Executive Summary

During and after the Global Financial Crisis ten years ago, there was intense pressure on UK financial institutions to reduce their risk exposure. A significant number of small and medium sized business customers, especially those which had borrowed substantially, often in regard to commercial property, were treated in a cavalier manner. Loans were called in, many businesses suffered financial distress and some collapsed.

Although their treatment by particular financial institutions may have been harsh, there is scant evidence of widespread criminality or any regulatory breaches. Commercial lending is not a regulated activity and the Financial Conduct Authority (FCA) clearly did not have the power to sanction the individuals involved.

In the wake of the financial crisis, regulatory standards have been substantially tightened - as have lending and capital requirements. The loans would never have been made in today's business environment, and the banks' approach could certainly be held to account. SME customer complaints now are relatively mundane and generally settled quickly and responsibly.

In any dispute between a financial institution and SME, there is a massive power imbalance. Only the richest businesses can contemplate taking a bank to court. A low-cost, rapid and independent vehicle is needed for arbitrating serious disputes between financial organisations and vulnerable companies, especially those employing fifty or fewer people with a turnover of a few million pounds a year.

The Financial Ombudsman Service today is heavily geared to complaints from individual consumers; it currently lacks the skill and specialisation to deal with complex financial disputes. A separate division with a clear business identity and appropriate skills should be set up under the statutory umbrella of the existing FOS. At the core of the new body will be real time data monitoring and feedback to the Financial Conduct Authority and appropriate government departments, which will enable potential problem areas to be identified at an early stage. An expert Financial Services advisory group should be brought together to advise this new vehicle on technical banking and legal issues.

All the extensions to jurisdiction announced following the FCA's consultation on SME access to the FOS in October 2018 should be implemented. In addition, the banks should agree to establish a mechanism on a voluntary basis to make a resolution capability available to businesses with turnover up to £10m. This mechanism should include some legacy disputes which have not been dealt with by any court or arbitration body

Finally, senior representatives of the major banks should support a formal process that seeks to achieve reconciliation and closure where they meet a representative sample of affected small and medium sized enterprises and listen to and acknowledge the loss experienced by those businesses and commit to a new system of dispute resolution and other measures to ensure past issues do not infect their future relationship.

Introduction

In the wake of revelations about the treatment of small and medium-size enterprises (SMEs)[1] by a number of finance providers responding to the Global Financial Crisis of 2007-8, there have been several investigations[2] which have detailed the severe impact on the lives and businesses of those who were affected.

This report does not intend to cover that ground or discuss individual cases. Instead it will analyse the potential of non-court methods for the fair and effective settlement of future disputes between banks and their SME customers, as well as suggesting a way of bringing closure to some of the victims of past malpractice. Key to the methodology of dispute resolution is the ability of a system to provide rapid feedback to regulators and government departments.

It is important to divide the past from the future. The nature, practice and regulatory regime governing UK finance providers has changed over the past decade. Of course, we must learn from the past, but designing a system focused principally on historic problems would limit its capacity rapidly to identify future systemic issues as they begin to be manifested. Such an approach would also be to reject all regulatory reform since the crisis as insufficient to prevent that era's problems from recurring.

---

[1] There are a number of thresholds in law and regulation below which businesses are considered to merit special attention or protection. EU thresholds range from those of the microenterprise definition (employing fewer than 10 people and with a turnover below 2 million euros) to those of the SME (up to 250 employees and a turnover up to 50 million euros and/or balance sheet of up to 43 million euros). For the purposes of this paper I am using the definition of a business with up to 50 employees and turnover of up to £6.5 m per annum, which matches the threshold past which businesses may opt out of ring-fencing, as described in the ringfenced activities order, or below which borrowers benefit from the protections set out in the Lending Standards Board's 'Standard of Business Lending Practice'. This is also the 'small business' threshold described in the FCA's consultation on the scope of the Financial Ombudsman Service.

[2] Including reports by Dr Lawrence Tomlinson, Clifford Chance, Sir Andrew Large and the Promontory Financial Group (UK) Ltd (with Mazars)

This Report

In April 2018 I was invited by UK Finance to undertake an independent assessment of alternatives to litigation in disputes between banks and small and medium sized businesses (SMEs). To assist in this exercise, I was helped by two distinguished academics, Professor Christopher Hodges, Professor of Justice Systems at the University of Oxford, and Professor Robert Blackburn, Director of the Small Business Research Centre at Kingston University.

Professor Hodges has produced a comprehensive summary of possible alternative dispute mechanisms to manage issues between banks and their business customers, with a particular emphasis on the need for the outputs to affect banking culture and future behavior. He also draws on concepts of restorative and transitional justice to discuss ways of providing emotional closure for those who have been victims of past abuse. This is published as part two of this review.

Professor Blackburn and his team have processed data from the major UK banks regarding complaints from SME customers and have also conducted qualitative interviews with SMEs who have current issues with their banks as well as with past claimants. In addition, they have incorporated data from a bespoke survey for this review undertaken by BDRC, the Charterhouse Business Banking Survey and the SME Finance Monitor. This is published as part three of this review

Objectives & Terms of Reference

The terms of reference given to me by UK Finance were extremely wide-ranging and encouraged me to seek input from SMEs, relevant trade associations, legal, regulatory and governmental organisations and those who saw themselves as victims of bad banking practice. I was offered assistance in making contact with individual banks but was given no steer on the outcome of my independent report.

In my previous roles as Director General of the Institute of Directors (IoD) from 2011 to 2017, and Chief Executive of the British Private Equity and Venture Capital Association (BVCA) between 2007 and 2011, I was at times extremely critical of UK banks and I have never hesitated to point out behaviour that I believed damaged public faith in this country's financial system.
I do however recognise the need for any market economy to have an efficient and properly regulated banking system in order for business and commerce to function. Notwithstanding the wrongs of the past, I regard my main challenge as recommending an appropriate and proportionate methodology for resolving future disputes between banks and their small and medium-sized customers which will also act as a brake on future wrongdoing.

This report then serves three purposes:
(i)To recommend ways in which banks and small and medium sized businesses can resolve future grievances and complaints. The emphasis is on fast, effective and fair dispute resolution wherever possible without incurring the expense of hiring lawyers and court action.
(ii)To help ensure that the excesses of the financial crisis in the first decade of this century cannot be repeated and that record-keeping and data flows about SMEs be used to monitor bank behaviour and culture and provide an early warning system of customer mistreatment.

(iii) To suggest a method of closure which might be acceptable to the individuals and their families who suffered because of poor SME-related banking practice following the 2007-8 financial crisis.

Since April 2018 I have undertaken a wide range of research and spoken to many individuals from banks, legal, accountancy and restructuring practices, financial regulatory authorities and ombudsmen, interest groups, business representative organisations, Members of Parliament and of the All Party Parliamentary Group on Fair Business Banking (APPG) many of whose participants were, or represented, victims of product mis-selling or unreasonable treatment by a number of banks during or after the Global Financial Crisis (GFC).

The APPG was set up in 2012 to campaign on the issue of interest rate hedging products (IRHPS). The Financial Conduct Authority identified failings in the sale of some of these products to unsophisticated customers and launched a review. The APPG subsequently expanded its remit to cover the mistreatment of customers of banks, particularly those of the Royal Bank of Scotland's Global Restructuring Group (RBS/GRG) and HBOS in Reading. I have focused much of my attention on these cases.

The Past

No one can fail to be moved by the experiences of those who suffered through mistreatment during and after the financial crisis and who believe it was caused by their banks. In the course of compiling this report I have met small business owners – some now bankrupted – who told me they suffered because of poor banking practice over the period of the financial crisis. Their stories represent genuine human, family and business tragedies. Many lost their livelihoods as a result of what seems to have been callous, sometimes brutal treatment: one example cited to me has a customer told "I don't give a shit about your business".

The most harrowing feature of the parliamentary debates initiated by the APPG has been the victims' stories. As noted, the group was set up to bring victims together, to fight for the rights of those who suffered through banking abuses, to seek a public enquiry and to recommend alternatives to going to court to secure satisfaction.

The cases date back mainly to the 2007-2008 crisis. Individuals running SMEs were sold complex and high-risk products they did not understand and to which they were clearly unsuited. These products certainly offered upside potential, but customers were not given any proper explanation of their potentially terminal downside risk.

All this, and much else, is spelled out in detail in the Skilled Person's (section 166) report prepared by Promontory for the Financial Conduct Authority. In relation to RBS, 5900 small and medium-sized companies were managed by its restructuring group GRG between 2008 and 2013. Ninety per cent of those customers are said to have received some form of mistreatment, and in the representative sample examined by Promontory, inappropriate behaviour by RBS caused material financial distress in around 16% of them.

It should be noted however that "almost all customers who entered GRG were already exhibiting clear signs of financial difficulty" and that "over a third of the 5900 SME customers transferred to GRG during the review period were not viable at or around the time of transfer".

It is important not to generalize about “the banks”. No doubt all banks faced strain during the GFC. But in terms of numbers, RBS business customers seem to have suffered disproportionately. According to Promontory, only 10% of businesses transferred into the GRG subsequently returned to the mainstream bank. The comparable figure for one of RBS’s main competitors was that 70% of companies going into its turnaround unit returned to the mainstream bank. There could be a number of explanations for this including other banks identifying problems at an earlier stage and/or dissatisfied customers taking an early decision to move from competitor banks. But RBS certainly saw a very different outcome to its banking peers.

Understandably most claimants represented by the APPG are very angry and frustrated. Many believe their lives have been wrecked – their businesses destroyed, their marriages broken and their health damaged by the way they have been treated. Established, often family, businesses went to the wall as collateral damage. Individuals are now bankrupt, and others have lost their houses. It is little surprise than they are angry and, sometimes, obsessive.

There is a considerable roll call of Members of Parliament who have represented their cases in strident terms. MPs are responsible to their constituents, not to banks, and there have been few voices raised to defend the financial sector.

At each of the parliamentary debates in the House of Commons during the past year, MPs from all wings of all parties told stories of shameful behaviour by the banks and demanded strong and immediate action.

What happened

The situation facing all the trading banks in the wake of the 2007-2008 crisis was fraught and unprecedented. It precipitated a major economic recession. Many businesses were not robust enough or adequately prepared to survive such circumstances. It was inevitable that there would be considerable collateral damage to customers, many of whom had gone out on a limb ahead of the financial crisis.

