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House of Commons Scottish Affairs Committee Inquiry into Banking in Scotland

The Government's response

Cm 7902

July 2010

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1 Response to the Committee's conclusions and recommendations

1.1 The Government's response to the conclusions and recommendations in the Scottish Affairs Committee report on Banking in Scotland are set out below.

1.2 Recommendation: It is clear that because of the mismanagement by senior executives of RBS and HBOS, modestly paid staff in the customer-facing retail services of those banks have suffered, and will continue to suffer many months of uncertainty over their future employment. These staff are not to blame for the risks taken by the banks and yet they face the brunt of public's anger at the less than favourable current economic conditions. Whilst it would be unlikely to expect cordial working relationships between unions and banks during this period of restructuring, we are disappointed to hear that the unions consider that they have not been kept fully informed of developments. We would expect banks to make every effort to provide unions with the latest information as soon as it is available and we intend to keep a watching brief on this matter.

1.3 Response: United Kingdom Financial Investments Limited (UKFI) manages the Government's shareholding in banks at an arm's length and on a commercial basis. As such, business decisions including those related to industrial relations remain the responsibility of the banks. Banks' independent Boards act in the interests of all shareholders and are responsible for business decisions such as those related to industrial relations. However UKFI maintains regular contact with unions and listens to their concerns from a shareholder perspective.

We expect the banks in which the Government has shareholdings to conduct communications and external relations in line with industry standards, regulations and good practice. The Government has drawn UKFI's attention to this recommendation.

1.4 Recommendation: We conclude that there is cause for concern that pressure is being put on front-line staff to sell products, including non-savings products, to customers at pre-recession levels or risk being performance managed out of their jobs. We agree with the unions that there is a danger that customers in debt could be persuaded by bank staff desperate for a sale to take out unsuitable products. We recommend that the regulatory authorities pay close attention to the banks' weighting of their products and performance management schemes in order to ensure that RBS and Lloyds are meeting their commitments to treat their customers fairly.

1.5 Response: The Government agrees that banks should treat customers fairly and that the regulatory system must ensure that all customers can engage with confidence in financial services and markets. The Chancellor announced that the Government will legislate to establish a strong, independent Consumer Protection and Markets Authority (CPMA) to ensure that the conduct of firms, and with it the interests of consumers and participants in our financial markets, are placed at the heart of the regulatory system.

Until the CPMA is set up, the FSA will continue to strengthen its consumer protection strategy and has committed to taking a tougher approach to regulating firms' conduct of business.

The FSA will also take a rigorous approach to ensuring firms comply with the principles of *Treating Customers Fairly*[1]. In Treating Customers Fairly the FSA sets out that firms must demonstrate that they are consistently delivering fair services to consumers and that senior management are taking responsibility for ensuring that the firm and staff at all levels deliver the consumer services relevant to their business through establishing an appropriate culture.

The FSA's Retail Distribution Review (RDR) will address the potential for remuneration biases in relation to advice on saving and investment products.

1.6 **Recommendation: Whilst it is not within the remit of this inquiry or this Committee to make recommendations on suitable remuneration for bank executives, we conclude that it is disappointing that the Scottish banks in receipt of tax payers' money continue to pay large remuneration packages to senior level executives, particularly when the rank and file bank employees on modest incomes are in fear of losing their jobs.**

1.7 Response: As part of the work being undertaken to reform the financial services sector the Government will take action to tackle unacceptable bonuses. Areas under development include looking at structural and non-structural measures to reform the banking system and promote competition. We will consult on a remuneration disclosure regime in the financial services sector and will explore the costs and benefits of a Financial Activities Tax (FAT) on profits and remuneration. In addition the Government will ask the FSA to examine further options in the forthcoming review of its remuneration code. In combination these measures will be effective in reducing risks being taken by senior staff.

The Financial Services Authority has issued a *Remuneration Code of Practice*[2]. This lays out detailed principles that require large banks, building societies and broker dealers in the UK to establish remuneration policies that are consistent with effective risk management.

The Financial Services Act 2010 placed a duty on the FSA to ensure that firms have remuneration policies, which are consistent with effective risk management and the Financial Stability Board's Implementation Standards endorsed at the G20 Leaders' Summit in Pittsburgh in September 2009.

UKFI has engaged with the banks in which the Government is a shareholder to ensure that they offer appropriate incentives to staff and protect the interest of the taxpayer. UKFI has worked with the Royal Bank of Scotland and Lloyds Banking Group to implement some of the most far-reaching reforms to remuneration of any large banks in the world. In return for the taxpayer support provided, the Royal Bank of Scotland and Lloyds Banking Group agreed: not to pay discretionary cash bonuses in relation to performances in 2009 to any staff earning above £39,000; and executive board members deferred bonus payments due for 2009 until 2012, to ensure that their remuneration is better aligned with the long-term performance of their banks. Stephen Hester and Eric Daniels also waived any annual bonus payments for 2009.

