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

31st January 2019

Dear John,

Thank you for your letter dated 19th December on the regulation of SME lending in the Republic of Ireland. I very much appreciate you taking the time to respond to my letter, and for setting out specific jurisdiction of the regulations in Ireland and how they are similar to the regime in the UK, including the expanded grounds for appealing certain decisions made by regulated lenders. There are, however, other key areas of the regulations that are not covered in your letter.

Treatment of Businesses in Distress

Crucially, it is worth noting that the regulations in Ireland focus to a greater extent on the treatment of businesses in distress by laying out clear procedures for the rules that the banks must adhere to. Of particular note are the prescribed timescales and procedures for businesses in financial difficulty, and the fact that these procedures are legally enforceable and, therefore, offer significant protection to small and medium sized businesses.

For instance, the regulations stipulate that a regulated entity shall establish and maintain in writing policies and procedures for dealing with borrowers in financial difficulties and that they must adhere to these policies, which must also have the core objective of assisting the borrower to resolve their financial difficulties, which is not the case in the UK. Furthermore, the regulations also enshrine legally enforceable requirements for transparency, including provisions to ensure that lenders have clear rules for communicating with customers in financial difficulty by informing borrowers of the procedures and policies that are in place when the they are in financial difficulty.

The scandalous mistreatment of SMEs in the UK by RBS GRG, and other turnaround divisions by financial institutions, demonstrates that the UK urgently requires clear regulations that stipulate that lenders must outline the procedures for dealing with borrowers in financial difficulties. Many of these business owners were simply unaware that they had even been placed into a restructuring unit and were not given reasonable time to deal with their financial difficulties before being placed into administration. The severe mistreatment they experienced could have been avoided had there been a regulatory requirement for robust policies to be in place to handle and deal with these borrowers when they are in difficulties.

Email: kevin.hollinrake.mp@parliament.uk Tel: 020 7219 4746
Constituency Office: 9 Hanover House, Market Place, Easingwold, York YO61 3AD Tel: 01347 666880

Personal Guarantees

In Ireland, the lender must also provide a clear explanation to the borrower and guarantor as to why the security is required and the potential consequences for the borrower of providing such security. Lenders must also provide a warning statement to borrowers and guarantors when security is required, which sets out clearly and succinctly the potential consequences of the borrower getting into financial difficulties.

This requirement for transparency and information is in distinct contrast to the situation in the UK. Many business owners have lost their homes through the actions of financial institutions. The most pertinent example of this is Dunbar Bank, the former bank owned by Zurich. There are claims that the bank duped individuals into signing onerous personal guarantees by not making clear to borrowers and guarantors the implications of the borrower defaulting, whilst giving the borrower the impression that the guarantees would never be enforced. After the financial crisis, the bank enforced the personal guarantees extremely aggressively, even resulting in friends and families of the borrowers being taken as security for the loan.

Vulture Funds

On 21st January, the Irish Consumer Protection (Regulation of Credit Servicing Firms) Act 2018 came into force, which protects consumers against the sale of non-core loans to vulture funds. The Act extends the regulatory oversight of the Central Bank of Ireland to ensure that borrowers whose loans were sold to unregulated entities would have the same regulatory protections after the sale as they did prior to the sale.

This means that businesses who have borrowed from a bank are protected by the SME lending regulations if the original bank sells on the debt to a third-party.

The APPG is extremely concerned that unregulated vulture funds are able to purchase non-core loans from regulated financial institutions in the UK, leading to the situation where an unregulated entity is controlling an unregulated product, with no regulatory protections afforded to the borrower.

There is evidence that these unregulated vulture funds are inducing financial distress to force borrowers into insolvency. We firmly believe that introducing similar regulations in the UK will increase protections to borrowers and therefore increase confidence in the market and economy more widely.

UK Regulations

In contrast to new protections in Ireland, SME lending in the UK is largely unregulated, meaning that the majority of the FCA's Principles for Business do not apply to SMEs who borrow from a financial institution and they are therefore not afforded the same level of protection as borrowers in Ireland.

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For instance, firms are not required to pay due regard to the interests of its customers and treat them fairly. There are also no requirements to pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading. Worryingly, there are also no requirements for firms to conduct their business with due skill, care and diligence.

The case of Crestsign v National Westminster Bank plc and Royal Bank of Scotland plc demonstrates that banks can absolve itself of any responsibility for giving negligent advice by the virtue of well-worded 'basis clauses' in the documentation provided to customers prior to giving the advice. Crestsign were granted permission to appeal in 2015, but RBS settled on a confidential basis, knowing the implications of allowing the case to be heard in court and the precedent that would be made.

Similarly, the case of Property Alliance Group Limited (PAG) v Royal Bank of Scotland plc demonstrates that a financial institution owes no duty to explain the effect of a proposed transaction. PAG entered into four swaps with RBS from 2003 and when floating rates fell, PAG experienced damaging fixed rates and huge break costs. They were then transferred to GRG, where they had to incur a break cost of £8.261m to terminate the swap agreement.

In conjunction with the lack of regulatory protections, I firmly believe that SMEs currently do not have access to, and will not have access to in the future, a fair and independent dispute resolution mechanism that offers them redress in the event of misconduct. As we have recommended previously, a financial services tribunal will also provide a mechanism for accountability in the absence of robust regulations.

The Senior Managers and Certification Regime (SMCR)

We often hear that the regulatory environment has been transformed since the financial crisis through the introduction of the SMCR, and that this will prevent episodes of misconduct from occurring again. But the SMCR remains a largely untested and, more importantly, untrusted method of holding individuals accountable for misconduct.

This week, Andrew Bailey has written to me to confirm that Juan Colombas is the senior manager responsible for the Griggs Review under the SMCR. However, Mr Bailey confirmed that he is only accountable for making sure that the review is properly set up and adequately resourced, and he is not responsible for the outcomes. This strikes me as perverse. Senior managers must be accountable for outcomes, otherwise the SMCR is totally irrelevant.

To this day, nobody has been held personally accountable for the misconduct experienced by small businesses in the UK since the introduction of the regime in 2016. Until such a time, business owners will not have confidence in the ability of the SMCR to provide accountability and confidence in the financial sector.

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Cost of Lending

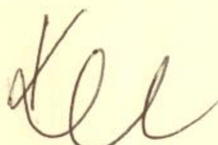
In their response to the Treasury Select Committee's SME Finance Inquiry, the Government stated that the regulation of commercial lending will put costs on the lenders that could ultimately lead to higher costs for business.

However, statistics from the Central Bank of Ireland[1] demonstrate that the cost of borrowing on loans to non-financial corporations have been slowly decreasing since the introduction of the regulations in 2015. Although this reduction may be as a result of other factors, such as the steady decrease of the Euribor, it shows that the cost of borrowing has not increased in Ireland as a result of the introduction of the regulations.

Indeed, as I stated in my letter to you on 29th November 2018, there has been a simultaneous increase in lending in Ireland of more than 51 per cent from the end of 2014 to the start of 2018.

Businesses must have confidence in the system, it is the only way they will be willing to take on risks and borrow money from a financial institution. This confidence will come from the knowledge that they are afforded regulatory protections to encourage fair treatment, and an effective and independent redress mechanism to resolve disputes in the event of a breakdown in the relationship.

Yours ever,



Kevin Hollinrake MP
Co-Chair of the All-Party Parliamentary Group on Fair Business Banking

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

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