



House of Commons
Treasury Committee

Conduct and competition in SME lending

Eleventh Report of Session 2014–15



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*Report, together with formal minutes relating
to the report*

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Treasury Committee

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1 Introduction

1. Small and medium sized enterprises (SMEs) form a large part of the UK economy. According to official statistics, there were 5.243 million private sector businesses at the start of 2014. 5.236 million had 0–250 employees and are classed as SMEs, of which 5.204 million had fewer than 50 employees and are classed as small businesses. SMEs account for 60 per cent of all private sector employment, and registered an annual turnover of £1.6 trillion at the start of 2014—47 per cent of the private sector total. A large majority of SMEs are sole traders—76% of all businesses are non-employers.¹

2. The definition of the term SME can vary. Some define SMEs as firms with a turnover of up to £25 million a year, some as firms with fewer than 250 employees, and some use a combination of both employee count and turnover.² SMEs themselves are highly heterogeneous. The Association of Chartered Certified Accountants (ACCA) wrote:

[...] ACCA has repeatedly cautioned against aggregation when discussing SMEs. The ‘SME’ label, applicable as it is to 99.9% of businesses in the UK, is so broad as to render most statistics and anecdotal evidence meaningless. This is even more true because demand for finance is significantly skewed, and a minority of SMEs will always account for the bulk of demand.³

The importance of SME lending

3. The Government believes that access to finance for SMEs is “key to the recovery and long term growth of the economy”.⁴ Research by National Endowment for Science, Technology and the Arts (NESTA) in 2009 found that the “6 per cent of UK businesses generated half of the new jobs created by existing businesses between 2002 and 2008”. Citing this research, the Department for Business, Innovation and Skills said:

High growth firms are particularly important to the economy, driving competition and productivity growth. Research found that from 2005 to 2008, seven per cent of SMEs met the OECD definition of ‘high growth’. A similar proportion also achieved this over 2002–05 and 2007–10. Over a three year period, these high growth SMEs are credited with creating around a quarter of all new jobs among existing businesses.⁵

1 Department for Business, Innovation and Skills and Office for National Statistics, Business population estimates for the UK and regions 2014, 26 November 2014

2 Bank of England, Lending to businesses – a new data source, March 2012; House of Commons Library, Small businesses and the UK economy, 9 December 2014; European Commission, The new SME definition, 2005

3 SME0011

4 Department for Business, Innovation and Skills, Evaluating changes in bank lending to UK SMEs over 2001–12 – ongoing tight credit, April 2013

5 Department for Business, Innovation and Skills, SMEs: The Key Enablers of Business Success and the Economic Rationale for Government Intervention December 2013

4. A large proportion of SMEs rely on external finance in some form. The SME Finance Monitor, an industry led survey of SME lending, found in Q2 2014 that approximately 40 per cent of SMEs used external finance, with 30 per cent of SMEs using “core products”—loans, overdrafts and/or credit cards. Stephen Nickell, member of the Budget Responsibility Committee, told the Committee in December 2014 that SMEs are particularly vulnerable to changes to bank lending:

Large companies, generally speaking, have access to alternatives to bank lending, the bond market and so on. Of course SMEs and small companies generally rely on or have in the past relied on the banking system.⁶

Indeed, one interpretation of the persistently low post-economic crisis productivity growth is a loss of bank lending to rapidly growing firms such as SMEs. Mr Nickell said:

If push came to shove, I think we would argue that it is the consequences of the credit crunch that have led to this productivity puzzle. That is to say quite a high proportion of productivity growth is generated because high productivity firms start up and expand and low productivity firms contract and go out of business. There is some evidence to suggest that, because of the credit crunch, there has been a barrier to the expansion of high productivity firms and the starting up of high productivity firms. I am not too convinced about this, but some people argue that the credit crunch as part of the whole business has also led to low productivity activities surviving, so-called zombie firms and so on and so forth.⁷

Evidence received by the Committee

5. Over the course of the inquiry, the Committee received a considerable amount of written evidence, as well as oral evidence from 32 witnesses over seven evidence sessions. Key topics and problems explored in the evidence included:

- The state of the SME lending market, including current market conditions and potential problems that exist in the availability of finance;
- The importance of SME perceptions in improving the flow of credit to businesses;
- Competition in the SME lending and banking markets, including the current state of banking competition, potential methods of improving competition, and the role of alternative lenders in improving the competitive environment;
- Allegations of mistreatment of SME customers in financial distress by RBS in its Global Restructuring Group (GRG) division; and

6 Oral evidence by Stephen Nickell to the Treasury Committee, q 149

7 Oral evidence by Stephen Nickell to the Treasury Committee, q 140

- Allegations of mis-selling of loans with features of interest rate hedging products by Clydesdale Bank, and the perimeter of regulation regarding such loans.

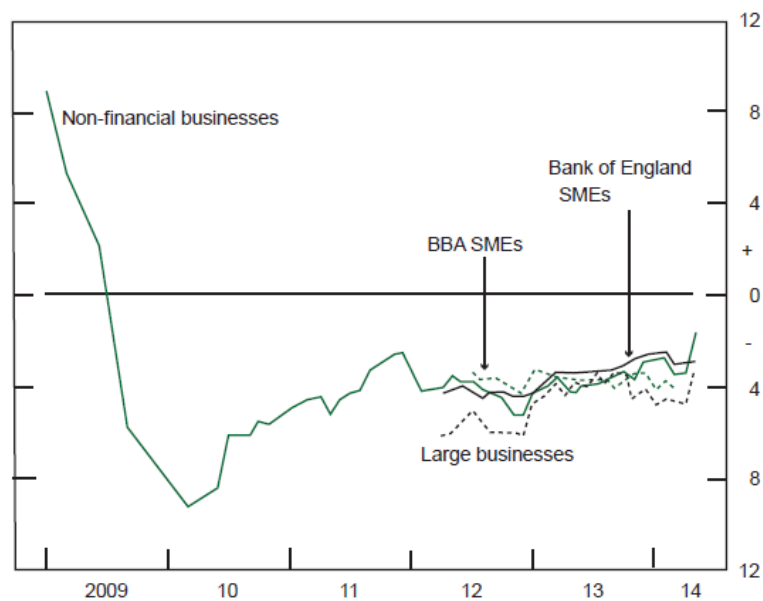
6. The Committee is grateful for the written submissions and oral evidence received from banks, alternative lenders, think tanks, professional services firms and government bodies. The Committee is also particularly grateful for the large number of submissions from individual businesses who have been personally affected by alleged mis-selling. The evidence received from all of them has been invaluable for the preparation of this report. We are also grateful for the assistance of our specialist advisers for this inquiry, Mike Cherry, the National Policy Chairman of the Federation of Small Businesses, and Professor Richard Roberts, member of the ACCA SME Advisory Panel. A letter from the FCA of 9 March, which gave some further information about the FCA's IRHP review scheme, arrived too late for the Committee to consider carefully and it may wish to return to the issues raised at a later date.

2 The state of the SME lending market

Current market conditions

7. Data from the Bank of England is a key source of information for understanding the state of the SME lending market. The Bank of England has published data on business lending disaggregated to the SME level from April 2011 onward. In previous years, the Bank published only aggregate business lending data. This measure, which is still published, excludes unincorporated businesses, such as sole traders, which make up a large proportion of SMEs.⁸

Chart 1: Lending to UK businesses



Source: *Trends in Lending July 2014*, Bank of England, July 2014

8. There are two principal measures of lending to SMEs—gross lending and net lending. The Bank of England’s definition of gross lending to SMEs measures new loans, advances and finance leases granted to non-financial SMEs within a period. Its definition of net lending calculates gross lending minus loan repayments, and is a measure of the change in the total stock of lending to SMEs.⁹

9. During the 2008/2009 financial crisis, lending to businesses appeared to fall significantly. The April 2009 Bank of England *Trends in Lending* report said that “growth in the stock of lending to UK businesses slowed markedly during 2008, reflecting reduced flows of net

⁸ Bank of England, Measures of lending to UK businesses, 29 September 2014

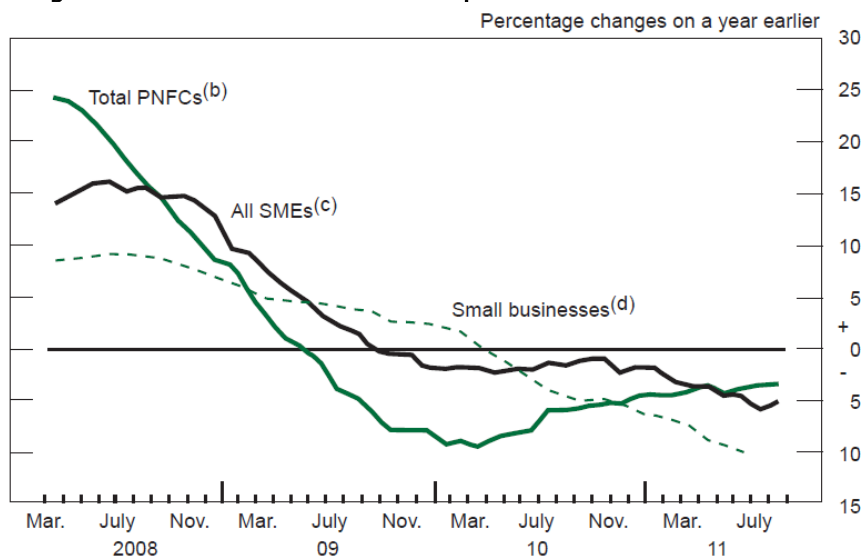
⁹ Bank of England, Explanatory Notes—Monetary financial institutions loans to non-financial businesses, by size of business, as at 2 February 2014

lending by foreign as well as domestic lenders”.¹⁰ Over the period 2009 to 2011, this negative trend appeared to worsen. The October 2011 *Trends in Lending* said:

The BIS data over recent months have indicated that growth rates of the stock of lending to SMEs are more negative than the position six months ago. The annual growth rate stood at -5% in August 2011.

Data published by the British Bankers’ Association (BBA) on the stock of lending to small businesses, defined as turnover of up to £1 million, and which are available up to June 2011, have shown negative lending growth rates for this sector, with the annual rate standing at -10% in June 2011.¹¹

Chart 2: Lending to small and medium-sized enterprises



Source: *Trends in Lending October 2011*, Bank of England, October 2011

10. More recent data suggests that this post crisis trend has been gradually reversing. On gross lending, the Bank of England’s data shows improvement at a gradual rate from early 2012, with the first nine months of 2014 showing 32 per cent higher gross lending than the comparable period in 2012. On net lending, the Bank’s data shows that there has been a net outflow of total credit extended to SMEs for 34 months out of 45 since April 2011, with SME net lending outflows—excluding overdrafts—of £12.9 billion in total. However, over this period, the rate of contraction of the stock of lending has been falling. Average negative net lending during the nine months to September 2014 was £203 million, compared to £249 million and £540 million in the nine months to September 2013 and September 2012 respectively.¹² Prior to April 2011, the Bank’s data on lending to non-financial businesses

10 Bank of England, *Trends in lending April 2009*, 21 April 2009

11 Bank of England, *Trends in lending October 2011*, 20 October 2011

12 Bank of England, *Monetary financial institutions loans to non-financial businesses, by size of business*, 2 January 2015

shows a gradual reduction in the size of negative net lending flows from a trough in late 2009.¹³

11. Interpreting the Bank of England's net lending figures, Alan Clarke, Head of UK and Eurozone Economics, Scotiabank, said that negative net lending largely reflected higher repayments and not a fall in new lending:

Net investment has been going down, but one thing the Bank of England stressed in their bank lending survey has been lots of firms repaying loans, so that has adversely affected those data. It looks like there is less new lending. There has been new lending; it is just a lot of the old lending has been repaid. That might be telling you something about credit conditions because if firms have the spare cash to repay those loans they must be confident that if they need credit further down the road they will be able to get it.¹⁴

12. Witnesses to the Committee broadly agreed that some improvement in lending conditions for SMEs had occurred since the crisis. Matthew Fell, Director of Competitive Markets at the Confederation of British Industry (CBI), said that lending had started from a "very low base" since the crisis, but that there had been some improvement recently.¹⁵

I do not think the situation is going to continue for the next five years as it has for the last five. I think quite a lot has changed since then. I do think particularly in the straightforward bank lending sector, we are seeing something emerge that we at the CBI have described as a new normal. Regulatory reform, particularly additional capital structural reform hitting banks, the banks themselves having to restructure their balance sheets and, frankly, a more realistic pricing of risk has changed the rules of the game. More encouragingly, I think banks' balance sheets are in better shape than they were five years ago, so their appetite for lending is on the increase. We have seen quite a lot of exciting developments happen to increase choice and competition, both in the banking sector and with alternative forms of finance, which we can come on to. I also think that even within the last six or nine months on the demand side of the equation, which has been as much a problem in previous years, small and medium-sized firms' appetite for growth and investment is returning and they are now more actively seeking finance than they were at the height of the crisis.¹⁶

Priyen Patel, who was at the time Senior Policy Advisor at the Federation of Small Businesses (FSB), said:

13 Bank of England, Trends in Lending July 2014, 18 July 2014, p 5, chart 1.1

14 Oral evidence by Alan Clarke to the Treasury Committee, 9 December 2014, q 36

15 Q 135

16 Q 81

In terms of what we are saying at the FSB, there is steady, positive progress. We have seen, over the course of a year or so, a slight reduction of spread that small businesses are getting on their credit, whether that be loans, overdrafts, credit cards, whatever they happen to be. You can put that down to a generally slightly more upbeat economy, so the general stock of credit small businesses around the country is slightly higher, or we could put it down to FLS, the Funding for Lending Scheme.¹⁷

Kevin Daly, Senior Economist at Goldman Sachs, cautioned however that there was substantial room for progress. He told the Committee:

The availability of credit to SMEs is improving. I think it has an awful long way to improve. It is coming from a very low base. The SMEs were really starved of credit availability. As I say, the good news is that it is getting better but I think there is a long way to go [...]¹⁸

13. Written evidence also suggested that limited progress had been made. Survey data from the EEF, a manufacturers' industry group, suggests that lending conditions have been gradually improving. In its submission to the Committee, the EEF said that "there appears to have been some stabilisation and then gradual improvement in SME credit conditions" from an "extremely challenging 2008/09 period".¹⁹ However, EEF also wrote:

While we have noted that finance has been flowing a bit more freely to SMEs, there remains a large minority of companies (across all sectors) that are not successful in securing funding. It seems the post crisis leap in rejection rates—high compared with other European countries—remains elevated.²⁰

14. Referring to information collected within the *SME Finance Monitor*, the Association of Chartered Certified Accountants (ACCA) said that there appeared to have been some improvement in credit availability:

The percentage of UK SMEs reporting access to finance as a significant barrier to pursuing their business objectives (8%) was lower in Q4 2013 than it has ever been since the independent SME Finance Monitor surveys began in early 2011. This figure only rises to about 12% after excluding SMEs disengaged from the banking sector, and has been falling across size-bands in any case. This is part of a medium-term trend suggesting an easing of the credit crunch that followed the last recession.²¹

15. Trade bodies told the Committee that access to finance was no longer the biggest concern for businesses. Mr Fell of the CBI said:

17 Q 82

18 Oral evidence by Kevin Daly to the Treasury Committee, 9 December 2014, q 36

19 SME0092

20 SME0092

21 SME0011

I do not think access to finance is the biggest problem or challenge facing small businesses. I think that remains due to uncertainties on the economic outlook and being confident enough on the demand side for their businesses. I think that is the single biggest problem.²²

The CBI wrote:

Small and medium-sized businesses report that access to finance is crucial to their businesses success. However, we have seen a decrease in the importance of access to finance for our small and medium sized business members. In 2012 small and medium-sized businesses were significantly more likely to report that ‘availability of finance’ was a key success factor for achieving the company’s business objectives than large employers. A survey of our members last year showed that although the availability of finance was still a significant challenge to growing the business, members reported that difficulties recruiting skilled staff is now their biggest challenge.²³

Underserved segments of the market

16. Despite improvements in overall credit availability, evidence to the Committee suggested that some sorts of firms may find it harder to access credit than others. In particular, evidence from the Association of Chartered Certified Accountants noted that “fast growing, intangible-capital-intensive businesses” were credit rationed.²⁴ Mr Fell also told the Committee that firms with more intangible assets found it harder to get credit from banks:

That is a problem that has existed for them before 2008, before the credit crunch hit and has clearly been exacerbated by it. Our sense is that banks historically have been much more confident lending against businesses with physical assets to secure that lending against than they are for intangible assets such as the creative industries, and we do think that is an area that should continue to be looked at and explored. There is scope for improvement there.²⁵

The Big Innovation Centre agreed, explaining that “traditional banking business models” failed to “accurately value [...] intangible assets (such as computerised information, innovative and intellectual property, etc.)”.²⁶ The CBI wrote:

[...] requirements for businesses to have fixed collateral upon which to secure finance has a disproportionate impact on businesses not backed by

22 Q 105

23 SME0080

24 SME0011

25 Q 89

26 SME0103

traditional assets. These businesses do have a range of intangible assets such as patents, a brand, a website which, if valued effectively could be used to secure finance against. However, intangible assets are difficult to value and hard to use as collateral which results in many businesses being unable to secure finance.²⁷

The ACCA said that “banks’ attitude towards intangibles may not be optimal but it is rational” and that “default rates among intangibles intensive SMEs are higher than those among other SMEs”. It also said that “fast-growing, innovative, intangible-capital intensive businesses were already credit rationed in the heady days of 2006–7, not only in the UK but throughout Europe”.²⁸

17. Evidence also suggested that new firms had difficulty accessing finance. Respublica, a think tank, wrote that “it is new business that struggle the most” to access credit.²⁹ The ACCA said that “evidence from the SME Finance Monitor suggests that, while almost all applications for renewed loan and overdraft facilities are successful, only a minority of first-ever applications are approved”.³⁰ Indeed, the results of the SME Finance Monitor show that only 56 per cent of first time loan applicants ended their lending process with a facility, compared to 66 per cent for those with previous loans seeking a new facility, and 94 per cent for loan renewals.³¹ The ACCA explained:

[...] approval rates increase as the applicant develops a track record in business, becomes better known to the bank and more tried-and-tested as a user of the specific facility. This is partly because repeat borrowers are larger and more established, but also partly because the banks generate and use proprietary information, both financial and nonfinancial, in order to assess the creditworthiness of SMEs.³²

The ACCA also believed that this reluctance to provide credit was “mostly due to structural problems which predated the last recession”.³³

Equity finance

18. Debt finance provided by banks may not always be the most appropriate source of finance for SMEs. The Committee received evidence suggesting that, for some SMEs, equity finance was a more suitable form of funding than debt. Written evidence from RBS suggested that this was particularly true for start-up businesses:

27 SME0080

28 SME0011

29 SME0083

30 SME0011

31 BDRC Continental, SME Finance Monitor Q4 2014, 26 February 2015, p 151

32 SME0011

33 SME0011

Many SMEs seeking loan finance are in fact either overleveraged already or if not they do not have sufficient cashflow to service the debt. On the latter this is most notable for young start-up businesses. In reality in both situations, equity finance is often more suitable than debt.³⁴

Evidence from the CBI agreed, stating that “there is a greater role for equity finance to provide patient finance to small and medium-sized businesses, but it is extremely under-used in the UK due to barriers on both the demand and supply side”.³⁵

19. The RBS Independent Lending Review—an RBS funded review into its own business lending performance—blamed the UK’s over-reliance on debt compared to equity on the poor lending standards that existed before the crisis:

Pre-crisis practices created unrealistic expectations amongst SMEs: In the run up to the financial crisis, the distinction between the need for equity versus debt financing became blurred. Banks lent without sufficient discipline, and SMEs were able to borrow cheaply and easily instead of raising equity. This was particularly true for lending to the Commercial Real Estate sector, and for lending secured by property.³⁶

Government schemes

20. There have been a large number of government schemes aimed at helping businesses who are seeking finance. These have included the Funding for Lending Scheme (FLS), Enterprise Finance Guarantee (EFG), Business Finance Partnership (BFP), Start-Up Loans scheme, Seed Enterprise Investment Scheme (SEIS), Enterprise Investment Scheme (EIS), Venture Capital Trust Scheme (VCT), Business Angel Co-Investment Fund, Enterprise Capital Fund (ECF) Programme, UK Innovation Investment Fund (UKIIF), Regional Growth Fund (RGF) and Growing Places Fund.³⁷

21. Some government schemes directly target perceived gaps in SME debt finance markets. For example, the Government states that the aim of the EFG scheme is to “facilitate lending to viable businesses that have been turned down for a normal commercial loan due to a lack of security or a proven track record”.³⁸ Some government schemes also target the provision of equity financing for firms. For example, the SEIS is designed to “help small,

34 SME0093

35 SME0080

36 Sir Andrew Large, Independent Lending Review, November 2013, p 12, para 3.1

37 Department for Business, Innovation and Skills, SME access to finance schemes—measures to support SME growth, April 2013

38 Department for Business, Innovation and Skills, Understanding the Enterprise Finance Guarantee, updated 14 July 2014

early-stage companies to raise equity finance through encouraging individual investors to purchase new shares in qualifying companies”.³⁹

22. When asked about the number of SMEs who were fully aware of the large number of Government schemes available to support them, Peter Hollis, owner of the accountancy firm Hollis and Co, told the Committee that awareness was probably “minimal”.⁴⁰ Chris Lane, partner at accountancy firm Kingston Smith, said that while he was aware of some schemes such as the “the Business Growth Fund and the investment fund for equity investment”, he was not aware of the large number of schemes available.⁴¹

23. The Government itself has acknowledged that awareness of schemes has been low. A 2013 study funded by BIS said:

Overall, only 15 per cent of SMEs that had used finance in the last 3 years claimed they were aware of Government finance schemes. However, of these, the majority were not able to say which financial products were covered by the schemes. When prompted with the name of a specific scheme, the majority of SMEs were still not aware of the existence of the finance scheme mentioned.⁴²

24. The Committee also found evidence to suggest an over-optimistic perception of schemes by businesses, referred to by the British Chambers of Commerce (BCC) as a “capability expectations gap”:

Businesses expected swift availability, clear information, and efficient processes—but the reality on the ground has been far different, with coal-face bank personnel often unable or unwilling to facilitate access to what is a bewildering array of products.⁴³

The BCC also identified a number of potential causes for the inability of government schemes to deliver what businesses expected:

Inexperienced relationship managers and credit officers are still often incapable of explaining how state-backed products work, or how local businesses can access them. It is an open question whether this is down to incomplete information, difficulties in rolling out training, or the fact that banks’ incentive structures are geared to the sale of their own products, rather than helping companies to access government support.⁴⁴

39 Department for Business, Innovation and Skills, SME access to finance schemes—measures to support SME growth, April 2013, p 11

40 Q 167

41 Q 167

42 BMG Research, SME Journey Towards Raising External Finance, October 2013, p 3–4

43 SME0104

44 SME0104

25. However, some government schemes were viewed positively by witnesses. Mr Hollis described the Enterprise Finance Guarantee Scheme as having worked “quite well” and said that “people are aware of it and it has been around a long time”.⁴⁵ Mr Lane was extremely positive about the Enterprise Investment Schemes:

The [Enterprise Investment Scheme] and [Seed Enterprise Investment Scheme] are fantastic, and I see a lot more activity in those areas, so I think where the banks have withdrawn and there is sort of a funding gap, these other schemes have helped to fill that. I think they have been very successful and certainly SEIS is going from strength to strength.⁴⁶

26. Some of the Government’s SME finance assistance schemes—for example the Enterprise Finance Guarantee Scheme—are now operated through the British Business Bank.⁴⁷ Keith Morgan, CEO of the British Business Bank, said that one of the Bank’s objectives was to improve awareness of government support schemes:

We have done plenty of surveying and speaking with small businesses, and it is very clear that there is a job to do to increase the awareness and understanding of offers in the marketplace. One area that we are particularly focused on—I think it was referenced by the BBA—is that we think there is a role to bring together much more consistency in the marketplace.

When it comes to companies knowing what is on offer, we brought together the [Institute of Chartered Accountants in England and Wales, the Confederation of British Industry, the Institute of Directors, the British Bankers’ Association, the Federation of Small Businesses], and a clutch of other people to put out one shorthand document—one reference in layman’s terms—about what is available in terms of options in the marketplace. That is something we have been pushing very strongly since we launched it in July and it is one of our priorities for the year.⁴⁸

27. Official and industry data, as well as evidence presented to the Committee, show that the overall availability of credit has improved since the low point of the financial crisis. While the cyclical downturn in lending may not yet have been fully reversed, anecdotal evidence suggests that many businesses are finding it less difficult to obtain credit. This is welcome.

28. However, SMEs are highly heterogeneous. The credit crunch may have abated, but long standing structural problems in SME finance dating from before the financial crisis remain. In particular, firms seeking finance for the first time and firms based

45 Q 170

46 Q 172

47 British Business Bank, Strategic Plan, June 2014

48 Oral evidence by Keith Morgan to the Business, Innovation and Skills Committee, 2 December 2014, q 220

heavily on intangible assets appear to find it much harder to obtain access to credit than others. This may in part be because new firms lack a track record on which lenders can assess their credit risk. It may also result from the risks that arise from the use of intangible assets as collateral for loans. In such cases, the unwillingness of a bank to lend may reflect greater risk within the business which is seeking credit. It may also be due to a bank's reassessment of risk following the crash.

29. There are sound economic foundations to government schemes that aim to address gaps in the availability of funding for SMEs. There are a large number of different schemes and funds, each with their own, specialised rules. It is noteworthy that, in evidence to the Committee, business advisors themselves appeared unaware of some of the schemes available—it will be all the harder for very small firms to be aware of the schemes that may apply to them. It is therefore not surprising that many businesses are unaware of the targeted funding support available to them, or have difficulty navigating what is available. The schemes may be reaching only a proportion of the businesses that they are designed to help. The British Business Bank has been given the role of increasing businesses' awareness of government schemes. The Government should also review the schemes and their purposes, and with a view to simplifying both the schemes and their availability, as a matter of urgency.