1.8 **Recommendation: We conclude that whilst the banks insist they are open for business, a significant amount of SMEs in Scotland still appear to be struggling to gain access to affordable finance. Whilst we agree that banks must take a more responsible attitude towards lending than they had in the past, banks in receipt of taxpayers' money now have an obligation to explain their decisions on lending to businesses applying for finance. In future we would expect the FSB Scotland to be able to tell us that their members fully understand the reasoning behind the terms on which they have been offered finance.**

[1] Available at http://www.fsa.gov.uk/pages/doing/regulated/tcf/

[2] Available at www.fsa.gov.uk

1.9 Response: The Government believes that small and medium-sized enterprises (SMEs) are fundamental to the economic recovery and to tackling unemployment. However, some SMEs continue to have problems accessing the affordable finance they need. To address this, the Government is announcing measures to help SMEs access the funds that they need.

Banks consider a number of elements in order to decide the terms of credit and the price borrowers pay to borrow. Two key elements are the cost of obtaining funds to lend to borrowers and the risk of borrowers being unable to repay debt. Banks have informed us that the costs associated with both of these elements have increased significantly following the financial crisis and that these increases have led them to change the way they lend and the price they charge for lending to businesses.

The Government has a clear view that UK banks need to better promote lending to SMEs. In June 2010 the banking industry published a new set of principles that the high street banks will follow when lending to SMEs. The Government will also be working with the banking industry on the disclosure of regional lending data.

In addition, the Enterprise Finance Guarantee (EFG) supports lending to viable small businesses that lack sufficient collateral or the financial track record to access a normal commercial loan. To ensure that more businesses have access to credit as the economy recovers, the EFG facility for this year is being increased by £200 million to support additional lending of up to £700 million for small businesses until 31 March 2011. In addition, a processing target of 20 business days will be introduced for all major lenders participating in the EFG. This will provide certainty for businesses about how long their applications will take to process.

The Government will also create the Growth Capital Fund. This will address the Rowlands Review findings that, for some fast-growing SMEs, capital for growth is not being provided by the market and that this problem was exacerbated by the recession. To support small businesses with high growth potential, a new Enterprise Capital Fund is being launched. This new Fund will form part of the existing £237 million programme of Enterprise Capital Funds and will provide an extra £37.5 million in equity finance. It will be funded through a £25 million Government contribution and £12.5 million in private co-investment.

To improve the transparency of business lending, in December 2009, LBG and RBS both launched Customer Charters for small and medium sized enterprises (SMEs)[3]. The Charters which cover 98 per cent of the SME customer base commit LBG and RBS to cap arrangement fees on overdrafts and loans at 1.5 per cent of the overall facility and not to increase margins on existing loans without a material increase in risk.

1.10 **Recommendation: Evidence to us suggested that the measures introduced by the Government to promote responsible lending have been welcomed. The Government must continue to monitor the levels of lending, particularly to SMEs to ensure that the pendulum has not swung too far the other way and that banks have become risk averse to businesses.**

1.11 Response: It is important that the Government monitors the trends in SME lending. The Department for Business, Innovation and Skills (BIS), together with the Bank of England, have been collecting lending data from the four main lenders to SMEs since November 2008 (turnover of up to £25m), which include indicators on demand, supply and cost. Officials from BIS, the Bank of England and HM Treasury meet as a monitoring panel on a regular basis to agree the headline issues and concerns. In order to inform policy, the trends, headline issues and areas of concern are reported to Ministers, who in turn refer to them in discussions with banks

[3] The LBG SME Charter is available at http://www.lloydstsbbusiness.com and the RBS SME Charter is available at www.rbs.com

and business representatives. This data also features in the Bank of England's monthly publication *Trends in Lending*[4].

The Government will also be publishing a Green Paper on business finance before the summer recess. The paper will consider the broad range of finance options for businesses of different sizes including bank lending, equity and corporate debt. It will invite views from business, investors and lenders on priorities and approaches to enhancing the access of credit-worthy businesses to appropriate sources of finance.

1.12 **Recommendation: We conclude that banks continue to use aggressive tactics towards customers who have fallen into debt. We have heard from our own constituents of their terrible stress and anxiety at the repeated, often automated, calls from unsympathetic bank call centres. Whilst we acknowledge that customers must accept responsibility for their spending, we consider that banks, particularly those in receipt of taxpayers' money, have a special obligation to ensure that their staff do not use unduly uncompromising or unfair practices in their communications with their customers. We recommend that the banks use the research undertaken by Citizens Advice Scotland to identify specific areas in which they can improve their communications with customers.**

1.13 Response: The Government is supportive of initiatives to improve communications between banks and their customers. An example of this is the introduction of bank customer charters highlighted in section 1.9 above.

