidence to support them was found. As they allege criminal behaviour on his part we also asked the client to either provide information to the police or to us for us to pass on. No such information/evidence was provided.'*

4.104. In fact, the Bank had identified emails which raised suspicions, including suspicions of fraud and/or personal gain on the part of Mr Scourfield. The information provided to the Authority did not refer to the emails that had been identified or the remaining suspicions which BOS had been unable to address following Mr Scourfield's resignation.

## **The Firm's October 2007 communication with the Authority**

- 4.105. By the start of October 2007, BOS was aware of the matters detailed in paragraphs 4.99 to 4.104 above. In a communication on 24 October 2007, BOS did disclose to the Authority a brief summary of its investigation including that suspicious emails and an exit fee had been identified which appeared to be owed to BOS being re-directed to an account controlled by a director of QCS but it nevertheless failed to be open and cooperative and failed to provide full disclosure of all relevant information.
- 4.106. On 2 October 2007, there was a meeting of the BOS Audit Committee which discussed the issues identified within IAR. Ahead of the meeting Group Credit Risk briefed Senior Manager F on 18 September 2007 that *'For background, there is a lack of evidence that Reading was a fraud, rather it is being treated as mal-practice and poor credit decisioning/ rogue behaviour by the senior director involved...'*. Senior Manager F's subsequent presentation to the Audit Committee stated that following the investigation *'there is a lack of evidence that [Mr Scourfield's] actions were for personal gain or of a fraudulent nature'*. It was also noted that the full year losses attributed to the issues within IAR were expected to increase to £100 million by the end of the year (this presentation was subsequently provided to the Authority on 19 October 2007). On 2 October 2007, Group Risk presented a paper to the Audit Committee on financial crime prevention. In that report, it is noted that the issues in IAR had *'...not been categorised as Fraud'*.
- 4.107. On 3 October 2007, BOS was contacted by a journalist stating they had received allegations that Mr Scourfield had channelled *'millions of pounds into Quayside client companies'* leading to financial difficulties for customers.
- 4.108. On 18 October 2007, BOS identified a loan from one of IAR's customers that had purportedly been made to members of Mr Scourfield's family and formed part of the lending managed by IAR. The CFCP Team was made aware of this loan in November 2007 but it does not appear that further investigation was undertaken.
- 4.109. Having reviewed the HBOS Group Credit Risk Report that had been provided to the Authority, the Authority noted internally on 19 October 2007 that the report *'...categorises the Reading incident as "credit losses" rather than fraud but have we satisfied ourselves that fraud was not the intent? Have we seen HBOS's full report of this incident and have we expressed any concerns to them about the way they are portraying this to the Execs?'*. On the same day, the Authority emailed Senior Manager H twice:
- (1) in the first email, the Authority referred to the email from Manager F dated 28 September 2007 and asked for an update stating *'We also note that you are emphatic that [Mr Scourfield] was not acting fraudulently or corruptly; we would be grateful for some more detail on your reasons for this belief, and the steps you have taken to investigate'*; and
  - (2) in the second email, the Authority noted that it had just received the 2 October 2007 BOS Audit Committee paper (see paragraph 4.106) but stated that *'...we would still be interested in answers to our questions on the investigation into [Mr Scourfield's] fraudulent intent or lack thereof'*.
- 4.110. Senior Manager E emailed Senior Manager H on 23 October 2007 with a summary response to the Authority's questions. When providing that summary response to Senior Manager H, Senior Manager E stated *'I am not sure where the "emphatic" message came from as [the CFCP Team] have not found anything concrete enough*



*to be emphatic about (positive or negative)*'. The email then briefly summarised what the CFCP Team had found in its investigation.

- 4.111. On 24 October 2007 Senior Manager H sent a response to the Authority's emails of 19 October 2007 which summarised what the investigation had considered and in relation to Mr Scourfield's conduct stated that:

*'In all of the above, we could find no firm evidence of direct personal benefit. The closest thing was some e-mail correspondence referring to a business trip to the US and a holiday in Barbados, however, no "smoking gun". In addition, an Insolvency Practitioner advised of his suspicions regarding an "exit fee" which he was instructed to send to a Business account rather than a Corporate fee account. Investigation established that the funds were moved between [an individual connected to QCS] accounts to an offshore account with another Bank. This suspicion was raised due to rumoured allegations of asset stripping, which in itself is not illegal, and was not sufficient evidence to confirm criminal activity. A full report by [the CFCP Team] was furnished to Corporate Credit Risk in July 2007 for input into their investigation. In conclusion there is a lack of evidence that the individual's actions were for personal gain or of a fraudulent nature. If you need any further information, please let me know.'*

- 4.112. The email is largely the same as the summary provided by Senior Manager E however Senior Manager H had:

- (1) removed the sentence raising doubts about the "emphatic" message and did not state that the investigation *'had not found anything concrete enough to be emphatic about (positive or negative)'*; and
- (2) added a sentence stating *'In conclusion there is a lack of evidence that the individual's actions were for personal gain or of a fraudulent nature'*.

- 4.113. The email on 24 October 2007 was the first time that the Authority was notified of some of the information that had been identified which raised suspicions of potential fraud. However BOS failed to provide the Authority with the detail that called into question the Authority's belief that BOS had been emphatic that there was no evidence of fraud. BOS did not provide the documentation relating to the emails or the exit fee and did not provide the investigation report to the Authority. The Authority was not aware of any of these details and responded on 25 October 2007 *'Many thanks for this. It looks pretty thorough'*.

- 4.114. On 25 October 2007, the Authority had a close and continuous meeting with Group Credit Risk. The meeting covered several areas including the issues within IAR. The Authority's note of the meeting records that the view given by Group Credit Risk was that *'[Mr Scourfield] was "soft" rather than corrupt, although the odd holiday, etc'*.

- 4.115. On 12 November 2007, Senior Manager A presented a paper on the issues identified within IAR to the Corporate Operational Risk Committee. The paper summarised the investigation and findings in the same terms as those provided to the Authority on 24 October 2007.

- 4.116. On 15 November 2007, Senior Manager E provided an update to Senior Manager H on current fraud cases where the CFCP Team was involved. In relation to Mr Scourfield it was noted that *'There was no firm evidence of Scourfield directly benefiting from the case, however, money trails leading to offshore jurisdictions and a number of suspicious emails were noted and fed back to Credit Risk who are managing the overall case for Corporate'*.