In mid-2007 there had been a period of financial instability and many banks began to stop lending to each other due to fears of potential losses on high-risk US mortgages, leading to the credit crunch. The collapse and subsequent nationalisation of Northern Rock, Lloyds' takeover of Halifax Bank of Scotland (HBOS) and government control of Bradford and Bingley led to a febrile financial climate. Property values also fell rapidly. There were major problems in the commercial real estate sector where yields fell significantly, endangering the stability of loans where property had been required as collateral, and where its subsequent sale became the source of repayment.

Banks are never likely to be popular institutions, particularly at a time of financial crisis, and over the past two decades there have been a series of crises – payment protection insurance (PPI), Libor fixing, alleged money-laundering - that have damaged their public standing. The two best known examples which have particularly impacted the UK SME sector relate to Royal Bank of Scotland and to Lloyds, which took over a failing HBOS, at the time Britain's biggest mortgage lender, in 2008. The two cases are different.

RBS

Following its expansion during the Fred Goodwin era, RBS had become by some measures the largest bank in the world. When the Bank had to be rescued by the British Government in October 2008 at a cost to taxpayers of around £45 billion, in the words of the Chancellor, Alastair Darling, "we were very clear that if RBS had collapsed it would have brought down the entire (financial) system" leading to "complete panic….and the breakdown of law and order".[i]

The immediate requirement for RBS's new management was to reduce the bank's size drastically and slash its balance sheet from over £2 trillion to £800 billion, a staggering cut. The urgency of that task meant that reducing the bank's exposure – which included calling in loans to small and medium-sized businesses - was seen by some as an easy early option.

More than half of what subsequently came to be widely known as RBS's Global Restructuring Group (GRG) cases involved commercial property. It is true to say that many SMEs which had previously borrowed to expand or invest had become over-extended. This is an important point. Although media reports have sometimes suggested banks were guilty of selling swaps to small shopkeepers, a very high proportion of the GRG and Interest Rate Hedging Products population of complainants involved property businesses.

Commercial property values fell significantly over the financial crisis. Loans which provided adequate collateral at the time they were made now had much less of a margin of security simply because valuations had dropped substantially.

There was also significant mis-selling of complex and sometimes unnecessary financial products which exacerbated downside risk for SME customers already in difficulties. Many of the extra fees required by the banks were excessive, particularly in the case of RBS. It is plausibly argued that individual bank employees were inappropriately incentivised to call in loans too quickly and with a distinct lack of sympathy for the plight of the businesses affected.

In November 2013, Lawrence Tomlinson, the entrepreneur-in-residence at the Department of Business, Innovation and Skills, published a report which accused Royal Bank of Scotland of “killing off” small firms in its GRG turnaround unit by charging exorbitant fees and withdrawing lines of credit. RBS appointed Clifford Chance to examine these claims. The Financial Conduct Authority, clearly concerned, sought a response from all the banks, and subsequently initiated a skilled person’s section 166 review by Promontory Financial Group into RBS/GRG.

It is important to note that, whilst both reports were highly critical of RBS, neither found evidence of fraud or actions which were illegal (nor had Lawrence Tomlinson made this accusation).

The whole Global Restructuring Group saga reflects extremely poorly on the banking community. The obvious conflicts implicit in RBS’s West Register which ended up owning some of the assets sold out of receivership also show bad judgement from the top.

Lloyds/HBOS

The situation with Lloyds/HBOS was very different. The frauds, which took place in HBOS’s Reading branch over the period 2002-2007, referred victims to a turnaround consultancy where they were saddled with unmanageable amounts of debt before being taken over and asset stripped. There was clear criminality, and in 2017 six individuals, two of whom were bank employees, were sentenced to a combined 47 years in prison for fraud.[ii]

72 banking clients were affected including the entertainer Noel Edmonds who maintains he is owed £60 million by Lloyds and who has secured financial support for legal action from Therium, one of the world's longest-established litigation funders. [iii]

Responses by the Banks: Griggs and Blackburne

The banks initiated investigatory processes to assess complaints in these two areas with external supervision and the right of appeal in the hands of distinguished outsiders.

RBS: At the suggestion of the Financial Conduct Authority, RBS set up a complaints and compensation scheme with former High Court judge Sir William Blackburne providing external scrutiny. There was an automatic refund of complex fees and this process was completed in July 2017, with offers worth £115m made to 3,500 customers.

The bank assessed complaints via an internal process including legal input from a customer champion with the right of appeal to Sir William. This was opened in November 2016. The process is thorough, involving a significant number of highly qualified individuals. It is extremely expensive for RBS. There is no reason to doubt that the system is intended to be fair, but it cannot – perhaps understandably - be said to be transparent. This is exacerbated by the level of control the bank had over the setting up of the scheme: understandably it may not have looked independent to some SMEs. The fact that the process is on paper and impersonal also means there is no direct opportunity for the victims' voices to be heard and this adds to the need for some sort of closure and catharsis mechanism.

To date, RBS has received 1,230 complaints from the 16,000 customers eligible to use the scheme, and a further 165 complaints from those outside its scope. The bank has so far issued a conclusion in 803 cases, upholding 370 in full or part and making offers of £10,033,437 for direct losses. The bank is currently receiving about 6 complaints a week, a number that has been in decline since its peak of 35 a week in December 2016, and it has given notice of the scheme's closure at the end of October.

In complaints to Sir William, the onus is on the bank to supply evidence. This enables him to rule on whether there have been actual losses from, say, inappropriate financial products being sold to a business. He would typically order repayment of all direct losses, improperly charged fees etc, with an 8 per cent per annum interest charge.

Appeals have been lodged against 40-45 per cent of the Bank's decisions. As at the date of his sixth quarterly report, Sir William had received 169 appeals and communicated a conclusion to 55 customers. He has upheld 15 appeals in full or in part.

<u>Lloyds/HBOS:</u> Lloyds appointed Professor Russel Griggs to administer a compensation scheme for affected customers. Professor Griggs has been working with several banks over some years as an independent reviewer of lending appeals and the outcome of lending applications.

Professor Griggs notes that the overwhelming bulk of complaints involve companies that were affected by a range of factors and were in trouble before they reached the bank. Complainants may speak of how wonderful their business's prospects may have been, but Professor Griggs is invariably dealing with the financial equivalent of a car crash where he assesses that both parties had some responsibility and he is adjudicating proportionality. However, he adds that Lloyds typically gives a formal apology to all its victims as well as financial compensation and that this can go a long way to resolving disputes.

Neither Sir William nor Professor Griggs has the power to order disclosure or to compel witnesses, but they can draw inferences from either parties' failure to present material or provide verification. In both cases their assessment operates on the principle of what constitutes fair and reasonable behaviour. This is an important point to which I shall return.

Why no legal sanctions

There is a widespread and understandable feeling that no directly-involved individual has "paid the price" for the financial crisis generally, let alone for these two important aspects of it. Given the damage to individuals, let alone taxpayers, it is unsurprising that there is a demand for heads on spikes.

However, there have certainly been consequences for the owners of the banks, particularly RBS, Lloyds and HBOS. Their shareholders lost most of their investment and were sometimes wiped out. "Shareholders" in this context means the pension funds of ordinary consumers, who, in turn ended up paying to rescue the same banks in their other capacity, as taxpayers. One can understand the perception that management largely "got away with it" at everyone else's expense. The Senior Managers' regime discussed below gives the regulator some tools for dealing with this.

But although public indignation is understandable, there have been a number of detailed examinations and no tangible evidence that a provable crime was committed.

The Financial Conduct Authority has noted that “RBS fell well short” of the high standards it expects of those it regulates but concluded[iv] that it did not have the regulatory authority to discipline RBS or its senior managers over GRG. The GRG’s malpractice took place before the introduction of the Senior Managers’ Regime which would enable the FCA to tackle bosses at regulated firms. This is an approach the FCA has said it intends to use to hold banks to account for the way they treat SME customers in the future.[v]

The law distinguishes between corporate lending, which is not a regulated activity, and consumer lending, which is. Successive governments have resisted changing this. The consequence is that the GRG’s treatment of SMEs was governed by the commercial contract between bank and borrower, which was weighted heavily in the bank’s favour and did not oblige RBS to treat customers fairly.

It is unsurprising that Nicky Morgan, Chair of the Treasury Select Committee, has described the lack of regulatory or legal sanction as “disappointing and bewildering” and called for a change in the regulation of lending to SMEs. Kevin Hollinrake, Chair of the All-Party Parliamentary Group on Fair Business Banking has also argued that the FCA’s inability to take action is a threat to the integrity of the financial sector as a whole[vi].

I understand their regret. But the situation has changed: even without regulation of commercial lending, it would be possible to act against individuals under the Senior Managers & Certification Regime if this behavior took place today.

Before the SM&CR regulatory action was "built around culpability or direct involvement, making it prone to miss senior people who might not have been directly culpable but should have been accountable."

Certainly, the banks' treatment of customers would today breach the Lending Standards Board's Standards of Lending Practice for business customers as well as the Institute for Turnaround's statement of principles for banks' business support units. Under the FCA's proposals in PS18/18, the voluntary codes and the SM&CR mutually reinforce each other, and I would certainly recommend that the FCA recognize the Lending Standards Board's code in the manner described in its July 2018 policy statement.[vii]However, even if it were to assuage the justifiable anger of GRG victims, regulatory action cannot be taken retrospectively. Any attempt to do so would almost certainly be successfully challenged in the courts.

<u>Implications of past cases for future Bank-SME dispute resolution</u>

Like others who have looked at these issues, I have seen no evidence to sustain accusations of any deeper conspiracy between the banks (or, indeed, within individual financial institutions) to damage SME customers for commercial gain, or that British banks, in their feverish reaction to the global financial crisis, were driven by planned systemic malpractice. Rather, individuals and units within certain banks, particularly RBS, responded to the crisis in an ad hoc manner which was sometimes unreasonable and panicked, occasionally reprehensible, and almost always distressing for those affected.

What seems clear is that certain banks – particularly RBS - were callous and "mean" in the way they treated many SME customers. But meanness is not the same as breaking the law. The answer to the understandable outrage that no one went to prison for the financial crisis has to be that no criminal offence has been or is likely to be proved. While sharing the indignation and distaste of the critics of RBS and other banks, no reasonable person can argue that greed and sharp practice, if they are not illegal, justify punitive legal measures, particularly in retrospect.

In the area of contracts, it is worth noting that the courts have found no breach of contract by the banks in very many cases. Banking contracts themselves reflect the power imbalance between lender and borrower, and this is an important lesson for the future.