1.14 **Recommendation: We recommend that the regulatory authorities ensure that banks are monitored for bad practices in customer services to ensure that banks do not continue with, or develop further bad practices in these difficult economic times for both businesses and the general public.**

1.15 Response: As part of the Consumer Protection Agenda, the Government is introducing measures to end unfair bank and financial transaction charges as well as enhancing customer service in the private and public sectors.

Regulators will continue to monitor firms for poor practice, and are developing new initiatives in this area with clear examples in the cases of unarranged overdraft charges and banks using the "right of set off", whereby banks can combine the accounts held by a customer in instances such as failure to make a payment.

The Office of Fair Trading (OFT) has been working with the industry to agree a range of commitments relating to unarranged overdraft charges including agreeing that consumers should be able to opt out of unarranged overdraft facilities, and minimum standards for how this should work. They have also agreed to set up an industry working group to explore ways to give consumers greater control and access to real-time information and a working group of industry and consumer representatives that will develop best practice for personal current account providers in dealing with customers in financial difficulty who incur unarranged overdraft charges.

The Financial Services Authority (FSA) believes that it would be helpful to set out guidance in the *Banking Conduct of Business Sourcebook*[5] for firms regarding their use of set off. They intend to consult on this guidance in their July 2010 Quarterly Consultation Paper.

The FSA, Financial Ombudsman Service (FOS) and OFT have also recently announced a joint Consumer Protection Committee to highlight and resolve emerging risks of poor practice, before they occur and cause significant consumer detriment.

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[4] Available at www.bankofengland.co.uk

[5] Available at www.fsa.gov.uk

1.16 Recommendation: We welcome the news that the Government will provide additional £5m funding to Citizens Advice to allow extended opening hours in 2010–11, a proportional amount of this will be allocated to Scotland. Citizens Advice Bureaux supply a vital service to the general public who have fallen into debt and wish to find a way to get back on an even keel. We recommend that the Government monitors the public's need for advice services and continues to provide extra support for Citizens Advice where it is most needed.

1.17 Response: The Government has committed to providing a free national financial advice service and an annual family financial healthcheck to help people manage their finances. This will be funded in full from a new Social Responsibility Levy on the financial services sector.

The Government will continue to monitor consumers' need for advice. Future support for advice, including debt advice, will be considered in the October 2010 Spending Review.

1.18 Recommendation: We conclude that the general view appears to be that irreparable harm has not been done to Scotland's reputation as a centre of excellence for the financial and banking sectors. However, much will depend on whether Scotland's banking sector is able to rebuild trust.

1.19 Response: The Government supports this statement.

Conclusions

1.20 Conclusion: Banks in receipt of taxpayers' money have made commitments to increase lending to businesses and homeowners, to ensure bank charges are fair and transparent and to meet all reasonable applications for finance from viable businesses. Evidence to this inquiry suggests that banks continue to use unfair and aggressive tactics towards some customers who have fallen into debt. We recommend that the banks work with Citizens Advice Scotland to ensure that these practices are eliminated.

1.21 Response: The Government is supportive of initiatives to improve communications between banks and their customers. An example of this is the introduction of bank customer charters highlighted in section 1.9.

1.22 Conclusion: Whilst we recognise that in the current economic climate banks must lend responsibly, the Federation of Small Businesses, Scotland considers, as do we, that there is a danger that banks have swung too far away from the more generous lending of the past. Viable businesses are being starved of credit as a result. We look forward to the first report from HM Treasury to Parliament which will assess how the banks have met their lending commitments.

1.23 Response: The Treasury published an assessment of the year one performance of bank lending commitments in the March 2010 Budget, the June 2010 Budget confirmed that these lending commitments would remain in place.

1.24 Conclusion: We welcome the optimism of those working in the financial services sector who believe that the reputation of that sector in Scotland has not been permanently damaged by the difficulties experienced by two of Scotland's, and the UK's, largest banks. We are reassured that the quality of the location, the lower costs and the depth and diversity of its labour pool remain attractive to global corporations.

1.25 Response: The Government will continue to work with the Scottish Government to ensure that the financial services and banking sectors remain strong in the future.

1.26 Conclusion: We make this Report to the House at the end of a Parliament. We recommend that our successor Committee continues to monitor the financial services sector in Scotland to ensure that commitments made by banks, and the actions taken by the UK Government strengthen the banking sector there.

1.27 Response: The Government will continue to work with the Committee in its efforts to ensure a strong banking sector.

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