## **The Authority's ARROW assessment of HBOS in November and December 2007**

- 4.117. In addition to the regular close and continuous meetings, between November and December 2007 the Authority conducted its ARROW risk assessment of HBOS which involved meeting with several individuals from HBOS Group, including BOS Corporate Division, and HBOS's auditors. Due to the issues identified within IAR, credit controls were specifically included in the ARROW assessment. Financial crime issues were however excluded by the Authority from the scope of the ARROW assessment. Whilst the issues within IAR were referred to in a number of meetings the discussions focused on credit control issues and the written records do not refer to any details about the suspicious conduct within IAR being discussed.
- 4.118. The Authority met with Senior Manager C on 17 November 2007 to discuss IT services within HBOS. Following that meeting, BOS provided on 22 November 2007 some statistics that were relevant to the matters that had been discussed. An internal email between staff at the Authority notes that the information did not include the *'...provisions arising from the Reading controls failure. As they have a constant backlog in reconciliations, can they be sure they have picked up everything?'*
- 4.119. On 26 November 2007, Senior Manager H met with the Authority. This included an update on the issues in IAR, however only controls issues within IAR were discussed. The suspicious conduct within IAR and details of the investigation conducted by BOS were not discussed. The Authority, based on the information provided, asked whether the issues related to operational or credit risk failings. Senior Manager H stated that better controls and oversight *'ought to have been in place to prevent the loss'*. In this communication BOS again portrayed the issues as control failings only and did not refer to the suspicious conduct it had identified.
- 4.120. On 26 November 2007, the Authority also met with Senior Manager D. The Authority asked for an update on the changes to credit controls that had been made after the issues within IAR were identified. The Authority also asked whether issues had been identified in any other areas, how BOS would know that the failings would not occur again and what the provisioning/impact of the failings were. The suspicious conduct within IAR was not discussed.
- 4.121. During the meeting with Senior Manager D there was reference to an article in the press that had appeared at the weekend. On 24 November 2007, The Times had published an article entitled *'A loan too far from HBOS'*. The article stated that a customer had been brought to financial ruin as the result of a *'rogue branch manager'* making *'unauthorised loans'*. The article further alleged that BOS paid large sums of the customer's loan to QCS who in the customer's opinion *'did nothing'* for their business.
- 4.122. Following one of the Authority's meetings with BOS, Senior Manager F emailed the Authority on 29 November 2007 noting that there had been *'considerable focus on the classification of Reading as a credit loss versus an operational loss'* and provided details of how credit risk losses are assessed. A member of the Authority's HBOS supervision team emailed colleagues noting *'Are they always this defensive?'* to which a colleague responded *'They took Reading very seriously'*.
- 4.123. On 5 December 2007, the Authority met with Senior Manager B about the Corporate Division. During that meeting in respect of the issues in IAR the Authority recorded that *'Reading was attributed to "taking their eyes off the ball", partly due to resources being diverted to work on Basel. Preventative and detective controls were weak, and there was a perception that the high risk area was unlikely to be hit by*

*dishonesty...A full investigation has been carried out and no evidence found of gain on the part of [Mr Scourfield].'*

- 4.124. The Authority also had a close and continuous meeting arranged with Senior Manager F on 5 December 2007. In preparation for the meeting Senior Manager F asked Group Credit Risk for an update. In relation to the issues in IAR the update was that *'Reading – the loss number which...has been quoting in the ARROW interviews is c£200m (£147m provisions to end October with at least another £50m expected by the year end). There is one material case...which remains unresolved and will be the subject of discussion...later this week when we close-out our provisioning review. The exposure is £110m, current provision £18m. the value of the assets bridging the gap is very uncertain'*.
- 4.125. On 22 January 2008, Senior Manager I emailed Senior Manager C summarising a recent meeting with the Authority. In that meeting the credit control failings in IAR were discussed and there was no reference to the suspicious conduct within IAR that BOS had identified.
- 4.126. On 22 April 2008, the Authority wrote to HBOS summarising its findings from the ARROW review stating in relation to Financial Crime: *'This area of work was specifically excluded from our ARROW discovery plans but is a topic to which we will turn our attention during 2008. We will initially take this forward on a close and continuous basis and will be requesting regular updates on current and emerging risks. We will also endeavour to strengthen the links between HBOS' Financial Crime Prevention Team and the FSA's Financial Crime and Intelligence Division in order to facilitate a more robust and mutually rewarding vehicle for the sharing of information'*.

#### **Consideration of year end provisioning for losses**

- 4.127. Towards the end of 2007 and early 2008, BOS conducted a review of its lending to business customers managed by IAR to determine whether it was necessary to provision for further losses. This review identified that further significant provisions would be necessary. As part of this review BOS also considered the 'Turnbull' guidance (the guidance published by the Financial Reporting Council on how directors of listed companies should comply with the UK Corporate Governance Code requirements in respect of internal controls including financial and risk management) in respect of the impact of the losses on its financial reporting obligations.
- 4.128. There was a meeting of the Audit Committee on 4 December 2007 and it was noted that there was an audit taking place which, in part would consider the impact of the issues in IAR on credit provisioning. A paper was presented at the committee by Senior Manager F which stated that *'Unfortunately, the provisions requirement for Reading has deteriorated and the year end total is expected to be close to £200m. Further, there is one large exposure where the final recovery remains very uncertain and the existing provision may require to be significantly increased in the months ahead.'*
- 4.129. On 19 December 2007, an individual in Group Credit Risk emailed Senior Manager F to update him on a number of issues including *'The draft Group Credit review of year end provisions is now with Corporate. There is one material individual provision we have questioned and where we may be at odds with Corporate...one of the Reading cases...The value of this is uncertain and Corporate have undertaken to have it valued. This might result in an additional provision in the range £40-60M'*. Senior Manager F responded the next day stating *'Thanks – on Corporate provisions – whether others like it or not we need to be sure that the provisions*

are "in the range" maybe at the lower end and if they need to raid some conservatism elsewhere...then I can live with it but we cannot accept the unacceptable otherwise we might as well not turn up'.

- 4.130. On 15 January 2008, BOS informed the Authority that it did not intend to refer to the issues within IAR when it released its year end financial results.
- 4.131. Emails within Group Credit Risk on 22 and 23 January 2008 note that the provisions in respect of one IAR customer had been increased by a further £20 million and was at the top end of the range that had previously been suggested. It was noted that the further increase followed discussions with BOS's auditors and took the total provisions relating to IAR to £265 million with only one case remaining where there may be additional small provisions necessary.
- 4.132. A paper was presented to the Audit Committee on 5 February 2008 which referred to the issues in IAR which noted that for the 12 months to 31 December 2007 a provision of around £230 million was taken in respect of the IAR portfolio. During the meeting there was a discussion about the year end financial results and *'...some disclosure of the Reading Fraud and it was agreed that there was no appetite to refer specifically to this instance. However, further consideration would be given to how the impact of this incident would be disclosed in the [stock exchange announcement], because the Reading loss distorts [sic] many of the Corporate ratios'*.
- 4.133. An update paper entitled *'Reading Fraud – Update'* was provided to the HBOS Executive Committee meeting on 19 February 2008. In that paper it was noted that the total provision for losses relating to the IAR portfolio was £266 million. Before submitting the update to the Executive Committee individuals within Group Credit Risk had discussed over email that:
- (1) the provision levels on IAR cases at the time the fraud was operating were *'...clearly very materially wrong...'*;
  - (2) it was considered that £50 to £100 million of the £266 million provision *'...would have happened anyway had the fraud not occurred...'* which suggested a loss of £166 million to £216 million attributable to the misconduct within IAR. The author of this email later stated to TVP that the reference to fraud was *'loose phraseology'* and they did not have *'sufficient information to base a view on whether or not a fraud had occurred'*; and
  - (3) initially the paper referred to an additional provision of £22 million being necessary for further losses anticipated in 2008. It was noted that there were 11 cases currently viewed as requiring no extra provision that could result in an additional provision of £0 to £22 million being needed. BOS's view was it was likely a provision at the lower end of the range would be needed and the provision was unlikely to be £0. As a result, Group Credit Risk decided to remove explicit reference to potential additional provisions from the paper.
- 4.134. BOS's auditors conducted an audit of the Corporate Division for the year ending 31 December 2007 and provided a report to the Corporate Risk Control Committee on 20 February 2008 and the Audit Committee on 21 February 2008. The auditors noted that, in relation to the provisioning for the Corporate Division *'The additional provisioning resulting from the Reading Portfolio has accounted for over 40% of the total individual provisioning charge and has clearly put pressure on this balance. In some cases we believe this has resulted in provisions being at the lower end of an acceptable range. We have noted opposite the reducing cover of the collective*