While it can be argued that the terms of contracts are properly seen as a competitive matter between banks, there is today a societal expectation of a level of fairness and reasonableness in negotiated agreements between commercial parties, especially where there is a big difference in sophistication and resources. It is hard to conceive of a commercial relationship more unbalanced in this regard than “distressed business v large bank”.

Following financial scandals, the Australian parliament has passed legislation outlawing what it considers unfairly unbalanced contracts between banks and customers. Where the ‘customer’ is a consumer, the EU and the UK have unfair terms provisions (in the UK’s case in the Consumer Rights Act). The same does not exist for businesses, no matter how small.

Australia has legislated for a number of specific requirements in contracts, including a plain English summary containing the most salient features, no enforcement of provisions to call in loans below $A3 million (approximately £1.7 million) if interest payments have been kept up to date, and no foreclosing on agricultural loans on the basis of loan-to-value ratios for a period. It has also given the Australian Securities and Investments Commission the power to challenge unfair business-to-business terms, just as the FCA here can challenge unfair business-to-consumer terms.

The UK environment is changing. It is no longer acceptable for banks to point purely to the principle of caveat emptor when dealing with SMEs. Unless UK banks voluntarily ensure contracts are not hopelessly one-sided, they are inviting legislative action. It is to its credit that over the past year the UK financial sector has funded a working group to address the issue of contracts with the APPG on Fair Business Banking and this should be prioritised.

The UK cases which have engendered deep public distrust of the banks, caused media and political outrage and led to the original creation of the All-Party Parliamentary Group on Fair Banking are different. They are historic, dating back to the Global Financial Crisis.

There will always be some dishonest individuals working in the financial sector, as there are in any commercial arena. For their clients the implications of such wrongdoing can be immediate and devastating. It is self-evident that any financial institution's culture must be wholly alive to, and intolerant of, employee dishonesty. HBOS failed lamentably in rooting out criminality. After Lloyds Bank had taken over HBOS, the merged entity took far too long to acknowledge its responsibilities and has been accused of trying to cover up its failure.

Many companies in sensitive legal situations properly observe the caution advocated by their lawyers, but their credibility is damaged when they give too little weight to the need for transparency and candour to their customers. In 2017 Lloyds appointed Dame Linda Dobbs, a retired High Court Judge, to consider the adequacy of its investigation. But current indications are that she will not report back until 2019, and the bank is holding back from explaining its position fully until then. There is great public interest in issues of banking integrity and it only fuels conjecture when a business shelters behind an enquiry for so long.

An important lesson - Difficulties for those seeking redress

Victims clustered under the APPG umbrella are united by the difficulty of securing legal representation. Even before questions of cost, this was fraught. For companies that have gone into administration or liquidation, and individuals who have been bankrupted, litigation is a non-starter. There would be no point in individuals who had lost their companies pursuing claims: an insolvent business is managed in the interests of its creditors, not its shareholders.

Receivers and liquidators will shy away from the costs and delays involved in legal action, and the former owners, while incurring costs, would be unlikely to benefit from any positive settlement.

This raises genuine issues of unfairness to victims who were directors and shareholders. The Government's 2016 Review of the Corporate Insolvency Framework recognised a number of concerns about the regime and the APPG is compiling a report on these issues for BEIS. It is worth noting that the Australian review also covered insolvency. At present banking regulation is an HMT competency whereas insolvency is a BEIS competency, whereas the Australian Treasury owns both. It is worth considering whether BEIS and HMT should have a formal understanding on how they work together on the subject.

These are important policy issues and deserve proper consideration, but, as with so many issues, it is difficult to see how past unfairnesses can be unravelled retrospectively by resort to legal process.

There are also complaints of businesses being effectively prevented from having lawyers act for them, if their firm is currently or even potentially on a bank's "panel" of approved law firms. This applies particularly in Scotland where I was told it could be almost impossible to find a non-conflicted lawyer although this is disputed.

Banks are also accused of stringing out particular cases where they are at real legal risk, then settling just before going to court with confidentiality agreements which prevent public scrutiny. If true, this means that only the weakest cases are taken through full legal processes, a practice of "unnatural selection" which ensures that any actual case law will favour financial institutions.

Finally, there is the sheer scale of legal costs. Many, perhaps most, APPG complainants would not be able to pay any legal fees, such are their straitened circumstances. The fact that simply launching court action is estimated to cost £10000 and that costs can rapidly mount to £100,000 inhibits all but the wealthiest businesses. Timing and cashflow is also critical. Spending £100,000 to recover millions may be a good investment, but if a business is failing the cash is simply not there and no one will lend it. As Professor Hodges points out, the World Bank estimates that taking a dispute to court might cost a UK business 44% of its claim.[viii] The situation is compounded by the fact that the loser-pays cost basis of British law magnifies the claimant's potential downside, since the bank's costs will invariably be substantial. Applicants may have some control over their own costs, but they will have no influence over the bank's.

Litigation funding by private entities is starting to get under way in the UK though funded actions are normally required to be worth at least a potential £5 million, and sometimes £10 million. Litigation funders will take around 30% of any damages recovered. Noel Edmonds, the most high-profile Lloyds/HBOS victim, is reported to have secured litigation funding for his case against Lloyds. But it is hard to see this being a way through for any but a tiny number of SMEs.

Lessons from the past - Closure

The banks have done themselves few favours. Lloyds/HBOS and RBS's early denials and subsequent limited transparency in their appeal processes has fuelled suspicion and a sense of grievance. One has a sense of firms instinctually determined not to give the slightest acknowledgement of responsibility.

Lawyers understandably advise a client not to admit guilt but as has been apparent in many corporate and medical scandals, when combined with delay in reaching a conclusion, this prolongs and exacerbates a sense of victimhood in those who have suffered. It feeds their frustration and postpones the ability of all affected, including those in the financial sector, to move on.

This is a key reason why the need for some process to provide closure is so important. A sense of those with power closing up, being seen not to listen and declining accountability is guaranteed, as Professor Hodges suggests, to turn complainants into victims.[ix] Equally inevitable is a rapid appeal to regulators and government departments for intervention. Notwithstanding major regulatory and behavioural change over the past decade, the clamour for new sanctions based on past malpractice continues unabated.

In other ways, the banks have acknowledged the past. Cultural weaknesses have been addressed and customer complaints today are addressed promptly, proportionately and with adequate appeal mechanisms. But the continuing grievances of the historic victims of the 2008-2009 era make it difficult for public perception and trust levels to match today's reality.

The banking industry has a chance to emerge from these affairs with some credit, and to rebuild trust with the public – and particularly their small and medium-sized business customers.

There has been a gap – a failure to provide a (metaphorical, if not actual) "day in court" where victims' stories can be told, wrongs acknowledged, remorse articulated, and assurances given of behavioural and cultural change. Equally important is an understanding of concrete measures and a monitoring process designed to observe and track any malpractice which may appear to be systemic.

This is not a matter of paying out money – and it is important that customers who have suffered recognise this and harbour no such expectation of a closure process. English law is not properly equipped to measure and compensate for stress, emotional damage, broken marriages and nervous breakdowns as a result of commercial transactions. Measuring the damage done would be subjective and in many cases any compensation would go straight to creditors of those whose businesses went bust.

There are part-parallels in the enquiries into other human tragedies which provide a lesson in these situations which involved financial deprivation. Those who have suffered need to be heard in order to achieve closure. It is highly desirable that Britain's banks show a willingness at senior level to meet with those who suffered most from the excesses of 2008-10, to hear their stories and acknowledge their hurt. The alternative is that the banks may find themselves facing a parliament-initiated process which runs on for years until the victims have what has been described as "something akin to a 'day in court'"[x].

The Present

Today's Banking environment

Banking practice has changed markedly since the events of a decade ago. It is striking that while examples of alleged maltreatment of customers are readily discoverable for the first decade of the 21st century, there are few if any complaints of similar treatment over the past five years.

The qualitative research undertaken by the Kingston University team (part 3 of this report) shows the sort of issues that arise between banks and their SME customers in the current environment. This is borne out by subjective interviews with bank complainants and the contrast with those dating from the GFC era. I have personally examined hundreds of random anonymised complaints from SMEs about their banks. Most recent complaints are about delays and incompetence, undoubtedly irritating and damaging to businesses, but indicative of inefficiency and miscommunication rather than an intention to deliberately fleece customers. The Legal Services Board's surveys of small business needs

(2013, 2015 and 2017) document a falling trend in the share of small businesses with financial services disputes.

Banks may well have been on best behaviour over the past five years. There could be a number of reasons for this, including regulatory constraints. Moreover, the banks have dropped many of their more contentious and complex financial products and these are simply no longer available to small and medium-sized businesses. The majority of those SMEs affected by the crash era scandals simply would never have been given the loans they received then in today's marketplace. Perhaps most powerfully, the sector has been chastened by changes in public attitude – a deeply-held public distrust of financial institutions – and by the fines and penalties handed out by governments and regulators in the UK and other countries.

SMEs today still have grievances with their banks but in the main these are attributable to issues like IT problems, delays in implementing instructions, responsibility for third-party fraud, and disagreements about who said what to whom. These issues, the overwhelming source of each year's average 135,000 complaints to Britain's banks (out of perhaps 125 million interactions), may be indicative of weaknesses, but they are not the systemic and institutional failings of a decade ago.

During the past three decades, the banking system has changed irrevocably, largely as a consequence of automation and globalisation. The days of local branches and individual bank managers are over for any but the most affluent personal and business customers. The internet has come between bank and customer and all accounts have been commoditised. For many people under thirty-five, their only experience of personalised service is via technology rather than a human relationship. The era of individually personalised banking is not coming back.

These changes have exacerbated the general climate of distrust towards banks. Previous levels of personal acquaintance and understanding have been lost with personnel changes. The local branch account manager who knew and understood a customer's business challenges when an ongoing facility was sought has largely disappeared.

The tighter regulatory regime has had other perhaps unforeseen impacts: trade groups have told me that SME-focused bankers now shrink from giving advice because of regulation. They suggest a business cannot ask "I'm thinking of doing this. What do you reckon?" and hope for a genuinely thoughtful reply. Individual bank staff are understandably worried about being seen as shadow directors if their answers are construed as advocating or advising against a course of action.

The abolition of the Business Link service in 2011 has also meant that many SMEs have nowhere to turn for the sort of advice that was available a decade ago. Some Local Enterprise Partnerships have engaged with banks regionally over support for SMEs, but this is extremely patchy and leaves real gaps that are beyond the scope of this review but certainly worth policy consideration.

