



Treasury Committee

Oral evidence: [SME Lending](#), HC 1008

Tuesday 29 April 2014

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Members present: Mr Andrew Tyrie (Chair); Stewart Hosie; Mr Pat McFadden; Mr George Mudie; Mr Brooks Newmark; Jesse Norman; John Thurso.

Questions 136-260.

Witness[es]: **Peter Hollis**, Hollis and Co, **Chris Lane**, Kingston Smith, **Ronel Lehmann**, Lehmann Communications Ltd, **Laurence Beere**, L&H Hotels Ltd, **Tim Murphy**, Seneca Banking Consultants and **Jeremy Roe**, Bully-Banks gave evidence.

Q136 Chair: Thank you very much for coming to give evidence to us this morning; we are fairly pressed for time. We are particularly grateful to you all for coming here today, because of course the strike has not made life easy for a number of us getting in.

Can I begin by asking a very simple question to Peter Hollis and Chris Lane? On the basis of the experience that you have had and which you know of from your clients, are banks competing more or less for customers than they used to in the old days, prior to the crash?

Peter Hollis: Thank you, Chair. I do not see any meaningful competition between the four large banks at all.

Q137 Chair: So the answer is there is not any competition?

Chris Lane: I would agree with that.

Peter Hollis: Yes. It is still a take it or leave it type of approach.

Q138 Chair: This is Hobson's choice—that is what you are telling us—for SME lending for a large proportion of SME borrowers, is that correct? Is that what both of you are saying?

Peter Hollis: Yes. If you are a large company at the top end of the SME scale and you are very profitable, I think banks will compete for that business, but for the great majority of people out there, I do not think there is any competition.

Q139 Chair: Do you have any sympathy with the view of the industry that has been put to us, for example, via the chartered certified accountants, and I quote, "SME clients are expensive to acquire and their lifetime value to lenders has fallen" and, again I quote, "SMEs may no longer be worth competing over"? Do you think that is the attitude the industry takes?

Chris Lane: Possibly. I think it is certainly expensive to monitor these SMEs from the bank's point of view, so there is a cost-benefit approach, but to get a big business, you have to start with a small one sometimes, so I think this is naive.

Q140 Chair: Isn't this all closely related to the question of trust, the collapse of trust in banking, which, when there had been a trusting relationship, often meant that banks saw businesses as lifetime clients from whom they could earn a reasonable income over a long period, and as the counterpart to that, businesses themselves—having earned the respect of the bank—felt that the bank would look after them when the going got tough and therefore tide them over the various problems that SME businesses often encounter, and that that trust is now much weaker in banking?

Peter Hollis: I think there has been a significant erosion of trust in the banking sector. I think much of that is due to banks wanting their money back or part of their money back when times get tough, so when the business is under most pressure, the bank wants to withdraw some of its funding. I think many people would identify with that. I think the businesses that have pulled back and are not borrowing as much are very happy with that, because they feel secure, but I think from the point of view of the country, they are not conducting the level of economic activity that they are capable of.

Chair: Mr Lane?

Chris Lane: On the trust point you make, that changed a long time ago. We are in a different paradigm now to where we were before the recession, but I think some of the banks were in a worse state than some of clients, some of the customers, so they used every excuse in the book to pull back their lending.

Q141 Chair: As you know, this Committee has made strenuous efforts to try to change the regulatory structure and a number of other

things in order to try to increase competition and deal with exactly the problems that you are addressing or articulating now. We are going to come later on in this set of questions to asking whether we have measures in place that will achieve that, so I will not go further with that now.

Before passing the questioning on, Mr Lehmann, is there anything you would like to add to what has been said? Yours is a very interesting name for a banker just now. Is there anything you would like to add?

Ronel Lehmann: My late father was a banker and my grandfather was a banker too, but Lehman Brothers obviously has one "n" and Lehmann has two.

I will just mention the question of competition. Of course all the banks are open for business. There was a time when they would be prepared to match another offer or better it, because they were being rewarded on the basis of the customers that they could bring in, but those days are over.

On the question of perception, I trust my bank, because you do trust your banker; they are there in a position of authority. But I think the perception is that they are not really helping. That is what has been eroded over the last few years, and certainly since the economic downturn.

