November 2018

Fair Business Banking

The All-Party Parliamentary Group on Fair Business Banking

Response to FCA Consultation DP18/5 on Duty of Care

About the APPG on Fair Business Banking

An All-Party Parliamentary Group (APPG) is a cross-party interest group of parliamentarians. The APPG for Fair Business Banking is a platform through which businesses, professionals and trade bodies can discuss issues regarding commercial banking and its role in the life cycle of a business, and through which parliamentarians can access information on banking, finance and related issues, including business rescue and insolvency, on behalf of constituents. As a cross-party group, with a large membership of both MPs and peers, the APPG is an effective vehicle to promote meaningful change via the parliamentary system. The Group does not have charitable status, or official status in the House, nor is it funded by Parliament. It relies wholly on the participation and contribution of parliamentarians, industry members and stakeholders committed to creating a strong platform for business in the UK to thrive.

Our primary interest as a group in this consultation is how it may relate to the relationship between financial firms (particularly large ones, mainly the larger banks) and their private business customers.

The term "private businesses" encompasses both the small and medium-sized enterprises (SMEs) that are so often called the "lifeblood" of the economy and also larger entrepreneur-owned entities with multi-million pound balance sheets and hundreds of employees. Cumulatively, and through their interconnected relationships with employees, customers and suppliers, private businesses have a huge positive impact on the UK economy.

In our experience, what the vast majority of these private entrepreneur-owned businesses have in common is that

a. they all need access to financial services during their life cycles and

b. they are ***not* on a level playing field**, in terms of size and negotiating power, with their main suppliers of financial products and services, the big banks.

Not a level playing field

There are some key issues which prevent the majority of private businesses and all SMEs from being on a level playing field with large financial firms.

There is still negligible competition between a small number of very large, well established and powerful suppliers of commercial financial services, each of which remains too systemically important to be allowed to fail, which results in a lack of variety of price and features between the main suppliers' offerings in this market.

A lack of choice and negotiating power can leave business consumers without sufficiently clear information and understanding of features and risks to make informed decisions about financial products and services that will meet their needs and give them a certainty of outcome. With no requirement for financial firms to provide transparency, a duty of care or to act in good faith,

problems can be sealed into commercial banking relationship from the outset. There may be little option but to agree to unfavourable and onerous contractual terms in order to access the funding necessary to develop or grow a business. Once committed to certain facilities, business customers are unlikely to be able to easily switch between suppliers, if a better alternative can be found. They will also find it extremely difficult to make a successful legal challenge against any commercial contractual terms they have agreed to that cause damage and appear unfair.

The huge disparity in power between the main financial services providers and their business customers leaves those customers open to a potential abuse of power. There is currently little disincentive to deter large financial firms from hastening or even participating in the failure (insolvency) of their business customers or selling on their debt to unregulated entities and thereby potentially exposing them to asset-stripping due to commercial or regulatory pressure to de-risk or exit certain markets.

Losses experienced by businesses can have a more serious and widespread effect than those experienced by other consumers. The financial sums involved can often be much greater and the impact of those losses or of the resultant failure of a business can be felt not just by the business owner(s) but also by its employees, customers and suppliers. Larger businesses are as much at risk as smaller ones, if they are not in a position to negotiate on an equal footing with financial firms, but the scale and extent of the loss or failure and number of those affected by that loss or failure can be much greater.

The damage to individuals and the wider economy as a result of problems between businesses and their financial services providers cannot be understated; job losses, personal bankruptcy, mental health problems, suicide, family break-ups and cuts in local and national funding from loss of revenue to councils, HMRC and others, are all common effects.

Our understanding of a duty of care

In its consultation paper the FCA defines a 'duty of care' as "an obligation to exercise reasonable care and skill when providing a product or service." However, this is only a partial definition of what a requirement for a duty of care would bring to financial services. As we understand it, the concept of a duty of care goes much further to also encompass an obligation to take reasonable care to avoid acts or omissions which could foreseeably cause harm or loss to the other party.