Importance of perceptions

30. On the demand side, expectations of the availability of credit may be an important factor in determining the SMEs' willingness to approach banks for credit. Stuart Fraser of Warwick Business School wrote in *Back to borrowing? Perspectives on the 'arc of discouragement'* that SMEs may be discouraged from applying for finance in two key ways:

- Borrowers may be indirectly discouraged—this is where they believe their bank is reluctant to lend despite having no discussion with the bank.
- Borrowers may be directly discouraged—this is where the borrower has become discouraged owing to direct interaction with their bank.⁴⁹

31. In reference to RBS, Sir Andrew Large, former Deputy Governor of the Bank of England, wrote in the RBS Independent Lending review that perceptions of lending affected demand for credit:

[...] any perception that the bank is not lending money, but rather withdrawing it, has the potential to discourage some customers from approaching RBS to discuss new borrowing needs, thus reducing current and future demand for borrowing.⁵⁰

The EEF expressed a similar viewpoint in its submission to the Committee:

49 Stuart Fraser, *Back to borrowing? Perspectives on the 'arc of discouragement'*, March 2014, p 3

50 Sir Andrew Large, *RBS Independent Lending Review*, 25 November 2013, p 50

These are companies that have a financing requirement but not an appetite to borrow. The factors behind discouragement can either stem from a belief that applications will be unsuccessful; higher borrowing costs or restrictive terms and conditions; or previous experiences with finance providers.⁵¹

Kingston Smith LLP also identified similar views among its own SME clients, and told the Committee that “many SMEs perceive bank lending policies to be more negative than they actually are and so do not seek finance”. In particular, its submission notes that “SMEs’ negative perception of banks is influenced by the media”.⁵² However, the ACCA found that a bank’s own behaviour was more important than external factors such as word-of-mouth or the media:

SMEs have typically underestimated their chances of getting finance from a bank by 7–16 percentage points. This expectation gap has been closing gradually since 2011, as discouraged borrowers are becoming more realistic (and thus more optimistic). Surprisingly, low expectations tend to be driven mostly by a poor relationship with the SMEs’ bank—not media coverage or word-of-mouth.⁵³

32. Qualitative data from a number of surveys also underlines the importance of customers’ perceptions for credit demand. According to a Forum of Private Business (FPB) survey from 2013, “95% of [its] members felt the perception that banks were lending was important”. According to an FPB survey from 2012, the largest reason for low customer demand was discouragement.⁵⁴ The FPB said:

[...] 61% reported that they or other small businesses within their network had received signals from banks that they were not prepared to lend to businesses such as theirs.⁵⁵

33. In *Back to borrowing? Perspectives on the ‘arc of discouragement’*, Stuart Fraser suggests that a significant number of discouraged borrowers exist:

While the number varies over the economic cycle, estimates indicate there are approximately 173,000 [discouraged borrowers (DB)] the majority of which, around 115,000, are indirectly discouraged. Although the number of DBs corresponds to less than 4% of the 4.8m SME population, and compares to 3.6m (75%) ‘happy non seekers’ (businesses which say they have no need for external finance), it is about the same as the number of businesses denied bank finance.⁵⁶

51 SME0092

52 SME0038

53 SME0011

54 SME0046

55 SME0046

56 Stuart Fraser, *Back to borrowing? Perspectives on the ‘arc of discouragement’*, March 2014, p 3

Communications from banks

34. In some cases, SME discouragement may be due to a mismatch between banks' communications and customer experiences. Sir Andrew said that "a perception has arisen among some SME customers that RBS is unwilling to lend" and that 30% of SMEs disagreed with the statement that RBS was "open for lending".⁵⁷ However, Sir Andrew found that, in the case of RBS, there existed a "mismatch between the expectations of [RBS's] external stakeholders and the bank's own communications".⁵⁸ In particular, he concluded that RBS's approach to communicating with the market was focused on defending itself against its critics, rather than creating realistic expectations in potential consumers:

The mismatch between the expectations of its external stakeholders and the bank's own communications are themselves a problem for RBS. RBS shared with the Review many details of the communications it has had with market stakeholders. It is clear from these documents that RBS has frequently sought to explain its point of view in response to external criticisms. Yet it is clear that it has not actively addressed mismatches in expectations. Beyond the reporting of lending results [...], a good example of this relates to approval rates. While RBS has focused on the fact that it approves at least 80% of all the applications it receives, it has failed to acknowledge the fact that many customers who approach it to discuss financing are "screened out" of the process before they submit a formal application.⁵⁹

As a result of such a communications approach, Sir Andrew notes that "market stakeholders such as the Government and Business Associations have been left confused by the divergence between what they hear from customers and what they hear from the bank".⁶⁰ Sir Andrew also raised the problem of a lack of publicly available data on RBS's lending performance:

There is no comprehensive, publicly accessible data set on which to form a view about RBS's performance: instead, the perspectives of market stakeholders are shaped by a combination of personal experience, incomplete facts and anecdote.⁶¹

35. Whilst Sir Andrew's report focuses only on perceptions of RBS, such a mismatch of expectations may extend beyond just one bank. The Institute of Chartered Accountants of Scotland (ICAS) commented on banking sector communications regarding lending performance, emphasising the importance of transparency and trust:

57 Sir Andrew Large, RBS Independent Lending Review, 25 November 2013, p 4

58 Sir Andrew Large, RBS Independent Lending Review, 25 November 2013, p 56

59 Sir Andrew Large, RBS Independent Lending Review, 25 November 2013, p 56

60 Sir Andrew Large, RBS Independent Lending Review, 25 November 2013, p 56

61 Sir Andrew Large, RBS Independent Lending Review, 25 November 2013, p 55

We believe that trust will also be built if banks are encouraged by Government to be more transparent in their reporting of lending to SMEs. Gross and net lending statistics present only an aggregate and sometimes distorted picture. Banks should publish statistics on the number of applications from SMEs, and specifically on sub-groups within this broad range, and the success rates of these applications. We would also like the banks to explain better how they are improving behaviour within their operations by, for example, increasing the numbers of local relationship managers targeting SMEs and explain the impact of these improvements and how it is meeting the objective of greater levels of SME lending.⁶²

Public debate on the causes of restricted credit to businesses

36. The divergence between the public's and banks' perceptions of credit availability may also have stemmed from public debate on the topic. Since the crisis, there has been much evidence of a disagreement between banks and the public about the availability of credit to businesses. Mr Patel, then senior policy advisor at the FSB, characterised part of the dispute as a disagreement over whether subdued lending figures were due to credit restriction from banks or low demand from businesses:

I think there was, and there probably still is, a debate, and I am putting it very simply, from maybe the business side, the press and maybe parliamentarians, saying businesses cannot get money, and on the other side, once again simplifying, banks and financial institutions saying the demand is not quite there.⁶³

37. Evidence of this debate can be seen recently in public discourse on the Funding for Lending Scheme (FLS) and its effect on SME finance. The banking industry has been broadly positive about the performance of the FLS. In May 2014, the BBA said that "Funding for Lending has had a positive impact on both liquidity and loan pricing since it was first introduced in 2012".⁶⁴ In August 2014, the BBA argued that FLS data showed "a pickup in borrowing by small and medium sized businesses" and said that it was "encouraging to see that the Funding for Lending Scheme is continuing to be used to help businesses".⁶⁵ However, many business groups' statements about the performance of the FLS have been negative. In August 2014, the Federation of Small Businesses said that small businesses were "still struggling to access finance"⁶⁶, whilst the Forum of Private Business

62 SME0101

63 Q 86

64 BBA, BBA Q1 2014 SME lending statistics release and response to latest FLS, 29 May 2014

65 BBA, BBA Q2 2014 SME lending statistics release and response to latest FLS, 28 August 2014

66 Federation of Small Businesses, Small businesses still struggling to access finance, says FSB, 28 August 2014

described FLS figures as “disappointing”.⁶⁷ Media coverage has also focused on negative net lending figures published within the FLS data.⁶⁸

Availability of data

38. Data on bank lending provides a means of assessing credit market conditions. Until recently, the Bank of England’s business lending data was only available on an aggregated basis. The Bank publishes a number of datasets in this regard. These are:

- *Private Non-Financial Corporations (PNFC) M4Lx*—sterling loans to private non-financial corporations. Data is available quarterly from March 1963 and monthly from September 1997, and excludes unincorporated businesses.
- *Sterling loans to PNFCs*—sterling loans to private non-financial corporations. Excludes securities and commercial paper. Data is available quarterly from June 1990 and monthly from September 1997, and excludes unincorporated businesses.
- *All currency loans to PNFCs*—sterling and foreign currency loans to private non-financial corporations. Excludes securities and commercial paper. Data is available monthly from January 1998, and excludes unincorporated businesses.
- *Loans to non-financial businesses by industry*—sterling and foreign currency loans to non-financial businesses split by industrial sector. Excludes securities, commercial paper and some other components (including acceptances and bills). Data is available quarterly from December 1997 and monthly from June 2009.⁶⁹

39. As a result of the financial crisis, the Bank of England encountered new requirements for data that it did not collect. This was particularly true for SME lending, about which the Bank had been collecting only limited information. The Bank wrote in 2012:

User demand for detailed data on bank and building society lending to the UK private sector came into sharper focus following the deterioration in banking conditions in late 2008, and this remains the case. There is particular interest in credit to businesses, including small and medium-sized enterprises (SMEs).

[...]

The priorities for enhanced data in late 2008 were higher frequency (twice monthly, for a limited duration) and a broader range of private sector credit

67 Forum of Private Business, Latest Funding for Lending SME figures disappointing says Forum of Private Business, 28 August 2014

68 “SMEs feeling the pinch as Funding for Lending fails to pick up,” Angela Monaghan, *The Guardian*, 28 August 2014; “Business lending continues to contract despite revamped Funding for Lending rules,” Szu Ping Chan, *The Telegraph*, 28 August 2014; “Bank of England business lending scheme questioned as credit for companies falls by £3.9bn,” *Thisismoney.co.uk*, Camilla Canocchi, 28 August 2014

69 Bank of England, Measures of lending to UK businesses, 29 September 2014

variables, which were to be sourced from a limited survey of the largest lending institutions. Data definitions were allowed to be relatively flexible, in order to accommodate what individual reporters could reliably commit to, at short notice. At the same time, the Department for Business, Innovation and Skills (BIS) agreed with a number of major UK lenders to collect detailed data on bank lending to SMEs in order to inform the debate on lending to this segment of the economy.⁷⁰

40. The Bank of England described this new data in its first *Trends in Lending* from April 2009:

The new collection—referred to as ‘Lending Panel data’—covers the major UK lenders: Banco Santander, Barclays, HSBC, Lloyds Banking Group, Nationwide and Royal Bank of Scotland. Together they accounted for around 65% of the stock of lending to businesses, 50% of the stock of consumer credit, and 70% of the stock of mortgage lending at the end of 2008. Lending Panel data have provided a useful input to discussions between the major lenders and Bank staff, giving staff a better understanding of the business developments driving the figures, and this intelligence is reflected in the report.⁷¹

In April 2009, using this new data, and supplemented by the Bank’s existing surveys and data as well as its network of agents, the Bank began to publish a new document on credit conditions called *Trends in Lending*.

41. However, the new data collected in the aftermath of the crisis was ‘ad hoc’ in nature, and not systematically published. In July 2010, the Bank undertook a review of business lending data collection in consultation with the British Bankers’ Association (BBA) Statistics Advisory Panel. The resulting proposals were published in October 2010, and led to the creation of *Form LN, Lending to Businesses*—a new set of data to be collected systematically from banks on a regular basis.⁷²

42. For SME lending, a key output of this new data collection was the data series *Monetary financial institutions loans to non-financial businesses, by size of business*.⁷³ This series was first published in the January 2013 *Monetary & Financial Statistics* release.⁷⁴ It separates business lending into small and medium sized enterprises, and large corporates. Data in the series is available from April 2011, with corresponding quarterly data from Q2 2011.⁷⁵

70 Bank of England, *Lending to businesses – a new data source*, March 2012, p 1

71 Bank of England, *Trends in Lending April 2009*, 21 April 2009

72 Bank of England, *Lending to businesses – a new data source*, March 2012

73 Bank of England, *Explanatory Notes – Monetary financial institutions loans to non-financial businesses, by size of business*, as at 20 October 2014

74 Bank of England, *Bankstats (Monetary & Financial Statistics) January 2013*, 1 March 2013

75 Bank of England, *Explanatory Notes – Monetary financial institutions loans to non-financial businesses, by size of business*, as at 20 October 2014

43. In the immediate aftermath of the crisis, the Bank also published a set of specific of SME lending figures as part of *Project Merlin*—an agreement between Banks and the Government regarding lending to businesses.⁷⁶ However, this was only published for 2011 and was not collected under the Bank of England's statistical code of practice, as it used inconsistent definitions across the different submitting banks.⁷⁷ Most recently, the Bank has also published some SME lending data through its Funding for Lending Scheme (FLS). FLS lending data has been published since April 2014, and is available on a quarterly basis from Q1 2014.⁷⁸ However, coverage of the data is limited only to FLS participants and is therefore not comprehensive.

44. Before 2011, virtually no data from official sources on the stock and flow of SME lending was published. However, some data was collected by private sector organisations. For example, the BBA publishes monthly statistics on SME lending covering a portion of the SME credit market—major high street banks.⁷⁹

Data on alternative lenders

45. Under the Bank of England Act 1998, the Bank of England's statutory powers to gather information are limited to deposit-taking institutions, organisations who have issued debt securities, and institutions who have extended secured credit for residential purposes.⁸⁰

46. *Trends in Lending* has done some work on documenting lending from alternative sources. For example, the October 2014 issue provides information on the contribution to business credit provision from alternative lenders such as peer-to-peer lending and asset-based finance. However, data and analysis from the Bank of England has been based upon industry estimates, and not its own data.⁸¹ The Bank itself does not publish its own data on lending from many alternative sources, in particular crowdfunding or peer-to-peer lending.

47. Evidence suggests, however, that use of alternative lending sources is increasing amongst SMEs. The Bank of England's April 2014 *Trends in Lending* said:

SMEs' use of alternative sources of finance to borrowing from banks is increasing. In 2013, contacts of the Bank's network of Agents reported a growing use of non-bank finance by SMEs, albeit from low levels, including peer to peer lending, crowdfunding and venture capital funds.⁸²

76 House of Commons Library, Project Merlin, 14 February 2013

77 Bank of England, Additional data for lending to UK businesses including "Project Merlin" data, as at 20 February 2015

78 Bank of England, Funding for Lending Scheme—usage and lending data for the first part of the scheme, as at 20 February 2015

79 BBA, High street banking—January 2015, 25 February 2015

80 Bank of England Act 1998

81 Bank of England, Trends in Lending October 2014, 20 October 2014, p 13, Chart B

82 Bank of England, Trends in Lending April 2014, 22 April 2014, p 9

Anil Stocker, CEO and co-founder of alternative lender MarketInvoice, told the Committee:

[...] you have to look at the growth rates. We have grown 465% this year compared to last year. Yes, we are off a small base, but I think I speak also for other alternative funding platforms where, if you extrapolate our growth rates, we could become a serious force in SME lending. We will not be called alternative any more; we will be more called mainstream.⁸³

48. SMEs' negative perceptions of banks' willingness to lend appear to have resulted in an increased reluctance of SMEs to apply for credit. However, these perceptions may also be too pessimistic—SMEs may be more likely to have their applications for credit accepted than they perceive.

49. The divergence of businesses' and banks' perceptions of the availability of credit is partly the result of past behaviour by the industry. Sir Andrew Large's Independent Lending Review found, for example, that RBS claimed to approve 80 per cent of loan applications, but that this figure did not take into account the informal rejections that customers often faced during the early stages of an application. While it is difficult to measure how serious a deterrent this has been, it is one explanation as to why RBS has struggled to convince many customers that it is "open for lending".

50. While businesses may not all directly take an interest in lending statistics themselves, their perceptions of the lending environment are influenced by commentators and the media, who do. The publication of data on bank lending can therefore help to improve businesses' understanding of banks' willingness to lend. Recent efforts by the Bank of England to collect data on SME lending are welcome. However, this new data has only been collected as a reaction to the crisis. Data on the stock and flow of SME lending was extremely limited until 2011. This makes it difficult, for example, to determine how current levels of SME lending compare with the period before the financial crisis. The Bank of England should examine the case for expanding its work on SME lending by increasing the collection and publication of SME lending data; for example, the publication of lending to SMEs disaggregated by industrial category.

51. Improvements in the publication of information also assist policymakers, who need to have accurate data on credit conditions.

52. The amount of lending from alternative sources is not yet well documented. Official sources barely record it at all. As alternative lenders grow, it is important that their contribution to the SME funding market is recognised and understood as part of a wider picture of business lending. The Bank of England should consider whether it needs to begin routinely collecting more lending data from non-bank sources. If it

believes additional data collection is necessary, it should examine its existing data collection powers and write to this Committee and to the Treasury if it believes that they are insufficient.

3 RBS Global Restructuring Group (GRG)

Treatment of customers in GRG

53. A number of serious allegations have been made about RBS's treatment of financially distressed customers. These allegations have centred on RBS's internal division—Global Restructuring Group (GRG). GRG is comprised of several parts, but this Report focuses in particular on Business Restructuring Group (BRG) and West Register. BRG is the part of GRG that managed the most financially distressed SMEs in RBS. West Register was an entity within GRG that purchased properties.⁸⁴

Allegations against GRG

54. In November 2013, Lawrence Tomlinson, then Entrepreneur in Residence at the Department for Business, Innovation and Skills, made a number of allegations against RBS in his report entitled *Banks' Lending Practices: Treatment of Businesses in Distress*. Principally, he alleged that RBS was “unnecessarily engineering” businesses into default in order to move the business from local relationship management to turnaround divisions—such as GRG. He alleged that the purpose of doing so was to generate revenue through “fees, increased margins and devalued assets”.⁸⁵

55. Supporting the principal allegation contained within Dr Tomlinson's report were a number of further allegations about RBS's treatment of businesses in financial distress. These allegations included:

- Inaccuracy and manipulation of property asset valuations. Specifically, Dr Tomlinson alleged that businesses' assets had been undervalued for the purpose of determining adherence to loan-to-value covenants;⁸⁶
- Technical or “insignificant” breaches of covenants being used to bring businesses into default and transfer them out of local management;⁸⁷
- Transparency of decision making about the transfer of a business into GRG. The report alleged that “there is much confusion on the part of businesses” and that “the rationale and reason for their treatment is not clear to the business at the time it happens”;⁸⁸

84 Clifford Chance LLP, Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank's lending practices: treatment of businesses in distress’, 11 April 2014, p 4

85 Lawrence Tomlinson, *Banks' Lending Practices: Treatment of Businesses in distress*, 25 November 2013, p 2

86 Lawrence Tomlinson, *Banks' Lending Practices: Treatment of Businesses in distress*, 25 November 2013, p 6–7

87 Lawrence Tomlinson, *Banks' Lending Practices: Treatment of Businesses in distress*, 25 November 2013, p 8

88 Lawrence Tomlinson, *Banks' Lending Practices: Treatment of Businesses in distress*, 25 November 2013, p 9–

- “Excessive” fees and increased interest payments charged to businesses upon entering GRG; and⁸⁹
- Allegations of conflicts of interest arising from the sale of assets. Specifically, the report alleged that conflicts of interest existed between West Register, a property management subsidiary of RBS which frequently bought distressed assets, and BRG, which sold distressed assets.⁹⁰

Responses to allegations against GRG

56. In response to Dr Tomlinson’s report, RBS asked law firm Clifford Chance to review and report on the “principal allegation” of Dr Tomlinson’s report. Clifford Chance was asked by RBS to investigate the allegation that RBS was “guilty of ‘systematic and institutional’ behaviour in artificially distressing otherwise viable businesses, putting its customers ‘on a journey towards administration, receivership and liquidation’”.⁹¹ The Clifford Chance report focused on a sample of customer files that was intentionally compiled in a way that was, according to Clifford Chance, “more likely to identify facts adverse to the bank”, interviewing 138 customers and reviewing 130 files.⁹²

57. The review itself was “conducted solely by Clifford Chance”. However, the role of Jon Pain, Group Head of Conduct and Regulatory Affairs at RBS, was to “oversee” the review. Clifford Chance reported its findings to Mr Pain. Mr Pain subsequently presented the results to RBS’s board and senior management.⁹³

58. The Clifford Chance report was published in April 2014. It found no evidence to support the principal allegation against RBS, stating that it did not identify “any files which fitted the description of the bank ‘engineering’ a default or ‘artificially distressing’ a customer”.⁹⁴ RBS welcomed the review having found “no evidence of systematic defrauding of business customers”.⁹⁵

59. At the time that Dr Tomlinson was conducting his investigation, Sir Andrew Large was in the process of conducting an RBS-commissioned report into its own lending performance—the *RBS Independent Lending Review*.⁹⁶ Sir Andrew’s report did not look at the validity of the principal allegation made against RBS by Mr Tomlinson. He said:

89 Lawrence Tomlinson, “Banks’ Lending Practices: Treatment of Businesses in distress,” 25 November 2013, p 11

90 Lawrence Tomlinson, “Banks’ Lending Practices: Treatment of Businesses in distress,” 25 November 2013, p 14

91 Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.’ 11 April 2014, p 3

92 Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.’ 11 April 2014, p 4

93 Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.’ 11 April 2014, p 51–52

94 Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.’ 11 April 2014, p 6

95 “RBS responds to Clifford Chance report into allegation of systematic fraud,” RBS news release, 17 April 2014

96 RBS independent Lending Review, Sir Andrew large, 25 November 2013

The validity of the accusations made in these sources has not been investigated, as a forensic inquiry into individual cases was not in the scope of the Independent Lending Review.⁹⁷

60. Some of the other allegations made by Dr Tomlinson were directly addressed in the Clifford Chance report. For example, Clifford Chance “did not observe examples within our sample of purchases of properties from SMEs which resulted in subsequent sales at a substantial profit to West Register (comparing the purchase price and sale price only).”⁹⁸ However, in response to Clifford Chance, RBS acknowledged that there was a “damaging perception that the bank had a conflict of interest” regarding West Register, and decided to wind down the division.⁹⁹

61. Some allegations against RBS by Dr Tomlinson were only partially addressed by the Clifford Chance report. On the inaccuracy of asset valuations, Clifford Chance concluded that there was “no evidence that the bank deliberately manipulated valuations to procure a customer’s transfer to [Business Restructuring Group].” Clifford Chance also said that it did not see “any instances of an LTV breach being the event that precipitated transfer to BRG.” However, whilst Clifford Chance had access to copies of property valuations for each of the cases it examined, it “did not test the accuracy of the bank’s valuation methodology” when coming to its conclusion.¹⁰⁰

62. On the topic of fees charged to customers, Clifford Chance found problems with the transparency of pricing in GRG. Their report noted that GRG had been aware of complaints regarding pricing transparency from polls conducted at least as early as 2008.¹⁰¹ In investigating the pricing of GRG products, Clifford Chance had found it “difficult to assess allegations of unfairness” owing to the limited transparency of RBS’s fee structure.¹⁰² The report said:

A number of complainants commented that they felt pricing of restructured facilities lacked transparency. [...] In reviewing the files, we found it difficult to understand how the bank calculated the fees which it proposed to customers in any particular case and therefore found it difficult to assess allegations of unfairness.¹⁰³

97 RBS independent Lending Review, Sir Andrew Large, 25 November 2013, p 52

98 Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.’” 11 April 2014, p 8

99 RBS responds to Clifford Chance report into allegation of systematic fraud, RBS news release, 17 April 2014

100 Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.’” 11 April 2014, p 6, 22

101 Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.’” 11 April 2014, p 36

102 Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.’” 11 April 2014, p 35

103 Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.’” 11 April 2014, p 7

63. When questioned by the Committee on the transparency of GRG's fees, Derek Sach, Head of Global Restructuring Group, described it as a "reasonable criticism" and said that "something that we have been working on since 2012 [is] to try to improve people's understanding of the fees we charge and to make the fees less onerous for them".¹⁰⁴ However, Mr Sach disagreed with the assertion that there was no accountability or structure to the fees, and that GRG charged whatever it liked.¹⁰⁵ Chris Sullivan, Deputy CEO of RBS, added:

There is absolutely justification. [...] every single case is different. There are different levels of risk, different levels of stress within the organisation, different facilities for each customer. On the basis of the mix of all of those things the relationship manager will take a decision that would relate to the amount of risk the bank was were taking and an appropriate reward for that risk. The appropriate reward element comes from market practice and internal checks that are made both by the managers of the bank and then the internal audit department above them.¹⁰⁶

64. Mr Sach said that RBS had been slow to improve pricing transparency because GRG was under strain from its increased case load:

In the early days of 2008, 2009 you were looking at an organisation in terms of GRG that multiplied 10-fold over nine months as the bank was obviously in a very difficult circumstance [...]. Any business that multiplies 10-fold in nine months is going to have stresses and strains.¹⁰⁷

65. When challenged by the Committee on whether fees that could not be explained were fair fees, Derek Sach responded that fees are not transparent if they are "not well explained to the customer",¹⁰⁸ and that "generally banks need to be much more transparent".¹⁰⁹

FCA review into GRG

66. Allegations against RBS have also drawn attention from the Financial Conduct Authority (FCA). The FCA announced on 17 January 2014 that it was conducting a separate, independent review of RBS's treatment of business customers in financial difficulty. In an update on the progress of the review, the FCA said:

The report will examine Royal Bank of Scotland's (RBS) treatment of business customers in financial difficulty and consider allegations of poor

104 Q 540

105 Qq 612–613

106 Q 614

107 Q 617, 619

108 Q 620

109 Q 622

practice set out in the report by Dr Lawrence Tomlinson and referenced in Sir Andrew Large's report.

The first stage of the review will consider RBS' treatment of a sample of customers referred to its Global Restructuring Group. This will include some cases where customers have already raised concerns with Dr Tomlinson, the Department of Business, Innovation and Skills or the FCA.

The review will also consider whether any poor practices identified are widespread and systematic. If this is the case, the second stage of the review will identify the root cause of these issues and make recommendations to address any shortcomings identified.¹¹⁰

67. The FCA's review is being conducted by an independent skilled person under section 166 of the Financial Services and Markets Act (FSMA) 2000. The FCA has stated that "due to the complex nature of the review and the seriousness of the allegations," it is expected that the review will report in early 2015. The FCA appointed Promontory Financial Group and Mazars to conduct the review.¹¹¹

68. The Clifford Chance review of RBS's treatment of distressed customers, principally by the Global Restructuring Group, was welcomed by RBS as finding "no evidence of systematic defrauding of business customers". However, the review—overseen by a bank executive rather than a non-executive director—was not independent, was based on narrow terms of reference, and left a number of questions unanswered, such as why GRG could not explain the size of fees it had charged, and the accuracy of its asset valuations.

69. The FCA is conducting its own review into GRG. It is important that this review comprehensively address the allegations against GRG, so that the public can be confident that any wrongdoing is identified and resolved.

Conflicts of interest, customer perceptions and governance

70. Sir Andrew Large, in his independent review of RBS's lending practices, did not investigate individual allegations of wrongdoing. He did, however, criticise GRG's governance and its communications procedures, and concluded that these could lead to negative perceptions amongst customers. Sir Andrew said that "the decisions and actions taken by the bank can be highly unsettling and emotional for the customer" and that "they will likely impact the livelihoods of the individuals and families who own and run the SMEs in question". He also found that the individual SME "may be unaware or unprepared for the consequences of the change", and highlighted the lack of recourse available to

110 Financial Conduct Authority, "Update on independent review of Royal Bank of Scotland's treatment of business customers in financial difficulty," 24 February 2015

111 Financial Conduct Authority, "Update on independent review of Royal Bank of Scotland's treatment of business customers in financial difficulty," 24 February 2015

customers in such situations, stating that “SMEs typically lack the funds or expertise required to challenge the banks in protecting their interest”.¹¹²

71. During the potentially stressful process of transferring an SME to GRG, Sir Andrew found that internal structures within RBS were “not well suited to mitigating the risk of poor perceptions [...]”.¹¹³ In particular, Sir Andrew identified as a problem the combination of GRG both being run as an “internal profit centre” and having ultimate responsibility over which customers are transferred to it. Sir Andrew told the Committee:

It comes to a significant extent to questions of organisation and governance. When a bank lends to an SME, the two parties have a common interest in the SME being successful in servicing the debt, paying it down and the relationship continuing. That situation is the case right up to the point where the decision has been made that this organisation is irretrievable and therefore the interests have to diverge as between the bank and the customer in that resolution has to take place in the interests of the shareholder, recovering what can be recovered.

The situation that I commented on in the review [...] is that the ultimate decision as to which SMEs will be handled by the Global Restructuring Group is made by the Global Restructuring Group. They have the say. Equally, the decision that might be made at a later stage that the organisation is beyond retrieval and has to be resolved is made within the Global Restructuring Group, which is an internal profit centre within the bank. Perceptually, and I would also argue in other ways as well, I think that is flawed.¹¹⁴

Sir Andrew said that “particular care” was needed at the point where “interests of the customer and the bank are likely to diverge”—for example, the point of insolvency. However, he found that the governance process for transfer into GRG from normal relationship management was “opaque” to both the SME itself and also to its normal relationship manager. He concluded that these “governance structure issues exacerbate the risk of a perceived conflict of interest.”¹¹⁵

72. Transparency of decision making was also a problem identified by Clifford Chance. In its report, Clifford Chance described RBS’s handover procedure from normal relationship management into GRG. This included a handover meeting and “a pro-forma letter to be sent to the customer setting out the reasons for the transfer to BRG”.¹¹⁶ Nevertheless,

¹¹² Sir Andrew Large, RBS independent Lending Review, 25 November 2013, p 52–53

¹¹³ Sir Andrew Large, RBS independent Lending Review, 25 November 2013, p 52

¹¹⁴ Oral evidence by Sir Andrew Large to the Treasury Committee, 22 January 2014, q 34

¹¹⁵ Sir Andrew Large, RBS independent Lending Review, 25 November 2013, p 52

¹¹⁶ Clifford Chance LLP, “Independent review of the central allegation made by Dr Lawrence Tomlinson in ‘Bank’s lending practices: treatment of businesses in distress.” 11 April 2014, p 25

Clifford Chance found similar complaints from its sample of customers about the opacity of the decision-making process. Clifford Chance said:

In our interviews with customers, some complained about aspects of the handover process. Their complaints included the fact that they had not understood prior to the handover meeting that they were being transferred to BRG, that they did not understand why they were being transferred, that they had no choice in the matter and that the transfer from [RBS's normal relationship management] to BRG [...] was disruptive.¹¹⁷

GRG as a profit centre

73. In both oral evidence and written evidence to the Committee, RBS contested the basis of Sir Andrew's arguments. On GRG's status as a profit centre, Mr Sullivan told the Committee that GRG was "absolutely not" a profit centre and that describing it as such was "totally inappropriate".¹¹⁸ Mr Sullivan explained to the Committee that, instead of a profit centre, GRG was "absolutely, unequivocally [...] a cost centre".¹¹⁹ Mr Sach too said he believed that Sir Andrew had been wrong in his assertion about GRG being a profit centre.¹²⁰ He argued that "it cannot be a profit centre because we are making a loss on this particular segment".¹²¹ A letter from RBS Communications to the Clerk of the Treasury Committee on 21 February 2014 also stated that "GRG does not act as a 'profit centre'".¹²²

74. At the time that Mr Sullivan and Mr Sach gave evidence, the Chairman of the Committee provided both Mr Sullivan and Mr Sach with an opportunity immediately to correct their oral evidence. This was after the Chairman had reminded them that Sir Andrew had referred to GRG as an "internal profit centre" and read out the definition used in his report. Mr Sach responded, and maintained that GRG was not a profit centre.¹²³ Mr Sullivan did not respond. Mr Sach also stated that "drafts were certainly fact checked" by RBS.¹²⁴

75. Sir Andrew defended the findings of his report. He emphasised that his report had identified GRG as a profit centre on an internal and management basis, not a statutory or legal one:

Perhaps as important as the terminology employed is the substance of what it means. The Glossary of Terms [from the document "RBS Independent

117 Clifford Chance LLP, "Independent review of the central allegation made by Dr Lawrence Tomlinson in 'Bank's lending practices: treatment of businesses in distress.'" 11 April 2014, p 25

118 Qq 563-564

119 Q 566

120 Qq 578-9

121 Q 596

122 SME0144

123 Q 578

124 Q 531

Lending Review”] describes ‘profit centre’ as used in the Report as ‘internal organizational boundaries defined to measure the financial contribution of a particular area of a larger organization’. The particular area in question in this instance is, of course, GRG.

