KEVIN HOLLINRAKE MP

HOUSE OF COMMONS
LONDON SW1A 0AA

John Glen MP
Economic Secretary to the Treasury
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

13th December 2018

Dear John,

Thank you for outlining in more detail the Government's approach to SME dispute resolution. I wish to respond to you in detail with the APPG on Fair Business Banking's position following UK Finance's response to the Simon Walker Report and your letter of 3rd December.

The Financial Ombudsman Service

Extending the remit of the Financial Ombudsman Service (FOS) with an increased award limit of £350,000 is a step in the right direction, but only if it takes the form of a significantly improved, business-focused unit that has eliminated the problems of the existing service.

The FOS does not currently have a robust and respected mechanism to resolve complaints. Indeed, it has a poor reputation with many consumers and parliamentarians. The Treasury Select Committee concluded in their *SME Finance* inquiry[1] that *"the Ombudsman's powers and procedures are unlikely to be appropriate for the resolution of large and complex cases. The Ombudsman lacks the power to take evidence under oath, compel the attendance of witnesses, or test evidence by cross-examination"*. The response from UK Finance incorrectly states that the FOS has the powers to disclose information from the banks.

A voluntary ombudsman scheme for historic cases

Our concerns:

UK Finance's proposals include a variation in the claim limit between the retrospective and prospective schemes. The prospective scheme will have a binding award limit of £600,000, whereas the historic scheme will have an award limit of £350,000. This is unacceptable as it would mean that all the cases the APPG deal with, and all the cases raised in debates in the past, will fall outside of this limit. In fact, the APPG sees UK Finance's proposals as a step backwards from the Walker report, which does not suggest a reduced award level for historic cases.

[1] House of Commons Treasury Committee, SME Finance Inquiry, October 2018

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The proposals presented by UK Finance will leave the courts as the only appeal mechanism for complainants. This will put us back to square one as it will be inaccessible to all but the very largest businesses and decisions, assuming no change in the Financial Services and Markets Act (FSMA) rules, will not be determined on a 'fair and reasonable' basis.

Our solutions:

The binding award limit should be raised to £600,000 in line with the prospective proposals. The APPG proposes that the banks agree to a voluntary independent arbitration mechanism, modelled on a tribunal, which should be used as an appeal mechanism.

The basis of the arbitration decisions should be based on an extension of the principles of S138d of (FSMA) to ensure claims are decided on a 'fair and reasonable' basis.

Dispute resolution for larger businesses

Our concerns:

The numbers presented in the report are misleading. In relation to the prospective scheme, UK Finance claim that 99.5% of businesses will now be covered by the prospective dispute resolution mechanism. This figure is skewed by a large number of small businesses, and it does not take into account the size of a claim nor the fact that those businesses that are not represented by the prospective mechanism employ 52% of employees and generate 64% of revenue.

Furthermore, the FCA's consultation on SME Access to the FOS[2] clearly demonstrates that a new limit of £600,000 **would still exclude 41% of complainants** who would have claims above £600,000. This gap in the redress landscape will need to be filled. For the avoidance of doubt, no cases that the APPG has seen would be helped by this limit.

Table 1: Impact of raising the Financial Ombudsman Service's award limit on high value disputes

New limit[33]	Share of potential redress outside the current limit that would be covered under the new limit
£250,000	7%
£400,000	16%
£600,000	59%

[2] FCA, Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/7: SMEs as Users of Financial Services, January 2018.

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It is unreasonable to suggest, as you do in your letter, that businesses with a turnover above £10m and/or a claim beyond £600,000 have a reasonable prospect of taking a multi-national financial institution to court. Taking cases to court can be hugely difficult for businesses, as is highlighted in the FCA consultation: *"Even well-resourced businesses might find it difficult to take legal action. This is because financial services disputes often coincide with cash flow stresses and other threats to the business. In these circumstances, the cost and speed of redress is often critical to an SME's ability to stay in business".*

My constituents, Jon and Kerry Welsby, are currently attempting to litigate against Lloyds Banking Group for a relatively small and simple dispute over the consequential loss of his business. It will cost them in excess of £2m to bring the claim to court. It is very difficult to secure 'after the event' insurance at this level.

Solutions:

As you know, the APPG has put forward proposals for a Financial Services Tribunal, which has support from the FCA, the Treasury Select Committee, the Small Business Commissioner, The Finance & Leasing Association, TSB and Metro Bank. These proposals will fill the gap in accessing justice for businesses in the UK and will increase accountability in the largely unregulated business lending market. UK Finance have not explained in their response why they do not believe these proposals for a tribunal will generate a satisfactory outcome for businesses in the UK.

In particular, the basis of decisions in the tribunal, from an amendment to S138d, would effectively allow for decisions to made on a 'fair and reasonable basis', and that decisions would need to take account of voluntary codes of conduct. Extending section 138d, which would be done by amending the 'private person' definition contained in the FSMA (RAR) 2001, would have the effect of giving SMEs a right of action for breach of the Conduct of Business Sourcebook (COBS) rules. The COBS rules form part of the FCA Handbook and set out in detail a regulated firm's conduct of business obligations, which stem from FCA Principle 6 which states that, 'A firm must pay due regard to the interests of its customers and treat them fairly.'

An alternative approach would be to extend SMEs' rights of action for breaches of the FCA Principles for Businesses. These principles are broader than the COBS rules and so would afford SMEs greater legal protection. The FCA Principles for Businesses require a firm, amongst others, to conduct its business with integrity (Principle 2) and due skill, care and diligence (Principle 3); and to pay due regard to the interests of its customers and treat them fairly (Principle 6).