*provision. Taken together, we consider that the impact of Reading and deteriorating market conditions have resulted in less conservative positioning of overall provisions, albeit that they remain within a justifiable range. Whilst our divisional procedures address both individual and collective provisions within the Corporate division, our ultimate assessment of the adequacy of provisions is made across the group as a whole.'*

4.135. The Audit Committee on 21 February 2008 reviewed the level of provisioning relevant to the Turnbull guidance including the provisioning related to IAR. Two papers were presented by Senior Manager F which referred to the issues in IAR:

- (1) the first paper summarised the impact of the '*Reading fraud*'. It was noted that there were a few cases from the IAR portfolio that were still to be finalised in 2008 however it was expected that any further provisions were expected to be small; and
- (2) in the second paper, it was noted that total provisions of £266 million had been made relating to the IAR portfolio, although £91 million of those provisions had been made before Mr Scourfield joined IAR. The provision related to 'suspect' lending was therefore around £175 million.

4.136. A meeting of the board of directors of HBOS was held on 26 February 2008 at which Senior Manager F, amongst other items, presented an update on the issues in IAR. The presentation summarised the credit risk control weaknesses that had been identified and the changes that were proposed to the controls. In relation to Mr Scourfield it was stated that '*...there was no evidence of "personal gain", despite the aberrant behaviour*'.

#### **Contact with the police in 2008**

4.137. BOS did not at any point report its suspicions to the police, despite being contacted twice by police forces in 2008 in response to allegations raised by IAR customers.

##### First Police Force

4.138. On 10 January 2008, BOS was contacted by a Detective Constable, a Divisional Fraud Investigator for the first police force, after he had received allegations of fraud from an IAR customer stating that: '*there may be an offence of "conspiracy to defraud", in that Lyndon Scourfield and the directors of Quayside Corporate Services are closely associated, have acted together, and the net result has been a financial loss to HBOS*'. The Detective Constable then queried if BOS was '*in the process of compiling an "evidence package" prior to putting the matter in the hands of the Police? If so, I can advise that this would need to be submitted to Thames Valley Police in the first instance*'.

4.139. The CFCP Team spoke to the Detective Constable in relation to the request. On 22 January 2008, the CFCP Team was again contacted by the Detective Constable after the IAR customer provided further details of the allegations of fraud. Providing a copy of the information he had received he stated '*I've told the [IAR customer] I don't intend to get too involved in this...I'm supplying the factsheet (plus anything in the same vein) so that you can judge whether or not the Bank should be making a criminal complaint to the relevant Force. Although I must say it all looks a bit dishonest to me, and I would think that any legitimate business should be consulting the Police if there was any truth in such allegations. But that's just my opinion based on the only side of the story I've heard!*'

- 4.140. BOS considered that the details provided by the IAR customer to the Detective Constable were similar to the details in complaints the customer had submitted to BOS in 2007. In responding to the complaints in 2007, BOS had asked the customer for evidence to support the allegations or suggested that they provide evidence to the police.
- 4.141. On 27 March 2008, BOS responded to the Detective Constable stating that *'it appears the information you have provided is no different than that of which the [IAR customer] have already supplied. If they have anything more concrete the Bank will happily take a look but until then there are no further developments'*. On 31 March 2008, BOS confirmed to the Detective Constable that it would not be reporting the matter to any Police Force unless *'new concrete evidence comes to light'*.

#### Second Police Force

- 4.142. On 11 March 2008, BOS was contacted by a different police force which had received complaints from another customer about Mr Scourfield. On 19 March 2008, the CFCP Team noted in internal emails that *'I don't think that we have had at any time authority to refer matters to the Police and its all very complex with various stakeholders involved and ongoing litigation/recovery work underway. We should consult with Credit, our legal advisers and [individuals in the CFCP Team] as to where we go with this but it may be we continue with the status quo of not making a complaint to the Police, albeit we would be forced to comply with any Production Orders etc. that come along. May also be useful to get a view from our PR people as they should be able to help in forming any responses required'*.
- 4.143. The police force asked BOS to detail whether Mr Scourfield's actions were under any formal investigation. The Bank declined to investigate further unless further evidence was provided by the customer.
- 4.144. On 19 March 2008, the CFCP Team produced an update to its July 2007 investigation report but it did not include any further information other than noting that BOS had been contacted by two police forces.
- 4.145. Despite being contacted by two police forces, BOS did not review its decision to close its investigation into the conduct of Mr Scourfield and did not inform the Authority about the allegations that it had received from customers or of the police interest.

#### **Close and continuous meetings between April and October 2008**

- 4.146. The Authority's regular close and continuous meetings with BOS continued throughout 2008. In one meeting, on 8 October 2008, the Authority met with Senior Manager H during which details were provided about a financial crime investigation that was ongoing in an area of BOS separate to IAR. That case also involved suspicious actions by a member of BOS staff and the CFCP Team was reviewing email accounts. Senior Manager H stated that the case was like Mr Scourfield in that BOS had *'suspicions that there was fraud involved but they have no concrete evidence at this stage to prove their case'*. It was noted that there should be information available to submit to the police within a fortnight and that *'it's quite possible that no action will be taken by the police and that... investigations go the same way as Reading i.e. it does not pass the "smell test" but there is no concrete evidence to support suspicions'*.