Q142 Mr Mudie: Mr Lehmann, you gave written evidence that Barclays withdrew their £200,000 facility when they gave you another facility, but that was working capital. What effect did it have on your business?

Ronel Lehmann: It was devastating, because they sat on my security and my wife's security over our family property, so it was charged by second charge for a year, having withdrawn the working capital facility. It was terrible. It caused a lot of problems and I have been quite vocal about it.

Q143 Mr Mudie: It could have finished off your business, I presume?

Ronel Lehmann: Yes, it could have done. If it had not been for my family, my friends, the shareholders, for those who supported me, I could have shut the business down. I then went on to make an acquisition right in the middle of not having the working capital, which I succeeded in, but it ultimately damaged the wholly owned subsidiary that we bought, because we had no working capital for two years.

Q144 Mr Mudie: My colleague, Stewart Hosie, is going to go through that type of behaviour, but can I ask you this, Mr Hollis, Mr Lane? The Committee has spent a lot of time looking at the first loan, the ability

to get the loan from the bank, but I find just as distressing, if not more, the way they change conditions halfway through a loan for this reason or that reason. We have had some pretty devastating evidence about, for example, the way Lloyds treated individuals halfway through their contract. What strikes me is that the regulation for borrowers seems pretty loaded—well, it seems non-existent—and so the power seems to be loaded on the bank side. Have you found instances of the type of behaviour you have just heard one instance of?

I will just ask the next questions. Have you come across that experience with your clients, and secondly, do you feel that there is a case for better regulation, if not first regulation, in terms of commercial borrowing?

Peter Hollis: A typical example I had of this was a client I had during 2012—it was a very profitable company historically, and been in business perhaps 15 years designing web training packages for industry. They had a fallow patch when business dropped off, and that was coupled with one of their large clients, an oil company, doubling the credit period from 30 to 60 days. The bank did not want to assist in increasing the £80,000 overdraft, so they borrowed £25,000 each from Finance Yorkshire and Donbac, which are regional loan agencies. That was an easy process, but part of the condition was that the bank confirm that the following April they would renew the overdraft facility at the current level. Well, it came to April and the bank, despite having confirmed in writing to these people they would do this, declined to renew the facility.

Eventually the client was bullied into taking out a £55,000 bank loan rather than the £80,000 overdraft, so that sucked £25,000 out. The longer-term effect of that is now the business has half the number of employees, it does not really want to borrow any more money. It is still quite successful, but they will take on self-employed workers as and when needed, which in terms of the social fabric of the place is not quite as good as some permanent jobs, and they are quite risk averse to borrowing now.

Q145 Mr Mudie: But what about the second part of the question? Do you think there is a case for a more level playing field with better regulation?

Peter Hollis: I think one of the things Government could look at is stopping lenders reducing a facility on the basis that the value of their security has diminished. This has been a major problem for some of my clients, where, because the property market has been very weak over the last five years, borrowing has been reduced substantially because the value of the security behind it is perceived to have reduced. I understand from a bank's point of view why that is an issue, but it

takes working capital out of a business at a time when it probably most needs it and it restricts the ability of those businesses to expand and employ people.

Q146 Mr Mudie: They go further than that. They point out that Lloyds did it as a deliberate policy of getting lower valuations in order to take other action with a borrower, and I have had experience of that, where the valuations are so out of line. You know property values are down, but they were so out of line, and even when the customer produced two other valuations from two creditable companies, Lloyds would not accept it, and the basis was they had sold on the loans.

Peter Hollis: It is not terribly helpful, and I have read about circumstances like that. I think part of the issue is the banks now will only use a very small number of chartered surveyors to produce these valuations and they have a long track record of suing these people when they get it wrong, so these valuers are very, very risk averse. I think it all conspires to remove borrowing out of the sector.

Chair: That is an interesting point about valuation, which has not been put to us before.

Q147 Stewart Hosie: Just on that point of valuation, Mr Hollis, let me ask this: are you familiar with a variation on that story, which is the business has its assets revalued at its expense at the request of the bank, the value is reduced so the loan to value changes, and then the business is put on a punitive rate on the loan as well at precisely the wrong time? Let me ask you, does that make any sense? If the business is continuing to generate the same turnover and revenue, what possible issue can there be with the value of an asset that underpins a loan?