The use of the word ‘internal’ was important. The Report makes it clear that for both GRG and the bank this was an ‘internal’ matter since the actual assets and income/losses accrue to the donor department. There was no suggestion that there was a formal basis in which GRG acted as a profit centre, or for the purposes of statutory financial reporting.

Internal profit centres of this sort—which can of course be loss making—are a perfectly normal mechanism used to assist in determining the performance of units within banks and other forms of enterprise when those units perform some service on behalf of either other departments or the enterprise as a whole. They are usually constructed using ‘management information’ (rather than the ‘financial information’ used for statutory reporting).¹²⁵

76. In his letter, Sir Andrew also referred to information sent to him by GRG during the course of the RBS Independent Lending Review. This stated that “GRG has a ‘shadow’ P&L which tracks contribution based on incremental income generated [...] and the costs of providing support—predominantly staff costs”. Sir Andrew described such a ‘shadow’ profit and loss account as “consistent” with his use of the term “internal profit centre”.¹²⁶

77. Following the response from Sir Andrew, the Committee contacted RBS seeking further comment on the matter. Mr Sullivan responded, stating that he and Mr Sach did not disagree with Sir Andrew’s description of GRG as a profit centre:

[...] with regard to the term of ‘profit centre’ we wish to make clear we do not disagree with the way that that accounting term was used by Sir Andrew Large in his report. Sir Andrew clearly set out his definition for that accounting term in his glossary and it is indeed the case that the financial performance of GRG was monitored to enable us to understand GRG’s financial performance. This is a standard accounting practice across all sectors of our business (for example our Property Service division, which exists to support amongst other things our branch network, can also be classified as a profit centre by virtue of its recordings of assets, as well as costs and income). However, what Mr Sach and I were taking issue with is the way others have used Sir Andrew’s report to suggest that GRG had a profit motive with a prejudice against our customers, rather than a turnaround motive.¹²⁷

¹²⁵ Letter from Sir Andrew Large to Andrew Tyrie MP, 8 July 2014

¹²⁶ Letter from Sir Andrew Large to Andrew Tyrie MP, 8 July 2014

¹²⁷ Letter from Chris Sullivan to Andrew Tyrie MP, 15 July 2014

78. Following the letter from Mr Sullivan, the Committee wrote to Sir Philip Hampton, Chairman of RBS, seeking further comment.¹²⁸ Regarding the question of whether GRG was a profit centre, Sir Phillip wrote:

The answer to whether Sir Andrew was right is “yes”; his definition was reasonable and correct as it applies to GRG. Having read his 8th July letter it is plain that that is the answer the Committee should have received and I am sorry that they did not.

In his 8th July letter Sir Andrew notes that “the possibility remains that the bank feels that the term “profit centre” in some way adds to any public perception that the presence of such a mechanism leads of a systematic abuse of the banks position...” Mr Sach and Mr Sullivan have confirmed that when providing evidence to the Committee that their responses were informed by their reaction to this adverse characterisation of “profit centre”.

This was a mistake. Your questions and those of your colleagues were clear. Based on the review we have undertaken my colleagues on the Board and I believe it was an honest mistake and that neither of the bank’s representatives intended to mislead the Committee. When the clear definition of “profit centre”, used by Sir Andrew, was subsequently brought to their attention, both Mr Sullivan and Mr Sach agreed with it and agreed that the Committee deserved a clearer answer and that is why Mr Sullivan wrote to you.¹²⁹

Future of GRG

79. Following the Committee’s evidence from Mr Sullivan and Mr Sach, it has been reported that RBS has decided to close down GRG as a stand-alone unit, with Mr Sach leaving RBS in March 2015. Furthermore, it has also been reported that Mr Sullivan has left RBS earlier than expected.¹³⁰

80. In his report on RBS, Sir Andrew Large said that GRG was run as an “internal profit centre”. However, in written and oral evidence to the Committee, RBS disputed that description—even though it had had the opportunity to contest that point when it saw Sir Andrew’s report in draft. Mr Sullivan and Mr Sach told the Committee, on behalf of RBS, that GRG was not a profit centre. The Committee, having received further written evidence from Sir Andrew Large, the Chairman of RBS, Mr Sach and Mr Sullivan, has concluded that Mr Sullivan and Mr Sach’s original statements to the Committee on this point were wrong. It is now agreed by all that Sir Andrew was correct in his description of GRG as an internal profit centre.

¹²⁸ Letter from Andrew Tyrie MP to Sir Phillip Hampton, 23 July 2014

¹²⁹ Letter from Sir Phillip Hampton to Andrew Tyrie MP, 22 August 2014

¹³⁰ Deputy CEO Sullivan to leave bank early, Martin Arnold, Financial Times, 5 January 2015; RBS begins to dismantle controversial restructuring division, Julia Kollewe, The Guardian, 8 August 2014

81. The evidence that Mr Sach and Mr Sullivan gave was incorrect and therefore misleading, whether intentionally or not. RBS has apologised to the Committee and corrected its evidence. However, given the seniority of the original RBS witnesses, it should not have required intervention by this Committee with the Chairman of RBS to obtain that apology and a full statement of RBS's position.

82. This misunderstanding of the bank's position by two senior executives is indicative of a systemic weakness of standards and culture. It is understandable, indeed right, that banks should seek to support businesses in difficulty with special measures but how that is done and whether the institution or the customer is the main beneficiary needs much greater clarity.

4 Mis-sale of Hedging Products

Box 1: Interest rate hedging products and Tailored Business Loans

Variable interest rates on loans rise or fall in line with the base rate or benchmark on which they are based. Adverse movements in variable rates are a risk to the business with the loan and to the bank through the business's diminished interest rate cover.

Businesses can protect themselves from this interest rate risk by purchasing a stand-alone interest rate protection product, called an Interest Rate Hedging Product (IRHP), or by taking out a loan with the hedging features embedded within the contract itself.

Standalone **Interest Rate Hedging Products (IRHP)** are a type of derivative contract sold by banks. They are a separate contract to that of the underlying loan or portfolio of loans. Businesses with IRHPs typically pay for their loan separately from the IRHP. The IRHPs can then provide interest rate protection to a business by creating a separate set of payments to and from the business that offset the variability of the interest rate paid on the underlying loan. IRHPs are regulated by the FCA as Contracts for Difference. These products are sometimes referred to as "swaps".

Loans with embedded interest rate hedging features are individual loan products that contain interest rate hedging features embedded within the contract of the loan itself. When paying off the loan, the business typically makes only a single payment that accounts for both loan interest and interest rate protection. These loans are also referred to as "loans with embedded swaps" and "loans with embedded IRHPs". Clydesdale sold such loans under its **Tailored Business Loan (TBL)** brand. Such loans are not regulated by the FCA as they are classified as commercial lending.

Both methods of interest rate hedging can come in a variety of types, with each type offering different types of interest rate protection. There are three key types of protection available: caps, swaps and collars. Standalone IRHPs and loans with embedded IRHPs can both contain cap, swap or collar features. Each type can perform the same economic function whether they are sold as standalone IRHPs or as an embedded interest rate hedging feature within a loan.

Caps can set a maximum interest rate to be paid by the business for the underlying loan, but do not set a floor. This means that, over time, the interest paid on the underlying loan cannot exceed a certain amount, but is allowed to fall freely when interest rates fall.

Collars can set both maximum and minimum interest rates to be paid by the business for the underlying loan. This means that, over time, the interest paid on the underlying loan can both rise and fall, but only to a pre-determined maximum or minimum level. Collars can vary in complexity, with **structured collars** offering more complex interest rate ceilings and floors.

Swaps can be used to fix the interest rate to be paid by the business for the underlying loan—over time, the interest paid for the underlying loan can vary, but the total amount paid by the business remains unchanged. The term ‘swap’ is also frequently used to describe an interest rate hedging product. Used in this context, the term does not exclusively refer to fixed rate products.

FCA Interest Rate Hedging Product review

83. Stand-alone interest rate hedging products (IRHPs) are sold by banks to help businesses to manage the interest rate they pay on loans. In June 2012 the Financial Services Authority (FSA) announced that it had found “serious failings in the sale of IRHPs to some small and medium sized businesses”.¹³¹ The FSA identified a range of poor sales practices including:

- Poor disclosure of exit costs;
- Failure to ascertain the customers’ understanding of risk;
- Non advised sales straying into advice;
- “Over-hedging” (i.e. where the amounts and/or duration did not match the underlying loans); and
- Rewards and incentives being a driver of these practices.¹³²

84. On 29 June and 23 July 2012, the FSA announced that a number of UK banks had entered into voluntary agreements to conduct a redress exercise in relation to their sales of IRHPs. This review covers only stand-alone IRHPs. Initially, a pilot study of “a small sample of the typically more complex cases” was undertaken. The FSA said that “the pilot was vital to ensuring that each bank’s approach to reviewing their sales would deliver fair and reasonable outcomes for customers”.¹³³

85. The full review of IRHPs started in May 2013 and involved a total of nine banks: Allied Irish Bank (UK), Bank of Ireland, Barclays, Clydesdale & Yorkshire Banks, Co-operative Bank, HSBC, Lloyds Banking Group, Royal Bank of Scotland and Santander UK. The FCA has recently said that “all nine banks have now completed their sales reviews and have delivered redress letters to all but a handful of these customers”.¹³⁴

- The review population covered 29,568 sales of IRHPs.

¹³¹ Financial Services Authority, FSA agrees settlement with four banks over interest rate hedging products, 29 June 2012

¹³² Financial Services Authority, FSA agrees settlement with four banks over interest rate hedging products, 29 June 2012

¹³³ Financial Services Authority, Interest rate hedging products pilot findings, March 2013, p 5–6

¹³⁴ FCA, Interest rate hedging products, 26 February 2015

- As at 31 December 2014, 19,185 customers were found eligible for review, 10,372 customers were classified as “sophisticated” and subsequently excluded from the review, and 10 sophistication assessments remained in progress.
- Of the 19,185 customers eligible for review. 14,119 had been given redress offers. Of the remainder, around 2,000 had opted out, around 1,500 had been assessed as requiring no redress, and around 100 assessments remained in progress.
- 11,200 redress offers by banks had been accepted, paying out a total of £1.79 billion.¹³⁵

86. The definition of a sophisticated customer was deemed to be those with an aggregate annual turnover of “over £6.5 million net (or £7.8 million gross)”, along with either an aggregate balance sheet total of “more than £3.26 million net (or £3.9 million gross)”, or more than 50 employees. Customers were also deemed to be sophisticated if the aggregate notional value of “all live (i.e. not matured) IRHPs” held by the customer immediately after the IRHP sale exceeded £10 million. This was a definition agreed between the FCA and the banks that is not based on the legal definition of sophistication.

Operation of the scheme

87. The IRHP review is being conducted by the nine banks involved. The FCA states that the core tenet of the review is to pay “fair and reasonable redress to customers where appropriate” and that “fair and reasonable redress requires that the customer be put back into the position they would have been in if there had not been such a breach of the Regulatory Requirements”.¹³⁶ In a case where mis-selling is identified, three outcomes for redress are possible:

- Full redress—where the product is refunded in full;
- Alternative product redress—where an alternative product to the purchased IRHP is offered as part of a firm’s redress package. The cash redress paid to the customer is the notional full redress sum, minus the notional cost to the customer of the alternative product; or
- No redress.¹³⁷

88. The FSA has noted that banks had been concerned that the principles of the review were “too high level and hence open to interpretation”. In response, the FSA said that “general guidance will not assist banks when carrying out this review, because a case by case assessment is necessary”. It also said that the redress process requires “an objective assessment of the facts to determine whether, in [each] customer’s circumstances, the firm

¹³⁵ Progress of sales through stages of the review as at 31 December 2014, Financial Conduct Authority, 28 January 2015

¹³⁶ Letter from Clive Adamson to banks, 29 January 2013

¹³⁷ Financial Services Authority, Interest Rate Hedging Products Pilot Findings, March 2013, p 14

has complied with the Regulatory Requirements [...], and in particular, whether the Customer was provided with sufficient information to enable the Customer to understand the features and risks of the product”.¹³⁸

89. The redress scheme itself has been conducted on a voluntary basis between banks and the FCA. Discussing the rationale for the voluntary nature of the scheme, John Griffiths-Jones, Chairman of the FCA, said:

I think that if we, as a regulator, are to do mass redress schemes, of which this is classically one, we have two ways of doing it. Either we go through the law courts, which takes a very great length of time and costs a very great deal of money, or, as a proactive regulator, we go out on the front foot and say, “This is how we are going to do it”, and the necessary part of “this is how we are going to do it” is coming to an arrangement with the banks that is “voluntary”, or at least contractually voluntary, to do it that way. If they refuse, we end up in the law court and we get into a PPI-type situation.¹³⁹

Discussing the benefits of a voluntary scheme, the Mr Griffiths-Jones said:

[...] on the back of the knowledge of the PPI unsatisfactory outcome, Martin [Wheatley] and his team took the proactive decision to do it on an arranged basis. The upside to that was that people would get their money quicker and it would be much cheaper for the consumers who we were trying to protect. The downside would be that it was potentially subject to legal challenge thereafter, which would unravel the scheme because we are subject to judicial review, and we could be unravelled.¹⁴⁰

90. Oversight of the process is primarily through an ‘independent reviewer’. The FCA said:

The independent reviewer will review all aspects of the proactive redress exercise and past business review. This will include the methodology and review of each individual case.¹⁴¹

Independent reviewers are professional services firms hired by banks as ‘skilled persons’ under section 166 of the Financial Services and Markets Act. Independent reviewers are approved by the FCA with the aim of ensuring that they have “appropriate skills, knowledge and expertise to scrutinise the bank’s review and that there are no conflicts of interest”.¹⁴²

91. The FCA’s IRHP redress process is guided by the principle that “redress must be fair and reasonable”, and that “redress should aim to put customers back in the

138 Letter from Clive Adamson to banks, 29 January 2013

139 Oral evidence by John Griffiths-Jones to the Treasury Committee, 9 September 2014, q 168

140 Oral evidence by John Griffiths-Jones to the Treasury Committee, 9 September 2014, q 168

141 FCA, Interest rate hedging product review—FAQs, as at 24 February 2015

142 Financial Services Authority, Interest Rate Hedging Products Pilot Findings, March 2013, p 6

position they would have been in had the breach of regulatory requirements not occurred.” This is a statement of principles, and is open to interpretation by banks conducting the review. The outcome in each customer’s review therefore relies primarily on the judgement of the bank, on a case by case basis, subject to approval from an independent reviewer. In addition different banks came to different conclusions with inconsistency between different independent reviewers.

92. The arbitrary sophistication test may have been necessary to obtain agreement to a voluntary scheme from banks, but it is clear that not all non-sophisticated customers have been included in the review.

Alternative product redress

93. The FCA sets out the circumstances in which alternative redress should be offered by the Bank to the SME as follows:

If it is reasonable to conclude that, had the sale complied with the regulatory requirements, the customer would have purchased a different IRHP, fair and reasonable redress will be the alternative product and the refund of any difference in payments between the alternative product and the product actually purchased, including, where appropriate, the difference in any break costs previously paid.¹⁴³

The FCA states that, in cases where fair and reasonable redress is an alternative product, two principles will apply to the alternative redress offered:

The alternative product will be simple—this is because we believe that, if the original sale had complied with our regulatory requirements, customers would only have purchased simple products (e.g. a cap, vanilla swap or vanilla collar).

The alternative product would not have had potential break costs in excess of 7.5%, in a pessimistic but plausible scenario, of the amount hedged at the point of sale—this is because we believe that, if the original sale had complied with our regulatory requirements, customers would have not entered into a product with potentially sizeable break costs.¹⁴⁴

According to FCA published statistics to December 2013, just over 40 per cent of cases where redress has been due have involved alternative products.¹⁴⁵

94. Alternative product redress means a business is given a different IRHP as part of its redress, and therefore less cash than would have been the case with a full tear-up. The more

¹⁴³ Interest Rate Hedging Products Pilot Findings, FSA, March 2013, p 14

¹⁴⁴ Interest Rate Hedging Products Pilot Findings, FSA, March 2013, p 14

¹⁴⁵ Progress of sales through stages of the review as at 31 December 2014, Financial Conduct Authority, 28 January 2015

expensive such an alternative product is deemed to be, the less cash redress will be offered.¹⁴⁶ Some customers have been dissatisfied by such offers, and have challenged their validity as redress.¹⁴⁷ Fox Williams said:

On occasion an entirely different product has been proposed as an Alternative IRHP, such as an interest rate cap. [...] it is unclear on what basis a Participating Bank can assume that an interest rate cap would have been purchased by a customer in circumstances where it is clear that no such product other than the transacted IRHP was ever discussed with the customer.¹⁴⁸

AHV Associates, a corporate finance advisory firm, said that “often, there is no evidence that the company would have bought such a cap since such a product was not discussed or it could not have afforded the premium.”¹⁴⁹ Martin Berkeley of Vedanta Hedging, a derivatives consultancy, said “the replacements are quite expensively priced and are often not particularly suitable or perhaps what a client would have chosen”.¹⁵⁰

95. Particular concern has been expressed regarding long dated caps offered as alternative products, and whether customers would have bought them. Guto Bebb MP, chair of the All Party Parliamentary Group on Interest Rate Mis-Selling, said that “experts in the field of derivatives and interest rate protection tell me that there is no demand in the marketplace for a 10-year cap”.¹⁵¹ However, he said banks offered such products as alternative redress:

Yet, time and again when businesses are offered a cap as an alternative product, the cap is for 10 years. It will not surprise hon. Members to learn that a 10-year cap is significantly more expensive than a five-year one.¹⁵²

When asked by the Committee whether “it is typical for a 15-year loan to be covered by a 15-year cap”, Mr Wheatley said:

Yes, I have looked at it. In these products it is not in itself unusual for the protection to be the same period as the loan.¹⁵³

96. Alternative product redress is determined by the bank and the independent reviewer, who retrospectively determine what a business would have bought had a sale

146 Berg, Backbench business debate on Financial Conduct Authority Redress Scheme House of Commons, Main Chamber—4 December 2014, Case study evidence examples, 3 December 2014; Warwick Risk Management, Replacement Caps Valuation Report, 18 February 2015

147 Berg, Backbench business debate on Financial Conduct Authority Redress Scheme House of Commons, Main Chamber—4 December 2014, Case study evidence examples,” 3 December 2014

148 SME0163

149 SME0174

150 Vedanta Hedging, Martin Berkeley interviewed by IB Times about hidden problems of FCA IRHP Redress offers, 10 February 2014

151 HC Deb, 4 December 2014, Col 481

152 HC Deb, 4 December 2014, Col 480–481

153 Oral evidence by Martin Wheatley to the Treasury Committee, 10 February 2015, q 8

been compliant. This is a matter of judgement, and one not necessarily easily made, by the bank and the independent reviewer.

Criticisms of the FCA IRHP review

Drafting of the voluntary agreements

97. In addition to the agreements between the FSA and banks disclosed by the FCA, the Committee has seen an earlier draft of the letter from Mr Adamson to banks dated 17 January 2013.¹⁵⁴ This draft letter contains some material differences to the final version of the letter sent on the 29 January 2013. Some of the important differences are:

- The first letter does not contain the £10 million cap on the customer's aggregate nominal IRHP hedge value that the review applies;¹⁵⁵
- There are 17 instances where reference to involvement of the skilled person in the decision making process of the review was removed from the document. With reference to the second letter, the relevant paragraphs are 6, 17, 20, 22 (ii), 24, 26, 30, 36, 38, 39, 40, 41, 43, 44, 46, 47, 49, 50, and 51.¹⁵⁶
- The decision not to proceed with a special Financial Ombudsman Service scheme for the IRHP review is mentioned in the second letter but not the first;¹⁵⁷
- A requirement for banks to “presume” that certain facts are correct or that the customer would have behaved in a certain way, in the absence of evidence to the contrary, is included in the final letter.¹⁵⁸
- The test applied to check whether a sale was compliant was altered from the first letter to the second. Specifically, the test was changed from whether the customer “understood the features and risks of the product”,¹⁵⁹ to whether the customer “was provided with sufficient information to enable the Customer to understand the features and risks of the product”.¹⁶⁰

98. The Committee raised some of these differences with the FCA in oral evidence on 10 February 2015. Martin Wheatley, CEO of the FCA, acknowledged that the £10 million cap on the aggregate notional hedge value of an IRHP added to the final letter “took out about a third of the total of the products that were sold”.¹⁶¹ He also acknowledged that the value of the products removed by this cap would be higher than a third, as the removed caps

¹⁵⁴ Letter from Clive Adamson to banks, 17 January 2013

¹⁵⁵ Letter from Clive Adamson to banks, 29 January 2013, p 5, Annex 1, para 9 (iv)

¹⁵⁶ Letter from Clive Adamson to banks; 17 January 2013, 29 January 2013

¹⁵⁷ Letter from Clive Adamson to banks, 29 January 2013, p 5, para 9 (iv)

¹⁵⁸ Letter from Clive Adamson to banks, 29 January 2013, Annex 3, paras 11–13; 16, 22 (i), (ii), 52

¹⁵⁹ Letter from Clive Adamson to banks, 17 January 2013, Annex 2, para 9

¹⁶⁰ Letter from Clive Adamson to banks, 29 January 2013, Annex 2, para 2

¹⁶¹ Oral evidence by Martin Wheatley to the Treasury Committee, 10 February 2015, q 20

were “typically the larger customers”.¹⁶² On the removal of references to the independent reviewer between drafts, Mr Wheatley subsequently wrote:

[...] the Committee raised concerns that the role of the independent reviewers had in some way been ‘watered down’ when it came to assessing the legitimacy of the banks’ conditions of lending. Please be assured that on this point, the final drafting of the IRHP agreement clarified the fact that the parties to the agreement were the FCA and the banks but did not change the requirement of the independent reviewers to look at every case and assess whether the revised methodology was applied appropriately by the banks, including on the condition of lending. The independent reviewers specifically report to us on this particular point.¹⁶³

99. The FCA has acknowledged that the introduction of a £10 million cap on the size of an IRHP has excluded approximately one third of the largest IRHP review participants. The FCA should write to the Committee to explain its decision-making on this cap. This explanation must state whether, in its view, it represented a concession to bank lobbying, and if not, why not.

Possible conflicts of interest

100. Fox Williams, a law firm, submitted evidence raising potential conflicts of interest in the independent reviewers hired by each bank:

We are [...] aware of a case where an Independent Reviewer for a Participating Bank was implicated in mis-selling IRHPs whilst employed at another bank. This clearly in breach of the role of the reviewer envisaged by the FSA.¹⁶⁴

In response, the FCA said that banks had been asked to identify potential conflicts of interest, including the “nature and value of previous work undertaken by the independent reviewer” and their possible “involvement in the design of the products and sales processes being reviewed”. The FCA said that “to the best of our knowledge there are no former bank employees who were involved in the sale of IRHPs within the independent review teams”.¹⁶⁵

101. Fox Williams also said that that conflicts of interest could arise in bank’s own internal review teams:

We have found evidence that the Participating Banks are employing individuals as case reviewers who themselves have been implicated in mis-

¹⁶² Oral evidence by Martin Wheatley to the Treasury Committee, 10 February 2015, q 22

¹⁶³ Letter from Martin Wheatley to Andrew Tyrie MP, 16 February 2015

¹⁶⁴ SME0163

¹⁶⁵ Letter from Martin Wheatley to Andrew Tyrie MP, 16 February 2015

selling IRHPs either at the same bank or during their previous employment at another bank.¹⁶⁶

The FCA said that “some staff who were connected to the sale of IRHPs may be involved in some basic processing roles on the banks’ IRHP review teams”. However, the FCA said that “they are unable to influence customer outcomes”.¹⁶⁷ The FCA also said:

We understand concerns about bank employees who were involved in the sale of IRHPs having even a limited role in the banks’ review teams—however, more than 3,000 people have been involved in the banks’ IRHP reviews and it would be impractical for us to try and remove every one.¹⁶⁸

Complainant access to the independent reviewer

102. When asked by the Committee whether the FCA would expect independent reviewers to be “contacting the firms in order to obtain the firms’ views”, Mr Wheatley told the Committee that he would “expect them to”. However, he said that the FCA would not check whether this was happening on every case but “if we had complaints that they were not doing that we would go back to the bank and the skilled person to check on that”.¹⁶⁹

103. Evidence received by the Committee suggested that in some cases independent reviewers had not been contacting firms seeking their views and that firms had in some cases been barred from contacting the independent reviewer altogether. Larry Berkovitz, on behalf of a business participating in the IRHP review, said:

We have not heard from nor been allowed or given any access to the independent reviewer (“skilled person”) whatsoever; we do not even know who that person is; nor, crucially, what that person has been shown.

[...]

We have been told by RBS that—

- a) We are not able / entitled to have any contact with the independent reviewer (“skilled person”)
- b) They will not be providing copies of any document or transcript upon which they have relied in arriving at their decision.¹⁷⁰

Chris Mounsor, who owns a business participating in the IRHP review, told us that “There has been no clarity in the appeal process whatsoever and I have never had any direct contact with the [independent reviewer]. I don’t know his name and I have never spoken

166 SME0163

167 Letter from Martin Wheatley to Andrew Tyrie MP, 16 February 2015

168 Letter from Martin Wheatley to Andrew Tyrie MP, 16 February 2015

169 Oral evidence by Martin Wheatley to the Treasury Committee, 10 February 2015, q 17

170 SME0173

to him (despite requesting to do so)". He also said that "RBS have specifically denied me access to the [independent reviewer]" and that "the only information that our [independent reviewer] has had from us is 3rd hand and sanctioned by RBS—despite our requests".¹⁷¹

Complainant access to case information

104. Banks are required by the FCA to explain the rationale for redress on a case by case basis. The FCA said that "for customers to make an informed decision as to whether to accept a redress offer, banks are required to clearly explain how they have reached their determination, including what facts they have relied on".¹⁷² It also said:

Redress offer letters must at a minimum set out the basis of banks' decisions. In addition to the letter, all customers are also offered a face to face meeting. All letters are reviewed by independent reviewers, and they also oversee the meetings.¹⁷³

Regarding the quality of disclosures by banks, the FCA said that, overall, it believed "banks are explaining their decisions to a reasonable and consistent standard." However, it did acknowledge that "in a number of cases, the explanations provided by the banks in redress meeting have been judged to be insufficient by the independent reviewers. In these cases, the banks have had to hold the meeting again or provide a more comprehensive written explanation".¹⁷⁴

105. Regarding disclosure of information about a businesses' IRHP case, the FCA said that it expects "banks to carefully consider customer requests for copies of documents in line with their usual policies and legal obligations".¹⁷⁵ However, the Committee has received complaints about the willingness of banks to provide information used to form the basis of redress determinations to complainants. Fox Williams said:

Participating banks have refused to engage in dialogue as to the basis of the assumptions they have relied up and to provide documentary evidence for the conclusions drawn. In each case, we have been informed that the Participating Bank is not required to do so in accordance with the rules agreed between the bank and the FCA.¹⁷⁶

Berg said that, for one case, Barclays was "not prepared to disclose the internal documents upon which they relied when determining their offer of redress".¹⁷⁷ Bully banks said that

171 SME0169

172 FCA, Interest rate hedging product review—FAQs, as at 24 February 2015

173 Letter from Martin Wheatley to Andrew Tyrie MP, 16 February 2015

174 Letter from Martin Wheatley to Andrew Tyrie MP, 16 February 2015

175 SME0171

176 SME0163

177 Berg, Backbench business debate on Financial Conduct Authority Redress Scheme House of Commons, Main Chamber – 4 December 2014, Case study evidence examples, 3 December 2014

"banks refuse to disclose key documentation upon which the review decision and the redress decision are made".¹⁷⁸ AHV Associates, a corporate finance advice firm, said that "certain information about the IRHP transaction is often not made available, e.g. telephone transcripts, e-mails, etc".¹⁷⁹ AHV Associates also wrote that there appeared to be inconsistency between banks regarding the provision of information:

[Bank B] in particular has not provided telephone transcripts for customers incorporated as companies stating that it is not in a position to provide copies of voice recording or transcripts of any recorded call. However, other banks such as HSBC have provided such voice recording and transcripts.¹⁸⁰

Banks have, we are told, been unwilling to provide information as to how the pricing of alternative products has been arrived at. Seneca Banking Consultants, a claims management firm, said that banks "fail to provide any indication as to how they arrived at the cap rate (for example) or the value of the premium being charged".¹⁸¹

An appeals process?