## Customer complaints in 2008

4.147. Complaints from customers continued in 2008, including:

- (1) On 25 January 2008, the directors of an IAR business customer, who had previously complained in 2006 and 2007, contacted the Corporate Division and HBOS Group alleging fraudulent behaviour. The customer referred to having been provided information by a whistle-blower who *'...was privy to a lot of the planning and execution of the corporate misconduct'*.
- (2) On 2 May 2008, a customer contacted BOS raising Mr Scourfield's *'irregular, unethical and unprofessional behaviour'* in managing the customer's account. This letter was provided again to BOS by the customer's MP on 7 May 2008. The customer wrote to BOS again on 23 May 2008. BOS in internal discussions stated that the MP stressed that the customer had *'suffered at the hands of a "rogue" banker'* and that they needed to *'deal with the issue of the "rogue" banker'* as it was the basis on which *'a whole range of MPs are now being contacted'*.
- (3) On 9 May 2008, BOS was contacted by a customer stating that an individual connected to QCS and Mr Scourfield had used his company as a *'slush fund financed by BOS via Lynden Scourfield which they used to fund their own luxurious and sometimes salacious lifestyle'*. Senior Manager B noted internally that *'This also appears linked to [other customers that were complaining]. Can we please kill this stone dead once and for all. A draft response to [the customer] is needed.'*
- (4) On 15 May 2008, BOS was contacted by shareholders of a corporate within IAR's portfolio. The shareholders provided information that two individuals connected to QCS had previously been involved in a fraud. The shareholders noted that one of the same individuals had been appointed as a director of the customer's company. One of the shareholders described that when he had raised concerns with the individual connected to QCS the response had been that he would be wasting his time raising any concerns with Mr Scourfield as he was *'...in the pocket of [QCS]'* and that *'[QCS] had, amongst other gifts, organised and paid all expenses for a holiday in the West Indies for Mr Scourfield and his wife'*. The shareholder also stated that he had learnt from former employees that the company's funds were used *'for the procurement of the services of prostitutes for the benefit of [an individual connected to QCS] and Mr Scourfield'*. Senior Manager B noted internally that *'More stuff on Reading...It is beginning to look like a co-ordinated approach, so we must be robust and say this is nothing to do necessarily with the relevance of the business which you were operating was not viable [sic]'*.
- (5) On 23 May 2008, a number of IAR customers collectively wrote to the Corporate Division and HBOS Group alleging misconduct by Mr Scourfield and QCS. This letter was also copied to the Authority and a number of MPs.
- (6) A customer who had previously complained to Mr Scourfield in 2004 about an individual connected to QCS wrote to BOS on 19 December 2007 raising similar matters of complaint. The customer alleged that the individual had previously been involved in a fraud. And further, that BOS was aware of that fact before the individual was appointed to the Board of the customer. A response was initially sent to the customer by the Corporate Division on 4 January 2008 informing the customer that they would be launching an investigation into their complaint. IAR then wrote to the customer on 28

January 2008 stating that *'the Bank had no relevant knowledge of the allegations'* and that the customer should take the matter up with the relevant authorities. The customer then escalated the complaint within the Corporate Division on 14 May 2008. Solicitors acting on behalf of BOS responded to the customer on 28 May 2008. The response stated that *'You have not seen fit to put forward any detailed evidence in support of this allegation, or to articulate the nature of any claim to which it may give rise. Suffice it to say that as far as the Bank is concerned the allegation is ill-founded and misconceived. In the circumstances, the Bank has no reason to compensate you, and will not be doing so.'*

- (7) On 25 November 2008, staff in a branch of BOS received an allegation of corruption by telephone from a customer who stated that *'he knows what happened at the Reading branch and why the manager "Linden" has been sacked. He said it is to do with a consultancy firm "Quayside" and that [BOS] have covered it all up and not released what happened to the press'*. This allegation was passed to the CFCP Team.
- (8) On 31 December 2008, BOS was contacted by the Financial Ombudsman Service which, following the receipt of allegations from customers, was requesting information regarding Mr Scourfield's dismissal, his relationship with QCS and relevant customer information.
- (9) On 23 January 2009, BOS responded to the Financial Ombudsman Service stating that Mr Scourfield's actions had been investigated by BOS and that *'there was no evidence of direct personal benefit on the part of Mr Scourfield'*.

#### **Press and Parliamentary interest in 2008**

4.148. Throughout 2008, BOS was contacted several times by journalists and MPs regarding the conduct of Mr Scourfield and QCS, including:

- (1) On 7 May 2008, BOS was contacted by an MP raising *'huge concerns'* that a customer of IAR appears to be a *'victim of a rogue banker'*.
- (2) On 25 May 2008, the Manx Herald released an article which referred to the *'questionable activities of Scourfield and Quayside'* which cost BOS *'at least £400m'*. A customer was quoted in the article asking why BOS refused to acknowledge anything is amiss and accusing BOS of a cover up.
- (3) On 14 October 2008, a complaint from a former shareholder in an IAR business customer, who had complained to IAR in 2006, was received by Lloyds TSB (prior to the forthcoming merger). The letter referred to correspondence from other IAR customers sent to BOS and referred to allegations of fraud by QCS.
- (4) On 20 November 2008, BOS was contacted by a group of MPs, who had all communicated with BOS, regarding QCS and Mr Scourfield. The MPs stated that they had reached a conclusion that there was *'more than coincidence'* involved in the matters and that their constituents had been *'ill-served'* by BOS. The MPs requested a meeting with BOS to discuss their concerns.
- (5) On 25 and 26 November 2008, BOS was contacted by a journalist from the Sunday Herald regarding various allegations including that in 2005 a business customer of IAR had provided envelopes of cash to Mr Scourfield on behalf of QCS, that Mr Scourfield and QCS had submitted inflated sales



figures to obtain an increased overdraft facility on the business's bank account. The journalist asked if BOS was aware that two QCS employees had previously been implicated in a fraud. The journalist noted that these two individuals had been appointed to the board of several of IAR's customers where QCS was providing turnaround services. BOS responded that it could not comment on the individual circumstances.

- (6) On 30 November 2008, the Sunday Herald released two articles which referred to two QCS employees who had resigned from previous roles at another company after '*misappropriating company funds for their own personal use*' and alleged that QCS took '*enormous fees*' from BOS customers and did not provide any services.
- (7) On 3 December 2008, the Manx Herald released another article which referred to the '*HBOS 'Rogue Banker' scandal*' and described a campaign by customers to have the '*scandal*' investigated and that '*a significant number of HBOS customers, have had their businesses, and lives, ruined*' by the involvement of Scourfield and QCS'.

### **Merger with Lloyds TSB in 2009**

- 4.149. On 1 October 2008, HBOS Group was approaching a point where it was no longer able to meet its liabilities as they fell due and so sought Emergency Liquidity Assistance from the Bank of England. Following the financial collapse of HBOS Group it merged with Lloyds TSB Bank plc on 16 January 2009 to form LBG.
- 4.150. Following the merger, there was a significant amount of restructuring of the former HBOS Group business and integration within LBG. As a result, there was significant structural and management changes within the Corporate Division including to IAR.
- 4.151. Following the merger, BOS continued to receive complaints from customers and press and parliamentary interest in the matters continued.
- 4.152. Ahead of an internal meeting, an individual from the BOS Risk function requested that the CFCP Team provide an update on its report from 2007. The CFCP Team did not undertake any further investigation but produced a summary of its original findings on 21 January 2009.
- 4.153. On 22 January 2009, Senior Manager D emailed Senior Manager E asking '*I assume with the passing of time and general silence that we never discovered any proof that LS personally benefited financially from his actions?*'. Senior Manager E responded '*...Essentially we have exhausted the avenues available. Despite external complaints, the individuals have not been forthcoming with any evidence*'.
- 4.154. BOS met with a group of MPs on 27 January 2009 during which BOS agreed that it would conduct a further review of IAR customer complaints that the MPs had received. After the meeting, BOS determined that complaints would be responded to on a case-by-case basis and any compensation would be limited to the fees paid to QCS. In internal email correspondence BOS also considered that compensation would be offered to one of the customers '***but not to any of the others***' [emphasis as original].
- 4.155. BOS wrote a letter to one of the MPs on 18 February 2009 summarising the conclusions of its review and BOS's position in relation to the customers' complaints. BOS noted that '*the detail of the individual cases are complex*', including that certain customers had no involvement with QCS and very little involvement with Mr Scourfield. BOS stated in the letter that it was firmly of the

view that the customers referred to in the letter did not have a valid claim for compensation, *'however, in some cases we discussed, [BOS] is prepared, as a matter of goodwill, to make certain proposals'*. In that letter BOS stated that:

- (1) *'In certain instances, the entities through which the constituents traded were granted increased loans by [Mr Scourfield]... Whilst [BOS] appears to have been more supportive than it should have been in responding to requests for increased facilities, this occasioned loss to [BOS] and there is no evidence that it led to the failure of already stressed businesses.*
- (2) *In certain instances, Mr Scourfield was instrumental in the appointment of [QCS] as consultants to the entities in which the constituents were involved. So far as I am aware, there is no evidence that anybody at [BOS] knew, at that time, that the reputation of [QCS] (or of individuals within [QCS]) was, in any way, questionable.*
- (3) *In early 2007, [BOS] identified issues concerning Mr Scourfield's approach to lending. As pointed out above, the Bank was more supportive than it should have been in responding to requests for increased facilities from some of the customers in question. After Mr Scourfield had been suspended from duty on account of these matters, he resigned in late April 2007.*
- (4) *Following communication between [BOS] and [the Authority], improved procedures were implemented to ensure that there was no recurrence of those practices. To be clear, these procedures were designed to ensure that, in future, [BOS] did not lend more than it should to its customers.*
- (5) *Following Mr Scourfield's departure, [BOS] carried out an extensive internal review and concluded that there was a lack of evidence of direct personal benefit on the part of Mr Scourfield from his relationship with [QCS].'*

#### **The Authority requests further information from BOS in 2009**

4.156. On 9 April 2009, the Authority had a meeting with several individuals from BOS who dealt with *'wholesale risk'*, including Senior Manager H. A note of the meeting made by BOS records that:

*'[The Authority] asked for an update on Reading and [Mr Scourfield] and if any customers had lost out. Senior Manager H reminded [the Authority] that there had been a full internal investigation involving the financial crime prevention team but no evidence could be found of wrong doing by [Mr Scourfield]. As to whether or not customers had lost out it was complicated by the fact that these were already impaired connections and the real loser by [Mr Scourfield] inappropriately extending further facilities had been [BOS] which had suffered considerable additional loss. However [Senior Manager H] added that [Mr Scourfield] had directed the vast majority of the cases to [QCS] who had benefitted from the arrangements through fees but again whilst paid for by the customers funded through increased lines from [BOS]... [The Authority] asked whether [Mr Scourfield] had been sacked. [Senior Manager H] advised [Mr Scourfield] had resigned whilst suspended. [The Authority] asked if anyone had been dismissed in connection with Reading. [Senior Manager H] advised nobody. [The Authority] said... [it] would like to understand if nobody had been dismissed as a result of...such extreme control failings as...Reading what it would take for a leader to be dismissed.'*

4.157. The Authority also requested a copy of the correspondence between BOS and an MP in February 2009 (see above).

- 4.158. On 9 April 2009, the Authority separately contacted BOS asking several questions about QCS and whether BOS had involved the police. BOS considered the request was prompted by the new member of staff at the Authority as they stated '*New supervisor cycling [sic] up basically. Don't let it get in way of action*'. BOS's response to the Authority on 11 May 2009 included that '*A complaint was made to [a police force] by a customer, no action was taken. HBOS did not involve the Police in any aspect of Reading.*' BOS also informed the Authority that the BBC would be broadcasting a programme about the issues in IAR which look into claims that BOS failed to investigate properly the concerns of customers and would raise questions about whether suspicious behaviour brought to the attention of the bank was reported to the appropriate authorities.
- 4.159. On 22 May 2009, during a meeting with BOS the Authority requested that a copy of BOS's investigation report be provided.
- 4.160. On 26 May 2009, the BBC broadcast the results of a 'File on 4' investigation into IAR and referred to the links between Mr Scourfield and QCS. The broadcast of these findings led to a parliamentary debate on 2 June 2009.
- 4.161. Ahead of the 'File on 4' broadcast, BOS had prepared a briefing note on customer cases that were likely to be referred to during the programme. BOS noted that one of the customers had '*suggested that business plans and forecasts prepared by him were subsequently substantially and unrealistically inflated by QCS with [Mr Scourfield's] knowledge.*'
- 4.162. The CFCP Team produced a summary on 26 May 2009 that stated '*Background is that Lynden Scourfield was a relationship manager dealing with the high risk portfolio in Reading. He often used a recovery "expert" – [an individual connected to QCS] and the allegations were that LS had a cosy arrangement with [an individual connected to QCS] in that he would parachute [an individual connected to QCS] into struggling companies and extend increased credit facilities that would be creamed off leaving the original borrowers deeper in debt and losing homes put up as security etc.*'
- 4.163. On 17 June 2009 BOS provided to the Authority a two-page short overview document of the investigation which was dated 21 January 2009. The summary had been prepared previously by the CFCP Team to update an individual from the BOS Risk function. Some of the information in this overview document had been provided in a more limited format in the email of 24 October 2007 to the Authority. The summary stated that the investigators '*could find no firm evidence of direct personal benefit. The closest thing was some e-mail correspondence referring to a business trip to the US and a holiday in Barbados, however nothing specific or substantiated. In addition, an Insolvency Practitioner advised of his suspicions regarding an "exit fee" ...In conclusion there is a lack of evidence that the individual's actions were for personal gain or of a fraudulent nature...'*
- 4.164. The Authority submitted a SAR to SOCA on 26 June 2009.
- 4.165. The Authority noted that the document referred to a full report having been produced and on 26 June 2009 requested that the full copy be provided. The Authority also requested other information including details of the management of the investigation, the extent and value of money lent because of QCS involvement and any referrals that had been made to the police.
- 4.166. On 9 July 2009, BOS provided the full report to the Authority. BOS also provided a timeline of events and a briefing note on reporting by BOS to the Authority about the issues that had been identified in IAR. The Authority's conclusion on reviewing

the full report was that it was *'very poor'* with many unanswered questions. When the Authority raised this concern and queried whether any other reports had been produced as it was so poor, it was agreed by BOS in discussions with the Authority on 16 July 2009 that the report was *'woefully inadequate'*, that no further reports had been identified by BOS and that there were many *'unanswered questions about the conduct of [Mr Scourfield]'*.