Peter Hollis: I do not really get it, but the banks are quite obsessed with what happens if they are in a collect-out situation. I agree with what you have said. I have come across those types of situations; I have come across people being pitched into the RBS Business Recovery Unit, being charged horrendous bank charges; I have come across the bank wanting to take equity stakes in struggling businesses. It is not very edifying.

Chris Lane: It is worse than that. In addition to what you have just spoken about is that often when they are put into intensive care, then they have to have another accountant going in and there are all those fees that are taken directly out of their bank account or added to the overdraft automatically, so it is quite an expensive process.

Q148 Stewart Hosie: I am aware of cases like that, but it is useful to have that on the record. It is also interesting that it has taken us half an hour so far and that is the first mention of the RBS Business Recovery Unit. I suspect there may be a little more about that.

Mr Hollis and Mr Lane, a number of businesses have written to us noting that the firms have loan facilities recalled at short notice—recalled entirely. How much experience do you or your clients have of that kind of situation?

Chris Lane: I asked my fellow partners for examples of this and I can tell you stories where the banks, for no reason whatsoever, just recalled totally—so this was at the start of the recession, before the bail-out of the banks—all their facilities and either caused the business to fail and be liquidated, or they had to get rebanked somewhere, which was very difficult and very expensive.

I have other situations where the customer or the business put their hand up and wanted a little bit more for a normal, commercial, everyday reason and that seemed to trigger an alarm bell in the bank which meant then it was pull back all the lending automatically and they automatically went into recovery, intensive care and so on, and that caused all sorts of problems.

Q149 Stewart Hosie: So the consequences of that kind of action by the bank would be anything from a business retrenching to a business laying off staff, to a business failing entirely, in the absence of working capital or an overdraft facility, for example?

Chris Lane: Yes. I have an example of a client that was borrowing £20 million plus, so a fairly large business, and it went into liquidation and the bank only got half of that back, so they needed that half more than the debt.

Q150 Stewart Hosie: I am sure every member of this Committee and most Members of Parliament will have variations on that story, of the apparent irrationality of some of the banks' decisions, where they end up with less than they would otherwise receive. In your experience then, what reasons do the banks give for the withdrawal of facilities?

Chris Lane: I think they hang that decision on anything they can find. Looking a few years back when they were trying to recover these debts, they will use any reason, and had no reason in some instances as well.

Q151 Stewart Hosie: So there is no pattern of justification for this that you have seen?

Chris Lane: No. It could be anything.

Ronel Lehmann: Can I make a point about the consequences if you are an entrepreneur and you are trying to make an acquisition and the bank removes your facility? The one thing that your prospective shareholders all want to know if they put money in is what the bank is going to do. It sends the worst possible message, because you can be trusted to succeed by people who are your peers, who have been there, done it, succeeded in business and want to help you get there and then you do not have a bank, and it gives the worst possible message.

Q152 Stewart Hosie: Is there an argument for suggesting that along with individuals, with shareholders, the banks are not now taking their share of the heavy lifting when it comes to investment in business start-up and business growth?

Ronel Lehmann: We never look to the bank for risk capital. We got it from outside investors, but the days where if you raised £1, the bank provided £1 are long gone. They have provided nothing and that is what is very galling.

Q153 Stewart Hosie: That is quite a scathing criticism, if I was in Government and looking to grow the economy, to hear someone like you suggesting the banks are doing nothing. Has that changed over the last year or two or it as bad as it was at the height of the crisis?

Ronel Lehmann: If you ask the Prime Minister, the Chancellor of the Exchequer or the Financial Secretary to the Treasury, they say the one thing that will bring the economic recovery in this country quicker is if the banks lend to SMEs, and yet they are not.

Q154 Stewart Hosie: Okay. Just two final questions to the panel, just whoever wants to answer would be great. Surely the banks or other lenders will be justified on some occasions in rejecting and removing facilities if there is a genuine under-performing business. I take it that would be recognised by the panel?

Chris Lane: Correct.

