



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Kevin Hollinrake MP
Co-Chair, APPG on Fair Business Banking
House of Commons
London
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3rd December 2018

Dear Kevin,

SME dispute resolution

Following the Chancellor's recent Budget announcement, and the publication of UK Finance's response to the recommendations in Simon Walker's independent review of alternative dispute resolution for SMEs, I thought it would be helpful if I set out in some more detail the rationale behind the Government's approach to this important issue.

The Financial Ombudsman Service

In 2015, the Financial Conduct Authority (FCA) estimated that 97.3% of SMEs were eligible to take a complaint to the Financial Ombudsman Service (FOS) as a 'micro-enterprise' (a business with fewer than 10 employees, and either a turnover or balance sheet of less than €2m). In addition from 1 April 2019 the FCA plan to introduce 'small business' as a new category of eligible complainant for the FOS (defined as businesses with a turnover of less than £6.5m and either fewer than 50 employees or a balance sheet of less than £5m). The FCA estimate that the introduction of this new category will give an additional 210,000 SMEs access to the FOS, meaning that well over 99% of businesses will have access to the FOS.

The FCA also estimate that the current FOS award limit of £150,000 is sufficient to cover over 90% of the complaints that newly-eligible SMEs will bring. Nevertheless if larger and more complex SMEs are able to complain to the FOS, it is right that the FCA look again at the award limit. That is why I support the FCA's consultation on whether to increase the FOS award limit to £350,000.

Dispute resolution for larger businesses

It is my view that these reforms create a strong dispute resolution mechanism for UK SMEs. I am, however, conscious that the All-Party Parliamentary Group on Fair Business Banking (the APPG) want to go further and provide access to dispute resolution services for businesses above £6.5m turnover. I believe Simon

Walker's proposal for a voluntary ombudsman mechanism for resolving complaints from businesses with a turnover between £6.5m and £10m rises to this challenge. It is my strong view that businesses with a turnover greater than £10m can reasonably be expected to be in a position to go to court.

The merits of an expanded Financial Ombudsman Service

I thought it might be helpful to set out why the Government believes that this ombudsman-style approach is preferable to a Tribunal.

First, as the APPG's paper notes, for a Tribunal to function it would need a legal basis upon which to make decisions. The APPG's paper recommends amending section 138D of the Financial Services and Markets Act 2000, to extend the description of "private person" to cover SMEs and therefore allow businesses a right of action for damages for the breach of an FCA rule; and then the extension of the regulatory perimeter to include SME lending, to establish what those FCA rules would be.

The Government is committed to regulating only where there is a clear case for doing so, to avoid putting additional costs on lenders that could ultimately lead to higher costs for businesses. We must remember that the industry has changed very significantly since the very challenging period following the financial crisis. For example, all of the major SME lenders have signed up to the Standards of Lending Practice (SLP), which contain clear guidance on best practice. As industry standards and codes of conduct are taken into account by the FOS, the SLP are part of how the FOS decides what is fair and reasonable when adjudicating. And the FCA now also has the ability to take enforcement action against individuals through the Senior Managers & Certification Regime.

Given these factors, it is not obvious that there is a clear case for bringing SME lending into regulation. It is my view that there would be a number of direct and indirect costs associated with such a move. Direct costs would include annual FCA fees, product reviews and increased compliance and monitoring costs; while indirect costs would include stifled product innovation, narrower product choice for SMEs, and higher barriers to entry leading to reduced competition in the SME lending market. These changes could in turn impact on the price and availability of credit for small businesses, which is not a desirable outcome.

Secondly, and notwithstanding the point about the regulatory perimeter, there is a real difference between how an ombudsman and a Tribunal make adjudications. As already noted, a Tribunal must have a strict legal basis upon which to make a judgement. An ombudsman, by comparison, has the ability to make a judgement based on what is 'fair and reasonable' in the circumstances of

the case. As Simon Walker notes, if a contract allows a bank to act in a certain way, then a Tribunal can simply make a judgement about whether either party has broken that contract. An ombudsman, on the other hand, can decide whether such a contract was fair in the first place. Applying the 'fair and reasonable' test is therefore more likely to lead to better outcomes for SMEs than a Tribunal's more legalistic approach.

Thirdly, it is important to consider the costs of a Tribunal for SMEs. While access to a Tribunal might be cheaper than going to court, it is highly likely to still involve SMEs paying for expensive legal expertise. An ombudsman, by contrast, does not require legal representation for either party. As such, it represents a much less expensive process for SMEs, thereby reducing a barrier to them getting justice.

Fourthly, the process operated by an ombudsman allows for decisions to be made faster than in a Tribunal. By operating in a more informal fashion, and with mediation and reconciliation built into the earliest stages of the process, an ombudsman can resolve a case far more swiftly than a Tribunal could. Ensuring that disputes are resolved swiftly and efficiently will allow SMEs to move on and get back to running their business.

Finally, we must consider the fact that establishing a new Tribunal would require primary legislation. While that is of course not in and of itself a reason not to go down this route, we must be mindful of the time that it would take to pass this legislation through Parliament and then set up a Tribunal. I do not believe this would be a proportionate response, given FCA estimates that the expansion in eligibility for the FOS will result in no more than an additional 1,300 cases from businesses, on top of the existing 6,000 cases from micro-enterprises. To put this into context, the Employment Tribunal received over 109,000 cases in the 2017/18 financial year alone.

Next steps for small businesses

For these reasons, I am supportive of both the FCA's proposal to expand access to the FOS to 'small businesses' as well as micro-enterprises, and the banking industry's commitment to establish voluntary ombudsman schemes to address both unresolved historic cases and future complaints from SMEs with a turnover of £6.5m-£10m.

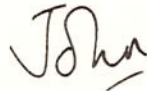
From conversations, meetings, and debates over the course of my tenure, I have seen that there are a number of businesses who feel that they have not already had access to a process which can address their complaints. This is why I am glad that the banking industry propose to put in place a method of addressing

unresolved historic cases. Established independently of the banking industry, and overseen by a former senior judge, the scheme to consider these cases will make decisions on a 'fair and reasonable' basis, be adequately resourced to deal with more complex disputes, and operate in a transparent manner. The industry have also committed to producing proposals on the implementation of the voluntary scheme for future complaints from larger businesses, and I look forward to the next steps in this work.

I trust that you welcome these developments, and will continue to work constructively with UK Finance on the delivery of these schemes by September 2019.

Thank you for ongoing interest in this matter, and for sharing the Government's objective of achieving the best outcome for small businesses.

with very best regards

A handwritten signature in black ink, appearing to read 'John Glen', with a horizontal line under the 'n'.

JOHN GLEN