- 4.167. The Authority met with BOS on 16 July 2009 and it was agreed that BOS would provide the Authority with further relevant information. It was also discussed whether further investigation of the issues was required by the Authority and/or BOS. On 10 August 2009, the Authority confirmed that it would be preferable for any investigation work to be conducted by an independent person and the Authority would consider further how that would be taken forward. This resulted in the appointment on 23 October 2009 of a skilled person, under Section 166 of the Act, to conduct the investigation work (see paragraphs 4.169 to 4.173).
- 4.168. It was around this time (July 2009) that the Authority also obtained information about a potential fraud from a customer of IAR. In this regard:
- (1) the Authority had received the allegation that there had been a potential fraud from the customer of IAR in September 2007. The customer requested a secure email address and dedicated contact to share information with the Authority. The Authority did not set up such a facility, and instead suggested alternative communication methods, but as a result further information was not shared at that time;
  - (2) the Authority was contacted again by the customer in August and September 2008. The main focus of the customer's complaint related to FOS but also raised allegations of fraudulent behaviour. The Authority's response focused only on the customer's dissatisfaction with the outcome of their complaint to FOS; and
  - (3) the customer contacted the Authority again in December 2008 and June 2009 offering to share information with the Authority. The Authority responded in July 2009 and arrangements were made for the details relating to the allegations to be shared. This information has formed part of the evidence that has been considered during the Authority's investigation (see further details of the investigation in paragraphs 4.174 to 4.181 below).

### **Skilled person's report**

- 4.169. The Authority determined, after having reviewed all the material that it had received, that it was appropriate to appoint a skilled person under Section 166 of the Act to investigate the Authority's concerns regarding BOS's response to the discovery of the issues in IAR. After discussions within the Authority to agree the scope of the review, the Authority provided a draft requirement notice to BOS on 4 September 2009. BOS provided comments on the draft on 9 and 18 September 2009.
- 4.170. On 19 October 2009, the Authority issued the formal requirement notice to BOS requiring it to appoint a skilled person. The scope of the review required that the skilled person assess (among other things):
- (1) the adequacy of the fraud investigative policies and procedures that governed the investigations by BOS at the time;

- (2) the adequacy of the fraud investigative work conducted by BOS in relation to discovery of the issues in IAR including related management decisions;
- (3) the adequacy of BOS's handling of issues related to customers who suffered losses and any customer complaints filed in relation to the issue in IAR;
- (4) whether the honesty and integrity of any individuals may be called into question; and
- (5) the financial impact on Mr Scourfield's customers who dealt with QCS and whose loans became impaired. It was agreed between the skilled person, the Authority and BOS that the skilled person would not seek to evaluate whether the increased lending improved business stability and/or sustainability, or whether there were trading losses arising through either the provision of increased facilities or their curtailment. The review therefore focussed on fees paid to QCS.

4.171. BOS issued a formal letter of engagement to the skilled person on 23 October 2009. The skilled person's report into the matters under investigation was issued on 9 July 2010 (after a draft report was initially produced on 23 April 2010). To investigate the matter the skilled person reviewed:

- (1) a sample of files for customers whose loans had become impaired and where Mr Scourfield was the relationship manager;
- (2) the policies and procedures that governed the financial crime investigation, the work that was performed by the BOS investigation team and the action that was taken as a result of that investigation;
- (3) how BOS handled the complaints that were raised by customers; and
- (4) the role of any individuals, within BOS or third parties, who were involved with the matters identified within IAR.

4.172. The skilled person's key findings included that:

- (1) whilst the information reviewed could not in itself evidence whether a fraud had been perpetrated on BOS, or whether customers had been disadvantaged, there were unanswered questions about the practices within IAR;
- (2) from the files reviewed by the skilled person, six business customers had made a formal complaint but, apart from one business customer, full details had not been recorded on the HBOS complaint management system;
- (3) no direct evidence could be identified to confirm whether Mr Scourfield benefitted financially from the lending that he oversaw but there were a number of unanswered questions in relation to his conduct;
- (4) there were certain shortcomings in the investigative work conducted by BOS and the rationale for certain decisions, including the rationale for the decision not to pursue further investigative work despite it being recommended in the 5 July 2007 addendum to Senior Manager D's report (see paragraphs 4.76 to 4.88 above);
- (5) no direct evidence of dishonesty or lack of integrity by QCS, and associated individuals, was identified but there were a number of unanswered questions

that had been identified from the sample of customer files that were reviewed; and

- (6) from the sample of customer files reviewed, over £3.9 million of actual payments to QCS, related entities and individuals had been identified. There was also a further £4.1 million that had potentially been paid but could not be confirmed. Of the £3.9 million of actual payments made to QCS just over £3 million had been paid by customers with the remaining sum being paid by BOS and others.

4.173. The Authority provided a copy of the draft skilled person report to TVP in July 2010 and the final report in September 2010.

### **The Authority's investigation**

4.174. The Authority appointed investigators to conduct an investigation into BOS on 4 June 2010.

4.175. The initial focus of the Authority's investigation was into whether:

- (1) the investigation by BOS in 2007 was adequate;
- (2) the complaints received from customers had been handled appropriately; and
- (3) the controls over commercial lending within IAR were adequate.

4.176. The Authority's investigations into the first two concerns were subsequently closed. As the commercial lending at the heart of the issues at IAR is an unregulated activity the Authority does not have jurisdiction to investigate the controls over commercial lending and complaints in respect of that lending other than in certain specific circumstances. Those specific circumstances were not met in this case.

4.177. The Authority's investigation into the controls within IAR continued as part of a wider investigation into the controls across the Corporate Division. On 9 March 2012, the Authority published a Final Notice against BOS for failures in the Firm's control framework within the Corporate Division. These failings were illustrated in part with reference to the issues within IAR. The paragraphs referring to IAR were redacted at the time of publication at TVP's request to ensure that no prejudice would be caused to the ongoing investigation by TVP. The redactions were subsequently removed on 4 July 2017 following the completion of the criminal prosecutions.

4.178. During the Authority's investigation, evidence was identified which suggested that BOS may not have promptly or clearly reported information that raised suspicions of fraud and/or corruption to the Authority. The scope of the investigation was amended on 20 February 2012 to consider whether BOS may have breached Principle 11.

4.179. When the Authority informed BOS that it was proposing to change the scope of the investigation, BOS responded that:

*'[BOS] did not identify any conclusive evidence of personal gain or dishonesty arising from the breach of internal processes and controls. Although it is arguable, with hindsight, that more could have been done at the time to investigate whether evidence of criminal conduct might be uncovered, it is nonetheless apparent that there was a genuinely held belief at the time that the matter had been properly*

*investigated and that no firm evidence of fraud had been uncovered' and 'It is clear from the CFCP terms of reference that there was a concern within [BOS's] senior management to establish whether the breach of process was motivated by financial gain or involved any criminal conduct by employees. However, the CFCP investigation concluded that there was insufficient evidence to suggest that there had been any personal gain or fraudulent activity'. BOS also added: 'Although the [Skilled Person's] report is critical of the quality of the CFCP investigation and the decision not to continue with further investigative work, they were unable to conclude that any employee had acted dishonestly or that there was any evidence of fraud having been perpetrated against HBOS. They also concluded that there was no evidence calling into question the honesty or integrity of those who had carried out the internal investigation or, indeed, of HBOS Corporate Management'.*

4.180. On 21 August 2013, the Authority placed its investigation on hold at the request of TVP. By this time the Authority had determined that it would be necessary to interview a number of individuals. TVP informed the Authority that some of the individuals had already provided witness statements and that they might be called as witnesses in the criminal proceedings.