Current Banking Complaints from SMEs

All organisations get things wrong but, because of the number of customers, volume of transactions and dependence on detailed data, banks are always likely to make more mistakes, in total if not pro rata, than most businesses. Over the past three years research compiled for this report (see part 3) finds that small businesses, including sole traders and partnerships, generated 415,000 complaints, an average of 135,000 annually. Two-thirds of these were upheld and resolved within the banks' own systems, usually within a day and with half involving the payment of some financial redress. This would seem to demonstrate that it is wrong today to regard Britain's banks as institutionally unresponsive. In respect of current complaints, the banking sector has cleaned up its act.

Today's banking environment differs fundamentally from the pre-2010 era in key aspects which are critical to customer interests. Capital requirements are much higher, regulation is appropriately much stricter and banks, humbled by fines and public opprobrium, are competing with each other in an appropriate manner. To say that the situation is different today is not to excuse or diminish the excesses of the past. It is important that regulators and politicians are permanently on guard against fresh malpractices. It is vital that this is built in to any future system of dispute resolution. Real time data monitoring is the most crucial element of any institutional efforts to rectify future wrongs, as noted by Professor Hodges.[xi]This is an area I shall return to in more detail.

SMEs and why they're not borrowing

One consequence of tightened regulation is secured lending on property is treated more favourably in terms of capital adequacy. Banks are effectively encouraged to lend against concrete assets rather than making loans to businesses wishing to expand. This can be difficult for less established SMEs. It is important to note that banks are supposed to offer *secured* debt. They are not providers of risk capital, even if in pre-crash days they may have behaved as if they were.

The SME sector is crucial for the economic health of the British economy, providing as it does 60% of the country's jobs and 47% of its turnover. It is particularly important as an engine for economic growth and productivity. While large companies have shed jobs over the past thirty years, the SME sector has actually increased employment numbers. Smaller firms must have access to capital in order to grow and fulfil their potential, particularly in an era when boosting exports is an economic imperative. The inability of many flourishing British start-ups to "scale up", as their US and, increasingly, European competitors manage to do is a real threat to Britain's ability to participate fully in the global economy and a brake on the country's economic growth.

Over the past decade UK companies, particularly SMEs, have shown a marked reluctance to borrow for expansion. SME business leaders tend to choose debt over external equity, and to be unwilling to pay properly for risk capital.

British business has been said to be sitting on a cash pile of anything up to £800 billion. According to SME Finance Monitor (BDRC), in 2017 only one in three SMEs was willing to borrow to finance growth compared to half of SMEs two years earlier. Only one in six companies not already using external finance said they were prepared to do so, down from a quarter in 2015. A full 50% of businesses have no external borrowing.

According to the Competition and Markets Authority, the big four banks account for 90% of business loans, making UK SMEs far more dependent on their banks than American businesses. Some business groups, notably the Federation of Small Businesses (FSB) argue that deep distrust of banks as institutions significantly explains this aversion to borrowing. Although this is unlikely to be the whole explanation, reluctance to borrow being a longstanding feature of the UK business landscape, institutional distrust cannot help.

There are several other explanations, starting with the obvious political and business uncertainty unleashed by the Euro crisis and moving on to the European referendum and the economic upheaval surrounding Brexit. Moreover, British managers are more risk averse than their American counterparts. Given this innate reluctance it is particularly important that access to borrowing is available when solid or potentially high-performing businesses are seeking to expand. "Normalising" a durably beneficial relationship between banks and SMEs is an economic imperative.

Before 2007 lending to small businesses was hotly contested. Major banks aggressively tried to sign up new customers, poach business from competitors, and at times seemed to vie with each other to look generous and accommodating. In the case of Lloyds/HBOS around 90 per cent of the SMEs which subsequently ended up in difficulties were either completely new clients or had been persuaded to switch over from a competitor (quite possibly without much resistance from the previous bank if the customer had been perceived as "difficult").

Cases of businesses with an annual turnover of £30,000 being offered loans and overdraft facilities of £250,000 before the financial crisis have been spoken of. To many (perhaps naïve) business owners, the commercial property market at the time looked like a one-way bet, and the temptation for small businesses, to invest in bricks and mortar (and indeed for banks to lend), was considerable.

All this has changed. Tiny businesses which a decade ago might have secured substantial loans are now unlikely to get an overdraft of more than 10 per cent of turnover. A combination of greater regulation strengthened capital requirements, simple, sensible prudence and perhaps fear of public scrutiny has meant that UK banks are much more circumspect about lending to SMEs.

Profile of current SME complaints about banks

On the basis of data commissioned for this report there continue to be many complaints from SMEs about their bankers. Over the period 2015-2018 there were 415,000 complaints. The bulk (56%) of these were from firms with annual turnover below £250,000, and 93.5 per cent had turnover below £6.5 million, the cut-off points for Financial Ombudsman Service eligibility under the extension now agreed by the FCA[xii].

Businesses with a turnover between £6.5 million and £25 million generate 6000 complaints a year – an important gap in the market, as many of these firms, particularly those below £10 million, will lack their own dedicated legal resource making the cost of litigation a real burden.

The majority of complainant firms are private limited companies, followed by sole traders and partnerships. This reflects the fact that limited companies are likely to be more exposed, having multiple bank accounts and using a range of different bank services.

A large proportion of complainant firms are well-established: 60 per cent are more than five years old and 41 per cent are over ten years old. Only 6.9 per cent had been established in the previous year. The overwhelming bulk are in services, with fewer than 10 per cent in manufacturing and a very small proportion in primary sectors.

The geographic spread reflects the UK economy with London as the biggest area for complaints. One in ten affected businesses have multiple locations. What is noteworthy is the nature of current complaints. Far and away the largest category is for general administrative or customer service issues (35%) followed by errors and “not following instructions” (19%) and delays and time scales (16%).

Complaints about unsuitable advice (1.8%) and product disclosure (1.3%) are now a long way behind. It is likely that the most serious abuses in the past – product mis-selling, interest rate hedging products and most of the practices involved in RBS/GRG – would have fallen into these categories.
These figures confirm much of the anecdotal evidence presented. External factors now represent a significant part of the threat. One bank noted that arguments around responsibility for third party fraud-related losses are currently its single largest source of complaints. While seriously problematic and the cause of genuine dispute, these cannot be said to represent banks systematically ripping off unsophisticated customers.

Almost two thirds of complaints were sustained through the banks’ own complaints processes. Just over half of firms had compensation paid by the banks and a third received redress for financial loss. The message to customers has to be that if something does go wrong, it is worth formally complaining to your bank.

Only just over one per cent of firms in dispute with their bank took their case to the Financial Ombudsman Service with almost a third of those cases upheld by the FOS. Only a tiny fraction of cases involved customers managed by a turnaround unit and an equally small number (.4 per cent) involved customers in financial difficulty.

Over half of firms making a complaint received some form of compensation. In half of these cases the amount was below a thousand pounds, though some were significantly higher, including four that were over £500,000.

The banks’ speed in dealing with complaints also seems to have improved. Nearly two-thirds were resolved through the bank’s own internal procedures on the day the complaint was made. A fifth took between a day and a month and fifteen per cent between one and six months. A relatively small proportion – less than half a per cent – took more than six months to resolve.

All this needs to be seen in the context of banks taking customer complaints rather more seriously than they did before the financial crisis and, indeed, often requiring what might once have been minor grumbles to be formalised as complaints.

A very recent survey by BDRC[xiii], the UK’s largest independent research consultancy, commissioned for this review, also appears to reflect fewer complaints from SMEs about banks. 79 per cent of customers reported no complaints, nor had they thought about complaining in the last five years. Of those who did complain, 71 per cent were satisfied with the resolution of the matter. Six in ten claimed that the issue had no negative impact on the running of their business and most did not seek compensation. The complaints process appears to be working.

One per cent of SME customers took the complaint “further” rising to 5 per cent of those with turnover above £5 million. Day-to-day banking issues, branch closures, and third-party fraud or attempted frauds were the source of the vast bulk of complaints. Refusals to lend and requests for early repayment were notable causes for dissatisfaction amongst customers who regarded their complaint as unresolved.

BDRC also reported separately for the Competition and Markets Authority on individual banks[xiv]. This is part of a regulatory requirement mandated by the FCA to monitor service quality.

The new, smaller challenger banks - Handelsbanken and Metro - scored well above the established banks for business customers. Royal Bank of Scotland, TSB, Clydesdale and The Co-operative Bank were weaker when business customers were asked how likely they would be to recommend them to other SMEs, perhaps reflecting branch closures, IT difficulties and other well-publicised problems. Other large banks – Barclays, Lloyds and NatWest – generally fared respectably. The range of customer opinion – between 47 and 84 per cent of each individual bank's SME customers would recommend their bank to another SME – reflects the relative normalisation of competition within the banking sector when compared with similar surveys in other areas of the economy. Scores for trust as measured in the SME Finance Monitor also show more positive customer views with 78 per cent of SMEs with over 50 employees scoring their bank between 8 and 10 on a scale of 1-to-10.

Perhaps peripherally, a debt advice charity reports that the proportion of problem debts attributable to overdrafts, personal loans and credit cards, typically bank products, has fallen from seventy to thirty percent of their clients over the past decade.[xv]

There will be understandable speculation about the extent to which any improvement represents sustained cultural change as opposed to the banks' collective response to public pressure, concern about potential negative publicity, and regulatory threats made more real by the substantial fines levied on the banking sector over the past decade. But there does appear to have been genuine change. It is vital to maintain surveillance to choke off misconduct, but it would be a distraction at this stage to put in place a regulatory and redress mechanism designed to fight the last war when politicians and regulators ought to be setting up a system that monitors and prevents the next one.

The Future

Lessons from the past

While there is legal and technical continuity between the corporate identity of the big banks and their forerunners from the era of the banking crisis, their culture, senior management and ownership have changed out of all recognition. They are effectively new organisations.

There is no doubt that past weaknesses must be addressed. These include the length of time taken to resolve disagreements and the affordability and disproportionate cost of seeking redress through judicial process.

Historic wrongs need to be addressed separately in a way that does not prevent regulators arriving at a workable methodology for the kinds of disputes that are arising now in a changed economic and regulatory landscape. The policy priority must be the establishment of a system of lending and dispute resolution that works towards 2020 and beyond. The development of a system to manage bank-SME relationships for the coming decades should take account of but not be anchored in misdemeanours which took place in a context which no longer dominates.