Our views on a duty of care

We continue to support and endorse calls from The Financial Services Consumer Panel, the FSB and others for the introduction of an enforceable duty of care on the part of firms towards their customers. We also believe that there is a need for firms to commit to always acting in good faith towards their customers.

These measures should apply to the provision of **all** products, services and transactions, not just those that are currently within the current regulatory perimeter.

An appropriately framed duty of care and a requirement for good faith will provide for a minimum standard of behaviour towards all customers and also more generally in all financial market activities.

There is no need for these simple overarching duties and responsibilities to interfere or conflict with firms' commercial activities; appropriately applied and enforced, they will still enable firms to act in their own commercial interests and seek profits. A commercial relationship should not need to be exploitative to be profitable and it is entirely reasonable that firms should take responsibility for their actions and not seek to harm or be negligent towards the interests of their customers.

Question 1

Do you believe there is a gap in the FCA's existing regulatory framework that could be addressed by introducing a New Duty, whether through a duty of care or other change(s)?

If you believe that there is, please explain what change(s) you want to see.

We are particularly interested in your views on:

- *i. The types of harm and/or misconduct any changes would address.*
- *ii. Whether a New Duty should be introduced and, if so, what form it should take.*
- *iii. What additional consumer protection and benefit this would provide, above the current regime (including over and above the existing implied term in the CRA for reasonable care and skill).*
- *iv. How a New Duty could and should act to mitigate or remove conflicts of interest, including the types of conflicts which exist in the provision of financial services?*
- *v. Whether a New Duty could reduce complexity and bring greater clarity, or whether it could result in an additional layer of regulation and make it more complex, and, if so, how?*
- *vi. Whether other alternatives could help address any gaps, for example, extending the clients' best interests rule to different activities.*
- *vii. Whether we should introduce more detailed rules and guidance, and, if so, what specific rules and guidance are required?*
- *viii. Whether the scope of any changes should differ between markets and whether it should include wholesale transactions.*

Gaps in regulation

There are clear regulatory gaps, both in the level of regulatory protection offered to business customers and the availability of and access to suitable mechanisms to secure adequate redress when things go wrong.

While other consumers receive a high degree of protection when accessing financial services, there is little regulatory protection for most business customers. The majority of their financial interactions and transactions currently sit outside the "regulatory perimeter".

However, the decision makers within private businesses are often no different to 'ordinary' individual consumers, in terms of their level of knowledge and understanding of the financial products and services they need to access. Entrepreneurs are not usually experts in all fields and cannot be considered to have innate financial sophistication as a result of being successful in one or more spheres of business.

In commercial contracts the principle of 'Caveat emptor' - 'buyer beware' - applies. The additional protections afforded to other consumers by the Consumer Rights Act and other legislation do not

apply to business customers. But in circumstances where customers do not have access to sufficient information to make an informed decision or don't have a very wide or free choice we would suggest it is unfair to expect consumers to take sole responsibility for the decisions that they make with respect to financial products and services.

The fact that some commercial financial transactions fall inside the regulatory perimeter and others are outside can be confusing. Financially unsophisticated customers can fall between the cracks in regulation if their businesses grow a little, or if an offer of unregulated commercial lending is conditional on the acceptance of some other complex and potentially unsuitable instrument such as an interest rate hedging product (IRHP).

Gaps in regulation have resulted in selective piecemeal interventions, leading to markedly different treatment and outcomes for consumers sold different products but with similar features or risks that have caused similar levels of detriment in similar circumstances. For instance, a review and redress scheme was provided for customers mis-sold stand-alone IRHPs, which are regulated products, but it excluded non-regulated fixed rate loans with embedded or attached derivatives with similar large fees to exit.

Some commercial financial products may even be designed specifically to evade regulation. The Treasury Select Committee came to the conclusion that this was the case with Clydesdale's Tailored Business Loans, which it sold to several thousand businesses.

