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THE ROYAL BANK OF SCOTLAND AGREES TO PAY $4.9 BILLION FOR FINANCIAL CRISIS-ERA MISCONDUCT

Settlement Is Largest Penalty Imposed On A Single Entity By The Justice Department For Financial Crisis-Era Misconduct

BOSTON – The U.S. Attorney's Office in Massachusetts announced a $4.9 billion settlement with The Royal Bank of Scotland Group plc (RBS Group) resolving federal civil claims that RBS Group's subsidiaries in the United States (RBS) misled investors in the underwriting and issuing of residential mortgage-backed securities (RMBS) between 2005 and 2008. The penalty is the largest imposed by the Justice Department for financial crisis-era misconduct at a single entity under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, which allows the Justice Department to seek civil penalties for violations of criminal statutes.

"This resolution – the largest of its kind – holds RBS accountable for defrauding the people and institutions that form the backbone of our investing community," said Andrew E. Lelling, U.S. Attorney for the District of Massachusetts. "Despite assurances by RBS to its investors, RBS's deals were backed by mortgage loans with a high risk of default. Our settlement today makes clear that institutions like RBS cannot evade responsibility for the damage caused by their illicit conduct, and it serves as a reminder that the Justice Department, and this Office, will hold those who engage in fraudulent conduct accountable."

"Many Americans suffered lasting economic harm as a result of the 2008 financial crisis," said Acting Associate Attorney General Jesse Panuccio. "This settlement holds RBS accountable for serious misconduct that contributed to that financial crisis, and it sends an important message that the Department of Justice will pursue financial institutions that illicitly harm the American economy and our consumers."

"The actions of RBS resulted in significant losses to investors, including Fannie Mae and Freddie Mac, which purchased the Residential Mortgage-Backed Securities backed by defective loans," said Associate Inspector General Jennifer Byrne of the Federal Housing Finance Agency-

Office of Inspector General's (FHFA-OIG). "We are proud to have partnered with the U.S Attorney's Office for the District of Massachusetts on this matter."

The settlement includes a statement of facts that details – using contemporaneous calls and emails of RBS executives – how RBS routinely made misrepresentations to investors about significant risks it failed to disclose about its RMBS. For example:

- **RBS failed to disclose systemic problems with originators' loan underwriting.** RBS's reviews of loans backing its RMBS (known as "due diligence") confirmed that loan originators had failed to follow their own underwriting procedures, and that their procedures were ineffective at preventing risky loans from being made. As a result, RBS routinely found that borrowers for the loans in its RMBS did not have the ability to repay and that appraisals for the properties guaranteeing the loans had materially inflated the property values. RBS's RMBS contained, as its Chief Credit Officer put it, "total f***ing garbage" loans with "random" and "rampant" fraud that was "all disguised to, you know look okay kind of . . . in a data file." RBS never disclosed that these material risks both existed and increased the likelihood that loans in its RMBS would default.

- **RBS changed due diligence findings without justification.** RBS knew that its due diligence practices did not remove fraudulent and high-risk loans from its RMBS. In fact, RBS executives internally discussed how RBS's due diligence process was "just a bunch of bullsh**." For example, when RBS's due diligence vendors graded loans materially defective, RBS frequently directed the vendors to "waive" the defects without justification. One due diligence vendor, which tracked waivers by most major participants in the RMBS industry, concluded that RBS waived material defects 30% more frequently than the industry average. RBS's waiver of material defects routinely resulted in the securitization of loans with excessive risk. When it engaged in such waivers, RBS never included enhanced "scratch-and-dent" disclosures that would have alerted investors that loans with excessive risks were included in the RMBS.

- **RBS provided investors with inaccurate loan data.** RBS's due diligence frequently found that loan data – which RBS passed on to investors, who used the data to analyze the risks associated with its RMBS – were riddled with errors. Many inaccuracies made the loans look less risky than they actually were. RBS, however, did not require originators to correct the data errors. In one deal, where RBS identified over 600 data errors associated with 563 loans (including debt-to-income ratios understated by as much as 2700%), RBS failed to disclose these errors even to the originator; instead, RBS reassured the originator that RBS had not required originators to correct data errors in the past and did not anticipate doing so for that deal.

- **RBS failed to disclose due diligence and kick-out caps.** To develop and maintain business relations with originators, RBS agreed to limit the number of loans it could review (due diligence caps) and/or limit the number of materially defective loans it could remove from a RMBS (kick-out caps). RBS's scheme reached its height in two deals issued in October 2007. In both of these RMBS, RBS identified hundreds of underlying loans that carried a particularly high risk of default and would cause losses to the RMBS investors. RBS kept these materially risky loans in the RMBS, without disclosing their inclusion to investors, because RBS had agreed to a kick-out cap limiting the number of defective loans that RBS could exclude from the securities in exchange for receiving a lower price for the loan pool. As a result, over the entirety of its scheme, RBS securitized tens of thousands of loans that it determined or suspected were fraudulent or had material problems without disclosing the nature of the loans to investors.

Through its scheme, RBS earned hundreds of millions of dollars, while simultaneously ensuring that it received repayment of billions of dollars it had lent to originators to fund the faulty loans underlying the RMBS. RBS used RMBS to push the risk of the loans, and tens of billions of dollars in subsequent losses, onto unsuspecting investors across the world, including non-profits, retirement funds, and federally-insured financial institutions. As losses mounted, and after many mortgage lenders who originated those loans had gone out of business, RBS executives showed little regard for this misconduct and made light of it.

U.S. Attorney Lelling, Acting Associate Attorney General Panuccio and FHFA-OIG Associate Inspector General Byrne made the announcement today. Assistant U.S. Attorneys Justin D. O'Connell, Brian M. LaMacchia, Elianna J. Nuzum, Steven T. Sharobem, and Sara M. Bloom of Lelling's Office handled the matter.