Q155 Stewart Hosie: Okay, so given that can be legitimate sometimes, and that we have this long series of stories from around the country where action has been taken that appears to be incredibly detrimental, what more, in your opinion, should be done by lenders to support businesses?

Peter Hollis: I think we need an attitude that says if we have a good business that is under pressure because of something that has gone wrong—say it might have had a fall in sales because of a fall in economic activity, it might have had a large bad debt, it might have

some technical problems with its products—but the underlying business is good, what we need is the bank to stick with the business and not try to withdraw facilities, which is what tends to happen now. As soon as the business hits a rocky period and perhaps makes a loss, the bank immediately looks to withdraw a facility or reduce a facility at a time when the business needs it more and needs more support. That can mean that a business that is a good business fails and we lose the employment and the economic activity because the bank will not stick with it. That is where I have most problems with the reduction in facilities.

Q156 Stewart Hosie: Does that come down to the failure of a real relationship between the bank and the business—a failure of the bank to understand the business properly?

Peter Hollis: I think it comes down to a failure of the bank to properly understand the business and also a failure in the policy side of the bank to want to stick with that type of situation. I think one point that I would like to make on this is that if you are a large business, you tend to have your own accountants and your own people with your strategy; you tend to be able to look after yourself very well, and you get the most qualified, most experienced person at the bank. If you are a small business, you might not have your own accountant, you might rely on external support, you might be trying to do everything yourself, and what you get at the bank is the youngest, most inexperienced person who is not particularly capable of helping you. There is something slightly topsy-turvy about that situation.

Stewart Hosie: That is helpful.

Q157 John Thurso: I would like to come back to that in a moment, but can I just ask you first one quick question? I have been particularly interested in the whole question of embedded swaps. You are both in the business of advising small businesses and have been doing so since before the crash. What advice have you ever given in relation to embedded swaps to small businesses?

Chris Lane: I do not know about you, Peter, but I have not advised anybody on these things.

John Thurso: Right, you have not, so you do not have any experience in that. Mr Hollis?

Peter Hollis: Yes, I have two cases at the moment that are claiming compensation. I have never advised on swaps, I do not really understand them, but I know they protect against interest rates. I have one who has now received redress of about £400,000 in connection

with a swap, and it was a 10-year arrangement against a five-year loan, which was a condition of the lending.

I have somebody else who had a cap and a collar, which is a similar sort of end result, who has just been offered £478,000 provisional redress over something that was compulsory.

Q158 John Thurso: Have you been advising them in getting that redress?

Peter Hollis: I have been advising the second one, but not the first one. The first one went to a firm of lawyers that specialised in that type of recovery.

Q159 John Thurso: Then the last question on that is to what extent were they able to show mis-selling by the bank in the first place as being the trigger for the compensation?

Peter Hollis: In both cases, the bank admitted the products had been mis-sold.

Q160 John Thurso: Okay. Can I come back to what you were talking about just then? The first witness we had in this inquiry was Professor Griggs, who sought to reassure us about the banks' appeals process, the Better Business Finance appeals process. What experience do any of you have of that and what opinions do you have of that?

Ronel Lehmann: I went to meet him. I asked for a meeting a couple of years back. He presents extremely well a compelling case that there are avenues open to SMEs when the bank turn you down. I think what would be a better use of time is if some of the bank managers and relationship managers come and spend time in an SME office and see for themselves what are the pressures at the end of the month when you have to pay the salaries, what are the pressures on the 19th of every month when you have to pay HMRC, actually understand the cash flow issues, rather than take electronic management accounts every month and pontificate about whether you need a facility or not. If they came and saw what people do and spent time in an office, they would understand that we are there to grow a business; we are there to manage staff, we are there to provide a good service, we want clients to refer new clients. We want the pressure taken off us so that we can go and do what we are good at. Sometimes these wonderful schemes that get put in place create headlines about how the banks are trying to do more to help us, but if they came and saw for themselves, and not just a one-hour visit, but spent a day or spent a week in an office so they understood what an SME goes through, it would do them a lot of good.