The gap between perception and reality

We have also found that there is there is often a wide gap between people's perceptions and reality, in terms of how large financial firms behave towards private businesses and the level of protection that covers those businesses' interactions and transactions with those firms. This is hardly surprising when there is such a disconnect between the marketing and public relations messages of financial firms and what happens in reality. In their adverts, large financial firms are keen to portray themselves as caring, helping, supporting, and even cushioning customers through each stage of their life or business. Customer-facing employees, including trusted Relationship Managers, can also be unclear about the extent to which any duty of care will be applied in the relationship, which can lead to business customers being lulled into a false sense of security.

Consequently, many entrepreneurs assume that their bank will act in good faith and extend them a duty of care or that, in the event that it fails to do so, they and their business will be protected from serious harm. Often, business customers only become aware of the fact that a financial firm owes them no such duty or responsibility and there is little or no regulatory protection when things go wrong.

This disparity between perception and reality can lead to greater damage than if all business customers conducted their relationships with their financial service suppliers with the full knowledge that these suppliers cannot be relied upon to not act in a way which may cause harm to their customers.

It is apparent from the public image that several of the larger financial firms are keen to portray that they fully appreciate the value of a duty of care to their customers.

The APPG is of the firm belief that it is totally unacceptable for these firms to trade on the perception of that value, without actually being required to deliver on it. We therefore see the introduction of a duty of care and requirements to act in good faith as an entirely logical and necessary step to rectify the problems caused by the current widespread misconceptions and misunderstandings.

Lack of trust

For other customers, there is a profound lack of trust in financial firms, particularly banks. Trust in the financial services industry has been severely damaged by poor behaviour, persistent denial by financial firms that they have committed any wrongdoing, and a failure, for the most part, to hold anyone to account for the bad behaviour.

Restoring trust is essential for achieving a strong, productive economy, but also for the future prosperity of financial firms themselves. Trust will only be restored when financial firms and employees of those firms are seen to take responsibility for their actions.

While the Senior Managers & Certification Regime may finally go some way towards achieving a degree of accountability in financial firms, it is unlikely to be enough, on its own, to inspire firms to strive to do the right thing for their customers rather than simply to avoid doing the things that are not permitted or else try to not get caught doing them.

Currently, without any requirement to act in good faith or provide a duty of care towards customers, firms continue to push the boundaries of what is considered to be satisfactory behaviour from a legal perspective with little regard for whether or not it is morally acceptable.

The introduction of a statutory duty of care and requirement to act in good faith would bring greater clarity and certainty for both firms and their customers. Such legally enforceable guiding principles would empower consumers to take responsibility for their decisions and would complement and enhance the Senior Managers & Certification Regime, helping to restore trust and confidence in financial services. They would also reflect more accurately the image and aspirations that many firms attempt to project in their marketing and lobbying.

A duty of care and requirement to act in good faith would enhance the regulatory framework

We cannot agree with the view proposed in the FCA's consultation paper, that a duty of care may merely replicate some of the existing regulatory rules and guidance. The introduction of a duty of care that corresponds to the more usual, wider definition, rather the narrow definition on page 5 of the FCA's paper, would go further than any of the current rules and protections extended to regulated customers by imposing an explicit obligation on firms to always consider whether their behaviour may cause damage to customers. With the addition of a requirement to act in good faith, firms would also need consider the intentions of their actions and inactions.

Within the current regulation of financial services there appears to be no requirement for firms to consider the effect of their behaviour on customers, except perhaps in relation to the giving of advice and where a customer may be vulnerable. However, since it is not always easy to confirm with certainty when advice is being given and which customers are vulnerable, there are inherent difficulties in the regulation of both these areas.

Advice

In some circumstances it may not be enough to just present customers with information, however detailed and well-presented; some customers will also need advice about which product or service is appropriate for their needs. We strongly believe that where products and services are particularly complex or the choice between them is not clear cut, firms should provide advice to their customers.

Where there is an advised sale, customers need to be able to trust the advice given. Advised sales of many products are subject to more detailed and stringent rules than those that are information-only, or non-advised. However, these rules have not always been enough to prevent egregious and widespread mis-selling, as in the cases of Payment Protection Insurance (PPI) and Interest Rate Hedging Products (IRHP), for instance.