The reality is that banks exist to lend and to make a profit. The small business community must keep in mind the rational basis for the bank-client relationship and recognise that, while treating customers fairly is necessary business practice, the *primary* responsibility of any privately-owned financial institution is to shareholders rather than customers. To a business, the bank is a supplier which should be risk-rated like any other supplier. The Federation of Small Business criticises advertising messages that portray banks as “cuddly and friendly”. Projecting a bank as a “friend” can actually mislead SME owners into thinking a banking relationship is not commercial. It is.

It will rightly be argued that bad practice can recur, and that the UK economy needs monitoring systems which ensure future abuse is identified early and dealt with rapidly. Proper and timely reporting to the Financial Conduct Authority, HM Treasury and other appropriate institutions needs to be built in to settlement procedures so that valuable information regarding high-risk commercial practice prompts a speedy regulatory response. Too much information about poor practice appears to have been lost in a fog of private settlements and non-disclosure agreements. An ombudsman mechanism with built in feedback to the regulator would have advantages over court-based solutions in this respect.

The establishment of a monitoring council that brings together SME representatives, Ombudsman, lenders, the Lending Standards Board and others could foster collaboration, ensure processes are optimal and effective and act as an early warning mechanism.

It is instructive that the first judgment in a payment protection insurance case (Price v TSB Bank) was in 1993 but because of a ten-year confidentiality clause, it was only released a decade later, leading to the Citizens Advice "super-complaint" to the Office of Fair Trading in September 2005 and the subsequent unravelling of the whole £44 billion PPI structure .[xvi] It must be probable that the PPI scandal would have caused far less pain to banking customers and indeed the banking system if the outcome of that case had become public at the time.

Lending to Businesses and to Individuals

There is a clear distinction between regulating lending to private individuals and to companies. There is a legal presumption that dealing with individuals needs close oversight and regulation precisely because financial matters are complex and private persons will not have the sophistication to make proper judgments. They can be hoodwinked and the principle of 'caveat emptor' is inappropriate.

This is not the case for businesses. There is an understandable assumption that the director of a company ought to have a degree of financial literacy and business savvy. The trade associations I met readily accepted that any firm should have someone in the business who understands how to finance the company.

Commercial lending is not regulated, although the Lending Standards Board, to which the major banks are signatories, requires lenders to treat all customers fairly and honestly. There are currently 20 signatories, and greater adoption – both amongst product providers and debt purchase and debt collection firms – would be highly desirable. As noted earlier, the Financial Conduct Authority's Senior Managers Regime – introduced since the financial crisis – requires senior employees to be fit and proper to carry out their business. It may be inferred from the FCA's references to the SMR that it would have used these powers against senior managers at RBS/GRG had they been applicable at the time.

The APPG on Fair Business Banking proposes that the legal right to take action under Section 138D of FSMA currently available only to "private persons" should be extended to SMEs below a certain threshold by amending the "private persons" definition, which could be done by secondary legislation without requiring parliamentary approval.[xvii] In 2014 the Law Commission considered the possibility of such an extension but stopped short of recommending change, regarding it as a matter for the Government after proper research and debate.

The APPG also argues that banks should have the same duty to SMEs as they do to private individuals, requiring banks to pay due regard to an SME's interests in commercial lending. This is a tenable position, but it represents a major shift in current law with significant implications across a wide range of existing business relationships. It will certainly require primary legislation and is likely to consume a great deal of parliamentary time. These options should be kept under review, but should not, in my view, stand in the way of a quicker, practical fix that can resolve disputes between banks and their SME customers – especially if – as I believe - this approach ensures monitoring and regulatory feedback in a way legal remedies are unlikely to match.

It is a reasonable expectation that someone setting up a company should have more commercial sophistication than an ordinary consumer of financial services. Limited liability companies also provide their directors with significant personal protection in the event of a business failing, and this needs to be balanced against the protection given to individuals. A frequent problem for SME owners is that many - particularly early in a company's existence - blur the differences between business and owner. They are likely to go to their personal bank when the business is set up, employ personal funds to get operations going and provide working capital, and may treat company cash as their own.

There is discussion to be had around these issues. As noted, the FCA Senior Managers Regime would give some flexibility to make subjective assessments if any business is unfairly treated. Professor Hodges refers to the focus on 'whole firm' activities and the requirement to observe proper standards of market conduct.[xviii] But freedom of commercial contract is an important principle. It is difficult to accept that such a major change should be slipped through without proper legislative scrutiny.

Requirements in a redress system

It is easy to see why any attempt to remedy the sort of wrongs imposed on SMEs after the financial crisis cries out for alternative non-legal methodology. Court processes are simply too expensive, too slow and too cumbersome for all but the largest businesses. The requirement is for a procedure that is fast, simple and cheap. But there is a balance to be achieved. Professor Hodges notes early on that "the truth cannot be escaped that seeking a forensically accurate outcome in every individual case – especially cases with small value or inherent complexity takes time and money".[xix]

Defining Vulnerable Businesses

At present there is a gap in coverage of businesses. Boundaries are always difficult, but they are necessary. Where they are set will be crucial in any speeded-up dispute resolution system. The key concern should be for SMEs unable to access or pay for legal redress because of cost and length of time involved in court processes, or because of serious damage caused by the diversion of management time needed for the functioning of the business.

If a company has a certain level of turnover, say £10 million annually, one can assume that it is likely to have, if not in-house legal capability, then at least the ability to buy in legal skills and to be capable of resolving issues via legal processes. I note here the Legal Services Board's and BDRC's survey suggesting that businesses are more likely to spend money on legal resources when their annual turnover reaches £5-10 million.[xx] It seems reasonable to expect also that companies of this size should have the skills to select and acquire appropriate financial advice in the first place, and their scale will mean they are less likely to be pushed around.

There are a number of methods of providing faster, cheaper, fairer access to dispute resolution outlined in detail by Professor Christopher Hodges. They are not mutually exclusive options and it could make sense for a combination of different approaches to be used particularly if easy-to-implement changes fail.

Possible mechanisms – ombudsman v tribunal

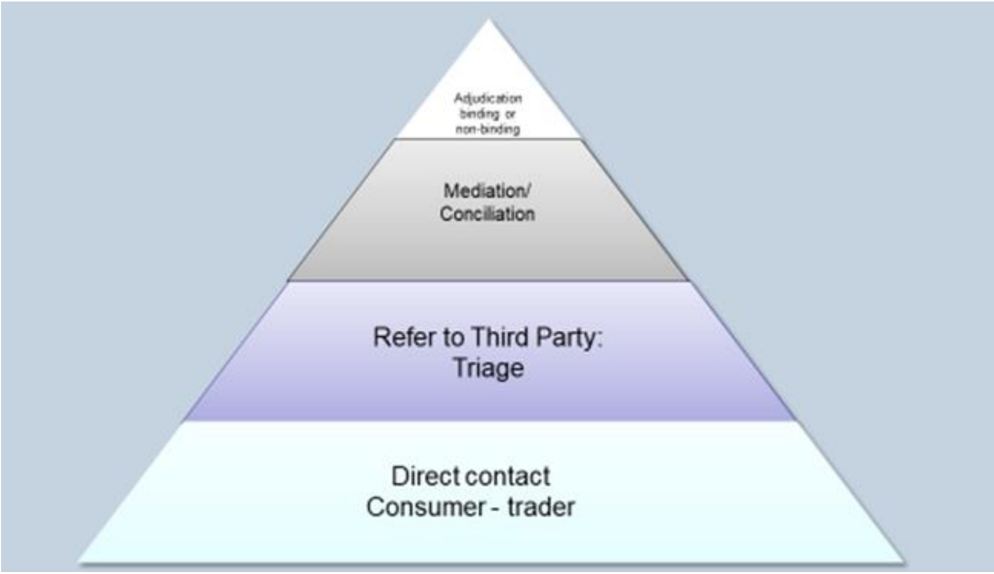
Most SMEs will be particularly attracted by Alternative Dispute Resolution procedures which operate in a non-adversarial fashion where a neutral third party helps to develop a binding solution quickly and at lowest cost. Mediation and other forms of ADR also have the advantage of potentially preserving a commercial relationship notwithstanding specific contractual difficulties. This is unlikely to be the case if the parties end up in court or another adversary procedure. Ombudsman systems are the most widely recognised form of alternative dispute resolution for consumers. The concept originated in Scandinavia to provide a check on government activity in the interests of the citizen and spread widely across Europe.

In Britain the system is well-established. Ombudsmen operate in the legal, motor vehicle, furniture and university sectors, as well as in previously nationalised industries like energy, rail and telecommunications. The Pensions Ombudsman was created under the UK Pension Schemes Act in 1993. A number of trade groups within the financial sector evolved from the 1960s and these were merged to form the Financial Ombudsman Service (FOS) under the Financial Services and Markets Act in 2000.

A particularly relevant example is the Asset Based Finance Association, part of UK Finance, which deals with complaints over factor invoicing and discounting, activities which are designated commercial and hence unregulated. The Association's Lending Code sets the standards members must meet and an independent complaints process, overseen by Ombudsman Services, adjudicates complaints. ABFA's Professional Standards Council, with a majority of independent members and independent chair, considers issues referred to it by ombudsmen as well as overall behaviour. Although a voluntary arrangement, 98% of the industry are members and abide by its rulings even if technically they are beyond its scope. Beyond its statutory role, the Financial Ombudsman Service also operates a voluntary jurisdiction, which mirrors the rules of its compulsory jurisdiction, but requires firms to opt into it, e.g. in the case of freight forwarding disputes.

Ombudsman facilities are generally free to consumers. In the UK, as Professor Hodges outlines[xxi], costs tend to be paid by the trade sector and/or individual defendants. With the Financial Ombudsman Service there is an annual charge on firms levied through the FCA and a charge of £550 for each case handled annually. This per-complaint cost in itself operates as a mild incentive to financial businesses to settle modest claims on terms favourable to the customer rather than see them progress to the FOS.

A particular attraction of the ombudsman model is the integrated pathway it offers for dispute resolution – as shown in Professor Hodges' pyramid model [xxii].



In 2017/8 the FOS received 1.45 million enquiries. It received 340,000 new complaints (of which 55 per cent concerned PPI) and resolved 400,000 complaints. Over ninety per cent of these cases were settled at the triage and mediation/conciliation stage meaning that only 32,780 – i.e. the top of the pyramid above - required an ombudsman's decision.[xxiii] Nearly three-quarters of all complaints were resolved within three months. In 2017-2018 the FOS resolved 72% of all complaints excluding PPI cases within three months.