106. The FCA states that the IRHP review scheme has "an in-built appeal mechanism". This is described as "a face to face meeting, during which they can [...], if appropriate, challenge the outcome. The banks and independent reviewers will carefully consider any points raised by customers and, if necessary, will review their decision".¹⁸² The FCA said that the circumstances where an appeal can be considered were:

After hearing the bank's explanations, the customer considers that the bank has clearly relied on erroneous information, such that the bank's rationale is based on faulty evidence; or

The customer believes that the bank has clearly missed an important piece of information, such that the bank's explanation is based on incomplete evidence.¹⁸³

Regarding the appeals process, the FCA also said:

It is important to understand that whilst we expect banks to explain their decisions, we do not expect them to present their evidence and debate their judgments in the same way that perhaps you might expect in a courtroom—the review does not replicate litigation. If customers wish to put all the evidence and facts on the table and then let experts argue over how to

178 Letter from Bully Banks to Vince Cable MP, 7 July 2014

179 SME0174

180 SME0174

181 SME0148

182 "Interest rate hedging product review—FAQs," FCA website, as at 24 February 2015

183 SME0172

interpret it in an adversarial way, then the IRHP review simply won't deliver this.¹⁸⁴

Complainants are limited in what information they are allowed to present during the appeals process. The FCA wrote that certain “expert reports” and “written submissions” are “unlikely to be viewed as new evidence and are therefore unlikely to change the outcome”.¹⁸⁵ Banks’ refusal to provide businesses with information about their case may also limit a customer’s ability to appeal. Berg wrote:

Barclays [...] confirmed that they were not prepared to disclose the internal documents upon which they relied when determining their offer of redress and so Berg and Vogue Jewels were unable to review the justification behind their decision.¹⁸⁶

Berg also wrote:

Businesses do not have full information and documentation. The Banks refuse to provide this. The Banks are seeking to limit the number of challenges (or appeals) to one, with requests for information and documents being treated as that ‘one challenge’. This means that businesses are having to appeal before they are in a credible position to do so, due to this lack of information and documentation and the Banks “have the upper hand”. It is not a level playing field.¹⁸⁷

107. The Committee has received one report of an appeal meeting where the independent reviewer had no knowledge at all of the customer’s case. Mr Mounsor said:

At the appeal process in August with the bank an IR from KPMG did attend—but at the outset of the meeting this IR read out a statement that “he was not the IR who oversaw my case, he had no knowledge of our case, that he was an observer and that he would ask no questions nor answer any”—which is what happened during a four hour meeting.¹⁸⁸

108. Businesses who are eligible to take complaints to the FOS can still do so if dissatisfied with the outcome of their review.¹⁸⁹ While considered by the regulator, a special FOS scheme for the IRHP review was not created:

In our announcement in June 2012 we said we would approach the FOS to ask if it would consider offering a specific Scheme for dealing with the

184 SME0172

185 SME0172

186 Berg, Backbench business debate on Financial Conduct Authority Redress Scheme House of Commons, Main Chamber—4 December 2014, Case study evidence examples,” 3 December 2014

187 Berg, Summary note of issues regarding the sale of interest rate hedging products (IRHP), 3 December 2014

188 SME0169

189 Oral evidence from Martin Wheatley to the Treasury Committee, 10 February 2015, q 23

outcome of the review and related matters. We have decided not to proceed with a FOS Scheme for customers dissatisfied with the determination of their case. We accept that a FOS Scheme will lengthen the review process. However, this means it is extremely important that the Skilled Persons are effective in their role, providing independent oversight and ensuring that the banks follow the FSA's position and provide fair outcomes for consumers.¹⁹⁰

109. Mr Bebb has argued for a stronger appeals process within the IRHP review. He said:

There would be much more confidence in that scheme if there were an appeals process. [...] It would give some comfort without complicating issues too much if, for example, assessors working for one bank in the redress scheme were able to provide an appeals process for another bank in it. That may not be perfect, but it would help to avoid over-complicating what is already a complicated redress process and it would give businesses the confidence that there is an appeal process and that they can turn to somebody else to argue their case. We should be very concerned about having a redress scheme without any appeal process, as it goes against the principle of natural justice, while opening up the door to litigation, when the whole point of the redress scheme was supposed to be to avoid litigation.¹⁹¹

110. The FCA does not know how many redress determinations have been altered as a result of the appeals process.¹⁹²

The scale of the problem

111. 29,568 IRHP sales were considered by the IRHP review.¹⁹³ In total, 1,223 complaints have been received by the FCA about the redress scheme, representing 602 unique correspondents. Of these, 116 unique correspondents have complained about their redress offer, while 45 have complained about the conduct of their bank.¹⁹⁴

112. The FCA has maintained that the IRHP review has worked as it intended. Mr Wheatley said:

To say that there were complaints—there absolutely have been complaints and some of the small businesses have felt it was unfair or unbalanced against them. We have looked into the process and we consider the process to have been reasonable and fair.¹⁹⁵

¹⁹⁰ Letter from Clive Adamson to banks, 29 January 2013

¹⁹¹ HC Deb, 24 Oct 2013, Col 462

¹⁹² Letter from Martin Wheatley to Andrew Tyrie MP, 16 February 2015

¹⁹³ Progress of sales through stages of the review as at 31 December 2014, Financial Conduct Authority, 28 January 2015

¹⁹⁴ Letter from Martin Wheatley to Andrew Tyrie MP, 16 February 2015

¹⁹⁵ Oral evidence from Martin Wheatley to the Treasury Committee, 10 February 2015, q 18

113. Members of the House of Commons have raised a number of concerns about the IRHP review. Primarily, complaints raised were regarding a lack of consistency in the application of the scheme between banks,¹⁹⁶ a lack of transparency about how the scheme was being run,¹⁹⁷ a lack of appeals process,¹⁹⁸ and the inappropriate nature of some alternative redress offered to businesses.¹⁹⁹

114. The FCA has consistently maintained that the redress process has worked as intended. But there have been complaints that the process of the IRHP review falls short of delivering fair and reasonable redress. It has been difficult for this Committee to determine, however, whether these complaints are examples of isolated exceptions to an adequate process, or are signs of a wider, systemic problem with the review.

115. This in itself is indicative of a flaw in the process which the FCA should address. In particular, the FCA should collect the information necessary to establish whether there are systemic failures in the review. The FCA should publish its findings, a summary of the complaints it has examined, and take any action it decides is appropriate to ensure that all customers receive fair and reasonable redress.

Transparency of the voluntary agreements

116. The agreement between the FSA and banks itself was not published at the time the IRHP review commenced. Following a request from the Committee for copies of the agreements, the FCA responded on 26 June 2014, stating that it was unable to disclose the agreements without permission from the banks themselves. The FCA stated that it had sought guidance from external legal counsel that found that “a request from a select committee does not of itself allow the FCA to disclose confidential information”,²⁰⁰ and that:

The FSA has been able to provide materials protected by section 348 to the select committee and the Parliamentary Commission on Banking Standards when the relevant firms have consented to disclosure of the information. This is not the position in this case.

We have considered whether we could provide the Committee with an anonymised version of the agreement. However, given that the agreement reached with all the banks was almost identical, this would still result in disclosing information which is confidential under section 348.²⁰¹

Section 348 of the Financial Services and Markets Act states:

¹⁹⁶ HC Deb, 4 Dec 2014, Col 479–480

¹⁹⁷ HC Deb, 4 Dec 2014, Col 484

¹⁹⁸ HC Deb, 4 Dec 2014, Col 482–484

¹⁹⁹ HC Deb, 4 Dec 2014, Col 489, 492–493

²⁰⁰ Letter from Sean Martin to Andrew Tyrie MP, 26 June 2014

²⁰¹ Letter from Sean Martin to Andrew Tyrie MP, 26 June 2014

(1) Confidential information must not be disclosed by a primary recipient, or by any person obtaining the information directly or indirectly from a primary recipient, without the consent of—

(a) the person from whom the primary recipient obtained the information; and

(b) if different, the person to whom it relates.²⁰²

117. The Committee was not satisfied with the FCA's response and raised the matter with the FCA publicly on three separate occasions: 1 July 2014, 9 September 2014 and 10 February 2014.²⁰³ On 12 February 2015, following its eventual disclosure to the Committee by the FCA, a generic copy of the agreements between the FCA and banks was published by the Committee.²⁰⁴ This was following the FCA obtaining permission for publication from all banks participating in the IRHP review.

118. Section 348 of the Financial Services and Markets Act 2000 (FSMA) prevents the FCA from disclosing confidential information to third parties without the permission of the regulated entity to which that information relates. The FCA cited this provision as the reason for its reluctance to provide the Committee with the agreement it had reached with banks about the IRHP review. At no stage did the FCA suggest that the Committee's request was unreasonable. The FCA did eventually provide the agreement, but only after considerable delay. The FCA should come forward with suggestions as to how such difficulties could be prevented in future.

Tailored Business Loans

119. Over the course of the review of standalone IRHPs, the FCA identified, as a potential problem, loans with the features of interest rate hedging facilities written into the contract.²⁰⁵ Martin Wheatley, Chief Executive of the FCA, wrote in a letter to the Financial Secretary of the Treasury:

[...] the size of the issue is potentially significant. Data collected from Barclays, HSBC, Lloyds, National Australia Bank Group and RBS shows that more than 60,000 of fixed rate loans with mark to market break costs have been sold since 2001, significantly more than the 40,000 standalone IRHP's covered by our review.²⁰⁶

202 Financial Services and Markets Act 2000

203 Qq 728–730; Oral evidence by John Griffiths–Jones to the Treasury Committee, 9 September 2014, Qq 168–169; Oral Evidence by John Griffiths–Jones to the Treasury Committee, 10 February 2015, Qq 2–6

204 Letter from Clive Adamson to banks, 29 January 2013; FCA and banks, Agreement relating to past sales of interest rate hedging products, June 2012; FCA and banks, Supplemental agreement relating to past sales of interest rate hedging products, January 2013

205 Letter from Martin Wheatley to Rt Hon Greg Clark MP, 9 May 2013

206 Letter from Martin Wheatley to Rt Hon Greg Clark MP, 9 May 2013

120. The campaign group Bully Banks identified at least ten banks whose customers had complained to the Financial Ombudsman Service about the sale of commercial loans with ‘embedded’ interest rate hedging facilities.²⁰⁷ This Committee has received a large number of written submissions, in particular from customers of Clydesdale Bank.

121. Clydesdale Bank plc, through both its own branches and through those under its trading name Yorkshire Bank, sold both standalone IRHPs and loans with embedded swaps. These loans were sold under its ‘Tailored Business Loan’ (TBL) brand. Clydesdale’s target market for TBLs was “a very broad range of SMEs”.²⁰⁸ Clydesdale wrote that it sold 11,271 loans across all of its Tailored Business Loan variants between September 2002 and July 2012. This included both fixed-rate products and more complex arrangements. Between December 2001 and July 2012, the firm states that it provided 8,372 fixed-rate Tailored Business Loans to 6,153 customers.²⁰⁹

Break costs and similarities with standalone IRHPs

122. The hedging element of a TBL and a standalone IHRP have very similar features and economic functions. David Thorburn, Chief Executive of Clydesdale and Yorkshire banks, described TBLs as having “many of the effects of a swap”.²¹⁰ The FCA said that TBLs “have a very similar economic impact to an IRHP coupled with a variable rate loan”.²¹¹ Mr Wheatley wrote to the Government:

A customer who has taken out a loan with an ‘embedded’ IRHP may be faced with exactly the same repayment features and exactly the same (potentially large) break cost that the customer would have faced had the customers taken out a loan and a standalone IRHP.²¹²

123. Like standalone IHRPs, TBLs can incur break costs when a customer exits the loan early. Debbie Crosbie, Executive Director of National Australia Group Europe, Clydesdale Bank’s parent company, explained how mark to market TBL break costs were calculated:

[...] we look at [...] the difference between the interest rate that is prevailing at the moment and when the interest rate was set, and for the remaining period of time, the customer is charged the difference effectively of those interest rates.²¹³

This break cost calculation process for a TBL appears to be the same as for a standalone IRHP delivering the same hedging function. Mr Thorburn said:

207 SME0116

208 Q 409

209 SME0142

210 Q 425

211 SME0140

212 Letter from Martin Wheatley to Rt Hon Greg Clark MP, 9 May 2013

213 Q 431

As long as it is for the same loan for the same duration broken at the same point in time and entered into at the same point in time [the break cost] should be the same.²¹⁴

124. Break costs on TBLs can be substantial. The costs reported to the Committee that customers have experienced have been as high as 40 per cent of the principal value of the original loan.²¹⁵ For example, Michael Neeld, who purchased a TBL, said that he faced a break cost of “up to £200,000” on a loan of £1,000,000 of which £600,000 was fixed for 22 years.²¹⁶ Lawrence Beere, who also purchased a TBL, said that he faced a “breakage cost in excess of £1.1 million” on a £3.9 million facility.²¹⁷

125. TBL break costs therefore appear to be significantly higher than the “1 per cent to 3 per cent of the capital loan” that Mr Thorburn estimated the standard break cost of a residential mortgage to be.²¹⁸ Part of the reason for these higher break costs may be the long duration of interest rate fix in many TBLs. Mr Thorburn said:

Although someone may have a 25-year mortgage, they would tend to fix the term for two, three, maybe five years maximum, whereas some of these business loans were fixed for up to 20 years, so you have a huge difference in the break costs because of the different term of them. The other one is that the standard practice in this country is to have a cap on mortgages for domestic customers and, therefore, there is a limit beyond which the customer’s break costs cannot go. For a business mortgage, that was not the case.²¹⁹

126. To protect themselves against the risk of providing a TBL’s hedging function, banks need to hedge the risk themselves. The FCA said that “the bank will have entered into a separate IRHP with a third party in order to manage its financial risk of entering into the loan”.²²⁰ Mr Thorburn confirmed that this was the case for Clydesdale Bank.²²¹ Break costs therefore partially reflect the cost to the bank of their own underlying hedge.

Disclosure

127. A number of Clydesdale’s customers wrote to the Committee stating they did not and could not fully understand certain features of the product they were sold, in particular break costs.²²² Anthony Maher wrote that “at the point of sale of the loan we were never

214 Q 437

215 SME0083

216 SME0099

217 SME0023

218 Q 452

219 Q 451

220 SME0140

221 Q 402

222 SME0010; SME0094; SME0070

given any information about break costs and were certainly not warned of the possible magnitude of the break costs”.²²³ Gael Properties wrote that they “would definitely not have taken on” a TBL had they been given “a clear indication of the likely break cost”, which did not happen “due to the lack of documentation provided and explanations given”.²²⁴ Laurence Beere, the owner of a small business who had purchased a TBL, said:

[...] the information that we were given was sorely lacking and I can sum that up simply by saying if in the process of completing our loan they had turned around and said to me, “Do you understand that on day one, you will have a breakage cost in excess of £1 million relative to this £3.9 million loan?” do you honestly think that I would have said, “That is perfectly acceptable”? For the bank to say, “Well, we told you there were breakage costs, so you should have understood” that is to me where trust breaks down. The bank understood what it was selling and it relied upon the fact that I did not.²²⁵

128. In particular, it appears that the size of potential break costs was often not set out in detail in the terms and conditions of the loan document. For example, Mr Neeld said that his product literature said that break costs “could be substantial” and that this explanation of risks “is wholly inadequate and provides no quantum of potential cost or the cost relative to the value of the loan”.²²⁶ Clydesdale said that some break cost information was provided in the form of a flyer.²²⁷ However, this information was not contained within the offer letter itself, and was provided late in the sales process.²²⁸ Patrick Walton, a former Managing Partner of Clydesdale’s Financial Solutions Centre in Leeds, said:

My review of customer files found no clear evidence that any bespoke TBL presentation was made to customers to explain the complexity of the TBL product. Features, risks and benefits explanation were simply conveyed by the general statement that the product would be “marked to market” if terminated early. The treasury experts may have sought to explain this at the meeting, however, I suspect that given the nature of the [Clydesdale and Yorkshire Bank] customer base they would not have appreciated the full ramifications of the contract into which they were entering.²²⁹

He also said that Clydesdale’s “documentation was inferior to that used at other banks to explain the products held by the customer”.²³⁰ Furthermore, Mr Walton said that without

223 SME0069

224 SME0042

225 Q 205

226 SME0099

227 SME0165

228 Q 411

229 SME0155

230 SME0155

“detailed explanation” it would be “unusual that SME customers would consider this key risk”.²³¹ Tim Murphy of Seneca Banking Consultants told the Committee:

On the TBLs, I think, with a standalone bank facility letter, it is difficult for a non-financially-aware person to understand all the nuances of that facility letter and it is skewed towards the bank. It is in the bank’s favour.²³²

129. Some customers believed that break costs would be comparable to regulated residential mortgages. The proprietors of the Muker Village Store wrote to the Committee saying that their “understanding was that we were taking out a Fixed Rate Loan much like the Fixed Rate Mortgages we had had in the past”.²³³ Similarly, NAB Customer Support Group told the Committee:

Most affected customers perceived that any break cost would be in the region of between 1% or 2% of the amount of the loan, consistent with those of domestic mortgages.²³⁴

130. When asked whether it was possible that customers of Clydesdale could have misunderstood the break costs of a TBL by thinking they were similar to a residential mortgage, Mr Thorburn said it was “possible” because “customers do not always read what you give them”.²³⁵ However, when asked by the Committee whether “the terms and conditions letter [...] issued with the loans [...] would not pass a plain English test”, Mr Thorburn replied “yes”.²³⁶ He said:

I think the standard terms and conditions were unfortunately the usual bank terms and conditions, which customers do not find very easy to understand. There were other documents that were used in this process, such as the flyer that accompanied the facility letter, which I think is pretty plain English. The terms and conditions themselves, no, they were not. That is one of the things we have learned, that that kind of language is unhelpful to customers.²³⁷

131. Discussing whether the level of break costs could have been anticipated by customers, Mr Thorburn conceded that he did “not think that customers could reasonably have anticipated” the high level of break costs.²³⁸ He agreed that many SME customers have very limited financial sophistication,²³⁹ and that “with the benefit of hindsight it was clear we were selling [TBLs] to customers who did not always understand what they were getting

231 SME0155

232 Q 233

233 SME0022

234 SME0128

235 Q 455

236 Q 450

237 Q 449

238 Q 432

239 Q 410

into in a falling interest rate environment.²⁴⁰ He acknowledged that “there is always that issue that the bank has a lot more information and sophistication compared with the customer”, that the sales process “should be designed to close that gap and help the customer understand what they are getting into”, and said that Clydesdale operated with “an honest endeavour to do just that”.²⁴¹

132. Mr Thorburn also admitted that the bank itself did not anticipate the high level of break costs:

[...] we did not foresee potentially the scale of break costs [...] in a situation where interest rates fell sharply from a relative high to a historic low and stayed there for a long period of time. That exaggerates the break costs required for customers caught at that moment in time.²⁴²

He also said:

The shortcoming on that product was when we illustrated the break costs we did not foresee the interest rate circumstances that took place between 2008, 2009 and today. I think the product actually works but we didn’t see that scenario playing out.²⁴³

Sales practices

133. Some of Clydesdale’s customers reported the use of pressure sales tactics by the bank in selling TBLs. Andrew Dykes of Crusoe Hotel wrote that, prior to the sale of their TBL, Clydesdale “bombarded us with phone calls”.²⁴⁴ GW & M Singleton & Sons said that, following their relationship manager’s move to Clydesdale, they “put pressure” on the business to transfer their loans to Clydesdale.²⁴⁵ Ballantyne Property Services described being “exposed to extreme pressure to the point of bullying and intimidation” in 2008 when Clydesdale attempted to increase the interest rate of their TBL agreed just over a year before.²⁴⁶

134. Patrick Walton, a former Managing Partner of Clydesdale’s ‘Financial Solutions Centre’ in Leeds, wrote negatively about Clydesdale’s sales process. Mr Walton said that “there was immense pressure to sell TBLs.” He said that the bank had a culture in which there was a “pressure to sell at all costs that was driven from the top of the organisation.” Staff who did not meet targets faced “disciplinary action”. Mr Walton described

240 Q 396

241 Q 463

242 Q 440

243 Q 465

244 SME0087

245 SME0066

246 SME0037

Clydesdale's culture "to be the most corrosive and threatening [he had] ever encountered".²⁴⁷

135. Mr Thorburn admitted that Clydesdale was undergoing rapid growth pre-crisis and that, sometimes, "staff overstepped the mark".²⁴⁸ He told the Committee:

There was a lot of organisational focus on doing more business with existing customers, attracting new customers [...]. It was an environment of growth and in the tailored business-loan product we felt that we had something that, because of its relative simplicity, was a bit different from some of the other banks. Therefore we put quite a lot of emphasis on introducing this service to customers. It should not have gone beyond that to anything associated with a pressurised sales environment. Sometimes staff overstepped the mark and when we find evidence of that, we will fix it for the customer. That is kind of a long answer but I just want to be open with you. It was a time of growth and we did focus on the product but it should never have crossed the line into being a pressurised sale from a customer perspective.²⁴⁹

136. However, Clydesdale also defended its practices. Mr Thorburn told the Committee that the bank's treasury representatives involved in the transaction "were regulated" and "trained to sell" TBLs.²⁵⁰ However, the FCA challenged the relevance of this statement. Chris Woolard, Director of Policy, Risk and Research at the FCA, said that while these individuals were "financial advisers who were regulated", this was only for "the sale of products that were within our regulatory boundary."²⁵¹ According to Mr Woolard:

What you can't do is simply say here is someone who is qualified to sell regulated products and they are going to take what is effectively an unregulated product and somehow they are regulated while they are selling that. There is a bit of a misnomer in terms of what was said on the record there.²⁵²

137. These are not the first allegations of poor incentives and sales cultures to be made against the banking sector. As the Parliamentary Commission on Banking Standards concluded, poorly designed incentive schemes and cultures within banks have distorted behaviour and encouraged mis-selling and poor conduct:

Though they have been much less generous than in investment banking, poorly constructed incentive schemes in retail banking have also hugely distorted behaviour. They are likely to have encouraged mis-selling and

247 SME0155

248 Q 416

249 Q 416

250 Q 412

251 Q 703

252 Q 703

misconduct. Senior management set incentive schemes for front-line staff which provided high rewards for selling products and left staff who did not sell facing pressure, performance management and the risk of dismissal. It shows a disregard for their customers and front-line staff that some senior executives were not even aware of the strong incentives for mis-selling caused by their own bank's schemes. These remuneration practices are ultimately not in the interests of banks themselves, still less of the customers they serve.²⁵³

Regulation of TBLs

138. The Financial Conduct Authority's (FCA) remit, or regulatory perimeter, is determined by the Financial Services and Markets Act 2000 (Regulated Activities Order) 2001 (RAO). In written evidence to the Committee, the FCA said that standalone IRHPs were covered by the perimeter of regulation, but that TBLs were not. They said:

Standalone IRHPs are contracts for differences (CFDs) for the purposes of Article 85 of the Regulated Activities Order. A CFD includes rights under a contract the purpose of which is to secure a profit or avoid a loss by reference to fluctuations in, for example, interest rates. Where interest rate contracts are purchased separately to a variable rate loan which the client wishes to hedge, they are a form of CFD.

In contrast, [Tailored Business Loans] are not CFDs because the purpose of the loan is not to secure a profit or avoid a loss by reference to fluctuations in interest rates. Rather, the purpose of the loan from the customer's perspective is to borrow money on the specified terms in the loan, for example, relating to the interest rate payable on the loan.²⁵⁴

The Committee sought a legal opinion from its specialist advisor, Jonathan Fisher QC, who agreed with the FCA on this matter.²⁵⁵ Commercial loans are not listed as a regulated activity in the Regulated Activities Order 2001.²⁵⁶ As a result of this, the FCA has extremely limited powers to investigate or bring enforcement action in respect of the sale of loans with embedded interest rate hedging features. The existing FCA IRHP review does not extend to TBLs or other loans with embedded interest rate hedging features.²⁵⁷

139. However, as discussed previously, the hedging features of TBLs are extremely similar, if not identical, to those of standalone IRHPs. Mr Woolard summarised the contrast between the legal treatment of TBLs and their economic impact on customers:

²⁵³ Parliamentary Commission on Banking Standards, *Changing Banking for Good*, First Report of Session 2013-14, HC 175-II, June 2013, p 131, para 119

²⁵⁴ SME0140

²⁵⁵ SME0162

²⁵⁶ Regulated Activities Order 2001

²⁵⁷ SME0162

[...] in many ways you could say they walk like a duck and quack like a duck but, legally, they are a very different product.²⁵⁸

140. Indeed, Clydesdale told the Committee that avoiding regulation was one of the reasons they created TBLs. In particular, Clydesdale wished to avoid the complex documentation that the sale of regulated products required. In explaining the design of TBLs, Mr Thorburn said:

The difference was simplicity essentially. A standalone interest rate hedging product will have a separate ISDA agreement quite separate to the loan. The documentation associated with it is really complex and really extensive. A tailored business loan provides potentially a similar outcome to an interest rate hedging product but without the complexity so the documentation is much, much simpler. It was modelled on a domestic mortgage product to try to make it more understandable. In a nutshell that is the difference between the two.²⁵⁹

Mr Thorburn also said:

[...] because the standalone [IRHP] is a regulated product you are required to go through a certain process, uses the documentation, which is very complex. That was something we did not need to put our smaller business customers through. If they wanted a loan that was fixed for a period of time we didn't need to put them through all that.²⁶⁰

141. The Committee explored the issue of the regulatory perimeter on multiple occasions, particularly in relation to commercial loans with 'embedded' interest rate hedging products, such as Tailored Business Loans. The FCA, when asked about problems illustrated by the possible mis-sale of certain TBLs by Clydesdale Bank, said:

I think we are of the view that this is a product that appears to be so close to one where we have had significant regulatory questions it would be better if we had the ability to regulate it.²⁶¹

142. However, banks expressed concerns about the consequences of a widening of the regulatory perimeter. Shawbrook Bank told the Committee that they supported "proportionate" regulation that created "good customer outcomes", but that there was a risk that overzealous change "could inhibit supply of credit for business lending".²⁶² Similarly, Lloyds Banking Group said that the current perimeter of regulation was sufficient. It told the Committee that "the distinctive needs of SMEs" needed to be "considered so that there are not unintended consequences from applying a one-size fits all

258 Q 678

259 Q 392

260 Q 486

261 Q 701

262 SME0123

solution.” It also believed that “increasing prescriptive and standardised rules” could “limit the flexibility and efficiency” of small business support.²⁶³ RBS questioned “whether extending the perimeter of regulation to include commercial lending would help the supply of finance to SMEs”, as to do so would “increase the operating costs of providers of SME lending, further depressing the weak returns on such lending.” It also warned that increased “costs of compliance, which include a significant fixed cost element, would also disproportionately affect smaller, challenger banks”.²⁶⁴

143. Other witnesses told the Committee that banks would not change without some form of intervention. Mr Tomlinson told the Committee that “nothing” would “happen by leaving the banks to do it themselves.”²⁶⁵ Others were critical of the regulators’ ability to create effective change, but believed that a change in regulation could lead to better outcomes for SMEs. Mr Roe, of the campaign group Bully Banks, said cultural change within the regulator to become “much more assertive” was required.²⁶⁶ Professor Mark Watson-Gandy, of Thirteen Old Square Chambers, described the current regulatory framework as combining “the two unattractive qualities of being leviathan in its volume and at the same time strikingly patchy in the protection it affords.” However, he appreciated that “when it does work, it works well.”²⁶⁷ Professor Watson-Gandy called for the regulatory perimeter to “be expanded to include more lending and selling of financial products to SMEs”, as businesses can misunderstand the regulatory protection afforded to them.²⁶⁸ Jonathan Fisher QC said, “In so far as issues of consumer protection are concerned, there is a lacuna in the law”.²⁶⁹

144. Small businesses’ understanding of financial products and the current regulatory perimeter has been highlighted as problematic, in that larger SMEs are not afforded the same protections of smaller businesses. Frances Coulson, Head of Insolvency and Litigation at Moon Beaver Solicitors and former President of R3, the insolvency trade body, thought that an “SME at the smaller end of the SME market is slightly akin to a consumer” in their understanding of financial transactions.²⁷⁰ This is corroborated by the CBI, who have found that SMEs “find it difficult to access the skills necessary” to understand financial transactions. According to the CBI, “25% of SMEs have a formally qualified financial manager”. As a result, they state that “the resource and skills to do deals is often not held internally” and that only 16% of SMEs “consult external advisers before making finance decisions”.²⁷¹

263 SME0118

264 SME0093

265 Oral evidence by Lawrence Tomlinson to the Treasury Committee, 29 January 2014, q 107

266 Q 256

267 SME0061

268 SME0061

269 SME0162

270 Q 339

271 SME0080

145. The Government, however, believes the regulatory perimeter should not be extended to business lending. The Economic Secretary to the Treasury said:

There is this fundamental principle that business lending itself is not regulated. It is provided normally by regulated entities but business loans themselves have not traditionally been regulated and I think according to the industry, there is not an appetite for general business lending to come under regulation.²⁷²

146. The FCA has written twice to the Treasury to raise concerns about the sale of loans with embedded interest rate hedging features and the FCA's inability to address the problem under the current perimeter of regulation.²⁷³ However, the Treasury appears not to have responded formally to the FCA on the matter:

I am not aware—and this is just from memory—if we replied to Martin's letter as such. Certainly, he would have had frequent meetings with the then FST, so it would have been discussed there in the context of TBL.²⁷⁴

In oral evidence, the Committee suggested to the Economic Secretary to the Treasury that the Government's Small Business, Enterprise and Employment Bill could be used to change the FCA's perimeter of regulation.²⁷⁵ However, the Government has published no plans to alter the regulatory perimeter to include loans with embedded interest rate hedging features.