Through wishing to avoid the stricter regulation that applies to advice-giving, firms can seek to avoid giving advice or evade responsibility for any advice they have given. Additionally, where the sale of a product or service has been non-advised, some firms have not always made it very clear to customers that any information they have provided does not constitute advice. Further, firms have sometimes attempted to deny that advice has been given when it is quite clear that the customer stood in need of advice and sought to rely on what they were told, as advice. Many business customers who were mis-sold IRHPs had carefully worded legal clauses inserted into contracts to deny that advice had been given or exclude the possibility of relying on any advice that had been given.

An overarching requirement to act with a duty of care and in good faith that covered all sales, whether advised or not, should remove all of these problems and anomalies and enable any customer to depend upon what they are told by any financial services firm.

Vulnerability

While it is clearly desirable to be aware of possible triggers for vulnerability and how customers can be affected, it is not always an easy task for firms to identify and target the vulnerable. The concept of 'vulnerability' is difficult to define and could apply to almost any customer at some point in their lives, many of whom would not thank their financial service provider for labelling them as such.

Furthermore, the FCA has reverted to the following definition of a vulnerable consumer from its Occasional Paper No 8 on Consumer Vulnerability:

"Someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care"

Without a corresponding overarching duty of care the above definition seems problematic. What are "appropriate levels of care" if there is no actual requirement on firms to act with care towards customers?

The application of universal standards of behaviour should ensure that vulnerable customers are treated well and it should also reduce the likelihood of customers becoming vulnerable in the first place. If all customers are treated responsibly, with a good degree of consideration and care, there should be less need to single out vulnerable customers for special treatment.

Rather than focusing resources on trying to identify and target specific groups of consumers, financial firms would ensure that they apply an appropriate degree of respect, care and flexibility to all consumers.

Ensuring that firms act in good faith and with a duty of care to all customers should also reduce the incidence of vulnerability that may result from firms' poor or inappropriate behaviour.

There is a clear case that the introduction of a duty of care and a requirement to act in good faith will provide additional consumer protection over and above the existing regulatory framework. However, it is important that these measures should apply to all customers, not just to those whose transactions fall within the regulatory perimeter; otherwise sanctuaries for poor behaviour will be created and reinforced in the markets that are not subject to the jurisdiction of the new duties.

Question 2

What might a New Duty for firms in financial services do to enhance positive behaviour and conduct from firms in the financial services market, and incentivise good consumer outcomes?

Question 5

Do you believe that a New Duty would be more effective in preventing harm and would therefore mean that redress would need to be relied on less?

If so, please set out the ways in which a New Duty would improve the current regime.

The introduction of a duty of care (one that corresponds to the more usual, wider definition, rather the narrow definition on page 5 of the FCA's paper) combined with the need to act in good faith would require a change of mindset for some financial firms. They would have to move away from the behaviour patterns that occur from seeking out gaps in regulation and assuming that it is acceptable to do anything which has not been explicitly forbidden. Instead, they would have to ask: is this fair to the customer? Is it likely to cause detriment to the customer if we do this? It should drive firms down a path of seeking to do the right thing for customers rather than simply doing what they can get away with.

A duty of care and requirement to act in good faith would apply much earlier in the customer relationship and pervade throughout to cover all aspects of that relationship; these overarching duties would influence financial firms' attitudes and behaviour right from the product design stage through information and advice giving, sales and even, where necessary, during complaints handling. The result should be greater accountability within firms and a reduction in the likelihood of egregious and widespread mis-selling and the kind of poor behaviour experienced by businesses in RBS GRG and equivalent units in other banks.

Firms would need to be clear, transparent and straightforward in their dealings with business customers. In particular, they would have to minimise the potential for any lack of understanding at

the point at which choices are made, which could result in future detriment. One of the effects of this should be to make firms' commercial contract documentation less obtuse, more clearly defined and predictable with fairer terms. In turn, this should eliminate many sources of complaints for business customers.