It is worth noting that the FOS can refer a case to the courts or another ADR provider (with the complainant's consent) either because it belongs there or because it raises a point of law and is thus a useful test case. This is unusual, but it seems a good model.

It is important to note that over half of all FOS cases (55%) concern PPI and that 85 per cent of these are brought by Claims Management Companies (CMCs). Further PPI claims are being barred from November 2019 and there are plans underway to reduce staff numbers as that deadline nears – more than half of staff are currently dedicated to PPI claims. At present about one in ten complaints to financial services firms are eventually handled formally by the FOS and many more consumers are given guidance and information when they contact the service. [xxiv] But beyond PPI it may well be argued that the Financial Ombudsman Service is currently underutilised by SMEs

A Financial Services Tribunal System

The idea of a Financial Services Tribunal has been endorsed by the All-Party Parliamentary Group on Fair Business Banking. The proposal has been set out at some length by barrister Richard Samuel using the analogy of Employment Tribunals, which were originally created as Industrial Tribunals in the 1960s[xxv]. The structure would have an independent legal chair and two specialist advisers representing different and ostensibly opposite interests, presumably banking and small business. The employment tribunal model seeks to represent the competing parties' sectoral interests on the panel (which of course should be and be seen to be neutral and unbiased).

Tribunals are expensive for government and for participants. In practice tribunals will require lawyers, both as specialist Chair, and, particularly, in acting for parties in the dispute. It is favoured by many politicians who believe that the decisions will somehow be more acceptable if both employers and trade union officials are involved.

Although lawyers are not a requirement for claims, in practice they are usually involved and invariably at the employer's expense. This helps to explain why employment tribunals are far from universally popular with employers, particularly SMEs. The cost-free element for individuals of bringing an employment claim has meant that virtually any dismissed or made redundant for any reason may feel incentivised to bring a claim against an employer well beyond any statutory compensation. The consequence has been that many employers have ended up making unjustified payments merely to avoid legal costs and the waste of management time.

The 2013 introduction of modest charges for bringing an employment tribunal claim resulted in an 80 per cent drop in cases taken to employment tribunals, but since the Supreme Court ruled these fees unlawful in 2017, fresh actions have again moved upwards. The system's infrastructure is considerable.

It is sometimes argued by proponents of employment tribunals that they have changed the whole nature and balance of employer-employee relations over the decades in which they have existed. I am not convinced by this. For a start there are many other factors that have contributed to the changed nature of employer-worker relations, including societal change and the end of an era of deference.

The direct costs of the Employment Tribunal system are around £27 million per annum on fees and salaries, with each appeal costing around £750. This is not in itself prohibitive, but the addition of legal costs for the parties involved also needs to be taken into account. The absence of loser-pays means the risk for an SME will be much less than with a court hearing, but the imbalance between legal firepower is likely to remain. As outlined below, decisions would have to be made on the basis of strict legality rather than what was "fair and reasonable". Equally critically, judicial bodies do not feedback data about complaint levels and results to regulators and government departments: that is not their job.

As Professor Hodges points out[xxvi], creating a new Tribunal system as a pathway between an ombudsman system and the courts and mandating that certain financial services disputes are brought into its jurisdiction would require primary legislation at a point where there is no time foreseeable on the parliamentary agenda. I support the principle of setting up a specialist legal-banking advisory body with some of the characteristics of a tribunal to advise a business ombudsman service. If ombudsman methods fail I would not rule out the creation of a new halfway house in terms of judicial processes simply to provide cheaper, quicker and easier alternatives to going to court.

The Choice between Alternatives

For the present the best interests of the SME sector in terms of fairness, speed, cost, and efficiency would be served by an Ombudsman system rather than creating a new legal outlet. On a purely practical level, I believe such a system could be up and running by the middle of 2019, whereas creating a Financial Service Tribunal regime is likely to take some years.

However, the primary reason for this conclusion is the basis of decision-making. Legal tribunals are required to apply the law explicitly and precisely. Tilting the balance for me is the ombudsman's ability to use a "fair and reasonable" test in a dispute. Because an ombudsman provides a non-legal service, it is not bound by the strict legality of a contract or situation. It is, as Professor Hodges notes, generally the case that the fairness standard assists individual consumers rather than the converse, and it is likely the same will be true for SMEs.[xxvii]

If a contract, drawn up by a bank's skilled lawyers, empowers the bank to act in a particular way, the tribunal, like the court, will have no option but to take a legalistic view on how the bank has behaved. By contrast, an ombudsman can look at the contract - and the situation - and rule on whether the provisions and the actions taken were "fair and reasonable" under the circumstances. This should benefit even those larger SMEs who can reasonably be expected to have, or buy in, legal advice.

As Professor Hodges points out[xxviii], in 99 per cent of RBS/GRG compensation cases the conduct of the bank was contractually legal, and the question relates to the bank's actual treatment of the SME. The bank may have had the legal power to take a particular action, but an ombudsman's decision can take into account whether the original contract was fair, and whether the bank behaved in a reasonable manner.

Meeting the CBI's Enterprise Forum in Birmingham I was given several examples of banks behaving in a cavalier manner to stereotypical SMEs. The actions included precipitately calling in a loan where repayments had been scrupulously maintained, because the decline in property values enabled the bank to argue that its loan to value ratio had been breached an APPG member gave me a similar example of a loan-to-value ratio breach which the bank had used, he claimed, to require full repayment by 10am the next morning. Another historic case involved doubling the interest rate on a loan and charging a substantial additional fee for borrowing which had previously been serviced perfectly adequately and continued to be repaid (at the new rate) until it was paid off three years later.

Calling in loan facilities is nowadays much less common, but in these situations, as the businesses readily acknowledged, the bank is acting within its contractual rights and a legal application is unlikely to prove successful. An ombudsman hearing these cases could however find that the bank had not been "fair and reasonable" either in requiring that clause in the contract or in the way it was implemented. The ombudsman can deal with "meanness" as well as legality. The distinction is important: a "fair and reasonable" test will put SMEs in a much stronger position than if they rely solely on contractual or common law rights.

A second reason is access to data and information flows and the ability to identify wider and systemic issues. An ombudsman can aggregate and feedback data to regulators and government department and have much more direct involvement in behaviour and culture (although this requires first rate management information, often dependent on technology, which needs to be prioritised). Tribunals make individual decisions in particular cases. Feeding back information is not their role.

As Professor Hodges points out[xxix] the collection of data from individual queries, complaints, disputes and decisions, and the aggregation of that data and its analysis to identify patterns of poor practice and trends, enables direct intervention with an organisation or industry to agree changes in culture or practice. This feedback loop can incentivise positive behaviour and bring changes in organisational culture. As Professor Hodges notes, the proactive intervention of the Groceries Code Adjudicator is a prime example of this[xxx]. Legal processes may lead to a financial settlement but rarely specify changes in how things are to be done in future.

Time is another factor. Tribunals will, in practice, require the expense and time involvement of lawyers even if there is no filing charge. Ombudsman services are typically free and conducted without lawyers, which will assist the speed of dealing with complaints.

The adversary nature of court or tribunal processes also makes permanent what may be a temporary breach between parties. Anecdotally a significant number of the complaints surveyed for this review involved SMEs who remained customers after the dispute with their bank was resolved. This is unlikely to be true if lawyers have been brought into play.

It may be argued that tribunals, unlike ombudsmen, can summon witnesses and require documents to be presented. Ombudsmen can only request data and attendance, although they can draw an adverse inference from a refusal. In practical terms the distinction is rarely significant. As Professor Hodges[xxxi] notes it is very unusual for a court to use its power to require a document to be produced, and an informed ombudsman can bring to bear expert knowledge of what evidence ought to exist. If necessary, a standards framework can be added to back this up.

Finally, there is the suggestion that the fear of negative media coverage from an adverse public ruling by a court or tribunal has some deterrent effect on bank behaviour. Leaving aside arguments about the nature of deterrence, I find this questionable. Most financial sector legal cases are relatively dull and unlikely to attract press notice unless particularly extreme behaviour – or a celebrity - is involved.

More importantly, as Professor Hodges points out, 95-99 per cent of legal cases in court are settled by defendants before being decided by a judge or tribunal[xxxii]. Not only does this limit the likelihood of media attention, but it means that data that would be useful to regulators and ministers in the formation of future case law or regulation is entirely lost.

While a tribunal decision is enforceable on both parties, the finding of an ombudsmen is binding on the organisation complained about but may leave a complainant who is still dissatisfied with the option of taking the matter to court.

For all these reasons it seems to me that SMEs which end up making formal complaints would be better served by a quick and easy investigatory process resolved by an ombudsman, probably on paper without any need to be present, let alone a requirement for legal advice or representation.

In a courtroom, tribunal or ombudsman situation there will be an onus on the bank to demonstrate the reasonableness of its position. However, in only one of these situations will the "reasonableness" determine the decision. And in only one will the data surrounding the complaint feedback to rule-makers to prevent the repetition of behaviour such as that which followed the GFC.

What might have been appropriate in the immediate wake of the Lloyds/HBOS and RBS/GRG scandals is not in my view the right vehicle for the very different level and character of complaints about the banks today. I am with Professor Hodges in his view that it would "complicate justice rather than promote it".[xxxiii] The creation of a new tribunal vehicle solely for dealing with the financial sector would represent a significantly burdensome and bureaucratic addition to current UK legal infrastructure.

Finally, there is the practical argument. As noted, creating a new framework for financial service tribunals would require primary legislation. Getting new legislation through parliament in the throes (and even the aftermath) of Brexit is likely to be difficult. Without other checks while we wait for legislation, rapid remedies for new cases would not be available. There is benefit in creating a facility which can be up and running before any future round of economic upheaval.

<u>What sort of an Ombudsman is Required?</u>

The most easily available option would be simply to use the Financial Ombudsman Service (FOS) which, as outlined, is a statutory body created under the Financial Services and Market Act of 2000. By itself, this would seem to me an inadequate response.

FOS's board is appointed by the Financial Conduct Authority. As noted, it is funded by the UKs financial services sector through a combination of statutory levies and case fees paid by financial businesses that are regulated by the Financial Conduct Authority (FCA) and by law are automatically covered by the ombudsman service.

The FCA has just concluded a consultation to examine raising the FOS's scope from what are effectively micro-enterprises to a larger segment of SMEs. This was described to me as a "no brainer" and I endorse the change.