We do not believe that extending these protections to businesses will increase the cost of lending nor stifle innovation. Indeed, expanding these protections will increase confidence in the SME lending market and therefore boost demand for credit, which will be good for the banks and the economy. In 2015, the Republic of Ireland extended similar regulatory

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protection to businesses. Data from the Central Bank of Ireland shows that introducing regulation does not curb lending. Indeed, it has been rapidly increasing over recent years[3].

Furthermore, claimants will be given the opportunity for an independent adjudication, made on a 'fair and reasonable' basis, by a judge using an inquisitorial and adversarial approach, supported by two wing members from both business and financial services backgrounds who provide knowledge and experience. They can summon witnesses and require documents to be presented; an Ombudsman cannot.

It is not necessarily the case that an Ombudsman will be faster than a tribunal. From Freedom of Information Requests, we have been able to establish that the average time the FOS took to resolve a fixed rate commercial loan complaint was 163 days. Employment Tribunals, in contrast, average between 17 to 26 weeks from ET1 to the hearing and then four to six weeks for the judgement.

We are happy to consider other solutions that can fairly resolve claims of a higher level, for instance, by a voluntary independent arbitration scheme until the necessary legislation can be effected. But we are of the firm belief that a tribunal is the only way to future-proof the dispute resolution landscape for businesses in the UK and that although legislation will take time, there is broad support in the House for our proposals.

Governance

We support:

The creation of a steering committee with representative and technical expertise to create an independent model for compensation.

Our concerns:

UK Finance's proposals are voluntary. The Chair will be appointed by the banks and there are no legislative requirements for a financial institution to sign up to their proposed prospective scheme and therefore it is unlikely to capture unregulated entities.

The APPG is concerned at the structure of the Independent DRS Implementation Steering Group, as it over-represents financial institutions, who are in greater numbers than those organisations representing businesses. This is a danger as UK Finance's proposals suggest that *"should consensus not be possible, decisions will be taken on a majority basis"*.

In its proposed structure, the Steering Group will be weighted in favour of financial institutions and the APPG will therefore be denied a meaningful vote on contentious issues. The Chair can also terminate the Steering Group if s/he considers it is not working effectively or meeting its objectives.

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[3] Central Bank of Ireland, SME Market Report, August 2018

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Our solutions:

The imbalance of representation within the Steering Group can be rectified if the financial industry had one vote between them, or if they were represented collectively by UK Finance.

The Chair must be appointed by a representative committee that includes the APPG and business representatives. The APPG must also be part of the independent board of directors for the Dispute Resolution Service, alongside the FSB and the British Chambers of Commerce.

Eligibility for historic cases

We support:

The inclusion of guarantors as eligible complainants. The acknowledgment that shareholder/directors of insolvent companies need to have rights to bring claims and that this must still be addressed.

Our concerns:

The APPG cannot accept limiting the historic scheme to complaints from 1st January 2008 onwards. This will exclude, for example, businesses who suffered as a result of the mis-sale of swaps prior to this date and therefore exclude a large number of potential claimants who have previously been unable to secure compensation for consequential loss.

It is unacceptable that those whose cases have already been considered by an *"independent review process (for example IRHP Skilled Persons Reviews, GRG, Griggs HBOS Reading or another skilled persons' review)"*.

It is entirely unacceptable, and a clear breach of the principle that 'justice must be seen to be done', that Lloyds Banking Group and RBS were ever allowed to establish and operate their own compensation schemes for victims who have suffered at their own hands.

The APPG has made it clear that the Lloyds Banking Group Griggs review is not fit for purpose and that the victims of the HBOS Reading fraud require truly independent arbitration. The victims who have had the misfortune to have been defrauded by bank employees have then had to suffer the further trials of being subject to a process that has been described to us as "*corrupt*", "*cynical and biased*", *"grossly inequitable"* an *"abuse of process"* and one that lacks any kind of credibility. We will write to you shortly with a fuller and more detailed report of our findings and concerns.

It is an affront to the principles of justice and an erosion of the very basis of our free market system, that anyone should be subjected to such a process. Those who have sanctioned this should hang their heads in shame.

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The APPG has also consistently expressed concerns over the design and operation of the FCA's IRHP scheme and RBS's GRG scheme. Similarly, we have expressed our concerns on many occasions over the capability and knowledge of the FOS to decide complex business banking cases. We therefore cannot accept a scheme so limited in scope as to not include the above schemes.

The APPG is clear that any historic compensation scheme must allow the directors and shareholders of insolvent businesses the ability to bring claims, whether a previous complaint has been made or not. For example, although the businesses may have gone through a process and accepted a claim, this may have been brought by an Insolvency Practitioner who refused to assign on or pursue a claim, to the detriment of the directors and shareholders. We acknowledge that this has been touched upon by UK Finance, but we are very clear that we are speaking on behalf of directors and shareholders of insolvent businesses who have been denied justice and must be included in a historic scheme.

Our solutions:

We will be willing to engage with financial institutions as part of a Steering Group if there is scope within the Steering Group for fact-based discussion over the scope and eligibility requirements of the schemes and we accept that this may include bilateral/trilateral talks with financial institutions.

Furthermore, businesses that have gone through court processes but with new evidence should be eligible for the historic scheme. In cases where debt has been sold on to a third party, if the claim originates with the original bank then the individual must have the right to bring a claim against the original bank.

Next steps for small businesses

We too are pleased to see a commitment from the banking industry to address unresolved historic cases. The Treasury, however, must ensure that the APPG has a significant influence in designing this scheme, including significant eligibility criteria and award limit. In their current format, the industry's proposals are not fit for purpose and will not address the complaints of the businesses we represent.

Yours ever,

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Co-chair of the All-Party Parliamentary Group on Fair Business Banking

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