4.181. The Authority's investigation into BOS, that is the subject of this Notice, was restarted in February 2017.

#### **Discovery of misconduct relating to an exit fee**

4.182. As explained earlier, the investigation by BOS of IAR in 2007 identified a potentially suspicious exit fee. Despite having suspicions, BOS did not report the matter to the police or any other law enforcement as BOS considered it had insufficient evidence. It was not until the Authority reported the issues within IAR to SOCA that this fee was investigated for potential criminal misconduct. The subsequent criminal investigation identified evidence of a corrupt relationship between Mr Dobson and individuals connected to QCS. Whilst the Authority acknowledges that the evidence proving the corrupt relationship was not available to BOS at the time, BOS did not investigate who had approved the payment and without the Authority's actions to report the suspicions Mr Dobson's criminal misconduct may not have been identified.

4.183. On 12 December 2006, a fee of £152,750 which was intended for BOS had been credited to a business banking account instead. On 13 December 2006, the funds were paid to an offshore account that was linked to an individual from QCS. The investigation in 2007 focused on whether the destination of the payment was suspicious. BOS did not consider the reasons why the payment had been made or who had approved the payment (as was subsequently proved at the criminal trial it had been approved by Mr Dobson).

4.184. BOS was subsequently contacted by a number of insolvency practitioners between April 2008 and March 2009 who asked for clarification about the basis for the payment. The response to these queries were dealt with by Mr Dobson or by solicitors for BOS with directions from Mr Dobson.

4.185. In December 2009, Mr Dobson was asked, during the skilled person's review, whether he recall any details relating to the payment but he responded that he could not.

4.186. During his trial, the prosecution's case against Mr Dobson included that he allowed the fee to be paid to parties connected with QCS without the authority of the bank, the business customer or the administrator and in return Mr Dobson received a payment of £30,000.

4.187. BOS did not report to the Authority any suspicions about the exit fee until 24 October 2007, and even then it portrayed the suspicions as an insolvency practitioner's suspicions rather than its own. In failing to be open and cooperative with the Authority and disclose appropriately information about these matters there was a significant delay in Mr Dobson's criminal misconduct being identified.

## **5. FAILINGS**

- 5.1. The regulatory provisions relevant to this Notice are referred to in Annex A.
- 5.2. Principle 11 required the Firm to deal with the Authority in an open and cooperative manner and to disclose appropriately information of which the Authority would reasonably expect notice.
- 5.3. The Authority considers that BOS breached Principle 11 because it failed to be open and cooperative and failed to disclose information appropriately in its communications with the Authority between 3 May 2007 to 16 January 2009. In particular, BOS:
  - (1) on 26 May, 24 July and 28 September 2007, informed the Authority that there was '*no evidence of fraud*' when in fact BOS had identified suspicious conduct suggesting an inappropriate and potentially corrupt relationship. As a result of these communications the Authority believed that BOS had been emphatic that there was no evidence that Mr Scourfield was acting fraudulently or corruptly;
  - (2) did not disclose to the Authority that the investigation had been closed on 13 August 2007 despite there being a number of unanswered questions and despite the investigation team recommending that further investigative work should be conducted;
  - (3) when eventually providing a brief summary of its investigation to the Authority on 24 October 2007, despite being aware that the Authority's understanding was that BOS emphatically believed no fraud had occurred, BOS failed to correct its previous messaging. In particular BOS failed to tell the Authority that it had in fact been unable to draw a definitive conclusion as to whether fraud had occurred, and failed to provide a copy of its full investigation report; and
  - (4) did not disclose to the Authority that it had been contacted by two police forces in 2008 regarding allegations of fraud, that one police force had suggested there may be evidence for BOS to make a report but BOS, having considered the information that it had identified, decided not to report the issue.

## **6. SANCTION**

- 6.1. The Authority's policy for imposing a financial penalty is set out in DEPP and EG. In determining the financial penalty, the Authority has had regard to this guidance.
- 6.2. Since BOS's conduct occurred before the introduction of the new penalty regime on 6 March 2010, the Authority has had regard to the penalty regime that was in place prior to 6 March 2010.
- 6.3. For the reasons set out above, the Authority considers that BOS breached Principle 11. In determining that the financial penalty is appropriate and proportionate in



this case, the Authority has considered all the relevant circumstances. The Authority considers the following factors to be particularly important.

### **Deterrence**

- 6.4. BOS is a large, sophisticated financial institution with a large potential to impact consumers, including business customers. Whilst the underlying business was unregulated, BOS was required to report matters where there was a potential significant impact on both the Firm and its customers. Given the circumstances of this case, the Authority considers it necessary to send a robust message to firms as to the fundamental importance of behaving openly and cooperatively and disclosing appropriately when communicating with the Authority.

### **Seriousness and impact of the breach**

- 6.5. The Authority has had regard to the seriousness of the breach including the nature of the requirement that was breached, the duration and frequency of the breach. The Authority considers the breach to be particularly serious for the following reasons:

- (1) the suspicions related to potentially serious criminal offences by staff at BOS and QCS;
- (2) the individuals who communicated to the Authority were senior and experienced managers and should therefore have appreciated what information should be communicated to the Authority;
- (3) BOS was aware before its first communication with the Authority in May 2007 that the impact of Mr Scourfield's misconduct was significant and would result in substantial losses to BOS. By June 2007, BOS had estimated the losses were approximately £50 million. It was later assessed that the total losses to BOS were £245 million and compensation to customers could be up to £115 million although the full impact will not be confirmed until redress has been calculated and an independent quality assurance review has been completed;
- (4) the Authority specifically told BOS on 14 May 2007 that it wished to be updated about any fraud that may have occurred. BOS confirmed that it would ensure that the Authority was informed should any suggestion of fraud be identified. BOS had numerous opportunities to inform the Authority about the information suggesting that there may have been a fraud, but did not do so. Whilst BOS provided limited information in October 2007, following a request by the Authority, the information was only finally disclosed in full at the request of the Authority, after a period of around two years, in July 2009;
- (5) the information was material to the Authority's assessment of BOS's response to the identification of the issues, changes to its procedures, its approach to the complaints received from customers and consideration of any losses to both the Firm and the customers involved; and
- (6) BOS did not report its suspicions to any other law enforcement agency. Instead it was the Authority that submitted a SAR in June 2009. If BOS had communicated its suspicions appropriately to the Authority, as it should have done, the criminal misconduct could have been identified much earlier. This delay risked creating difficulties for TVP when obtaining and reviewing

evidence years after the fraud had taken place and risked prejudicing the interests of justice.