To date only micro-enterprises - businesses, with a turnover below £2 million and no more than ten employees - could go to the FOS. The FCA has suggested the thresholds should move to £6.5 million, an annual balance sheet below £5 million and up to 50 employees.[xxxiv] Its proposals should result in around

210,000 more SMEs being able to refer unresolved disputes with financial services firms to the Ombudsman. This would mean around 99 per cent of all SMEs in the UK would be eligible, with only the very largest out of scope. It is likely to mean up to 1500 additional SME disputes going to the Ombudsman each year[xxxv].

The maximum compensation the FOS can order a firm to pay is £150,000 which will not always be sufficient to compensate losses sustained by a complainant. It should be noted that the FOS often hands out a formula for calculation of an award rather than specifying the amount itself. The maximum level was relatively recently raised and has been kept under review. The FOS has in past cases noted it would have awarded more had this been within its power, and asked banks to "put matters right" for a claimant, usually without specifying an amount. This usually seems to have been done and it is likely that the banks could be persuaded to accept this approach as routine.

The FCA is now consulting[xxxvi] on proposals to increase the binding award limit that can be imposed by the FOS, which was raised from £100,000 to £150,000 in 2012. It suggests the possibility of the limit rising to £350,000 from 1st April 2019. This is closer to the binding limit available to the Australian Financial Complaints Authority and seems to me a sensible starting move. In the longer term, the Australian limit of $1 million – roughly £600,00 – would seem to me to be appropriate. A very large penalty and compensation payments regime should require judicial oversight, but the threshold is open to debate. Australia seems a good parallel.

There are ombuds-alternatives to the FOS. Ombudsman Services is a non-profit company limited by guarantee which holds mandates as the energy ombudsman (from OFWAT) and communications ombudsman (from OFCOM) in the regulated sector, as well as for invoice finance and asset-based lending. This last sector supports 40,000 UK businesses, including larger SMEs, with combined sales turnover of £287 billion and has some parallels with the banks.

Ombudsman Services has grown significantly over the past decade and has a strong reputation. Like Professor Hodges I have considerable respect for its operations and, if a reframed dedicated structure carved out within the FOS was not practicable, combining Ombudsman Services' offering with an enhanced data system could provide a possible alternative.

Why the Financial Ombudsman Service?

In my judgment the first resort ought to be to use the resources and statutory framework, though not necessarily the name, branding and website supplied by the existing Financial Ombudsman Service. I would propose creating a separate facility effectively by structuring the current FOS as two pillars, one for consumers and the other for SMEs, each with an independent identity.

The FOS has the practical advantage of being the statutory body already charged with personal and SME complaints. It already has the existing infrastructure, employee numbers and budget to take on an explicitly broadened dispute resolution role for SMEs and banks. It is substantially the largest ombudsman body in the world, with over 3500 staff and a budget for the current financial year approaching £300 million. It has been said to be the largest employer of law graduates in the United Kingdom.

The statutory powers of the FOS, its compulsory status and the FCA's legal power to bring currently unregulated financial services activity into its remit by simple rule change make this an attractive way of future proofing ADR provision in the financial sector. The FOS has grown massively in the wake of the PPI scandal and the bulk of its employment growth is entirely due to that cause. There are consequent plans in train to reduce staff numbers. By far the simplest option available to create an alternative resolution framework for banks and SMEs would be to strengthen and redirect this resource.

The FOS is not a perfect organisation and over the past year in particular it has attracted significant press and political criticism. Following a critical Dispatches programme on Channel Four in March, Richard Lloyd, former head of the Consumer Association conducted a review of the Financial Ombudsman Service. While establishing that some charges of underqualification and inexperience were valid, he did not sustain the very strong challenges that had been raised.

The FOS undoubtedly has weaknesses and its board and senior management need to revamp and get a grip on the organisation. Its detailed business offering has slipped back as it has been swamped by mass issues largely brought on behalf of individual consumers by claims management companies.

The Service does not currently provide a viable forum for an expanded volume of financial business complaints. As its website suggests, it is primarily a consumer vehicle aimed at relatively unsophisticated individuals detached from commerce. It needs reshaping and reinvigorating, as it recognises. The FCA also acknowledges the need to hire extra staff and consultants with the necessary skills and expertise, which is why it has published "near-final" rules in its paper on SME access.[xxxvii] However, it cannot make sense to write off an existing statutory organisation with 3500 staff and a funded budget of hundreds of millions when SME oversight is clearly within its defined remit. Moreover, because the FOS has existing infrastructure, employee numbers and resource it would be relatively straightforward for the Government to endorse the creation of a suitable vehicle, noting that staff numbers are currently projected to fall as the cut-off date for new PPI claims approaches in November 2019.

The Remaining Gap for Larger SMEs

Implementing the proposals outlined in the FCA's consultation will leave a technical gap for companies with turnover above £6.5m per annum but still below £25 million. On the basis of the banks' data from 2015-2018, there were around 4000 complaints a year of any sort from companies in the £6.5- £25 million size bracket. Of these complaints, 70 per cent were upheld and settled by the banks. But this is a very broad range of businesses.

It might reasonably be thought that companies with an annual turnover above £10 million should generally be in a position to resort to the courts if they have substantial claims well above the FOS threshold. As things stand a small number of complaints from these larger companies (12) were in fact taken to the FOS over that period even without its having the ability to make a binding judgement.

There will be vulnerable SMEs with turnover above £6.5 million which are unable to take complaints to a freshly empowered business ombudsmen carved out of the FOS. There will also be some firms, probably businesses such as hotels, nursing homes or investment property portfolios with low turnover relative to assets, where claims could be in excess of an increased maximum binding award. These gaps will need to be closely monitored. But, certainly at present, I think the number of claims affected is likely to be low, and, from a national perspective the cost of setting up a tribunal system to fill the notional gap would be disproportionate.

As previously stated, at present the maximum sum the FOS can order a defendant business to pay is £150,000 plus interest. In practice the FOS does occasionally recommend that a defendant business pays a sum in excess of that amount – often a figure calculated to put right the damage a complainant has suffered. The payment is then at the defendant business's discretion, and in most cases that request is met.

I propose that the banks, on a voluntary basis, agree to establish and fund a voluntary ombudsman scheme that is available to businesses that are not 'eligible complainants' to the FOS by regulatory mandate. The voluntary scheme should be made available for businesses with turnover between £6.5m and £10m and in certain cases outside of the compulsory jurisdiction. This should largely fill the perceived gap.

A potential and in my view desirable mechanism for delivery would be via the FOS voluntary jurisdiction. I recognise that this will require proper commitment from the banks.

I also recommend that the banks consider whether a voluntary scheme could be established to review bank disputes that have arisen since the Financial Crisis. Any scheme should be limited to those who have previously lodged a formal complaint. It should exclude those that have already been dealt with by a court, tribunal, arbitrator or other external dispute resolution scheme, and those which are the subject of legal proceedings.

The standard EU definition of an SME goes much further than the proposed FCA extension covering businesses with annual turnover not exceeding 50 million euros, a balance sheet of 43 million euros and 250 employees. It seems to me appropriate to let the dust settle on the changes consulted upon but, if they are working well, to consider moving towards higher thresholds. If the system proves effective there is no reason why the aperture should not be as wide as possible.

A Banking Ombudsman Facility created within the FOS

The Financial Ombudsman Service recognises the need to up its game in order to provide a viable forum for business complaints. My recommendation is that a division under the FOS governance structure should be created alongside the existing FOS organisation. In line with the FCA's existing consultation on the FOS (see below), it should handle all eligible SME disputes including its micro-enterprise function. Importantly, it will have a new identity and a new website and its communications focus will be directed squarely at SMEs.

It should not be necessary to establish a separate legal persona given the existing structure of FOS within the Financial Conduct Authority's field of authority, albeit with operational independence. It would make sense to review governance, with a view to setting up an advisory board, whose members would have business and legal backgrounds. The banking ombudsman facility management should have appropriate experience in dispute resolution and a mandate to ensure the organisation can quickly reach and gain the confidence of a wide SME audience.

The Small Business Commissioner, whose responsibilities are currently largely focused on late payment issues, could be an ex-officio member of the advisory board. In several Australian states the Small Business Commissioner has emerged as a key champion of businesses across a much broader range of issues than late payment, as in the UK.

It would be made clear that the role of FOS under its current leadership is to help individual consumers to resolve complaints. A cadre of senior managers should be appointed to the new entity. Their role would be to refocus the carved-out organisation on its SME target audience A key responsibility would be an HR function with the capacity to identify and develop existing suitable FOS staff, and where necessary bring in external talent in order to help equip it with appropriate legal, business and banking capability. Additional costs for the new entity should be modest but could, if necessary, be recovered through the existing financial industry levy.

A Specialist Adjunct to the Banking Ombudsman Facility

The Financial Ombudsman Service has itself always recognised the need for occasional deep expertise – either legal, financial or both – and for additional inputs from the courts in extremely complex cases or on points of law.

One way of finessing this would be to create a separate advisory body to provide expert help where required on matters of legal or banking expertise. This panel might be chaired by a retired judge. It would also provide high-level guidance in situations akin to interest rates swaps where there is a need for mass redress in a multitude of analogous cases. It is important to distinguish this proposed vehicle from the suggestion that a nationwide regime should be established along the model of employment tribunals. But it would have the benefit of meeting the wishes of those who believe current ombudsmen staff lack the deep expertise required for highly technical business disputes involving SMEs.

The new banking ombudsman facility would give concurrent priority to the collection of data and feedback to the regulator and government departments. Whichever approach is adopted for the resolution of banking disputes, it seems to me vital that findings and a feedback loop to regulators and government departments is built in to the system. Given the history of cultural problems in the financial sector and the potentially devastating consequences of any repeat of the 2008-10 banking crisis, an early warning system such as this information stream would provide needs to be built in to the accountability regime developed.

It is important that the data generated by the banking ombudsman facility is captured, both to identify and bring to a rapid close any truly damaging practices. This focused data collection would also monitor bank activity and customer complaints to give an early warning system against any repetition of past malpractice.

At present the Financial Ombudsman Service sits on a great deal of data but its ability to generate management information from its database is relatively limited. It is critical that a new business-focused operation develops a semantic model that allows for the fastest possible machine reading of processed complaints.