Q161 John Thurso: That was a point that the Professor made to us in his evidence. I was really more interested in trying to find out if anybody had experience of dealing with an appeal, because certainly a great many of the constituents I have either do not know that the appeal exists or when they appeal, they get told internally by the manager that it has all been done perfectly and that is all there is to it. I just wondered if any of you had had actual experience of using the appeal process or advising clients with the appeal process.

Peter Hollis: No, I have not had a client who has used it. I think they generally feel that once they have been turned down, they might as well get on and look for another way forward.

Q162 John Thurso: So it would be fair to say that if you, who advise small businesses, do not have anything to do with it and know much about it, it is probably failing; that would be a good conclusion?

Chair: Or at least ineffectual.

John Thurso: Or does not work, yes.

Peter Hollis: I think I might be more inclined to pursue it now, having read some of the background papers on this and knowing a bit more about it.

Q163 John Thurso: Right, so it at least suffers from lack of being advertised.

Peter Hollis: I think so, yes.

Q164 John Thurso: At the very least, right.

The final question then comes on to this question of relationship managers. It was a point that you just brought up, and it was a point brought up by Professor Griggs. If you go and talk to the banks, they say you cannot have a relationship for an SME, there just is not enough money and you cannot make any money if you have a proper relationship manager, and yet we all know that for any business to succeed, it needs a manager who understands how your business is put together. Does this mean that the model of SME financing in this country is almost doomed to failure from the outset because the model that works for businesses probably with an enterprise value of £5 million or £6 million plus is a bank manager with a relationship who works with the business, but for the SMEs below that level, they are not going to get that?

Chris Lane: I think it is a fair conclusion, yes.

John Thurso: Any comments? I am doing all the concluding.

Chris Lane: It is tough. The banks are getting rid of people so there are less people to do all that monitoring, so it is hard, and they are just going to look at numbers rather than go and meet people, which is what my colleague here said.

Q165 John Thurso: If I have a range of bankers in front of me, what do I tell them they should be doing about it?

Peter Hollis: It did work when we had very experienced managers in branches who dealt with a range of sizes of clients. Small businesses got very experienced people, who tended in the main to keep them out of trouble, because they had seen the patterns of behaviour, they knew what worked and what did not work. That model worked and the banks made money on that.

Q166 John Thurso: So the definition here—what I think you are saying—is where you had a branch, full service, domestic clients, private clients, quite big commercial clients, SMEs, you had a strength and depth in the management, whereas the way banks have deconstructed and rebuilt with silos for little businesses, silos for big businesses, silos for mortgages and then a financial product boutique on the high street means that there is no place where you have the sufficient expertise assembled to do the job you are asking them?

Peter Hollis: I agree with that. I think on top of that, we need to bear in mind that these people change so often there is no continuity in the relationship. I get looked after reasonably well by the HSBC, I think because I am an accountant and I am perceived as somebody who might send them business. I think I have had five managers in seven years. You get fed up with talking to these people about your business and trying to explain what you do. My clients with the HSBC—and they are not on their own—find they move people around so often that clients become just like pieces of meat; there is no proper relationship going on.

Q167 Mr McFadden: I would like to ask you about Government support for SMEs. Obviously in the wake of the perception that banks have tightened things up, the Government has tried to become proactive in this area and I just want to go through this a little bit. I have had a look at the gov.uk website on business support, and it claims there are 791 different schemes for accessing support or Government finance. Can I start with awareness, Mr Hollis: your clients, what do you think their level of awareness of these 791 different ways of accessing Government support is?

Peter Hollis: I would have thought minimal.

Chris Lane: I would agree. I did not know there were 791, no. I mean, people are aware of the Business Growth Fund and the investment fund for equity investment, but I am not sure what those 791 schemes are doing.

Ronel Lehmann: I was excited by the old Loan Guarantee Scheme, which is called EFG now. You can get £25,000, up to £1 million, you do not have to draw it all in one go—but it was not available. The bank does not want to fill in the forms and pursue it, and if you have security, which they then rejected in my case, I was eligible for the EFG but could not get it.

Q168 Mr McFadden: So it was not available in your case?

Ronel Lehmann: No, it is not available, and in fact I know a lot of other SMEs who have tried to get EFG and not been able to get it.