147. We have received evidence suggesting that Clydesdale Bank mis-sold Tailored Business Loans. Clydesdale has itself admitted that its terms and conditions letters would not pass a plain English test, and that its TBL customers could not reasonably have anticipated the high levels of potential break costs to which they had exposed themselves. Many small businesses indeed did not grasp their exposure to such high break costs, nor could they reasonably have been expected to do so.

148. It appears that the bank did not explain the potential scale of break costs in a low interest rate environment because the bank itself had not taken into account this potential risk. Banks, however, should be the experts in assessing the potential risk of products they sell, and explain those risks to their customers. The sale of TBLs has led to considerable consumer detriment. The bank's failure adequately to assess the potential risk of its product may explain the detriment that the bank has caused to its customers, but does not excuse it.

149. From the point of view of the customer, the services provided by the hedging element of a loan with an embedded interest rate hedging facility—such as a Tailored

272 Q 741

273 Letter from Martin Wheatley to the Financial Secretary to the Treasury, 9 May 2013; Letter from Martin Wheatley to the Financial Secretary to the Treasury, 23 February 2013

274 Q 769

275 Qq 781–782

Business Loan—and a stand-alone IRHP are extremely similar, if not identical. But stand-alone IRHPs are regulated, while loans with embedded interest rate hedging facilities are not. It is a logically inconsistent result of the perimeter of regulation that products whose effects may be identical fall on both sides of the perimeter.

150. Clydesdale understood that TBLs were unregulated. It created TBLs to avoid requirements imposed by the regulator on the sale of a regulated product, IRHPs. It claims that this was to simplify the associated documentation, and to make the product easier for customers to understand. The use of TBLs has left regulators powerless to enforce compensation for customers to whom products were mis-sold, as they have done with IRHPs. Clydesdale created a product that retained the risks and complexities of the regulated product, but had none of the safeguards.

151. The Treasury should publish an assessment of the feasibility, benefits and costs of adjusting the perimeter of regulation to cover loans with features of interest rate hedging products. This assessment will need to take into account the possibility that other products may inadvertently be included in the perimeter as a by-product, and the negative consequences that this could entail.

Clydesdale's review of TBLs

152. Clydesdale has taken some action to address allegations that it mis-sold TBLs. Mr Thorburn told the Committee that in 2012, Clydesdale made adjustments to the TBL products they sold due to “difficulties surrounding their sale”, noting that the type of product Clydesdale now sold was a “straightforward fixed-rate loan.”²⁷⁶ He said:

[...] we further simplified the products so we still offer a fixed-rate business loan, a simpler fixed-rate business loan, to our customers today but the more complex ones—the category A and B products, as the FCA describes them—have been off sale since this situation arose.²⁷⁷

153. As well as its FCA-mandated review of standalone IRHPs, Clydesdale has also been voluntarily reviewing past sales of some TBL products. However, not all TBL products are eligible to be part of Clydesdale's voluntary review. TBLs where “the interest rate was fixed for the period of the loan or any part of it”, are excluded.²⁷⁸ Mr Thorburn said:

What we excluded from it were variable-rate tailored business loans and fixed-rate tailored business loans that do not have the same characteristics as the more complex interest-rate hedging products [...].²⁷⁹

276 Qq 396, 405

277 Q 396

278 Clydesdale Bank, Information relating to Clydesdale and Yorkshire Banks' Review of Interest Rate Hedging Products (IRHPs), April 2013

279 Q 458

In written evidence, Clydesdale said that its voluntary TBL review did not apply to 8,372 fixed rate loans—81 per cent of its TBL portfolio.²⁸⁰

154. Clydesdale have justified the exclusion of fixed-rate TBLs from their review of TBLs on the basis that they are not equivalent in complexity to standalone fixed-rate IRHPs. Ms Crosbie of Clydesdale Bank told the Committee:

The FCA standalone review detailed a set of products and they refer to them as category A, B and C. We accepted that a number of our tailored business loans had very similar characteristics, in that they would also be categorised as A, B and C. Where we found that to be the case we have opted all of those products in [...] Any products that have been excluded from that review are fixed-rate products and we believe they are different, simpler to understand because the customer gets a fixed payment for a fixed period of time and that payment will never change as long as the customer does not want to terminate the agreement early.²⁸¹

155. Standalone interest rate hedging products which exchange or “swap” two interest rate payments are used to fix the interest rate that a customer pays.²⁸² Such products are included in the in the FCA review as Category B.²⁸³ Fixed rate TBLs also fix the interest rate that a customer pays. Functionally, these two products are therefore very similar. Furthermore, the Financial Ombudsman Service has been determining TBL cases in a similar way to standalone IRHP cases. Tony Boorman, then Interim Chief Executive and Chief Ombudsman of the Financial Ombudsman Service, said:

The analysis that my ombudsmen have done suggests that our outcomes for the tailored business loans will be very similar to the analysis that we are undertaking in relation to the swaps cases.²⁸⁴

156. Clydesdale states that its own review uses “the same internal and external governance for the review of its in-scope Tailored Business Loans, including the same Independent Reviewer (Berwin Leighton Paisner), as it has used for the formal FCA review of standalone IRHPs”.²⁸⁵ However, aside from information submitted by Clydesdale to this Committee in in June 2014, and Clydesdale’s publication *Information relating to Clydesdale and Yorkshire Banks’ Review of Interest Rate Hedging Products (IRHPs)*, dated 9 April 2013, publicly available information on the operation and progress of Clydesdale’s voluntary

280 SME0142

281 Q 472

282 Financial Conduct Authority, [Interest rate hedging product review – FAQs](#), 11 August 2014

283 Financial Conduct Authority, [Interest rate hedging product review – FAQs](#), 11 August 2014

284 Q 711

285 SME0142

review remains limited.²⁸⁶ For example, Clydesdale has not published statistics on the progress of its review.

157. Customers with Fixed Rate Loans—which are all outside Clydesdale Bank’s voluntary TBL review—can complain to the bank directly through its normal complaints process. Ms Crosbie told the Committee that Clydesdale had sold “just over 8,300” fixed-rate TBLs and by June 2014 had “received 550 complaints about the sales process”.²⁸⁷

158. Ms Crosbie told the Committee that offers following reviews of past complaints are “informed by any adjudications [Clydesdale] have had from FOS”.²⁸⁸ She said that, of these complaints, Clydesdale project that somewhere “in the order of 60%” of customers will receive “some form of redress”. The main reason for redress were problems “around break cost”.²⁸⁹ When comparing findings of the FCA review of sales of standalone IRHPs to the sale of TBLs, Ms Crosbie said she did not see “the lack of understanding through the sales process that was evident in standalone review [...] mirrored” in the sale of TBLs.²⁹⁰

159. In the absence of an FCA review of Tailored Business Loan sales, Clydesdale has created its own review to assess potential mis-selling of such products. It has employed the same independent reviewer as for its FCA review of IRHPs.²⁹¹

160. However, Clydesdale’s review excluded fixed rate products.²⁹² This represents 80 per cent of all TBL sales.²⁹³ Customers with fixed rate products can complain to the bank through its usual internal complaints process.²⁹⁴ Clydesdale told us that this exclusion was on the grounds that there was no equivalent product within the FCA review.²⁹⁵

161. The lack of public oversight, minimal transparency and limited coverage of the scheme mean that the Committee cannot be confident that Clydesdale’s separate internal review will deliver outcomes equivalent to the FCA review upon which it is intended to be based. If Clydesdale’s aim is to build public trust in its actions, it should address all three of these problems.

286 Clydesdale Bank, Information relating to Clydesdale and Yorkshire Banks’ Review of Interest Rate Hedging Products (IRHPs), 9 April 2013

287 Q 415

288 Q 443

289 Q 501

290 Q 470

291 Clydesdale Bank, Information relating to Clydesdale and Yorkshire Banks’ Review of Interest Rate Hedging Products (IRHPs), 9 April 2013

292 Clydesdale Bank, Information relating to Clydesdale and Yorkshire Banks’ Review of Interest Rate Hedging Products (IRHPs), 9 April 2013

293 SME0142

294 Clydesdale Bank, Information relating to Clydesdale and Yorkshire Banks’ Review of Interest Rate Hedging Products (IRHPs), 9 April 2013

295 Q 472

Challenging banks through the courts

162. SMEs which are not covered by the FOS can challenge decisions by their banks through the courts. Bully Banks wrote: “the regulation of the banks in a free market economy is traditionally left to the courts and on many occasions the SME is advised to look to the courts for a remedy if they have a complaint which the bank refuses to recognize”.²⁹⁶

163. However, many who wrote to the Committee complained that the cost of taking a bank to court would often be prohibitive. Bully Banks wrote:

The banks conduct litigation with a strategic aim of increasing the costs of litigation as a deterrent to the customer to take or pursue legal proceedings. The costs of proceedings are huge. Just one current example will suffice to illustrate the point: one of our members with an IRHP to the value of £3.5 million is litigating against a bank for what appears to be an obvious mis-sale where the costs of both parties are currently estimated to be of the order of £700K. This level of costs is beyond the reach of the vast majority of SMEs [...]²⁹⁷

Minotaur, a claims management company, gave examples to the Committee that “highlight the plight of directors/owners who having appealed to the authorities available to them, realise their only real option for redress is court action that they are unable to finance”.²⁹⁸ Leander Joseph Difford, a care home owner, wrote to the Committee about his legal case against Clydesdale:

We had already paid out approximately £40,000 in legal fees. On the 29th January our lawyers asked for another £10,000 to appear in court the next day. We could not afford it and later that day we decided as a family that we could no longer fight [...]²⁹⁹

164. Bully Banks also noted that the continuing relationship between an SME and its bank made legal action difficult, saying that “the practical reality is that, given the dependence of the SME on its bank, it is an incredibly difficult decision for an SME to decide to sue its bank.”³⁰⁰

Financial Ombudsman Service

165. The Financial Ombudsman Service (FOS) currently provides a dispute resolution service to consumers and some SME businesses. The FOS describes itself as an

296 SME0116

297 SME0124

298 SME0102

299 SME0054

300 SME0124

“independent service for settling complaints fairly, reasonably, quickly and informally”.³⁰¹ Customers who are dissatisfied with the outcome of a bank’s internal complaints procedure have the option to raise their case with the FOS, which can re-assess the case on a “fair and reasonable basis”.³⁰² For a complaining customer, access to the FOS is free. The FOS is paid for by businesses through individual case fees, and an annual levy.³⁰³

166. The FOS may be of benefit to both banks and the customer. Walter Merricks, then Chief Ombudsman, said of the benefits to banks in 2001: “for the industry it has obvious side benefits: the financial contributions to the scheme are probably less than the legal fees it would pay if cases went to court, and there is probably a saving in management time.” On the benefits to consumers, he said: “the person who has a complaint can approach the ombudsman, without fear of having to pay more, or of forfeiting any legal rights—a real “no lose” situation”.³⁰⁴ The Treasury Committee said in 2004 that: “The Financial Ombudsman Service currently commands wide support among the industry and consumers as an inexpensive and speedy way of resolving disputes and achieving redress where redress is due.”³⁰⁵ More recently, the CBI said that “the FOS framework helps the efficiency of the complaints process and avoids the need on either side for lengthy and costly court battles”.³⁰⁶

167. Existing FOS rules restrict the SME complaints it can take up. As Mr Boorman explained:

I am limited to looking at small businesses, the microenterprise definition, which obviously cuts out a lot of the people that often are talked about.³⁰⁷

This microenterprise definition limits FOS coverage to businesses with an annual turnover of less than €2 million and fewer than ten employees. The FOS also has an award limit of £150,000.³⁰⁸ Mr Boorman told the Committee the current limit did not give the FOS “award powers that cover most of these swap and swap-related cases.” When referring to the lead decision on these cases Mr Boorman explained that the redress offer cost the “bank concerned about £3 million”.³⁰⁹ He said that the bank “did not technically have to follow” the ombudsman’s decision.³¹⁰

301 Financial Ombudsman Service, *Alternative dispute resolution for consumers: implementing the alternative dispute resolution directive and online dispute resolution regulation*, 3 June 2014

302 Financial Ombudsman Service, *information for businesses covered by the ombudsman service*, 5 March 2015

303 Financial Ombudsman Service, *Funding and case fees*, April 2014

304 Speech by Walter Merricks, Chief Ombudsman of the Financial Ombudsman Service, to the Chantrey Vellacott DFK Annual Reception, 6 June 2001

305 Treasury Committee, *Restoring confidence in long-term savings*, Eighth Report of Session 2003–04, HC 71–1, 19 July 2004, p 44, para 86

306 Confederation of British Industry, *The Financial Conduct Authority: Approach to Regulation*, CBI response, September 2011

307 Q 679

308 Financial Ombudsman Service, *“The Ombudsman and Smaller Businesses,”* 1 June 2014

309 Q 714

310 Q 714

168. The Committee asked witnesses whether the remit of the FOS should be expanded. Laurence Beere, who had purchased a TBL, expressed the frustration some small businesses experience when they fall outside the FOS remit.³¹¹ HSBC wrote that they were in favour of a consultation to consider the extension of the FOS's remit to "include more SMEs".³¹² Tim Murphy, of Seneca Banking Consultants, said that he had "no faith in [bank's] internal procedures".³¹³ He suggested that a wider FOS remit, possibly delivered by a "FOS Mark 2," which extended to businesses of around "£25 million turnover", would "hopefully keep banks' internal procedures on their toes".³¹⁴ Mr Roe of Bully Banks called for the enhanced "publication by each bank" of "what is happening within its complaint processes" and to ensure that the Ombudsman service had "appropriate jurisdiction" to permit a greater number of SMEs to access the FOS.³¹⁵

169. The ACCA said in its written evidence that the current remit of the FOS was not proportionate to the level of financial sophistication of SME businesses:

Indicatively, businesses with more than £1.7m in turnover cannot generally take cases to the Financial Ombudsman—even though at least a third of these do not have financially trained staff, another third don't have a written business plan, and one in six do not produce regular management accounts. A £5m turnover threshold would be much more sensible, ensuring that most businesses above the threshold have appropriate financial capabilities in place. But ideally, sophistication should be considered in terms of the adequacy of businesses' resources and expertise in relation to the complexity and significance of the financial decisions they are required to make.³¹⁶

170. Any expansion to the FOS remit would, according to Mr Boorman, need to be met with an increase in the FOS's award limit. Mr Boorman also challenged the capacity of the Ombudsman to be a suitable substitute for litigation:

[...] from my perspective a business-to-business dispute is one that is better resolved in court with court procedures rather than through an ombudsman service that is invited by Parliament to be informal and to make decisions on the basis of what is fair and reasonable.³¹⁷

Overall, Mr Boorman believed there was some "nervousness" on the board of the FOS about extending its "powers of resolving matters on a fair and reasonable basis, into very sizeable financial disputes".³¹⁸

311 Q 258

312 SME0115

313 Q 250

314 Q 251

315 Q 254

316 SME0011

317 Q 714

318 Q 721

171. The jurisdiction of the FOS is determined by FCA rules.³¹⁹ In response to a recommendation of the Parliamentary Commission on Banking Standards (PCBS)³²⁰ the FCA committed to consult on an expansion of the FOS.³²¹

172. Regulation has, in many cases, failed to prevent mis-selling. Dispute resolution services—such as the Financial Ombudsman Service (FOS)—can provide a means of redress to bank customers when things go wrong. The existence of the FOS has, overall, been positive for both banks and their customers. It provides a means of independent, affordable and effective dispute resolution through which to challenge a bank’s decision making.

173. There is a risk that a wider remit and the greater complexity of SME cases could greatly increase the workload of the FOS and overburden it. This could be detrimental to existing users of the FOS. However, it is clear that there is a group of small businesses which are too large to be covered by the FOS but too small to be able to afford to challenge their bank in court effectively. Such businesses are often unable to challenge poor decision making by banks or to seek redress when their banks treat them badly, even when their case is valid. It is not acceptable that these businesses should be denied adequate redress or that banks should, as it appears, be permitted to game the system to avoid responsibility for their actions.

174. Bearing in mind the risk identified above, the FCA consultation on the scope of the FOS, prompted by the Parliamentary Commission on Banking Standards, should also consider how this gap in coverage can be closed, and, as a matter of urgency, report to Parliament their conclusions.

319 FCA Handbook, Jurisdiction of the Financial Ombudsman Service (DISP 2), 6 March 2015

320 Parliamentary Commission on Banking Standards, Changing Banking for Good, First Report of Session 2013–14, HC 175-II, 11 March 2014, p 278, para 523

321 SME0140

5 Competition in SME lending

A history of competition problems

175. Competition in the banking sector has been perceived as a problem for many years. In March 2000, the Sir Donald Cruickshank examined the competition in the SME banking market as part of his report *Competition in UK Banking*. He concluded that “competition problems were found in all markets investigated”.³²²

176. Over the subsequent decade, a number of studies and follow up reports into banking competition were performed by the UK’s competition authorities—the Competition Commission (CC) and Office of Fair Trading (OFT), and later the Competition and Markets Authority (CMA). These are:

- *The supply of banking services by clearing banks to small and medium-sized enterprises* by the Competition Commission in March 2002³²³
- *SME Banking—Review of the undertakings given by banks following the 2002 Competition Commission report* by the OFT in August 2007³²⁴
- *Review of barriers to entry, expansion and exit in retail banking* by the OFT in November 2010.³²⁵

177. The most detailed of these reports was the Competition Commission’s 2002 market study into competition in SME banking services. At the time, it found competition problems including market concentration, a reluctance among customers to switch provider, practices that restricted and/or distort price competition, pricing transparency, and barriers to entry and expansion.³²⁶ The further reviews conducted in 2007 and 2010 found that elements of problems identified in 2002, for example low switching activity and low comparability of products, had persisted.³²⁷

178. Competition in banking has also been investigated by Parliament and by the Independent Commission on Banking (ICB). In 2011, the ICB expressed concern about the state of competition in retail banking. Its final report said:

322 Sir Donald Cruickshank, *Competition in UK Banking: A Report to the Chancellor of the Exchequer*, March 2000

323 Competition Commission, *The supply of banking services by clearing banks to small and medium-sized enterprises*, March 2002

324 Office of Fair Trading, *SME Banking—Review of the undertakings given by banks following the 2002 Competition Commission report*, August 2007

325 Office of Fair Trading, *Review of barriers to entry, expansion and exit in retail banking*, November 2010

326 Competition Commission, *The supply of banking services by clearing banks to small and medium-sized enterprises - Volume 1*, March 2002, p.3

327 Office of Fair Trading, *SME Banking—Review of the undertakings given by banks following the 2002 Competition Commission report*, August 2007, p 6, 8; Office for Fair Trading, *Review of barriers to entry, expansion and exit in retail banking*, November 2010, p 6

There have been long-standing problems with competition in UK retail banking markets, resulting in competition being both insufficient and misdirected. These problems stem from a concentrated market structure and significant barriers to entry, in conjunction with poor conditions for consumer choice, which reduce the threat of losing market share if a bank offers poor prices or service.³²⁸

179. In June 2013, the Parliamentary Commission on Banking Standards (PCBS) also concluded that competition problems in banking persisted. However, it also recognised that action was being taken to try to improve banking competition:

A large number of regulatory reforms to the banking sector are already in train, as well as those recommended by this Commission. An immediate Competition Commission referral would further add to the burden of uncertainty on the sector and would divert the banks from their core objective of recovery and lending to the real economy.³²⁹

The PCBS acknowledged that these developments “could have a significant impact on competition in this market”, but it considered that delay should “not be allowed to serve as an argument for indefinite inaction.”³³⁰ As a result, the PCBS recommended that the CMA “immediately commence a market study of the retail and SME banking sector” to be completed on a timetable “consistent with making a market investigation reference, should it so decide, before the end of 2015”.³³¹

Box 2: Ongoing measures to improve competition

There have been a number of recent measures by industry, business groups and the Government intended to improve competition in SME finance. These have included:

Divestments from Lloyds Banking Group and the Royal Bank of Scotland Group to create two additional banks. These divestments, the result of EU state aid rules, have created TSB and are in the process of creating Williams and Glyn.

Changes to the authorisations and prudential regulation regime for new banks. These were introduced by the FSA in March 2013, and included a simplified bank authorisations process and temporary reductions in capital requirements for new entrants.³³²

328 Independent Commission on Banking, Final Report, November 2011, p 197

329 Parliamentary Commission on Banking Standards, Changing Banking for Good, First Report of Session 2013–14, HC 175–II, 11 March 2014, p 240, para 403

330 Parliamentary Commission on Banking Standards, Changing Banking for Good, First Report of Session 2013–14, HC, 11 March 2014, 175–II, p 236, para 396; p 240, para 403

331 Parliamentary Commission on Banking Standards, Changing banking for good, First Report of Session 2013–14, 11 March 2014, HC 175–II, 11 March 2014, p 240, para 404

332 Financial Services Authority, A review of requirements for firms entering into or expanding in the banking sector, March 2013

The establishment of the Payment Systems Regulator (PSR) which will become fully operational in April 2015. The PSR's objectives will be to promote competition, innovation and the interests of end-users through overseeing designated UK domestic payment systems.³³³

The introduction of a seven-day Current Account Switch Service (CASS), which is available to smaller SMEs. Benefits for small businesses include automatic switching of direct debits, and a payments redirection service for money accidentally sent to the old account.³³⁴ The Government announced at the 2014 Autumn Statement that coverage of the service would be expanded to "99% of all SMEs" and that the redirection service would be extended to 36 months.³³⁵

Measures to increase the availability of SME creditworthiness information to help newer or smaller providers to make more effective lending decisions.³³⁶ The Small Business, Enterprise and Employment Bill is intended to legislate for this scheme.³³⁷

A programme called **Business Banking Insight** that regularly collects survey data on business customers' experiences of banks. The survey is conducted once every six months, and published online. The program is run by HM Treasury in conjunction with some major banks and business groups.³³⁸

A programme to **refer SMEs that have been rejected for loans to challenger banks and alternative finance providers** who are looking to offer finance. The Small Business, Enterprise and Employment Bill is intended to legislate for this scheme.³³⁹

The current state of competition

180. In response to the PCBS, the OFT brought forward its planned market study into small business banking. This study, *Banking services to small and medium enterprises*, was published in July 2014 by the OFT's successor the CMA, in conjunction with the FCA.

181. In its 2014 market study, the CMA and FCA acknowledged that, as the PCBS had highlighted, a number of developments had the potential to help alleviate competition concerns in SME banking.³⁴⁰ However, while these developments were considered "valuable in addressing some of the historical concerns" in competition, the CMA and FCA said that "fundamental competition concerns" remained.³⁴¹ In particular, the CMA

333 Competition and Markets Authority, *Banking services to small and medium-sized enterprises*, 18 July 2014, p 6

334 Payments Council, *Current Account Switch Service Small Business Fact Sheet*, as at 21 January 2015

335 Autumn Statement 2014, HM Treasury, 3 December 2014, p 84, para 2.178

336 Competition and Markets Authority, *Banking services to small and medium-sized enterprises*, 18 July 2014, p 6

337 Small Business, Enterprise and Employment Bill 2014-15

338 Business Banking Insight, using this website, as at 21 January 2014

339 HM Treasury, *SME finance: help to match SMEs rejected for finance with alternative lenders*, 18 December 2014

340 Competition and Markets Authority, *Banking services to small and medium-sized enterprises*, 18 July 2014, p 6

341 Competition and Markets Authority, *Banking services to small and medium-sized enterprises*, 18 July 2014, p 7

and FCA said that take up of seven-day switching had been “low”, with only 7,300 SMEs switching out of a population of 3.5 million business current account (BCA) holders.³⁴² The study also concluded that the divestment of Lloyds and RBS would only have “limited” impact on competition.³⁴³ The market study was, however, positive about changes to bank authorisations, predicting that the changes would be “likely to reduce some barriers to entry and expansion.”³⁴⁴ It was also positive about the Government’s scheme to increase the availability of SME creditworthiness information, saying that “action currently being taken by the Government provides an effective mechanism substantially to address any of the concerns in these areas if implemented in full.”³⁴⁵

182. Overall, the CMA and FCA concluded that the UK SME banking sector still did not exhibit many of the characteristics of a “well-functioning” and competitive sector. The report found four significant characteristics in the UK market that it considered consistent with markets where “competition is prevented, restricted or distorted”:³⁴⁶

- Markets were concentrated, with concentration levels persisting over an extended period of time;
- Barriers to entry and expansion, although reduced, continued to be present and significant in the markets;
- There were low rates of switching, negotiation and shopping around (in spite of the availability of easier switching), with evidence of a belief among SMEs that “all banks are the same”; and
- Transparency and comparability were limited.³⁴⁷

183. Alex Chisholm, Chief Executive of the Competition and Markets Authority, told the Committee that competition had worsened since the crisis. He said that the “the market context is different today from where it was five years ago”, and that the financial crisis had undone much of the progress in improving competition achieved in the early and mid 2000s.³⁴⁸

342 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 12

343 Letter from OFT to Chancellor: recommendations on Lloyds Banking Group and Royal Bank of Scotland divestments, 11 September 2013

344 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 64

345 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 99

346 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 176

347 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 176

348 Q 977

I think there has been progress, but clearly not enough. It is also fair to say, when you look back over that decade, things were moving towards a better place from a competition point of view and then took a number of steps back because of the financial crisis. Certainly, that is very evident in the levels of consolidation.³⁴⁹

The Committee also received evidence which suggested that competition had worsened. The Association of Chartered Certified Accountants said that “the financing landscape has become less competitive for most UK SMEs over the last two years, following a surge in competition in the early days of the recovery”.³⁵⁰

184. The market study concluded that many of the problems identified in 2014 were not new, noting that “many of the concerns identified in previous reviews remained”.³⁵¹ These included:

- The provision of BCAs and business loans was concentrated among the largest four banks, with those providers maintaining relatively stable market shares; indeed, the sector was now as concentrated as it was in 1999;
- New entry had been limited and there were still high barriers to entry and expansion for newer and smaller banks;
- SME customers believed there to be little differentiation between providers;
- SMEs had difficulty comparing offers across providers and demonstrated low levels of shopping around; and
- The banks with lower customer satisfaction levels had high market shares and were not losing significant market share—while those with the highest customer satisfaction were not able to expand.³⁵²

185. As a result of its findings, the CMA decided to make a provisional market investigation reference, subject to consultation and a final decision on the matter.³⁵³ On 6 November 2014, the CMA confirmed that it would undertake an “in-depth market investigation into the personal current account and SME retail banking sectors”.³⁵⁴

186. Witnesses to the Committee agreed with assertions from the CMA and FCA that competition in banking remained weak. Mr Lane of Kingston Smith and Dr Tomlinson,

349 Q 973

350 SME0011

351 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 5

352 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 64

353 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 16

354 Competition and Markets Authority, Personal current account and small business banking face full competition investigation, 6 November 2014

Entrepreneur in Residence at the Department for Business, Innovation and Skills, believed that competition in SME banking was limited.³⁵⁵ Mr Hollis, owner of Hollis & Co, agreed, telling the Committee that he did not see “any meaningful competition between the four large banks at all”.³⁵⁶ He also said that competition amongst banks for business was stronger for large firms than it was for small firms:

If you are a large company at the top end of the SME scale and you are very profitable, I think banks will compete for that business, but for the great majority of people out there, I do not think there is any competition.³⁵⁷

The Treasury also acknowledged there was a problem. The Economic Secretary to the Treasury said that “in the area of SME lending [...] there are improvements but there is a long way to go”.³⁵⁸

How have new entrants affected concentration?