A very important consequence of introducing a duty of care and requirement to act in good faith would be that there should be far less need for customers (and the regulator) to rely on redress mechanisms.

Question 3

How would a New Duty increase our effectiveness in preventing and tackling harm and achieving good outcomes for consumers? Do you believe that the way we regulate results in a gap that a New Duty would address?

The current regulatory framework and powers of the regulator have repeatedly failed to effectively deter poor behaviour and have therefore resulted in customer detriment, including the widespread mis-selling of a number of different products to different customer groups. On many occasions, the regulator has been reactive rather than proactive and the focus has been on a clean-up operation, seeking to deal with the consequences of the misconduct after the event when prevention would, of course, be better than the cure.

There are doubts that financial institution and banks in particular can be trusted to apply the same meaning as the average person in the street to words such as "fairness", "reasonableness" and "integrity". As a result of the gulf in interpretation and understanding between customers, regulators and firms of the meaning of such words, current rules and guidance which rely on words such as these may not achieve the desired effect. For instance, some of the FCA's Principles for business may be interpreted differently by firms and customers.

Principle 2, 'Skill, care and diligence' states "A firm must conduct its business with due skill, care and diligence". This could conceivably be interpreted as conducting the business with skill, care and diligence in order to act in the interests of the firm and its shareholders, which may mean to maximise short-term profits, and which will not usually coincide with providing a good service to customers.

Principle 8 'Conflicts of interest' states "A firm must manage conflicts of interest fairly, both between itself and its customer". Again, what is meant by "fairly" may vary, depending on the point of view and the financial interest.

With many firms' activities and customers not covered by regulation, the FCA does not always have the necessary powers to intervene or require firms to make good even where there is strong evidence of the mistreatment of customers, such as in the cases of RBS GRG and the HBOS reading fraud. It is not necessarily a co-incidence that some of the biggest challenges in financial services have occurred outside the regulatory perimeter.

Even where activities are regulated, there is a perception that the regulator has struggled to be able to use its powers quickly and flexibly without fear of legal challenge from the firms it regulates, as in the case of PPI.

We remain convinced that the most effective way of protecting and enhancing the UK's financial system while respecting and adhering to the FCA's key principles of regulation, including Efficiency and Proportionality, is to ensure that all firms adhere to relatively simple overarching duties and responsibilities.

It is likely that the many cases of unfair behaviour and mis-selling that customers have experienced could have been foreseen and forestalled, or the effects reduced, if a duty of care was in place.

We realise that the changes that we seek would need to be introduced in legislation, rather than by the FCA, but the FCA could have a decisive role to play in convincing parliament of the need to take this action. We believe that it would be appropriate for the FCA to consider and present examples where, as a minimum, an overarching duty of care (but preferably also a requirement to act in good faith) could have had an impact on outcomes and assist the regulator in a number of the problems it has grappled with over the past few years, including for instance, PPI, IRHP mis-selling and RBS GRG etc.

Question 4

Should the FCA reconsider whether breaches of the Principles should give rise to a private right for damages in court? Or should breaching a New Duty give this right?

Private businesses have been poorly served by existing complaint handling and dispute resolution processes. If firms' complaints handling processes were working well for business customers, resolving complaints promptly and fairly, then there would be no need for large numbers of these customers to seek alternative avenues for dispute resolution. In addition, if firms were fulfilling their obligations in respect of investigating and fixing the root causes of the complaints they received from business customers, then widespread issues of mis-selling and mistreatment including IRHP mis-selling, fixed-rate loan mis-selling and poor treatment of customers in banks' 'turnaround' divisions should have been detected and addressed in a timely manner by the financial firms themselves without the need for any other intervention.

Thousands of businesses do not qualify as "eligible complainants" because they fall outside of the limits for access to the Financial Ombudsman Service (FOS). This means that the complaints handling rules in the FCA's handbook do not apply to complaints to financial firms from these customers; firms are not obliged to respond to complaints from these customers or even record and report them to the FCA. While the FCA has recently announced that it will be extending access to the FOS to more of these businesses, many small and medium sized enterprises (SMEs) will be among the business customers who remain excluded from the category of "eligible complainant".