Q169 Mr McFadden: Let us name a few of these schemes, just to see if you know about them. I presume you know about the Regional Growth Fund. The Seed Enterprise Investment Scheme? Heard of that? Right, good. Venture Capital Trust Scheme? You have heard of that, yes. Enterprise Capital Programme?

Peter Hollis: No, not heard of that.

Mr McFadden: UK Innovation Investment Fund?

Peter Hollis: No.

Chris Lane: No.

Q170 Mr McFadden: I think we were on two or three out of five or six there. I am not going to go through all 791, do not worry. So if there is an awareness issue, tell me then, of the schemes that you know about. Of the Government attempts to support business financially, what works best? What is the one or two you are good at and say, "That one is really a significant help"? Again, I will start with you, Mr Hollis.

Peter Hollis: The successful Loan Guarantee Scheme works quite well—people are aware of it and it has been around a long time. The thing I think that has helped business most over the recession is the time-to-pay arrangements. This is all still in place, but HMRC really are not as inclined to allow it, but I think at the start of the recession, for the first two or three years, allowing people to pay VAT and pay-as-you-earn over an extended period helped in an awful lot of situations where banks did not want to help and I think it was a very good and proactive arrangement.

Q171 Mr McFadden: In a way, that was not a new scheme, was it? That was a bit of understanding from Government about the kind of cash flow problems that Mr Lehmann has spoken about.

Peter Hollis: But it is a way that Government can intervene and make something happen quickly, and that is the problem with a lot of this, it needs to happen quickly.

Q172 Mr McFadden: Okay, so your Champions League places would go to the Loan Guarantee Scheme and time to pay?

Peter Hollis: Yes.

Chris Lane: The EIS and SEIS schemes are fantastic, and I see a lot more activity in those areas, so I think where the banks have withdrawn and there is sort of a funding gap, these other schemes have helped to fill that. I think they have been very successful and certainly SEIS is going from strength to strength.

Mr McFadden: SEIS is the Seed Enterprise Investment Scheme?

Chris Lane: Yes.

Q173 Mr McFadden: What do you think the star performers in this field are, Mr Lehmann?

Ronel Lehmann: I think most businesses want to have an overdraft that covers for peaks and troughs for their cash flow, a loan to cover for anything that they are purchasing, an asset purchase or something that they can amortise over two or three years. Really all the schemes are there to be in a supporting role, not instead of an overdraft or loan finance. As I mentioned before, shareholders who are putting up the risk capital to help the business achieve its vision want to know that there are those instruments in place.

Q174 Mr McFadden: Is that a philosophical block on Government intervention to enter in this area, because Government will say, "The principal source of finance must come from the banks and we cannot replace the banks," and therefore every one of these schemes is sort of shaped by that thinking? Is that what you are driving at?

Ronel Lehmann: Yes. I think the banks are responsible, that is their role. After all, that is the service that they provide. They take deposits and they lend and they lend with a margin to cover for risk, they lend to make a profit. There was a scheme proposed—it must be three or four, five months ago—where you could buy an insurance like a credit insurance to cover the overdraft. I do not know what happened. There were quite a few articles about it as a scheme that might be coming. It

seemed eminently sensible to be able to insure the risk of borrowing—a reasonable insurance policy, as opposed to one that was extremely costly.

Q175 Mr McFadden: Just to finish with you, Mr Lehmann, if you—and I suppose your appearance here this morning is an opportunity to do this indirectly—could speak to Government and say, “Right, you have all these schemes, some of them are known about, some of them are not, some are effective, some are less so,” if there is a gap here and you were able to say to them, “This is the thing you, Government, should be doing in the field of finance for SMEs that is not out there,” what would that be?

Ronel Lehmann: It would give an automatic right to mature businesses to have a working capital facility.

Q176 Mr McFadden: An automatic right?

Ronel Lehmann: When I say “an automatic right”, a reasonable one for one month’s trading or two months’ trading or whatever the set amount should be, because businesses receive funds not within 30 days, sometimes 45 days, 60 days. They have to manage the peaks and troughs and not to have any overdraft is just unreasonable. If you look at SMEs over the last 30 years, they are big companies today, they do grow, and we should be proud of them. We see a lot of work: Lord Young has spoken about all the start-up work that he has done to help new businesses come—the new technology, the fast-growing industries—but we do not seem to be looking after those mature SMEs. I have been running this business for 25 years. It is outrageous.