187. The SME banking market has seen some changes arising from challenger banks. Metro Bank represents an entirely new entrant into the UK’s banking market, whilst banks such as Aldermore, Shawbrook and Handelsbanken have expanded their operations significantly since the financial crisis. From its first branch in 2010, Metro Bank opened its 33rd branch in February 2015.³⁵⁹ Handelsbanken announced its 175th UK branch in June 2014,³⁶⁰ and told the Committee that while it had operated in the UK since 1982, it was only in the “last couple of years the expansion has really picked up”.³⁶¹

188. In terms of debt financing, a number of innovate alternative finance providers have also emerged. For example, peer-to-peer and crowdfunding platforms such as Platform Black, Funding Circle and Zopa all provide loans to UK SMEs. The Liberium AltFi Index—a survey of alternative lending industry performance—found that the peer-to-business lending it surveyed had seen an annual growth rate of approximately 200 per cent between January 2014 and January 2015.³⁶²

189. One potential measure of competition is market concentration, which measures the market shares of players in a market. Mr Woolard told the Committee that the FCA used concentration an indicator of competition in a sector:

We look at a range of measures when we are approaching individual particular markets. We will certainly look at things like concentration. How

355 Q 137; Oral evidence by Lawrence Tomlinson to the Treasury Committee, Banks’ lending practices: treatment of business in distress, 29 January 2014, q 71

356 Q 136

357 Q 138

358 Q 742

359 Metro Bank, Metro Bank brings the banking revolution to Brighton, 10 February 2015

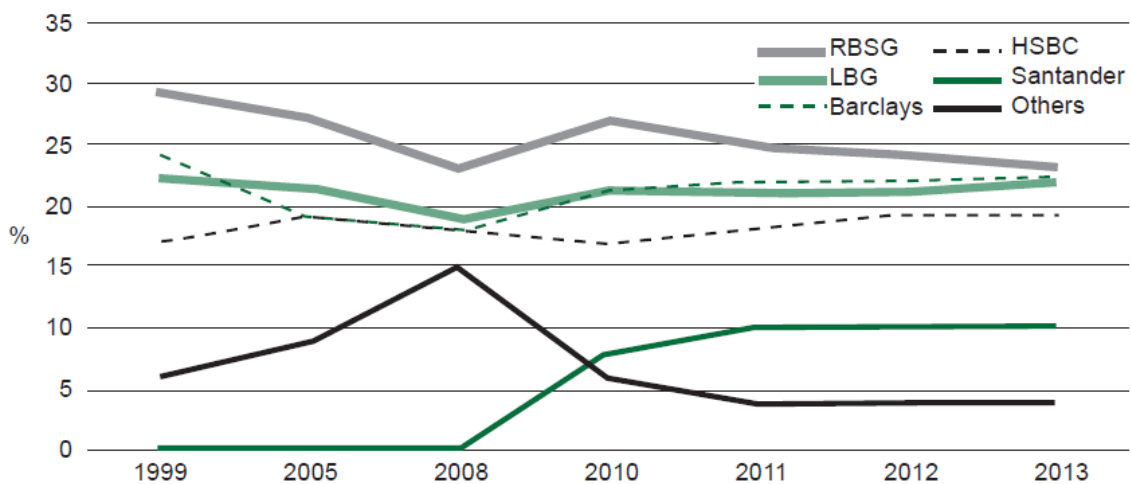
360 Q 273

361 Q 274

362 Liberium AltFi Volume Index, as at 19 January 2015

many players are there in the market? Who has the majority of share? You could have very many players, but if three or four have 90% of the market that clearly tells you something else about it.³⁶³

Chart 3: Market shares in the provision of BCAs to SMEs by volume of accounts/main banking relationships, England and Wales



Source: Competition and Markets Authority, *Banking services to small and medium-sized enterprises*, 18 July 2014, p 46

190. Despite the presence of new entrants and new types of providers, evidence still shows little change in the level of concentration in the UK SME banking market since 2002. In its market study, the CMA and FCA found that, in England and Wales, the “UK’s four largest banks have accounted for at least 85 per cent of SMEs’ main banking relationships for the past 14 years”.³⁶⁴ For Scotland, it found that the “largest three banks (RBS, Lloyds and

363 Q 686

364 Competition and Markets Authority, *Banking services to small and medium-sized enterprises*, 18 July 2014, p 45

Clydesdale) have accounted for over 80 per cent of the main banking relationships of SMEs since 1999”.³⁶⁵ In Northern Ireland, it found that two large and two mid-sized market participants cumulatively accounted for 90 per cent of the market for liquidity management services.³⁶⁶ Similarly, for business loans, it found that the 2013 market shares of the top three or four providers in England and Scotland both had a 90 per cent share of the market—unchanged from the Competition Commission’s review in 2002.³⁶⁷ The Economic Secretary to the Treasury said:

80% of all SME lending is done by the Big Four banks. The Herfindahl Index of Concentration suggests that the BBA’s latest estimate is that SME lending is just over 2,000, which is extremely concentrated.³⁶⁸

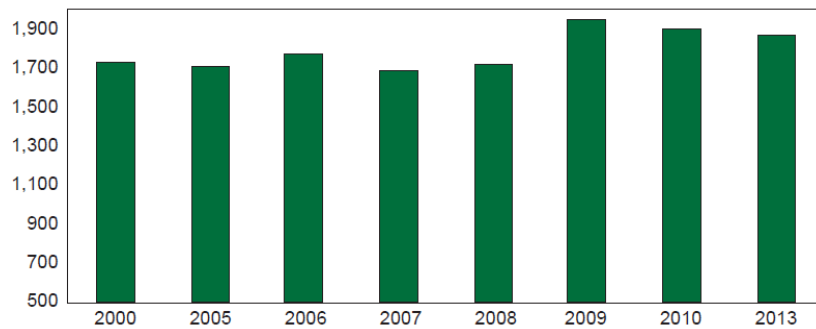
Indeed, the CMA and FCA found that the high Herfindahl index—a measure of competition in a market—for business current accounts across the UK as a whole was relatively unchanged over time:

365 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 46

366 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 48

367 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 49

368 Q 737

Chart 4: Concentration in BCA supply in Great Britain as measured by the HHI

Source: Competition and Markets Authority, *Banking services to small and medium-sized enterprises*, 18 July 2014, p 46

191. The CMA report notes that some progress had been made in new entry into the banking sector, but concludes that the effect on the overall market has so far been limited:

For full-service providers, providing multiple products, there are positive indications that several historic barriers to entry or expansion may be diminishing as a result of technological and regulatory change. However, it remains the case that only one new full-service provider has entered the SME banking market in recent years. We see no evidence that the newer providers in the sector represent a real scale threat to the largest banks.³⁶⁹

192. Alternative lenders also appear to have made only a limited impact on the overall shape of the SME finance market. Alternative lender penetration in debt markets overall appears to be low. The October 2013 Trends in Lending by the Bank of England said:

The vast majority of gross flows of external finance raised by UK businesses in recent years were from bank lending and capital market issuance, based on available data. The largest flow of external finance raised was bank lending to large businesses. The flow of new asset finance (leasing and hire purchase) was smaller in comparison, though was slightly higher in 2014 H1 compared to 2013 H1. Some of this lending is likely to be to small and medium-sized enterprises (SMEs).

SMEs can also use other types of external finance such as peer-to-peer lending/crowdfunding. Flows of peer-to-peer business lending increased in 2014 Q2 compared to the previous quarter, though at £0.3 billion for the first half of 2014 were small compared to gross bank lending to SMEs. Flows of other forms of peer-to-peer lending/crowdfunding, such as equity-based and reward-based crowdfunding, were very small in 2013.³⁷⁰

369 Competition and Markets Authority, *Banking services to small and medium-sized enterprises*, 18 July 2014, p 107

370 Bank of England, *Trends in Lending October 2014*, 20 October 2014

193. Alternative lenders, in particular peer-to-peer finance and crowdfunding, are discussed in more detail in section six of this report.

Why have competition problems persisted?

Barriers to entry

194. Regulatory barriers to entry have, in the past, been identified as being detrimental to competition in the UK SME banking market. The Parliamentary Commission on Banking Standards concluded that “for a very long time, the regulatory authorities in the UK have displayed an instinctive resistance to new entrants” and that the new bank authorisation process had “long stifled entry to the banking market”.³⁷¹

195. There are some signs that progress has been made in reducing these barriers to entry. In March 2013, the FSA announced two key changes to the authorisation of new banking firms.³⁷² Mr Woolard of the FCA told the Committee:

One of the first things we did was look at the barriers to entry that are created by regulation and how we can make that authorisation process getting into the system easier. To give you a sense of scale around that, if you went back just over a year ago we had around seven potential new entrants in the system at any one point in time, roughly speaking. Since we have made a number of changes around that, we are now in a position where we have up to 20 new entrants over half of whom are genuinely new businesses.³⁷³

196. However, other barriers to entry also exist. The SME banking market study lists these barriers under two categories:

- Inputs to develop an SME banking business. These included the need for IT systems, access to payments systems, access to customer credit information, the need for a distribution network and SME behaviours; and
- The behaviour of incumbent banks. These include waivers and deeds of priority, bundling of products, price discrimination and restrictions on banking services.

197. The market study found that some of these barriers were being gradually lifted, for example access to IT systems.³⁷⁴ However, the CMA said:

The most significant of these barriers continues to be the features of SME behaviour that make it difficult to acquire customers and the continued importance of branch networks.³⁷⁵

371 Changing Banking for Good, Parliamentary Commission on Banking Standards, March 2013, para 327

372 See box 2 for further information

373 Q 664

374 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 90

Some of these barriers are discussed in detail in the sections below.

New entrants, branch networks and “critical scale”

198. A problem of scale was mentioned by some as a barrier to establishing stronger competition in the sector.³⁷⁶ A number of challenger banks have entered and expanded in the banking market, and other new entrant banks appear to be in the process of authorisation. But some have argued that there is a minimum scale before new entrants can effectively challenge incumbent banks. Mr Chisholm of the CMA said:

[...] when you are trying to get the market to work better, you can have some entry occurring, but until it reaches a real level of scale it does not provide the right kind of competitive pressure to change the behaviour of the most established firms. That was certainly the experience in the UK or Ireland where I was working before and in a number of other European countries. In mobile comms, for example, it was only after a number of years where the third or the fourth player got up to a level of scale and put so much pressure on the market leaders that they had to change their way of working. That points to the need for scale of competition.³⁷⁷

In particular, the market study stated that, “whilst the usage of local branches by SMEs has diminished in recent years”, a branch network “continues to be particularly important to enable a bank to both acquire and service a wide range of customers”.³⁷⁸

199. In 2011, the Independent Commission on Banking also concluded that minimum scale was needed to create an effective challenger bank.³⁷⁹ It said that smaller banks on average grew at a slower rate than larger ones:

Evidence from the previous decade shows that small banks (below 5% PCA market share) on average have grown only slowly, with an average annual growth in market share of 0.07%. Banks with a PCA market share of between 5% and 12%, by contrast, grew significantly more quickly, with an average annual growth in market share of 0.34%.³⁸⁰

375 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 107

376 Q 972

377 Q 972

378 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 85

379 Independent Commission on Banking, Independent Commission on Banking: Final Report, September 2011, pp 201–212

380 Independent Commission on Banking, Independent Commission on Banking: Final Report, September 2011, p 210

200. Dan Moore, Project Director of the SME Banking Market Study at the Competition and Markets Authority, added that existing concentration worsened the problem. Challenger banks need scale to compete effectively with large incumbents, but achieving scale was difficult because it required competitiveness:

From our perspective, there is a real issue in that it is very difficult for any new or smaller provider to obtain substantial market share. It is very difficult to get customers to grow and then, because the large banks effectively have a large-scale business, the important issue is: can I grow as a new or smaller provider to try to be in a position to effectively compete with those providers? Concentration certainly gives the larger banks an advantage, which just makes it very difficult for the smaller providers to be able to compete on scale.³⁸¹

Limited switching behaviour from SMEs

201. The SME banking market study identified “low rates of switching, negotiation and shopping around” as both a symptom and cause of poor competition. In particular, the CMA found that shopping activity—when a business queries many banks searching for the best deal—was low amongst SMEs.³⁸² The study said that “the majority of SMEs (71%) approached only one provider on the last occasion they sought finance” and that “SMEs tended to spend very little time shopping around, with research showing that almost 60% of SMEs that shop around spend less than an hour considering their financing options”.³⁸³

202. The problem of limited switching behaviour was highlighted by the persistence of high market shares for those with the lowest satisfaction score. Mr Chisholm told the Committee that the SME banking sector had “low levels of satisfaction by comparison with some other sectors,”³⁸⁴ and that despite low satisfaction, SME customers did not switch providers. Mr Moore said that there was a “generalised pattern where those who have the highest satisfaction levels do not seem to be making that much progress”.³⁸⁵ He said:

What you would expect in a healthy market is to say, “Well, if people are not satisfied with their current provider, they would be shopping around and going elsewhere”, but we have not seen that in this market, which is why we feel that these problems are quite entrenched. The switching levels that we have seen have tended to be around about 3% or 4% in both these markets.³⁸⁶

203. Overall, the market study said that this lack of switching arose from three key factors:

381 Q 980

382 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 176

383 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 128

384 Q 974

385 Q 982

386 Q 975

- strong belief that there is limited differentiation between the offers available at different banks;
- limited negotiation between SMEs and banks; and
- the relatively high complexity of business current account and loan pricing.³⁸⁷

Product comparability and SMEs' perceptions of banks

204. Some evidence to the Committee suggested that the perception amongst SMEs was that there was very little difference between the offerings of major banks. Mr Moore of the CMA said:

The strong impression that we get from SMEs is that all banks are the same; that it is impossible to differentiate. I think that is something that is consistent both with the survey evidence we have seen but also directly what we keep on hearing from SMEs.³⁸⁸

In its written submission, the manufacturers' organisation EEF noted that its companies "point to a lack of differentiation between the major retail banks".³⁸⁹ Peter Hollis, owner of accountancy firm Hollis and Co, said that "I do not see any meaningful competition between the four large banks at all".³⁹⁰

205. SMEs perceived no difference between major banks, but some differences may indeed exist. Professor Russell Griggs, Independent External Reviewer of the Banking Taskforce Appeals Process, said:

I think it is competitive in terms of all the banks are different. There seems to be this view that all the big banks are the same, but they are not in how they operate and make decisions.³⁹¹

Mr Moore agreed, and said that the CMA had found "some differences between service levels and, in some cases, some significant differences between service levels and, in some cases, prices".³⁹²

206. Asked why many SMEs could not perceive differences between providers, Mr Moore suggested that limited information on banks' products and performance might be a source of the problem:

387 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 12

388 Q 979

389 SME0092

390 Q 136

391 Q 9

392 Q 979

At the moment, it is quite difficult for the average SME to be able to make an effective comparison so they can see those differentials. We think an important thing that needs to occur in this industry is that greater level of transparency, comparability and engagement on the part of SMEs.³⁹³

This lack of information may be reinforced by an overall lack of financial acumen on the part of SMEs, particularly small firms. The SME Finance Monitor found that the “proportion of SMEs with a financially qualified person looking after their finances has remained relatively stable, and was 28% in Q2 2014”.³⁹⁴ Some evidence also suggests that few SMEs take external advice. For example, the SME Finance Monitor said that the proportion of SMEs seeking advice before they applied for an overdraft was 9 per cent for overdrafts of under £25,000, rising to 18 per cent for overdrafts above £100,000.³⁹⁵ The Association of Chartered Certified Accountants recommended that “encouraging and helping businesses build up their in-house finance capabilities early on could help steer them away from disengagement”.³⁹⁶

Concentration and linkages between markets

207. The CMA and FCA market study identifies links between:

- personal current accounts (PCAs) and BCAs; and
- BCAs and business loans.

On the link between PCAs and BCAs, the market study states that “there is a strong propensity for start-ups to choose a BCA provider based on their choice of PCA provider”.³⁹⁷ The market study states:

Almost 60% of BCA customers at the four largest UK banks also have a PCA with the same bank, indicating the importance of the linkage between BCAs and PCAs. A strong propensity for start-up businesses to choose their BCA provider, based on where they hold their PCA, gives the larger banks an advantage over smaller stand-alone business bank providers and those lacking a strong presence in PCAs.³⁹⁸

393 Q 979

394 BDRC Continental, SME Finance Monitor Q2 2014, p 39

395 BDRC Continental, SME Finance Monitor Q2 2014, p 97

396 SME0011

397 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 61

398 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 9

The CMA concludes that “a major bank is likely to be able to count on obtaining a significant volume of business from its PCA customers, limiting, in turn, its incentives to compete as vigorously as it would otherwise do”.³⁹⁹

208. On the link between BCAs and business loans, data published by the CMA suggests that close to 90 per cent of SMEs have sourced business loans from their main bank.⁴⁰⁰ The CMA said:

We observe that the banks which have high, and relatively stable, market shares in the supply of BCAs in each of the relevant geographic markets similarly have high shares in the supply of business loans.

[...]

This reflects the strong tendency we observe for SMEs to obtain a business loan from their BCA provider, such that the BCA appears to act as a so-called ‘gateway product’. This is demonstrated through various surveys which confirm that the vast majority of SMEs source business loans through their main bank, where they will hold their BCA [...]. This does not change significantly depending upon the relative size of the SME.⁴⁰¹

209. In written evidence to the Committee, Lloyds Banking Group said that owing to the constant flow of new business creation and destruction, a natural “churn” existed in Business Current Account (BCA) markets:

The market for BCAs remains very competitive due to the significant dynamics of SME start ups and closures and, while more concentrated than the lending market, has a number of features which underpin competitive pressure. Including new businesses and start ups, the level of natural ‘churn’ in the provision of BCAs is significant: the Group’s stock of accounts turns over approximately 15-25% each year which is representative of the wider market.⁴⁰²

While the CMA and FCA acknowledged that natural SME BCA customer turnover occurred, they believed it only had a limited positive effect on competition due to the links between PCAs, BCAs and business loans:

We recognise that, despite the levels of concentration we observe, the high rate of churn in this market could lead to providers having to compete more intensely for new business customers to avoid losing market share over time.

399 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 61

400 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 57

401 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 57

402 SME0118

However, despite more intense competition for new customers and switchers, we believe that the larger incumbents continue to enjoy certain advantages which mean that competition is not sufficiently effective even for these customers. In particular, we have found that most SMEs (especially the smaller SMEs) choose, initially at least, to obtain a BCA from their PCA provider, providing the largest providers with a ‘first port of call’ advantage. They then are likely to take other products from that provider, particularly lending products. A provider is, therefore, less likely to capture new-to-market SMEs, and then to be able to cross-sell to them a range of products, if it does not currently provide their PCA. This limits the growth potential of stand-alone business bank providers or banks lacking a strong presence in the PCA market which, as we see in the accompanying market study into PCAs, is also a concentrated market.⁴⁰³

Mutual reinforcement of competition problems

210. The CMA and FCA concluded in their market study that individual factors inhibiting competition were “closely interrelated and mutually reinforce one another, resulting in competition being more limited than it would otherwise be”.⁴⁰⁴ The CMA’s market study explained:

In particular, SME inertia weakens competitive constraints by reducing provider incentives to compete. It also creates significant barriers for other providers to enter the sector, by significantly reducing the number of profitable customers available for smaller and newer providers to grow and develop their business. Customers’ belief that there is limited differentiation between providers, which may result from the relatively limited available choice of larger providers, each with a similar business model, results in SME inertia. This in turn means that there is no countervailing pressure on providers to improve offers to SMEs and differentiate themselves from the competition. To address these concerns, changes may therefore be necessary on the demand side (SME customer behaviour), on the supply side (to the market structure), or both.⁴⁰⁵

211. The CMA identified concentration in particular as a problem that reinforced and amplified other competition problems. The market study said that “concentration is often

403 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 11

404 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 13

405 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 13–14

not a competition concern in itself” but that “it is more likely to be a concern where there are barriers to entry and SME inertia”.⁴⁰⁶ Mr Chisholm of the CMA said:

We see the concentration levels as being part of the problem. This is a complex, multidimensional problem. We want to work on all aspects of it and one of those is to make it easier for people to come into the market; one is to make it easy for people to expand in the market; on the other side of it, to make it easier for firms to make their choices, to make comparisons, to switch, or to lose their fear of switching. All these things should be reinforcing to each other to bring about a better dynamic, which I expect would be associated with reductions in the concentration levels.⁴⁰⁷

212. Inadequate competition in banking is a long-standing problem. Many of the problems identified by the Parliamentary Commission on Banking Standards, the Independent Commission on Banking and the 2002 Competition Commission market investigation persist. The UK SME banking sector remains dominated by four major banking groups, who among them have a market share in England and Wales of 85 per cent. The largest firms have the lowest satisfaction scores.

213. Challenger banks and the growth in alternative lending have scope to increase competition. However, gross peer-to-peer lending to businesses in H1 2014 was £300m, only about 1% of the £24.8 billion lent by banks to SMEs over the same period, and the CMA found that the SME banking market share of banks outside the top 5 in England and Wales was less than 5%. Challenger banks and alternative lenders are therefore not yet at a scale sufficient to challenge incumbents. There is currently little evidence to suggest that new entrants in the SME finance market and existing measures to improve competition will deliver the transformation in competition that the industry needs. This lends weight to the importance of the CMA’s market investigation into SME banking.

Policies to improve competition

Multiple credit searches

214. The Committee received evidence about the role of credit score calculation methodology on competition. In particular, evidence to the Committee suggested that multiple credit searches by an SME could harm its credit score. In its written evidence to the Committee, HSBC explained:

Credit searches with Credit Reference Agencies (CRAs) are carried out each time a customer applies for credit. Multiple credit searches negatively impact a customer’s credit score: this is because customers that apply for lending

406 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 63

407 Q 985

from multiple providers are statistically more likely to default on their loans.⁴⁰⁸

215. Multiple credit searches may indicate heightened credit risk, but they may also merely indicate that an SME customer is shopping around. Rebecca McNeil, Head of Business Banking at Barclays, noted that multiple searches could mean “a customer is having to go to a lot of places to seek that finance because they are being turned down elsewhere”.⁴⁰⁹ However, as the ACCA noted, “while such behaviour often correlates with financial stress, it also correlates with ‘shopping around’ for a good deal”.⁴¹⁰ HSBC added:

This correlation, whilst statistically valid, may partly be present because of the tendency for most customers to apply to a limited number of providers for credit, leaving only the highest risk customers (which may have been refused credit elsewhere) to shop around.⁴¹¹

216. Evidence suggested that the existing treatment of credit searches creates a disincentive for SMEs to shop around for credit, reducing competitive forces in the SME market. HSBC wrote that this was “a potential barrier to switching, as customers may be deterred from shopping around for the best offer if they are concerned about the negative impact on their credit score”.⁴¹² The ACCA notes that “the banks’ collective advice to customers is to avoid asking for more than a simple quote when shopping around, in order to avoid impacting their credit score”.⁴¹³ Evidence from the Forum of Private Business notes that, when searching for credit, businesses needed to “access the right type of finance from the right provider first time”.⁴¹⁴ The negative repercussions of failed searches can also affect businesses who already had offers of credit. The FPB wrote:

[...] a business may apply for credit and fail a credit score, that failure denting their score further to an extent they cannot access credit from another institution that may have accepted them first time around.⁴¹⁵

217. At present, there does exist a facility within credit agencies that can differentiate between “quotations” and “applications” for credit. This is potentially a method for businesses to shop around without damaging their credit score. However, not all lenders provide such quotations. For example, Lloyds Banking Group said that its small SME services do not include providing “bespoke quotations”.⁴¹⁶

408 SME0115

409 Q 863

410 SME0011

411 SME0115

412 SME0115

413 SME0011

414 SME0046

415 SME0046

416 SME0157

218. HSBC has suggested that the existing disincentive could be “resolved by lenders agreeing to re-engineer their scorecards to remove or reduce such negative impact.”⁴¹⁷ However, Ms McNeil noted that it would be difficult to “separate out whether someone is shopping around or being turned down consistently”.⁴¹⁸

219. The presence of multiple credit searches in a business’s credit history can damage their credit score. Multiple credit searches may indicate that a customer’s applications for credit have been repeatedly declined, and therefore suggest to a lender that they are a higher risk. But they may simply be evidence that the customer is shopping around. Borrowers are sometimes deterred by the banks themselves from comparing providers by the negative impact that making applications to multiple banks could have on their credit score. As part of its market investigation, the CMA should, in consultation with the industry and the Information Commissioner’s Office, examine how this disincentive can be addressed.

Price comparison

220. The Committee received evidence which suggested that price comparison tools could contribute to improved competition in SME banking. However, the availability of price comparison tools appears to be limited. HSBC wrote in its written evidence that “there are currently limited online tools that particularly smaller SME customers can use to compare BCAs and loans offered by different banks”.⁴¹⁹ Lloyds also agreed, stating that “price comparison is not readily available from published tariffs”.⁴²⁰

221. Increasing the availability of price comparison tools may help to encourage competition. HSBC wrote that SME customers “may find it difficult to compare different banks’ BCA propositions due to the diverse tariff models and the lack of a standardised way of presenting these offerings across the industry”. HSBC wrote:

SME customers are likely to need to carry out a manual search of providers’ websites in order to select the most appropriate BCA or loan product. This is likely to have a dissuasive effect on shopping around.

HSBC considers that a comparison website designed for SME customers would significantly help SME customers with their purchasing decisions. In our view, such a website could help further drive entry and expansion by making it easier for efficient finance providers to access informed customers and thereby expand. HSBC believes that this is an area that could be

417 SME0115

418 Q 867

419 SME0115

420 SME0118

improved through industry action and we are looking at ways to progress this.⁴²¹

222. Mr Chisholm agreed with HSBCs position, noting that “electronic tools like price comparison websites can assist” in improving comparability.⁴²² However, he also warned that effort would be needed from SMEs to engage with such tools. He said:

[...] it also does require the SMEs themselves to exercise their choice where it exists and to sometimes invest some time and effort in that. I know how difficult that is. I have been in business myself, particularly running small businesses. You are typically very busy and the amount of time and effort that you can put into analysing a choice like that is probably quite limited.⁴²³

Mr Chisholm also noted some of the difficulties with generating comparisons for business banking services:

It is not just one figure, as you know. There are per item charges. There are sometimes standing charges per month. There are different levels of interest according to whether you have been authorised or not or how much you are borrowing. It is quite hard to be able to make a straight comparison between A, B and C.⁴²⁴

223. Dr Andrea Coscelli, Executive Director of Markets and Mergers at the Competition and Markets Authority, added that price comparison was not the only factor in SMEs decision making, and that qualitative features were also important:

Our view is that price matters for comparisons, quality matters, and also some of the softer, more TripAdvisor-type comments are also important. Our view is Business Banking Insight is doing quite well on the service and has been very helpful on price. More can be done. It is quite complicated in this area, but certainly more can be done. There is also this third area, more TripAdvisor, more local, more comments, which can be very helpful for SMEs as well. That is another area we could work on.⁴²⁵

224. Mr Chisholm also noted that stronger competition itself could lead to greater transparency that would complement the effectiveness of price comparison websites:

[...] customer engagement comes from much more competitive intensity on the supply side. If you have a lot more rivalry between firms then they find ways to make it easier for people to make those choices and to take an

421 SME0115

422 Q 987

423 Q 987

424 Q 987

425 Q 987

interest in the alternatives that they offer. You do not see enough of that intensity at the moment.⁴²⁶

225. Price comparison tools are prevalent in retail banking and insurance markets, but less so in business banking. This may be due to the relative complexity of products in the SME banking market. It may also be a symptom of a lack of competitive pressure in the industry. As part of its market investigation, the CMA should examine, in consultation with the industry, why the provision of price comparison tools for SME banking has so far been limited, and the scope for increasing it.