### **The nature of the breach**

- 6.6. As set out at paragraph 5.3 above, BOS's Principle 11 breach was not a one-off misjudgement or miscalculation. On numerous occasions, over a period of nearly 2 years, BOS failed properly to understand and appreciate the significance of the information that it had identified despite clear warning signs that fraud might be involved. Whilst BOS did not intend to breach Principle 11, it failed to give proper consideration to the need to disclose the suspicious information that it had identified to the Authority. There was insufficient challenge, scrutiny or inquiry across the organisation; the totality of the information that had been identified was not properly evaluated; and there was no assessment or understanding of the impact that failing to give a full and complete picture to the Authority was likely to have (on which see paragraphs 2.9(6) and 2.9(7) above), nor is there any evidence anyone realised or thought that a failure to inform the Authority would delay investigation by relevant law enforcement authorities or prejudice the interests of justice. On any reasonable basis, BOS should have appreciated that it was required to inform the Authority fully about the information which raised suspicions that a significant fraud may have occurred and this failure constituted a substantial failure by BOS.

### **The size, financial resources and other circumstances of the firm**

- 6.7. BOS is a large, sophisticated and well-resourced financial services institution. BOS had plenty of resources and expertise to investigate the misconduct in IAR and provide the Authority with appropriate information. BOS did not do that.
- 6.8. A public censure was issued by the Authority against BOS on 9 March 2012 in relation to failings within the Corporate Division between January 2006 and March 2008. Those failings were in part illustrated by the control failings within IAR. At the time that the public censure was issued, the Authority considered that a financial penalty would have been proportionate to the misconduct however the Authority decided not to impose a financial penalty due to exceptional circumstances. Those exceptional circumstances were that the misconduct contributed to HM Government using public funds to acquire share capital in LBG following the merger of HBOS and Lloyds TSB.
- 6.9. The Authority does not consider that those exceptional circumstances apply to the misconduct that is the subject of this Notice. Taking into account all relevant factors, the Authority considers it is appropriate to impose a financial penalty on BOS.

### **The amount of profits accrued or the loss avoided**

- 6.10. BOS did not accrue profits or avoid losses as a result of the breach of Principle 11.

### **Conduct following the breach**

- 6.11. BOS and LBG have cooperated with the Authority's investigation, including proactively providing relevant material.

### **Disciplinary record and compliance history**

- 6.12. Disciplinary action has been taken against BOS by the Authority a number of times both before and after the Relevant Period. The Firm has not however previously been disciplined for breaches of Principle 11.

### **Other action taken by the Authority**

- 6.13. In determining the level of financial penalty, the Authority has taken into account penalties imposed by the Authority on other authorised persons for similar behaviour.

### **Conclusions as to penalty**

- 6.14. The Authority considers in all the circumstances that the seriousness of the breach merits a substantial financial penalty and hereby imposes a financial penalty of £45,500,000 (£65 million pre-stage 1 discount).

## **7. PROCEDURAL MATTERS**

- 7.1. This Notice is given to BOS under and in accordance with the section 390 of the Act. The following statutory rights are important.

### **Decision maker**

- 7.2. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

### **Manner and time for payment**

- 7.3. The financial penalty must be paid in full by BOS to the Authority no later than 4 July 2019.

### **If the financial penalty is not paid**

- 7.4. If all or any of the financial penalty is outstanding on 5 July 2019, the Authority may recover the outstanding amount as a debt owed by BOS and due to the Authority.

### **Publicity**

- 7.5. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.
- 7.6. The Authority intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

### **Authority contacts**

- 7.7. For more information concerning this matter generally, contact Helen Tibbetts at the Authority (direct line: 020 7066 0656/email: [Helen.Tibbetts@fca.org.uk](mailto:Helen.Tibbetts@fca.org.uk)).

Laura Dawes

Head of Department

Financial Conduct Authority, Enforcement and Market Oversight Division

## ANNEX A – Legal requirements

### 1. The Act

#### 1.1. During the Relevant Period:

- (a) the Authority's regulatory objectives, as set out in section 2(2)(d) of the Act, included the reduction of financial crime;
- (b) Under section 6(1) of the Act the reduction of financial crime objective was *'reducing the extent to which it is possible for a business carried on (a) by a regulated person...be used for a purpose connected with financial crime'*.
- (c) Section 6(3) of the Act defined financial crime as including any offence involving *'(a) fraud and dishonesty...'*

#### 1.2 Under section 206 of the Act, the Authority may impose a penalty, in respect of a contravention of a relevant requirement, of such amount as it considers appropriate.

### 2. PRIN

#### 2.1. During the Relevant Period, the Principles for Business (contained in PRIN in the Authority's Handbook) were issued by the Authority pursuant to, amongst other sections, section 138 of the Act. Principle 11 (Relations with regulators) stated that: *'A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.'*

#### 2.2. During the Relevant Period PRIN 3.2.3R provided that Principle 11 also applied: *'with respect to the carrying on of unregulated activities...'*

### 3. Relevant Rules and Guidance from Supervision (SUP)

#### 3.1. Chapter 15 of SUP relates to requirements over notifications to the Authority.

#### 3.2. During the Relevant Period:

- (a) SUP 15.1.4R stated *'This chapter: (1) applies with respect to the carrying on of both regulated activities and unregulated activities...'*
- (b) SUP 15.3.17R required that *'A firm must notify the FSA immediately if one of the following events arises and the event is significant;...  
  
(2) it becomes aware that a person, whether or not employed by it, may have committed a fraud against it;...'*

#### (c) The guidance in relation to SUP 15.3.17R stated that:

SUP 15.3.18G: *'In determining whether a matter is significant, a firm should have regard to:*

*(1) the size of any monetary loss or potential monetary loss to itself or its customers (either in terms of a single incident or group of similar or related incidents);*

*(2) the risk of reputational loss to the firm; and*

*(3) whether the incident or a pattern of incidents reflects weaknesses in the firm's internal controls'.*

SUP 15.3.19G: *'The notifications under SUP 15.3.17R are required as the FSA needs to be aware of the types of fraudulent and irregular activity which are being attempted or undertaken, and to act, if necessary, to prevent effects on consumers or other firms. A notification under SUP 15.7.3G should provide all relevant and significant details of the incident or suspected incident of which the firm is aware.'*

SUP 15.3.20G: *'In addition, the firm may have suffered significant financial losses as a result of the incident, or may suffer reputational loss, and the FSA will wish to consider this and whether the incident suggests weaknesses in the firm's internal controls'.*

- (d) SUP 15.6.1R required that 'A firm must take reasonable steps to ensure that all information it gives to the FSA in accordance with a rule in any part of the Handbook (including Principle 11) is:

*(1) factually accurate or, in the case of estimates and judgments, fairly and properly based after appropriate enquiries have been made by the firm; and*

*(2) complete, in that it should include anything of which the FSA would reasonably expect notice.'*

#### **4. Decision Procedure and Penalties Manual (DEPP)**

- 4.1. Guidance on the imposition and amount of penalties is set out in Chapter 6 of DEPP. Changes to DEPP were introduced on 6 March 2010. Given that the misconduct occurred prior to that date, the FSA has had regard to the provisions of DEPP in force prior to that date. The FSA has also had regard to the provisions of the Enforcement Manual in force prior to 28 August 2007, in relation to the misconduct which occurred prior to that date.

- 4.2. DEPP 6.1.2 provides that the principal purpose of imposing a financial penalty is to *'promote high standards of regulatory and/or market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches, and demonstrating generally the benefits of compliant behaviour.'*