Q177 Mr McFadden: It cannot be automatic, can it? There has to be some element of judgment of the health of the business.

Ronel Lehmann: Yes, but there can be no judgment that says you cannot have a facility, and there are so many SMEs who cannot. I was boating just before Easter in Norfolk. It is a 90 year-old business. It is obvious that during the winter months, November, December, January, February, nobody wants to go boating in Norfolk. Do you think the bank manager understands seasonality? He is returning the boat yard’s cheques, direct debits, charging them £35 a pop and this is a business that has been in the family for generations, and of course if the good weather comes, then everybody is going out boating, sailing. So there is a fundamental disconnect between an understanding of a business and what it needs and how to give the help that it requires. We should be having bankers who are saying, “How can we help you to achieve what it is that you want to do?”

Q178 Chair: If you have a specific proposal, if you want to write down how you think this might work—given Pat’s caveat, which I thought was pretty powerful—then I think that would be of interest to the Committee.

Ronel Lehmann: I will do that.

Q179 Mr McFadden: I will just finish on this, Chairman, again to give Mr Lane and Mr Hollis a chance to recommend one thing that Government is not doing that it should be doing in this field.

Peter Hollis: I would like to see Government make it much easier for people to enter the market and open their own bank. I was very touched by the Channel 4 programme on “Bank of Dave” in Bolton and the problems this chap had wanting to start his own bank—an experienced businessman running a profitable business manufacturing minibuses. I think it is needed. I think it is far too complicated, I think there is far too much vested interest that stops people competing in this sector. In our area, we are much touched by the expansion of Handelsbanken, the Swedish bank, which I think now has 250 branches. They are good to deal with, they operate the old model with proper managers in branches, customers love it and it works.

Q180 Chair: We have discovered that one of the obstacles is regulatory—

Peter Hollis: Yes, it is the FCA.

Chair: —that the regulators themselves are slow to work out how to give licences.

Peter Hollis: I thought if Government had a target of six months to get through that process, it might help a lot.

Mr McFadden: Mr Lane?

Chris Lane: I think the problem is it is very difficult to force the commercial banks to do something that they do not want to do, and so therefore we have to understand why is it that they do not want to do this, and clearly it is a commercial risk that they are taking and they are, if you like, lending ordinary people’s money that is at stake.

Q181 Mr McFadden: But I am asking you what you would recommend Government do in terms of this activity.

Chris Lane: Rather than you pushing the banks, I think if the Government could offer some kind of preference capital, an interest rate that is long-term capital for SMEs, that would be quite an attractive proposition.

Mr McFadden: Again, I am sure the Chairman and the rest of us would welcome you expanding your thoughts if you want to. Thank you.

Q182 Mr Newmark: I think Peter has hit the nail on the head in some ways, but Chris has identified the problem, which is that there needs to be new entrants. There have been new entrants coming into the market. As someone who was in venture capital before, I am delighted to see Silicon Valley Bank here, because Silicon Valley Bank, which has 50% of the VC market in the States, understands you can lend to businesses that do not necessarily have cash flow, so that is not such a bad thing. Certainly we have seen groups like Handelsbanken come in, Aldermore and Shawbrook. How aware are you guys of these banks and have you been using them, have you been recommending them to friends to use them? Chris, any comments?

Chris Lane: Yes. Metro Bank is one you did not mention there; a challenger bank. They are coming up on the rails. I think they are certainly shaking up the market and it has to be encouraged.

Q183 Mr Newmark: Peter or Chris, what are they doing right that perhaps the big four or whatever, big three or big five—however you want to define them—are not doing? Why are these banks succeeding?

Chris Lane: I think local-based decisions, very experienced bank managers who understand businesses, long-term relationships and things done in a branch.

Q184 Mr Newmark: So that deals with the problem that Ron was talking about then, so that the market, if ultimately left alone, but helped along by the regulator, will effectively disintermediate the big banks that have had a lock on this?

Chris Lane: Correct.

Mr Newmark: Ron, what do you think about that?