Account switching for SMEs

226. A faster Current Account Switch Service (CASS) was launched in September 2013. The service offers a seven day switching service to retail customers, as well as some smaller businesses—those with fewer than ten employees and a turnover or balance sheet of less than €2 million. Alongside the transfer of balances, the service also offers the automatic transfer of payment arrangements both into and out of the account.⁴²⁷

227. Use of the CASS by SMEs appears to have been relatively limited since its introduction. The CMA and FCA wrote in their SME Banking market study:

[...] at the current time, we cannot say that the CASS has had a substantial and sustained impact on SME switching behaviour. In particular, the CASS has resulted in a modest overall increase in year-on-year switching volumes for both PCAs and BCAs of 16% in the six-month period to the end of June 2014. As regards SME banking specifically, only 1.8% of switchers using the service over this period were identified as being SMEs or charities. This means that some 7,330 SMEs switched using this service in that six-month period, out of a total of over 3.5 million BCA account holders.⁴²⁸

228. Mr Chisholm noted that more could be done to increase awareness of the CASS amongst SMEs:

The Current Account Switch Service was mainly marketed on the personal market. I think they could push that much more strongly to SMEs. If the awareness issue is then addressed and people are still not doing it, it is likely to be either it is difficult to do or there is anxiety about it.⁴²⁹

229. The CMA and FCA also found that SMEs were concerned about the risks of switching accounts. They found—from a study dating from before the introduction of the CASS—that “many SMEs consider the process of switching BCA provider to be costly or risky or

426 Q 996

427 Payments Council, Current Account Switch Service Small Business Fact Sheet, as at 5 March 2015

428 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 144

429 Q 998

both”.⁴³⁰ Concerns included the need to contact customers to update their payments to the new bank, the risk that errors would be made when transferring payments, and a risk of payments delayed or missed altogether.⁴³¹ Evidence from the Federation of Small Businesses suggests that the CASS may not be working as it should be for SMEs. The FSB wrote to the Committee that it was “concerned that small firms are still experiencing significant difficulties in switching accounts”, and that “in some cases, this has taken longer than expected with much of the leg work being undertaken by the businesses rather than the bank”.⁴³²

230. At the 2014 Autumn Statement, the Treasury announced changes to the existing CASS to improve availability for SME customers:

Autumn Statement 2014 announces an upgrade to the 7-day Current Account Switch Service to include 99% of all SMEs and an extension of the redirection service to 36 months. These upgrades will be delivered by March 2015. In addition, the Chancellor of the Exchequer has asked the Financial Conduct Authority, as part of their review of the switching service, to examine whether a 5-day switching period would deliver significant benefits to consumers and advise on this question before Budget 2015.⁴³³

231. The Current Account Switch Service has been geared primarily towards retail customers, not businesses. Changes announced by the Government at the 2014 Autumn Statement to improve the CASS for SMEs are therefore welcome. As part of its market investigation, the CMA should examine how the scheme could further benefit SMEs, and what steps can be taken to improve SME awareness of the scheme.

A structural remedy?

232. As part of a market investigation, the Competition and Markets Authority has the power to enact two kinds of remedies to address competition problems it has identified. Describing its powers, the Competition and Market’s Authority’s predecessor, the Competition Commission, said:

The CC has significant powers to remedy problems it identifies. When considering remedies, the CC is required to “achieve as comprehensive a solution as is reasonable and practicable” to address the adverse effect (section 134(6) Enterprise Act). The CC may also have regard to any relevant customer benefits (section 134(7) Enterprise Act). When deciding on what is an appropriate remedy, the CC will consider the effectiveness of different

430 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, p 139,

431 Competition and Markets Authority, Banking services to small and medium-sized enterprises, 18 July 2014, pp 139–140

432 SME0168

433 HM Treasury, Autumn Statement 2014, Cm 8961, 3 December 2014, p 84

remedies and their associated costs and will have regard to the principle of proportionality.

The CC's remedies fall into two basic categories: structural remedies and behavioural remedies. Structural remedies typically involve the divestment of assets—for example, in the Airports market investigation the CC has required the divestment of Gatwick, Stansted and either Glasgow or Edinburgh airports in order to remedy the adverse effects on competition identified.

Behavioural remedies fall into two categories. The first is enabling measures which are designed to overcome, for example, barriers to entry. The second category, very much a matter of last resort, is behavioural remedies which control the anti-competitive outcomes, for example by imposing a price cap. Both types of behavioural remedy are likely to require ongoing monitoring and, potentially, enforcement, to ensure compliance.⁴³⁴

Indeed, the Competition Commission has previously noted the advantages of structural remedies over behavioural remedies:

The CC (and the OFT) has a preference for structural remedies over behavioural remedies. Structural remedies generally constitute a direct, one-off, measure to restore the competitive position (for example, to restore the rivalry that would be lost by a merger). There is less risk of market distortion, and structural remedies avoid all the difficulties associated with monitoring and enforcing ongoing behavioural remedies. In merger inquiries the CC will generally seek divestiture of the smallest, viable stand-alone business that can compete successfully.⁴³⁵

233. In 2002, as part of its market investigation The supply of banking services by clearing banks to small and medium-sized enterprises, the Competition Commission proposed a number of behavioural remedies designed to “assist entry or otherwise serve SMEs’ interests and promote competition” in the SME banking sector.⁴³⁶ These took the form of commitments by the eight major clearing banks at the time to improve areas such as pricing transparency, ease of switching and credit data availability.⁴³⁷

234. However, at the time, the Competition Commission believed that these remedies would not solve completely the competition problems it had identified:

434 Memorandum submitted by the Competition Commission to the Regulatory Reform Committee, Published 21 July 2009

435 Memorandum submitted by the Competition Commission to the Regulatory Reform Committee, Published 21 July 2009

436 Competition Commission, The supply of banking services by clearing banks to small and medium-sized enterprises, March 2002, p 146

437 Supply of Banking Services to SMEs, Competition Commission press release, 14 March 2002

The behavioural remedies we have set out [...] will, in our view, over time assist entry or otherwise serve SMEs' interests and promote competition. They are necessary directly to address a number of adverse effects, in particular the restriction of choice and lack of information [...] hence should apply to all main clearing groups in England and Wales, Scotland and Northern Ireland. However, while they will assist the development of competition, and in time help reduce the current incidence of excessive prices of the four largest clearing groups to SMEs in England and Wales, there will inevitably remain a low propensity to switch in part because of SMEs' preference to maintain a relationship with their existing bank in case of future requirements for finance, and constraints on competition and entry will remain. Hence, we do not believe that these remedies will have sufficient impact on competition within the next two or three years to ensure that the incidence of excessive prices we have identified of the four largest clearing groups in England and Wales would disappear in a reasonable period of time. [...] we also do not believe that technological or other developments in the market will be sufficient to reduce the incidence of excessive prices and profits in a reasonable timescale; this would apply even if all our recommended behavioural remedies were implemented.⁴³⁸

235. As a result of the perceived ineffectiveness of its behavioural solutions, the Competition Commission also examined structural remedies. Three options were examined—the divestment of physical branches, divestment of SME businesses without property and divestment of SME businesses, with physical assets. The report concluded that there would be “formidable, and potentially insuperable, obstacles to structural remedies”⁴³⁹, noting in particular that forcing the divestment of a business would not “be a proportionate remedy for the SME-related problems the CC has identified”.⁴⁴⁰ The report also emphasised that personal as well as business customers would be affected by a business divestment and that such customers lay outside of the scope of the investigation.⁴⁴¹ At the time, structural remedies were not implemented.

236. Following the financial crisis and state support for some UK banks, both Lloyds Banking Group and RBS have conducted major branch divestments in order to comply with EU state aid rules. These projects—Verde at Lloyds and Rainbow at RBS—have created the challenger bank TSB from Verde, and will create Williams and Glyn from Rainbow. However, the Independent Commission on Banking warned that Verde was of insufficient scale to create an effective challenger bank:

438 Competition Commission, *The supply of banking services by clearing banks to small and medium-sized enterprises*, March 2002, p 146

439 Competition Commission, *The supply of banking services by clearing banks to small and medium-sized enterprises*, March 2002, p 147

440 Competition Commission, *The supply of banking services by clearing banks to small and medium-sized enterprises*, March 2002, p 148

441 Competition Commission, *The supply of banking services by clearing banks to small and medium-sized enterprises*, March 2002, p 147

there is a real danger that Verde will fall back into the range of small banks that have not exerted a strong competitive constraint in the past, if it remains at its current size. To ensure that the entity resulting from the divestiture has the best possible chance of becoming a strong, effective challenger, its PCA market share should be at least 6%, so that it is well within the scale of previous serious challengers.⁴⁴²

237. The Financial Times has reported the Chancellor as saying that he made a “mistake” in not radically restructuring the state-controlled Royal Bank of Scotland in 2010. It went on to report that he had said that for several years he had gone along with RBS’s insistence that the investment bank was going to be a viable business with operations all over the world.⁴⁴³

238. Measures taken so far by the competition authorities and the Government have not resulted in a transformational improvement in the competitive environment. The CMA has concluded that concentration in banking is part of the problem. It must now also decide whether reducing concentration would help to address it. This has been examined more than once before. In 2002, the Competition Commission concluded that the forced break-up of large banking groups would not be “proportionate”. The Parliamentary Commission on Banking Standards examined the possible benefits to banking from breaking up RBS into a ‘good’ and ‘bad’ bank. It stopped short of recommending an immediate breakup of the bank, but recommended that the Government commission a detailed analysis of the case for such a split. This study concluded against such a split. But the question of concentration will not go away. The Chancellor is now reported as having said that he made a mistake in not radically restructuring RBS in 2010. The Committee recommends that the CMA’s market investigation should include a detailed examination of whether the conclusions of both the Competition Commission and the Parliamentary Commission on Banking Standards remain relevant, and whether structural reforms may remain essential to secure a reduction in concentration in the market.

The FCA’s competition objective

239. In its final report, the Parliamentary Commission on Banking Standards noted that even well-intentioned regulation could, in some circumstances, do harm as well as good. The report concluded:

That regulation is well-intentioned is no guarantee that it is a force for good. Misconceived and poorly-targeted regulation has been a major contributory factor across the full range of banking standards failings. Regulators cannot always be expected to behave as disinterested guardians who will pursue the

442 Independent Commission on Banking, Independent Commission on Banking: Final Report, September 2011, p 212

443 Financial Times, George Osborne admits RBS error and calls for early sale, by George Parker and Laura Noonan, 5 March 2015

“right” approach. They are faced with complex challenges to which the appropriate solutions are ambiguous and contested. They have not in the past always risen to those challenges satisfactorily. They need to resist the temptation to retreat into a comfort zone of setting complex rules and measuring compliance. They also need to avoid placing too much reliance on complex models rather than examining actual risk exposures. Regulators were complicit in banks outsourcing responsibility for compliance to them by accepting narrow conformity to rules as evidence of prudent conduct. Such an approach is easily gamed by banks, and is no substitute for judgement by regulators.⁴⁴⁴

240. In particular, the report refers to the existence of an “old regulatory contract”—originally referred to by Sir Donald Cruickshank in his March 2000 report, *Competition in UK Banking: A Report to the Chancellor of the Exchequer*.⁴⁴⁵ Sir Donald’s report said:

In return for cooperating in the delivery of Government objectives, the banking industry escaped the rigours of effective competition. This contract cannot coexist with desirable levels of innovation, competition and efficiency in UK banking markets.⁴⁴⁶

The Commission noted comments from John Kay, Professor of Economics at the London School of Economics, that the “vestiges of the regulatory contract remain”.⁴⁴⁷ The Commission also noted comments from Professor Kay about “regulatory comfort”:

There is a very real phenomenon of what you have described as regulatory comfort. At the moment we are in the process of encouraging people to establish new banks, but implicitly and explicitly we say, “If you are going to be a new bank, you have to be pretty similar to an existing bank.”⁴⁴⁸

241. The Financial Services Act 2012 sets out, as an operational objective for the FCA, “promoting effective competition in the interests of consumers”.⁴⁴⁹ When questioned by the Committee about how deeply embedded the objective was in the culture of the regulator, Mr Woolard said:

We have a competition division established. We have around 60 people who specialise in competition within the organisation. We have already published a series of guidelines under section 1(k), which is the part of the legislation

444 Parliamentary Commission on Banking Standards, *Changing banking for good*, First Report of Session 2013–14, HC 175–II, 11 March 2014, 12 June 2013, p 148, para 158

445 Sir Donald Cruickshank, *Competition in UK Banking: A Report to the Chancellor of the Exchequer*, March 2000

446 Sir Donald Cruickshank, *Competition in UK Banking: A Report to the Chancellor of the Exchequer*, March 2000

447 Parliamentary Commission on Banking Standards, *Changing banking for good*, First Report of Session 2013–14, HC 175–II, 11 March 2014, 12 June 2013, p 145

448 Parliamentary Commission on Banking Standards, *Changing banking for good*, First Report of Session 2013–14, HC 175–II, 11 March 2014, 12 June 2013, p 145, para 152

449 Financial Services Act 2012, part 1a, chapter 1, 1E The competition objective

that says we have to say how we go about our business and how we intend to do those things. We have a number of market studies already out there and launched; for example cash savings, which is the big, live, current, ongoing case. We have said that we will bring forward a range of other work, including looking at wholesale markets at a strategic level. Again, I would hope we would publish that within the next few weeks in terms of kicking off that piece of work. We have also completed a first market study, which is around general insurance add-ons. I think it is fair to say, for a relatively new organisation, we have quite a lot around competition. There is obviously still more that we can do and that we are planning to do.⁴⁵⁰

242. The Committee also asked the FCA whether its approach to meeting its competition objective would lead to a change in behaviour across the organisation in general. Mr Woolard replied:

In terms of our supervision department, we have rolled out a range of training around competition for those supervisors. In terms of the information we provide to supervision teams before they go on a visit and in terms of how we ask them to think about doing their jobs, we provide far more information about the market as opposed to the firm that sits within that particular market.⁴⁵¹

243. The Committee also asked the Competition and Markets Authority about the FCA's ability to meet its competition objective. Mr Chisholm said that his impression was that the FCA was taking its competition duties "very seriously",⁴⁵² but suggested that competition was not in the FCA's "DNA" and that the FCA was in the process of "learning a new set of skills".⁴⁵³ Regarding dialogue between the two organisations, he noted:

They have also engaged very much with us through the UK Competition Network, which the Financial Conduct Authority is a member of. [...] We are making sure that we both share what is good practice in the competition space, whether it be a market study or an enforcement action, but also, [...] we are a pressure on them as well to say, "Look, is this the best you can do?" That is a necessary and desirable force because there is always a risk for the regulator to feel that they like the rule they have made and it is justified. In a way, to have somebody externally as well as internally challenging that sometimes and saying, "It may be good in itself, but what is the effect on competition? Is there another better way to achieve your objective?" is a very productive and necessary dialogue.⁴⁵⁴

450 Q 661

451 Q 662

452 Q 1002

453 Q 1003

454 Q 1003

The FCA and the Competition and Markets Authority (CMA)

244. The FCA was given, as part of its operational objectives, a duty to promote “effective competition in the interests of consumers” in the Financial Services Act 2012.⁴⁵⁵ Under the Financial Services (Banking Reform) Act 2013, the FCA is also to become a concurrent competition authority alongside the CMA.⁴⁵⁶ Concurrency will come into force on 1 April 2015, and provide the following powers to the FCA:

under the Competition Act 1998 to enforce against and fine for breaches of domestic and EU competition law prohibitions on anticompetitive agreements (for example, cartels) and abuses of a dominant position, and

under the Enterprise Act 2002 to make a Market Investigation Reference to the Competition and Markets Authority (CMA).⁴⁵⁷

The FCA has said:

These competition powers may also be exercised by the CMA with regard to financial services and other sectors of the economy. This means that, in respect of financial services, the CMA and the FCA will have ‘concurrent powers’ and the FCA will be a ‘concurrent regulator’. These powers are additional to our ability to use FSMA powers in pursuit of the FCA’s competition objective.⁴⁵⁸

245. The FCA and CMA’s powers differ in a number of places. For example, as the financial services conduct regulator, it has the various rule-making and guidance-giving powers under the Financial Services and Markets Act 2000. Another example is that the CMA has wider competition powers than the FCA, whose powers are limited to financial services.⁴⁵⁹ Some of the CMA and FCA powers are complementary. For example, the FCA has the power to request “the CMA to consider whether a feature, or combination of features, of a market in the United Kingdom for financial services may prevent, restrict or distort competition in connection with the supply or acquisition of any financial services [...]”.⁴⁶⁰

246. The FCA has a duty—set out under section 140G of FSMA—to consider advice provided to it by the CMA under section of 140B FSMA. The FCA must publish a response

455 Financial Services Act 2012

456 Financial Services (Banking Reform) Act 2013

457 Financial Conduct Authority, Promoting effective competition, 27 February 2015

458 Financial Conduct Authority, Promoting effective competition, 27 February 2015

459 Financial Conduct Authority, FCA Competition Concurrency Guidance and Handbook amendments, January 2015, p 14

460 Competition and Markets Authority and Financial Conduct Authority, Memorandum of Understanding between the Competition and Markets Authority and the Financial Conduct Authority, 12 June 2014

“stating how it proposes to deal with the advice”, including whether it has taken any action and the justification for any action, within 90 days of receiving the advice.⁴⁶¹

247. The relationship between the FCA and the CMA regarding their competition duties have been set out in a memorandum of understanding between the two organisations. This describes the circumstances each organisation would take responsibility for competition-related activities:

In some cases it will be clear which organisation should take the lead. For example, we would expect that the FCA would take the lead in dealing with issues where regulatory solutions are most appropriate, such as changes to the authorisation process to better enable new entry, using rule-making powers to improve the way that products are distributed, or taking supervisory or enforcement action against particular firms where existing requirements are not being met. Similarly, we would expect that CMA action would be more appropriate where the issue is best dealt with through enforcement of competition law (such as an investigation of suspected cartel behaviour or abuse of dominance), or in situations where the competition problem is such that a market investigation by the CMA would be appropriate, e.g. because the type of remedies available to the CMA may be appropriate. It may also be more appropriate for the CMA to take the lead where the competition problem is not unique to financial services markets.⁴⁶²

248. The FCA and CMA aim to have a “co-ordinated” approach, and, for example, “have agreed to consult each other early on when considering taking action” to address potential overlaps and duplication of work. The memorandum also notes that the CMA has “developed deep expertise in considering competition matters across a variety of sectors”, that the FCA has “significant sectoral experience in the financial services sector”, and that “organisations will [...] provide technical assistance to each other where it may be helpful”.⁴⁶³ But Regulation 8 of The Competition Act 1998 (Concurrency) Regulations 2014 allows the CMA to direct a regulator, such as the FCA, to transfer a competition case to it where the CMA “exercising the Part 1 functions rather than the regulator would further the promotion of competition, within any market or markets in the United Kingdom, for the benefit of consumers”.⁴⁶⁴ The CMA may not do this once the sector regulator has issued a “Statement of Objections”.⁴⁶⁵

461 Financial Services and Markets Act 2000, Section 140G

462 Competition and Markets Authority and Financial Conduct Authority, Memorandum of Understanding between the Competition and Markets Authority and the Financial Conduct Authority, 12 June 2014

463 Competition and Markets Authority and Financial Conduct Authority, Memorandum of Understanding between the Competition and Markets Authority and the Financial Conduct Authority, 12 June 2014

464 The Competition Act 1998 (Concurrency) Regulations 2014, Regulation 8

465 Competition and Markets Authority, Regulated Industries: Guidance on concurrent application of competition law to regulated industries, March 2014, CMA10, p 19, para 3.27

249. The FCA will not be alone in having concurrent powers with the Competition and Markets Authority (CMA).⁴⁶⁶ The Financial Conduct Authority is part of the UK Competition Network (UKCN), which includes other sector regulators, such as the Civil Aviation Authority and the Office of Gas and Electricity Markets.⁴⁶⁷ The Government describes the UKCN as “an alliance of the Competition and Markets Authority (CMA) with all the UK regulators that have a specific role to support and enable competition within their sectors”.⁴⁶⁸ The mission of the UKCN will be “to promote competition for the benefit of consumers and to prevent anti-competitive behaviour both through facilitating use of competition powers and development of pro-competitive regulatory frameworks, as appropriate.”⁴⁶⁹

250. Regulation can be an impediment to effective competition in banking. Regulators appear to have an instinctive resistance to new entrants: in the recent past, prudential requirements had been applied in a way that unnecessarily hindered new entrants, the authorisation process had been difficult for new entrants, and small banks had to reach an agreement with a larger one to have access to the payments system. The FCA now has a statutory objective to promote competition in the interests of consumers. The FCA must continue to transform its regulatory approach in order to fulfil this new objective. It is essential that the FCA’s approach to meeting this objective is not siloed within an individual department of the regulator, but instead permeates through the entire culture and approach of the organisation.

251. The FCA’s competition objective is new. The regulator is in the process of learning a new set of skills. The evidence suggests that this is a work in progress. The Committee recommends that the FCA, with oversight from the CMA, produce an annual report on the implementation of its pro-competition activities. In particular, the CMA should be invited to form a judgement on the effectiveness of the FCA’s competition regime. The FCA and CMA have concurrent competition objectives. They both remain active in the competition field. The danger is that the CMA retreats, and the FCA does not vigorously fill in the space left. The CMA should report publicly if it believes the FCA is not fulfilling its competition duties.

466 Competition and Markets Authority, Regulated Industries: Guidance on concurrent application of competition law to regulated industries, March 2014, CMA10, p 62

467 Gov.uk website, UK Competition Network, downloaded 6 March 2015

468 Gov.uk website, UK Competition Network, downloaded 6 March 2015

469 United Kingdom Competition Network (UKCN) Statement of Intent, p 2

6 Alternative finance

Crowdfunding/peer-to-peer finance

252. While much of this report has focused on competition in SME banking, not all competition in SME finance comes from the banking sector itself. SMEs are able to obtain funding from a variety of alternative sources. This includes both equity and debt funding. In this report, the Committee has focused on a relatively new form of disintermediated SME financing—crowdfunding and peer to peer finance.

253. Crowdfunding, a term sometimes used interchangeably with peer-to-peer finance, is a relatively new type of business funding that has attracted broader attention in recent years.⁴⁷⁰ With regard to SME finance, crowdfunding/peer-to-peer finance encompasses a variety of models where small individual lenders directly fund businesses. Unlike saving through bank deposits, the risk is borne directly by the investor.⁴⁷¹ Crowdfunding/peer-to-peer lending can come in several different forms, including:

- Peer-to-business lending, or loan-based crowdfunding, is a form of debt-based funding where businesses borrow small amounts of money from many small investors.⁴⁷²
- Equity or “investment-based” crowdfunding is a form of equity based funding where “people invest directly or indirectly in new or established businesses by buying shares” or other securities.⁴⁷³
- Peer-to-peer invoice financing, a form of asset-based finance where investors directly fund businesses through purchasing their invoices.⁴⁷⁴

254. As discussed previously in this report, there are few sources of official statistics on crowdfunding/peer-to-peer finance. Those that do exist suggest that, while alternative lenders appear to be small in comparison to established banks, they do exhibit a high growth rate. The think-tank Nesta, in a 2013 report, estimated that total finance raised by the sector—including lending to individuals, businesses and charities—“more than tripled from £309 million in 2011 to £939 million in 2013”.⁴⁷⁵ They also said that the “peer-to-business lending sector is more than doubling each year and the UK is the undisputable world leader of this alternative financing model”.⁴⁷⁶ In January 2015, the Liberium AltFi Index, an industry dataset on peer-to-peer and crowdfunding platforms, estimated that the total lent by alternative finance platforms had exceeded £2.7 billion. Of this, peer-to-

470 Financial Conduct Authority, Policy Statement 14/4, March 2014

471 Funding Circle, Understanding risk, 17 February 2015

472 Financial Conduct Authority, Policy Statement 14/4, March 2014, p 10

473 Financial Conduct Authority, Policy Statement 14/4, March 2014, p 11

474 SME0154

475 Nesta, *The Rise of Future Finance: The UK Alternative Finance Benchmarking Report*, December 2013, p 7

476 Nesta, *The Rise of Future Finance: The UK Alternative Finance Benchmarking Report*, December 2013, p 10

business lending accounted for just over £1 billion, with an annual growth rate of approximately 200 per cent.⁴⁷⁷

Advantages of crowdfunding/peer-to-peer lending

255. Evidence to the Committee attributes the sector’s growth to new technology and reduced confidence in traditional lenders following the financial crisis. Samir Desai, CEO and co-founder of the alternative lender Funding Circle, told the Committee that the “loss of trust and satisfaction with banks” was helping to drive growth in the industry. He added that “the costs of technology and being able to use technology have come down dramatically”⁴⁷⁸ and that technology was beginning to disrupt status quo in the financial services industry:

What we think is happening now—in the case of Funding Circle and the same with MarketInvoice—is that technology or the internet is starting to disrupt financial services. We have seen that disruption in the book industry and music, and what is happening now is that you have the digital equivalent of lending—digital loan and digital invoice finance—starting to take off. I personally think that is an unstoppable force.⁴⁷⁹

Anil Stocker, founder and CEO of alternative lender MarketInvoice, agreed, saying that new alternative providers could build business models which were leaner than traditional lenders:

We have better data now than ever before. We have a chance to redefine completely how we think about these products. We can introduce new products. We are not saddled by branches, big bloated infrastructure, cost bases and people.⁴⁸⁰

256. Mr Stocker emphasised the speed, flexibility and simplicity of crowdfunding/peer-to-peer finance, saying that:

When I look at the products that the banks have, there are so many negative features about them. There is so much lock-in. There are so many opaque things around the fees. Businesses do not understand what they are going to get charged, how they can exit and what collateral they have to give. Banks are constantly changing the goalposts. Right now I think there is a huge opportunity in the alternative finance market to make everything more transparent, faster and easier [...].⁴⁸¹

477 Liberum AltFi Volume Index *AltFi*, as at 19 January 2015

478 Q 922

479 Q 922

480 Q 929

481 Q 920

257. With regard to the speed of funding, MarketInvoice’s written evidence said that initially it took 21 days to fulfil an approved application for funds, which it stated was similar to the level that “banks have been stuck at for 30+ years”. The firm said it had improved this, so that it could provide funding “in a few hours”. This reduction was attributed by MarketInvoice to its “need to innovate” as a result of the “competitive marketplace” in which it operated.⁴⁸² Funding Circle also claimed to be “faster and more efficient than a bank loan”. It wrote that “on average it takes 12 days for a business to gain finance through Funding Circle, compared to ~15–20 weeks with a bank”.⁴⁸³

258. The New Economics Foundation (NEF), a think tank, believed that part of the usefulness of crowdfunded loans was due to the unsecured nature of the loans, which it said was “particularly suitable for the SME sector where borrowers often lack suitable collateral”. It said that, as a result, “borrowers who struggle to access bank finance, may be able to get credit and at lower rates than other sources of non-bank finance”.⁴⁸⁴ Mr Desai highlighted the similarity that crowdfunded lending has with sources of finance open to larger firms:

[...] if you look at big businesses, they do not have to borrow from banks. They can go to bond markets or equivalent syndicated loan markets and borrow the money directly from big investors. Platforms like Funding Circle allow smaller businesses to borrow directly from investors as well. If you look at bond markets or syndicated loan markets, they can be anywhere between 20% and 40% of finance markets, or even higher in the US. There is precedent for this in larger business finance.⁴⁸⁵

Crowdfunding and competition

259. In written evidence, the British Bankers’ Association said that UK businesses had a “traditional overreliance” on bank-sourced credit “with banks providing nearly 80 per cent of all credit”.⁴⁸⁶ RBS and HSBC said that crowdfunding and peer-to-peer finance were leading to greater competition. HSBC wrote:

There has been a range of new entrants to the market over the last five years. These entrants include challenger banks, such as Aldermore Bank and Metro Bank, and a number of new innovative funding sources for SME customers such as Funding Circle. These new entrants are helping to drive competition in the SME banking market and have increased their lending volumes at a time when overall net lending in the market has declined.⁴⁸⁷

482 SME0154

483 SME0108

484 SME0139

485 Q 931

486 SME0110

487 SME0115

RBS wrote that it was “seeing increasing competition from alternative sources of finance” and “though still small in absolute terms, [this] has been showing extremely rapid growth rates”. RBS said that alternative lenders were, “in some circumstances, better suited to the customer’s needs than a traditional bank product or service”.⁴⁸⁸ Other organisations offered a similar view. The CBI wrote that “increased competition in the banking sector coupled with the impact of alternative finance providers indicates a positive trajectory for the market”.⁴⁸⁹ The ACCA wrote that “it would only take the alternative lenders four years to rival today’s banks for lending volumes if their current growth rates are maintained”.⁴⁹⁰

260. Crowdfunded finance is, however, still regarded as niche by many businesses. The Institute of Chartered Accountants of Scotland (ICAS) believed that “innovations such as the emergence of retail bonds and crowdfunding remain, as yet, of only marginal significance”.⁴⁹¹ The British Chambers of Commerce (BCC) said that feedback from their members revealed a high degree of reliance on “traditional debt finance.” In a poll of their members, 49 per cent used banks or building societies, 10 per cent used equity and 8 per cent used “grants, venture capital, private equity, peer-to-peer lending and angel finance combined”. The BCC said that there “remains little understanding of alternative finance options.”⁴⁹²

261. In March 2014, the Government consulted on whether and how it could “legislate to create a mandatory process, whereby Small and Medium Sized Enterprises (SMEs) that have been rejected for finance are linked up with other lending opportunities from challenger banks and alternative finance providers”.⁴⁹³ Awareness of alternative lenders was a particular problem cited by witnesses to the Committee.⁴⁹⁴ Discussing the Government’s consultation on this issue, Mr Stocker said to the Committee:

There needs to be some way that we can either build awareness at the point of application, or build awareness alongside the banks and banking infrastructure. I think some things are already being debated and discussed around referrals and ways of signposting, just to build awareness, because I think that with awareness you are going to have a lot more businesses finding out about us, using us, and creating jobs.⁴⁹⁵

The Peer-to-Peer Finance Association wrote:

488 SME0093

489 SME0080

490 SME0011

491 SME0101

492 SME0104

493 HM Treasury and BIS consultation, Help to match SMEs rejected for finance with alternative lenders: summary of responses, August 2014, p 3

494 Q 968; SME0108

495 Q 968

The P2PFA considers that any mechanism which required banks to provide information to SME customers about alternate sources of finance a helpful step in the right direction.⁴⁹⁶

262. As a result of its consultation, the Government has proposed draft legislation on a requirement for banks to refer SMEs rejected for finance to alternative lenders in the Small Business, Enterprise and Employment Bill.⁴⁹⁷ It has also published, in draft, a statutory instrument to illustrate its current intention as to the exercise of powers under clause 5 of Bill.⁴⁹⁸

Risks of crowdfunding

263. Crowdfunding is currently regulated by the FCA.⁴⁹⁹ A number of risks from crowdfunding have been identified by the regulator, including:

- A lack of minimum standards of due diligence or disclosure. In particular, the reporting requirements on borrowing businesses may be lower than for listed companies;
- Investor over-optimism, particularly if due diligence or disclosure has been poor;
- Problems with technology, IT security or the internet; and
- A potential lack of regulatory experience or, with regard to loan-based crowdfunding, lending experience in crowdfunding firms.⁵⁰⁰

264. Crowdfunding/peer-to-peer finance is in principle a welcome addition to the UK SME lending market. For some SME borrowers, it can offer a credible alternative to bank lending. It represents a step towards more effective competition in the market.