Technology has the power to help this process. Professor Hodges refers to the consumer intermediary resolver.co.uk which currently receives and classifies customer complaints to 25,000 businesses, and to several leading regulators and ADR schemes[xxxviii]. Resolver does not itself adjudicate in disputes between a customer and a commercial entity, but its ability rapidly to flag up problem areas as they emerge on a granular basis would provide a suitable filter for the

FCA, Treasury and BEIS to be alert to future systemic and cultural banking problems.

Resolver does not make the decisions in disputes between a customer and a commercial entity. But it does classify complaints and demographics and can forecast with some accuracy the propensity of wronged – or just mildly irritated – customers to carry a complaint forward. It also classifies the results afterwards, so the information loop is constantly updated. Resolver or a similar service would seem to provide an attractive approach for the IT era. The eventual possibility of being able to handle many routine complaints online via algorithms is clearly time-saving and potentially beneficial. I would strongly urge consideration for a secure and IT-driven monitoring and data system through Resolver or a similar product.

Closure & Emotional Release

For many SME owners, one of the real complexities is the intermingling of their personal and business personas. A business may have been family-owned or set up by people who have put their whole lives into it. They have invested considerable emotional capital: a dispute threatening its existence threatens them too. And yet the reality is, by choosing a corporate identity and moving into a business-to-business environment, they have lost the protection and sympathy available to individual human beings harshly treated by an impersonal commercial adversary.

I noted earlier that many APPG victims had lamented the absence of a metaphorical, if not literal, “day in court” to tell their story. The emotional stress and impact on mental health of their treatment has been considerable.

As the aftermath of a number of scandals reminds us (admittedly in very different contexts) those who have suffered personally from the actions of professionals can only achieve closure if some sort of truth and reconciliation process results in those who were at fault acknowledging and recognising the consequence of their actions. As referred to in the second part of this review, the Bishop of Liverpool wrote eloquently in the Gosport Hospital Enquiry of the stress suffered by individuals who, when raising legitimate questions and concerns met with obfuscation from those in power and authority. The result was consuming frustration and anger among the victims, which, in turn made those in authority less inclined to build a bridge towards them and investigate their concerns thoroughly.

Several reports have now been written about the excesses of the financial crisis. Their findings have been damning in terms of the professionalism and behaviour of some banks and its impact on individuals. I do not believe there is point in setting up a further public enquiry into what happened, particularly but not exclusively in relation to RBS, in the wake of the Global Financial Crisis. Cavalier behaviour is shameful even if it is not criminal and cannot result in legal sanction. There is a residual responsibility on today's senior management to acknowledge the mistakes of their predecessors and commit to ensuring there is no repetition of the past.

I propose that a formal process is agreed and scheduled at which key representative figures from the All-Party Parliamentary Group on Fair Banking are given the opportunity to tell their stories to the senior management of the major UK banks and the banks are given the opportunity to respond openly. This should in no way be re-run of an inquiry, but an opportunity for all parties to understand what happened, to acknowledge the pressures and the wider hurts suffered, and to arrive at reconciliation and closure. The process should be chaired by a senior retired figure – perhaps a former Treasury minister or select committee chair - who combines understanding of financial markets with empathy for the victims of mis-selling. At the end of their testimony the banks should respond, express regret and commit themselves to an era where these situations will not be repeated. The discussion should then move on to current day circumstances and to ways in which such malpractices - and any fresh abuses - can be stopped in the future. A further output could be the establishment of the monitoring council suggested earlier which might meet six-monthly in order to provide independent oversight of future process.

This is not a matter of seeking fault. Many of those with the most tragic stories took chances and risks at a time when no one foresaw the economic crisis to come. Opportunities that might have succeeded in better times, failed disastrously. The financial sector went from a position of relative laxness and the easy availability of funding, to a dramatic tightening forced by the need to ensure its continued existence. The truly criminal activities have been punished in the courts. I have seen no evidence of systemic “dark arts” or criminal conspiracies among or between the banks.

But the financial sector ought to recognise what happened, how things went wrong and that for many SMEs the personal and business are inextricably intertwined.   This is not about monetary compensation, but a matter of acknowledging wrongs done, and pain felt. It would do credit to our largest banks if they were to take part in such a process.

SUMMARY AND CONCLUSION

- After considering carefully what happened to UK SMEs at the time of the Global Financial Crisis and reviewing the nature and number of complaints from SMEs about their banks today, my recommendation is to create a business banking facility clearly labelled as such. Ideally it would remain under the technical and budgetary aegis of the FOS using its existing resources, and some of its professional staff, but it should have its own senior management and corporate identity. The Financial Ombudsman Service does not currently – perhaps understandably - look or behave as if helping business is its principal focus. A business and banking ombudsman pillar within the FOS framework needs to present itself very differently if it is to win the confidence of the SME community. It should be possible to do so, with personnel changes and re-training.
- Other parts of the ombudsman or small business infrastructures, including Ombudsman Services and the Small Business Commissioner, should be involved in helping to create and strengthen the banking ombudsman facility as a separate division of the FOS.
- An expert and specialist advisory body involving senior legal, banking and business practitioners should be set up in order to consult and advise on technical legal and banking issues and to give guidance on business mass claims.
- I entirely support the changes proposed to the scope of the Financial Ombudsman Service in the FCA's consultation paper and believe they should be implemented in full for the proposed banking ombudsman facility.

- I further recommend that UK banks agree, on a voluntary basis, to establish and fund a voluntary ombudsman scheme for businesses that are not ‘eligible complainants’ to the FOS. The voluntary scheme should be made available for businesses with turnover between £6.5m and £10m and consideration could be given to cases outside of the compulsory jurisdiction. Such a scheme could ideally also be overseen by the new banking division ombudsman service under the overall aegis of the FOS.
- I also recommend that the banks consider whether a voluntary scheme be established to consider bank disputes that have arisen since the Financial Crisis.
- I would suggest that this voluntary scheme be limited to those who have previously lodged a formal complaint. It should also exclude those that have already been dealt with by a court, tribunal, arbitrator or other external dispute resolution scheme, and those which are the subject of legal proceedings.
- Once the new banking ombudsman regime has bedded down – say two years after it has been created, and subject to its satisfactory operation – I recommend that the size of business within its scope should be reviewed, and that its binding authority to make an award be raised to a limit of £600,000.
- The data links between the banking ombudsman facility and the FCA and appropriate government departments will be critical. I recommend that *resolver.co.uk* or a similar service be engaged to process data including enquiries, complaints and ombudsman’s rulings in order to provide an early warning system against future mis-selling or malpractice.
- I recognise that the banking ombudsman facility will only be able to review future complaints for businesses which would not have met FOS’s current, microenterprise criteria. I do not recommend retrospective

capability for the new body but recommend that banking microenterprise claims predating the date of its operation (but falling within the current 6/3-year FOS time limits) should be assessed by the new service.

- I propose that a process is agreed that provides an opportunity for stories to be heard by the most senior management of the major UK banks and the banks given the opportunity to respond openly.
- The discussion should then move on to current day circumstances and to ways in which such malpractices - and any fresh abuses - can be stopped in the future. A helpful output would be the establishment of a monitoring council of stakeholders, including SME representatives, to work in collaboration, ensure processes are optimal and effective, to deal with prevailing issues and ultimately act as an early warning mechanism.
- UK Finance should continue to work with the APPG on its joint Contracts Working Group.
- As part of this process, special attention should be given to measures to address the imbalance between banks and business customers. Australian measures including a requirement for a plain language summary and the prohibition of calling in debt on the basis of loan-to-value covenants where all payments have been kept up to date should be considered.
- UK Banks should commit not to onsell debt to institutions which are not signatories to the Lending Standards Board's code of practice, unless they will commit to maintaining equivalent standards. The sector should urge all debt collection agencies and debt purchase firms to register with the Lending Standards Board.
- UK Banks should commit themselves to showing restraint in taking security for a business loan on the sole residence of a borrower.
- The UK banking sector should work with the APPG in its report for BEIS and the Insolvency Service in response to the Government's Review of

the 2016 Corporate Insolvency Framework to ensure that insolvency should not in future effectively automatically prohibit company owners and directors from seeking redress.

- UK Finance should examine ways of co-ordinating member banks' complaints data in order to ensure broad comparability.
- In order to foster trust in the financial sector, the UK banking industry should monitor closely any claims that member banks are using legal panels in order to limit access to justice in parts of the UK where there are a relatively small number of law firms, or that efforts are being made to string out legal proceedings improperly.

---

[i] Alistair Darling Interview Business Insider, 28th May 2018
[ii] FT July 4th, 2018 HBOS Fraud Victims set to accept compensation from Lloyds
[iii] Times July 1st, 2018
[iv] Times August 1st, 2018
[v] Andrew Bailey, FCA press release (date)
[vi] Letter from Andrew Bailey, Chief Executive FCA, to Kevin Hollinrake MP 17 September 2018
[vii] Industry Codes of Conduct and Feedback on FCA Principle 5 Policy Statement PS 18/18 July 2018
[viii] Part 2, Page 12
[ix] Part 2, page 42
[x] Letter from Andrew Bailey, Chief Executive FCA, to Kevin Hollinrake MP 17 September 2018
[xi] Part 2, page 35
[xii] FCA press release October 16th, 2018
[xiii] BDRC survey of 750 SMEs conducted for UK Finance September 2018
[xiv] BDRC survey for Competition and Markets Authority, August 2018
[xv] Money Advice Trust data
[xvi] Ned Beale Journal of International Banking Law and Regulation 2018
[xvii] p40 APPG report.
[xviii] Part 2, page 40
[xix] Part 2, page 4
[xx] Part 2, Page 13
[xxi] Part 2, page 11
[xxii] Part 2, page 11
[xxiii] FOS Annual Review, 2018
[xxiv] Report of the Independent Review of the FOS, Richard Lloyd July 2018
[xxv] R Samuel Capital Markets Law Journal 2016 11(2), 12(3) and 2018 13(1)
[xxvi] Part 2, page 32
[xxvii] Part 2, page 27
[xxviii] Part 2, page 27
[xxix] Part 2, page 37
[xxx] Part 2, page 19 citing the GCA's action on Tesco supplier payments and references to the CMA
[xxxi] Part 2, page 25
[xxxii] Part 2, page 24
[xxxiii] Part 2, page 29
[xxxiv] FCA Press release 16/10/2018
[xxxv] FCA written evidence to Treasury Select Committee Inquiry into SME Finance 2018
[xxxvi] FCA Consultation Paper CP18/31 October 2018

[xxxvii] FCA Policy statement PS18/21 October 2018
[xxxviii] Part 2, page 15