Those that do qualify as "eligible complainants" can refer a complaint on to the FOS if they are not satisfied with the firm's response.

The experience of the APPG, gathered from members' constituents and their advisers and from evidence submitted in the course of our joint Inquiry into dispute resolution, is that while the FOS may be performing a valuable service for many thousands of financial services consumers with relatively low-value, straightforward complaints, it is ill-equipped to deal with serious complex financial disputes involving life-changing sums of money and potential insolvency. These are common characteristics of the vast majority of the commercial financial disputes that come to the attention of the APPG. The APPG is very clear that the FOS process, in its current form, is not a suitable mechanism for the resolution of many of the commercial financial disputes that are currently eligible for review by this service and without a considerable change in its resources, capabilities and powers it will not be fit for the purpose of resolving most of those disputes that will now come to it as a result of the greater access.

For those whose complaints are either outside of the eligibility or capabilities of the FOS, aside from any redress scheme set up to deal with certain specific products or bank customers, usually the only chance of resolving a dispute with a financial firm is to commence litigation. While this is not a financially feasible or desirable option for the vast majority of businesses, it is important that it should be available for those customers who have no other option.

We continue to work towards a key goal which is the introduction of a new form of dispute resolution process for business customers in dispute with financial firms. The favoured mechanism, a Financial Services Tribunal, should extend the opportunity to many more businesses to hold financial firms accountable for poor behaviour and obtain redress where they have suffered damage and loss.

However, while most ordinary non-business customers have the right to bring an action for damages in response to breaches of FCA rules, this right is currently limited to 'private persons', which excludes almost all businesses. In our report "Fair Business Banking for All" we recommend that the legal rights of businesses should be enhanced by extending section 138D right of action to all customers instead of just 'private persons' and/or **extending a right of action to customers for breaches of the FCA Principles for Business**.

Many of those issues of dispute between financial services firms and their business customers which fall outside of the regulatory perimeter are currently unlikely to succeed if pursued through the law. This is because, due to the lack of rules and regulations governing commercial financial transactions, most of which are instead subject to the principle of 'caveat emptor', even where a financial firm's behaviour causes damage and appears patently unfair, it can be difficult to identify a valid cause of action.

It is therefore very important for business customers to have a right of action for breaches of any new duty/duties.

Co-Chairs:

Kevin Hollinrake MP and the Rt Hon Norman Lamb MP

Vice-Chairs:

The Earl of Lindsay, Lord Cromwell, the Rt Hon Sammy Wilson MP, Dr Lisa Cameron MP, Martin Whitfield MP, Luke Graham MP and Stephen Kerr MP

Contact Points:

Heather Buchanan (Director of Policy and Strategy): buchananh@parliament.uk

James Ventress (Parliamentary Assistant): ventressj@parliament.uk

An All- Party Parliamentary Group (APPG) is an interest group that occupies a strategic and effective position within Parliament. It is cross-party, with a minimum number of parliamentarians from the Government and the official opposition, and cross-house, made up of both peers and MPs. The APPG on Fair Business Banking is a platform through which businesses, professionals and trade bodies can discuss issues regarding commercial banking and its role in the life cycle of a business, and through which parliamentarians can access information on banking, finance and related issues, including business rescue and insolvency, on behalf of constituents. As a cross-party group, the APPG is an effective vehicle to effect meaningful change via the Parliamentary system. The Group's status is that of an APPG is bound by the rules set out by The Office of the Parliamentary Commissioner for Standards. *It does not have charitable status, or official status in the House, nor is it funded by Parliament. It relies wholly on the participation and contribution of parliamentarians, industry members and stakeholders committed to creating a strong platform for business in the UK to thrive. The APPG is co-ordinated and administered via the APPG on Fair Business Banking Secretariat.*