265. Crowdfunding/peer-to-peer finance's market share of SME lending remains relatively small. Borrower awareness and understanding remain the most significant barriers to wider adoption. The Government has set out plans to require banks to refer those rejected for bank finance to alternative lenders. These are welcome in principle.

266. Commercial risk should remain with the lender. Crowdfunding and peer-to-peer lending platforms have a duty to explain clearly and fully, to those who wish to lend or invest through them, the risks that they are taking.

496 SME0068

497 Small Business, Enterprise and Employment Bill, HL Bill 57 2014–15, 20 November 2014

498 HM Treasury, The Small and Medium Sized Business (Finance Platforms) Regulations 2015 Regulations: draft regulations, 6 August 2014

499 Financial Conduct Authority, The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media, March 2014

500 Financial Conduct Authority, The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media, March 2014

Conclusions and recommendations

The state of the SME lending market

1. Official and industry data, as well as evidence presented to the Committee, show that the overall availability of credit has improved since the low point of the financial crisis. While the cyclical downturn in lending may not yet have been fully reversed, anecdotal evidence suggests that many businesses are finding it less difficult to obtain credit. This is welcome. (Paragraph 27)
2. However, SMEs are highly heterogeneous. The credit crunch may have abated, but long standing structural problems in SME finance dating from before the financial crisis remain. In particular, firms seeking finance for the first time and firms based heavily on intangible assets appear to find it much harder to obtain access to credit than others. This may in part be because new firms lack a track record on which lenders can assess their credit risk. It may also result from the risks that arise from the use of intangible assets as collateral for loans. In such cases, the unwillingness of a bank to lend may reflect greater risk within the business which is seeking credit. It may also be due to a bank's reassessment of risk following the crash. (Paragraph 28)
3. There are sound economic foundations to government schemes that aim to address gaps in the availability of funding for SMEs. There are a large number of different schemes and funds, each with their own, specialised rules. It is noteworthy that, in evidence to the Committee, business advisors themselves appeared unaware of some of the schemes available—it will be all the harder for very small firms to be aware of the schemes that may apply to them. It is therefore not surprising that many businesses are unaware of the targeted funding support available to them, or have difficulty navigating what is available. The schemes may be reaching only a proportion of the businesses that they are designed to help. The British Business Bank has been given the role of increasing businesses' awareness of government schemes. The Government should also review the schemes and their purposes, and with a view to simplifying both the schemes and their availability, as a matter of urgency. (Paragraph 29)
4. SMEs' negative perceptions of banks' willingness to lend appear to have resulted in an increased reluctance of SMEs to apply for credit. However, these perceptions may also be too pessimistic—SMEs may be more likely to have their applications for credit accepted than they perceive. (Paragraph 48)
5. The divergence of businesses' and banks' perceptions of the availability of credit is partly the result of past behaviour by the industry. Sir Andrew Large's Independent Lending Review found, for example, that RBS claimed to approve 80 per cent of loan applications, but that this figure did not take into account the informal rejections that customers often faced during the early stages of an application. While it is difficult to measure how serious a deterrent this has been, it is one explanation as to

why RBS has struggled to convince many customers that it is “open for lending”. (Paragraph 49)

6. While businesses may not all directly take an interest in lending statistics themselves, their perceptions of the lending environment are influenced by commentators and the media, who do. The publication of data on bank lending can therefore help to improve businesses’ understanding of banks’ willingness to lend. Recent efforts by the Bank of England to collect data on SME lending are welcome. However, this new data has only been collected as a reaction to the crisis. Data on the stock and flow of SME lending was extremely limited until 2011. This makes it difficult, for example, to determine how current levels of SME lending compare with the period before the financial crisis. The Bank of England should examine the case for expanding its work on SME lending by increasing the collection and publication of SME lending data; for example, the publication of lending to SMEs disaggregated by industrial category. (Paragraph 50)
7. Improvements in the publication of information also assist policymakers, who need to have accurate data on credit conditions. (Paragraph 51)

RBS Global Restructuring Group (GRG)

8. The amount of lending from alternative sources is not yet well documented. Official sources barely record it at all. As alternative lenders grow, it is important that their contribution to the SME funding market is recognised and understood as part of a wider picture of business lending. The Bank of England should consider whether it needs to begin routinely collecting more lending data from non-bank sources. If it believes additional data collection is necessary, it should examine its existing data collection powers and write to this Committee and to the Treasury if it believes that they are insufficient. (Paragraph 52)
9. The Clifford Chance review of RBS’s treatment of distressed customers, principally by the Global Restructuring Group, was welcomed by RBS as finding “no evidence of systematic defrauding of business customers”. However, the review—overseen by a bank executive rather than a non-executive director—was not independent, was based on narrow terms of reference, and left a number of questions unanswered, such as why GRG could not explain the size of fees it had charged, and the accuracy of its asset valuations. (Paragraph 68)
10. The FCA is conducting its own review into GRG. It is important that this review comprehensively address the allegations against GRG, so that the public can be confident that any wrongdoing is identified and resolved. (Paragraph 69)
11. In his report on RBS, Sir Andrew Large said that GRG was run as an “internal profit centre”. However, in written and oral evidence to the Committee, RBS disputed that description—even though it had had the opportunity to contest that point when it saw Sir Andrew’s report in draft. Mr Sullivan and Mr Sach told the Committee, on behalf of RBS, that GRG was not a profit centre. The Committee, having received

further written evidence from Sir Andrew Large, the Chairman of RBS, Mr Sach and Mr Sullivan, has concluded that Mr Sullivan and Mr Sach's original statements to the Committee on this point were wrong. It is now agreed by all that Sir Andrew was correct in his description of GRG as an internal profit centre. (Paragraph 80)

12. The evidence that Mr Sach and Mr Sullivan gave was incorrect and therefore misleading, whether intentionally or not. RBS has apologised to the Committee and corrected its evidence. However, given the seniority of the original RBS witnesses, it should not have required intervention by this Committee with the Chairman of RBS to obtain that apology and a full statement of RBS's position. (Paragraph 81)
13. This misunderstanding of the bank's position by two senior executives is indicative of a systemic weakness of standards and culture. It is understandable, indeed right, that banks should seek to support businesses in difficulty with special measures but how that is done and whether the institution or the customer is the main beneficiary needs much greater clarity. (Paragraph 82)

Mis-sale of Hedging Products

14. The FCA's IRHP redress process is guided by the principle that "redress must be fair and reasonable", and that "redress should aim to put customers back in the position they would have been in had the breach of regulatory requirements not occurred." This is a statement of principles, and is open to interpretation by banks conducting the review. The outcome in each customer's review therefore relies primarily on the judgement of the bank, on a case by case basis, subject to approval from an independent reviewer. In addition different banks came to different conclusions with inconsistency between different independent reviewers. (Paragraph 91)
15. The arbitrary sophistication test may have been necessary to obtain agreement to a voluntary scheme from banks, but it is clear that not all non-sophisticated customers have been included in the review. (Paragraph 92)
16. Alternative product redress is determined by the bank and the independent reviewer, who retrospectively determine what a business would have bought had a sale been compliant. This is a matter of judgement, and one not necessarily easily made, by the bank and the independent reviewer. (Paragraph 96)
17. The FCA has acknowledged that the introduction of a £10 million cap on the size of an IRHP has excluded approximately one third of the largest IRHP review participants. The FCA should write to the Committee to explain its decision-making on this cap. This explanation must state whether, in its view, it represented a concession to bank lobbying, and if not, why not. (Paragraph 99)
18. The FCA has consistently maintained that the redress process has worked as intended. But there have been complaints that the process of the IRHP review falls short of delivering fair and reasonable redress. It has been difficult for this Committee to determine, however, whether these complaints are examples of

isolated exceptions to an adequate process, or are signs of a wider, systemic problem with the review. (Paragraph 114)

19. This in itself is indicative of a flaw in the process which the FCA should address. In particular, the FCA should collect the information necessary to establish whether there are systemic failures in the review. The FCA should publish its findings, a summary of the complaints it has examined, and take any action it decides is appropriate to ensure that all customers receive fair and reasonable redress. (Paragraph 115)
20. Section 348 of the Financial Services and Markets Act 2000 (FSMA) prevents the FCA from disclosing confidential information to third parties without the permission of the regulated entity to which that information relates. The FCA cited this provision as the reason for its reluctance to provide the Committee with the agreement it had reached with banks about the IRHP review. At no stage did the FCA suggest that the Committee's request was unreasonable. The FCA did eventually provide the agreement, but only after considerable delay. The FCA should come forward with suggestions as to how such difficulties could be prevented in future. (Paragraph 118)
21. We have received evidence suggesting that Clydesdale Bank mis-sold Tailored Business Loans. Clydesdale has itself admitted that its terms and conditions letters would not pass a plain English test, and that its TBL customers could not reasonably have anticipated the high levels of potential break costs to which they had exposed themselves. Many small businesses indeed did not grasp their exposure to such high break costs, nor could they reasonably have been expected to do so. (Paragraph 147)
22. It appears that the bank did not explain the potential scale of break costs in a low interest rate environment because the bank itself had not taken into account this potential risk. Banks, however, should be the experts in assessing the potential risk of products they sell, and explain those risks to their customers. The sale of TBLs has led to considerable consumer detriment. The bank's failure adequately to assess the potential risk of its product may explain the detriment that the bank has caused to its customers, but does not excuse it. (Paragraph 148)
23. From the point of view of the customer, the services provided by the hedging element of a loan with an embedded interest rate hedging facility—such as a Tailored Business Loan—and a stand-alone IRHP are extremely similar, if not identical. But stand-alone IRHPs are regulated, while loans with embedded interest rate hedging facilities are not. It is a logically inconsistent result of the perimeter of regulation that products whose effects may be identical fall on both sides of the perimeter. (Paragraph 149)
24. Clydesdale understood that TBLs were unregulated. It created TBLs to avoid requirements imposed by the regulator on the sale of a regulated product, IRHPs. It claims that this was to simplify the associated documentation, and to make the product easier for customers to understand. The use of TBLs has left regulators

powerless to enforce compensation for customers to whom products were mis-sold, as they have done with IRHPs. Clydesdale created a product that retained the risks and complexities of the regulated product, but had none of the safeguards. (Paragraph 150)

25. The Treasury should publish an assessment of the feasibility, benefits and costs of adjusting the perimeter of regulation to cover loans with features of interest rate hedging products. This assessment will need to take into account the possibility that other products may inadvertently be included in the perimeter as a by-product, and the negative consequences that this could entail. (Paragraph 151)
26. The lack of public oversight, minimal transparency and limited coverage of the scheme mean that the Committee cannot be confident that Clydesdale's separate internal review will deliver outcomes equivalent to the FCA review upon which it is intended to be based. If Clydesdale's aim is to build public trust in its actions, it should address all three of these problems. (Paragraph 161)
27. Regulation has, in many cases, failed to prevent mis-selling. Dispute resolution services—such as the Financial Ombudsman Service (FOS)—can provide a means of redress to bank customers when things go wrong. The existence of the FOS has, overall, been positive for both banks and their customers. It provides a means of independent, affordable and effective dispute resolution through which to challenge a bank's decision making. (Paragraph 172)
28. There is a risk that a wider remit and the greater complexity of SME cases could greatly increase the workload of the FOS and overburden it. This could be detrimental to existing users of the FOS. However, it is clear that there is a group of small businesses which are too large to be covered by the FOS but too small to be able to afford to challenge their bank in court effectively. Such businesses are often unable to challenge poor decision making by banks or to seek redress when their banks treat them badly, even when their case is valid. It is not acceptable that these businesses should be denied adequate redress or that banks should, as it appears, be permitted to game the system to avoid responsibility for their actions. (Paragraph 173)
29. Bearing in mind the risk identified above, the FCA consultation on the scope of the FOS, prompted by the Parliamentary Commission on Banking Standards, should also consider how this gap in coverage can be closed, and, as a matter of urgency, report to Parliament their conclusions. (Paragraph 174)

Competition in SME lending

30. Inadequate competition in banking is a long-standing problem. Many of the problems identified by the Parliamentary Commission on Banking Standards, the Independent Commission on Banking and the 2002 Competition Commission market investigation persist. The UK SME banking sector remains dominated by four major banking groups, who among them have a market share in England and

Wales of 85 per cent. The largest firms have the lowest satisfaction scores. (Paragraph 212)

31. Challenger banks and the growth in alternative lending have scope to increase competition. However, gross peer-to-peer lending to businesses in H1 2014 was £300m, only about 1% of the £24.8 billion lent by banks to SMEs over the same period, and the CMA found that the SME banking market share of banks outside the top 5 in England and Wales was less than 5%. Challenger banks and alternative lenders are therefore not yet at a scale sufficient to challenge incumbents. There is currently little evidence to suggest that new entrants in the SME finance market and existing measures to improve competition will deliver the transformation in competition that the industry needs. This lends weight to the importance of the CMA's market investigation into SME banking. (Paragraph 213)
32. The presence of multiple credit searches in a business's credit history can damage their credit score. Multiple credit searches may indicate that a customer's applications for credit have been repeatedly declined, and therefore suggest to a lender that they are a higher risk. But they may simply be evidence that the customer is shopping around. Borrowers are sometimes deterred by the banks themselves from comparing providers by the negative impact that making applications to multiple banks could have on their credit score. As part of its market investigation, the CMA should, in consultation with the industry and the Information Commissioner's Office, examine how this disincentive can be addressed. (Paragraph 219)
33. Price comparison tools are prevalent in retail banking and insurance markets, but less so in business banking. This may be due to the relative complexity of products in the SME banking market. It may also be a symptom of a lack of competitive pressure in the industry. As part of its market investigation, the CMA should examine, in consultation with the industry, why the provision of price comparison tools for SME banking has so far been limited, and the scope for increasing it. (Paragraph 225)
34. The Current Account Switch Service has been geared primarily towards retail customers, not businesses. Changes announced by the Government at the 2014 Autumn Statement to improve the CASS for SMEs are therefore welcome. As part of its market investigation, the CMA should examine how the scheme could further benefit SMEs, and what steps can be taken to improve SME awareness of the scheme. (Paragraph 231)
35. Measures taken so far by the competition authorities and the Government have not resulted in a transformational improvement in the competitive environment. The CMA has concluded that concentration in banking is part of the problem. It must now also decide whether reducing concentration would help to address it. This has been examined more than once before. In 2002, the Competition Commission concluded that the forced break-up of large banking groups would not be "proportionate". The Parliamentary Commission on Banking Standards examined

the possible benefits to banking from breaking up RBS into a ‘good’ and ‘bad’ bank. It stopped short of recommending an immediate breakup of the bank, but recommended that the Government commission a detailed analysis of the case for such a split. This study concluded against such a split. But the question of concentration will not go away. The Chancellor is now reported as having said that he made a mistake in not radically restructuring RBS in 2010. The Committee recommends that the CMA’s market investigation should include a detailed examination of whether the conclusions of both the Competition Commission and the Parliamentary Commission on Banking Standards remain relevant, and whether structural reforms may remain essential to secure a reduction in concentration in the market. (Paragraph 238)

36. Regulation can be an impediment to effective competition in banking. Regulators appear to have an instinctive resistance to new entrants: in the recent past, prudential requirements had been applied in a way that unnecessarily hindered new entrants, the authorisation process had been difficult for new entrants, and small banks had to reach an agreement with a larger one to have access to the payments system. The FCA now has a statutory objective to promote competition in the interests of consumers. The FCA must continue to transform its regulatory approach in order to fulfil this new objective. It is essential that the FCA’s approach to meeting this objective is not siloed within an individual department of the regulator, but instead permeates through the entire culture and approach of the organisation. (Paragraph 250)
37. The FCA’s competition objective is new. The regulator is in the process of learning a new set of skills. The evidence suggests that this is a work in progress. The Committee recommends that the FCA, with oversight from the CMA, produce an annual report on the implementation of its pro-competition activities. In particular, the CMA should be invited to form a judgement on the effectiveness of the FCA’s competition regime. The FCA and CMA have concurrent competition objectives. They both remain active in the competition field. The danger is that the CMA retreats, and the FCA does not vigorously fill in the space left. The CMA should report publicly if it believes the FCA is not fulfilling its competition duties. (Paragraph 251)

Alternative finance

38. Crowdfunding/peer-to-peer finance is in principle a welcome addition to the UK SME lending market. For some SME borrowers, it can offer a credible alternative to bank lending. It represents a step towards more effective competition in the market. (Paragraph 264)
39. Crowdfunding/peer-to-peer finance’s market share of SME lending remains relatively small. Borrower awareness and understanding remain the most significant barriers to wider adoption. The Government has set out plans to require banks to

refer those rejected for bank finance to alternative lenders. These are welcome in principle. (Paragraph 265)

40. Commercial risk should remain with the lender. Crowdfunding and peer-to-peer lending platforms have a duty to explain clearly and fully, to those who wish to lend or invest through them, the risks that they are taking. (Paragraph 266)

Formal Minutes

Tuesday 10 March 2015

Members present:

Mr Andrew Tyrie, in the Chair

Rushanara Ali
Steve Baker
Mark Garnier
Stewart Hosie

Jesse Norman
Alok Sharma
John Thurso

Draft Report (*Conduct and competition in SME lending*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 266 read and agreed to.

Resolved, That the Report be the Eleventh Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Written evidence was ordered to be reported to the House for publication on the internet.

[Adjourned till Tuesday 17 March at 9.45am]

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page at www.parliament.uk/treascom.

Tuesday 25 February 2014

Question number

Professor Russel Griggs OBE, Independent External Reviewer, Banking Taskforce Appeals Process

[Q1–80](#)

Priyen Patel, Senior Policy Advisor, Federation of Small Businesses, and Matthew Fell, Director of Competitive Markets, Confederation of British Industry

[Q81–135](#)

Tuesday 29 April 2014

Peter Hollis, Hollis and Co, Chris Lane, Kingston Smith, and Ronel Lehmann, Lehmann Communications Ltd.

[Q136–202](#)

Laurence Beere, L&H Hotels Ltd, Tim Murphy, Seneca Banking Consultants and Jeremy Roe, Bully–Banks

[Q203–260](#)

Tuesday 10 June 2014

Richard Pyman, Chief Executive Officer, Shawbrook, and Anders Bouvin, UK Chief Executive Officer, Handelsbanken

[Q261–322](#)

Martin Morrin, Chair, Asset-based Lending Association and Managing Director, RBS Invoice Finance, Frances Coulson, Managing and Client Services Partner, Moon Beever Solicitors, and Professor Mark Watson-Gandy, Thirteen Old Square Chambers

[Q323–391](#)

Tuesday 17 June 2014

David Thorburn, Chief Executive, Clydesdale and Yorkshire Banks, and Debbie Crosbie, Executive Director, Customer Trust and Confidence, National Australia Group Europe

[Q392–525](#)

Chris Sullivan, Deputy Group Chief Executive, Royal Bank of Scotland, and Derek Sach, Head of Global Restructuring Group, Royal Bank of Scotland

[Q526–656](#)

Tuesday 1 July 2014

Tony Boorman, Interim Chief Executive and Chief Ombudsman, Financial Ombudsman Service, Chris Woolard, Director of Policy, Risk and Research, and Nausicaa Delfas, Head of the Specialist Supervision Department,

[Q657–735](#)

Financial Conduct Authority

Andrea Leadsom MP, Economic Secretary, Alison Cottrell, Financial Services, and Jeremy Pocklington, Director, Enterprise and Growth, HM Treasury

[Q736-785](#)

Wednesday 16 July 2014

Tim Hinton, Managing Director, SME & Mid Markets Banking, Commercial Banking, Lloyds Bank, and Rebecca McNeil, Head of Business Lending, Barclays

[Q786-918](#)

Samir Desai, Chief Executive Officer and Co-founder, Funding Circle, Anil Stocker, Chief Executive Officer and Founder, MarketInvoice, and Tony Askew, Chair, BVCA, Venture Capital Committee and Partner, Reed Elsevier Ventures

[Q919-968](#)

Monday 21 July 2014

Alex Chisholm, Chief Executive, Dr Andrea Coscelli, Executive Director, Markets and Mergers, and Dan Moore, Project Director, SME Banking Market Study, Competition and Markets Authority

[Q969-1004](#)

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/treascom.

- 1 A Quine Investments Ltd part 1 ([SME0014](#))
- 2 A Quine Investments Ltd part 2 ([SME0012](#))
- 3 Additional written evidence submitted by Clydesdale Bank ([SME0142](#))
- 4 ADS ([SME0107](#))
- 5 AHV Associates ([SME0174](#))
- 6 Amjad Ali ([SME0067](#))
- 7 Andrew Dykes ([SME0087](#))
- 8 Anthony Maher ([SME0069](#))
- 9 ART (Aston Reinvestment Trust) ([SME0088](#))
- 10 Asset Based Finance Association ([SME0090](#))
- 11 Asset Based Finance Association ([SME0158](#))
- 12 Asset Based Finance Association ([SME0147](#))
- 13 Asset Based Finance Association, Professional Standards Council ([SME0085](#))
- 14 Association of Chartered Certified Accountants ([SME0011](#))
- 15 Ballantyne Property Services ([SME0037](#))
- 16 Bell and Ross Ltd ([SME0023](#))
- 17 Berg ([SME0084](#))
- 18 Big Innovation Centre ([SME0103](#))
- 19 British Bankers' Association ([SME0110](#))
- 20 British Chambers Of Commerce ([SME0104](#))
- 21 Campaign For Community Banking Services ([SME0009](#))
- 22 CBI ([SME0080](#))
- 23 Chris Parry-Davies ([SME0133](#))
- 24 Clive May ([SME0001](#))
- 25 Clydesdale Bank ([SME0165](#))
- 26 Colin Phillips ([SME0007](#))
- 27 Community Development Finance Association (CDFA) ([SME0096](#))
- 28 Cumbria Small Business Finance Strategy Group ([SME0127](#))
- 29 Cuna Mutual ([SME0086](#))
- 30 Dan Evans ([SME0018](#))
- 31 David A Thomas ([SME0094](#))
- 32 Destiny Church Trust ([SME0100](#))
- 33 Donald And Dawn Ross, Ross Properties ([SME0044](#))
- 34 Donaldson And Lyttle Ltd ([SME0135](#))
- 35 EEF ([SME0092](#))
- 36 Equifax Ltd ([SME0058](#))
- 37 Everline ([SME0059](#))
- 38 Financial Conduct Authority ([SME0140](#))
- 39 Financial Conduct Authority ([SME0166](#))

- 40 Financial Conduct Authority (SME0167)
- 41 Financial Conduct Authority (SME0171)
- 42 Financial Conduct Authority (SME00172)
- 43 Federation of Small Businesses ([SME0149](#))
- 44 Forum of Private Businesses ([SME0046](#))
- 45 Fox Williams LLP And AHV Associates ([SME0163](#))
- 46 Funding Circle ([SME0108](#))
- 47 Gari Appleton ([SME0074](#))
- 48 Gary Gadston ([SME0064](#))
- 49 Handlesbanken – Supplementary evidence ([SME0143](#))
- 50 HSBC Bank Plc ([SME0115](#))
- 51 Ian Lightbody ([SME0042](#))
- 52 ICAS ([SME0101](#))
- 53 John ([SME0060](#))
- 54 John Melton ([SME0056](#))
- 55 John Smithson And Angela Bradley ([SME0019](#))
- 56 Johnathan Fisher QC ([SME0162](#))
- 57 Jonathan Kinder MA FCA, Kinder Consultants ([SME0145](#))
- 58 Kingston Smith Llp ([SME0038](#))
- 59 L Penman ([SME0078](#))
- 60 Larry Berkovitz (SME0173)
- 61 Leander Difford ([SME0054](#))
- 62 Lehmann Communications ([SME0131](#))
- 63 Lloyds Banking Group ([SME0118](#))
- 64 Lloyds Banking Group ([SME0157](#))
- 65 London Stock Exchange ([SME0120](#))
- 66 Mansel Beechey ([SME0141](#))
- 67 Marc Rossi ([SME0111](#))
- 68 Marcus Holden ([SME0129](#))
- 69 Mark A.G.L. Steeds ([SME0020](#))
- 70 Mark Combellack ([SME0050](#))
- 71 Market Invoice ([SME0154](#))
- 72 Michael Neeld ([SME0099](#))
- 73 Minotaur Claims Management Ltd ([SME0102](#))
- 74 Muker Village Store & Teashop ([SME0022](#))
- 75 NAB Customer Support Group ([SME0128](#))
- 76 National Federation Of Retail Newsagents ([SME0079](#))
- 77 Neville Griffiths ([SME0097](#))
- 78 New Economics Foundation ([SME0139](#))
- 79 Nicholas Emanuel ([SME0075](#))
- 80 Nigel Henderson ([SME0034](#))
- 81 Nigel K Henderson ([SME0048](#))
- 82 Office Of Fair Trading/Competition And Markets Authority ([SME0105](#))
- 83 Ordinary People In Business Limited ([SME0116](#))
- 84 Ordinary People in Business Ltd (Bully Banks) ([SME0124](#))

- 85 Oxera ([SME0159](#))
- 86 Patrick Walton ([SME0155](#))
- 87 Peak Ales ([SME0119](#))
- 88 Peer-To-Peer Finance Association ([SME0068](#))
- 89 Perry Burns ([SME0151](#))
- 90 Phil Thomas ([SME0047](#))
- 91 Philip J Milton ([SME0006](#))
- 92 Port Medway Marina Ltd ([SME0130](#))
- 93 Professional Standards Council For The Asset Based Finance Association ([SME0137](#))
- 94 Professor Mark Watson-Gandy ([SME0061](#))
- 95 Professor Russel Griggs ([SME0156](#))
- 96 Property For Sale Or Let Ltd ([SME0065](#))
- 97 R3 ([SME0136](#))
- 98 RBS ([SME0144](#))
- 99 Respublica ([SME0083](#))
- 100 Richard Godfrey-Wollin ([SME0053](#))
- 101 Richard Singleton ([SME0066](#))
- 102 Robert C.W.Eggleston ([SME0062](#))
- 103 Romano Petrucci ([SME0017](#))
- 104 Roy Munro ([SME0036](#))
- 105 Royal Bank Of Scotland ([SME0093](#))
- 106 Royal Bank Of Scotland ([SME0150](#))
- 107 S&J Holdings Ltd ([SME0024](#))
- 108 Sandy and Julie Brown ([SME0002](#))
- 109 Santander UK Plc ([SME0121](#))
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- 120 The Institue Of Chartered Accountants In England And Wales ([SME0117](#))
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