Ronel Lehmann: I am aware of these new banks—in fact, I know a couple who are applying for licences at the moment, one specifically to handle SME lending—but this does not obviate the need for the banks, the traditional banks, the lenders that we know, to perform the tasks that they are expected to do.

Q185 Mr Newmark: Yes, but if they do not perform the tasks, there are other banks coming in who will perform the tasks.

Ronel Lehmann: Yes, but the timeline—

Mr Newmark: You cannot force a bank to lend if it does not want to lend.

Ronel Lehmann: No.

Q186 Mr Newmark: Handelsbanken is coming in—certainly constituents I have spoken to say it behaves in exactly the way that the traditional banks are not. Having Government come in and say, “You must provide working capital to your boat company,” is not really a solution. What the solution is is to get perhaps a Handelsbanken in who understands what the customer’s needs are.

Ronel Lehmann: Yes. I think you find that their entry level is quite high.

Q187 Mr Newmark: I am assuming that you have been recommending your clients to look at some of these challenger banks, yes? Has the feedback been good?

Chris Lane: Yes, I think it is good, but I think it is right that Handelsbanken certainly are quite picky about what they will take on, but I think they can be at the moment. They are still growing like topsy; they can afford to be, to take the best.

Q188 Mr Newmark: Just again to try to and understand, because I am here to find solutions as well as identify problems, really your solution—not that I want to put words in your mouth, Peter or Chris—is to maybe loosen the regulatory environment a little bit to make it easier for new banks to start up, and not just the big ones that may be coming over from overseas, but people that want to start their own banks?

Peter Hollis: Yes, absolutely.

Q189 Mr Newmark: Preventing the abuses, because we have obviously seen a lot of abuses before this Committee on other lenders, even the Wongas of this world, so we have to make sure we prevent the abuses as well.

Peter Hollis: Absolutely.

Q190 Mr Newmark: I am going to get into some of that in a minute on asset-based lending.

What are SMEs’ perceptions of challenger banks? Do they consider them to be stable alternatives to the larger incumbents or are they still risky? Do they have concerns? Do people who are more desperate than others tend to go the challenger banks or are you finding traditional customers are going there?

Chris Lane: I think traditional customers, yes. As long as they are aware of these new banks, then they see there is no difference in—

Q191 Mr Newmark: So there have been no reasons that have come up why people are hesitant to move from a traditional bank to a challenger bank?

Chris Lane: I have not seen that, no.

Mr Newmark: Ron, have you seen any evidence of that?

Ronel Lehmann: No, not at all.

Q192 Mr Newmark: Okay, I guess when it comes to the question of their services, you are saying they are going back to the good old days of being much more sensitive to the needs of individuals rather than a tick the box environment, is that it? Chris, you are nodding.

Chris Lane: I think that is right. I think they are listening because they have to have a slightly different model, so they are opening, for example, longer and on the weekends and things like that, just to be more accessible.

Q193 Mr Newmark: Things like crowd funding, how do you see them fitting into this alternative space? Are they a good thing, are they good for angel investors? Do you think it is working, where again the big banks really are not there?

Chris Lane: I am quite worried about crowd funding, because I think it is quite a dangerous thing, because people go in there with perhaps not their eyes open, so it is a dangerous world, but yes—

Q194 Mr Newmark: Why is it dangerous? Just so I understand, why do you think crowd funding is dangerous?

Chris Lane: Because by the nature of it, business angel investment is risky and so people that are going into these crowd-funding schemes are not necessarily aware of the risks. That is what I am worried about.

Q195 Mr Newmark: But generally it is small amounts of money and that is why—

Chris Lane: It is small amounts of money, agreed, but all it takes is one of those to go bad and there will be lots of people with lots of small amounts that are upset.

Q196 Mr Newmark: Okay. Ron, what do you think about crowd funding?

Ronel Lehmann: We are in the digital age, so it is very easy and quick to be able to make an investment. I think the angel funding network is excellent. They have lots of due diligence, investors often have a representative on the board of the company. Again, one would expect a bank to support the business if angel investors or other shareholders were getting involved.

Q197 Mr Newmark: But things like the Seed Enterprise Investment Scheme is a way of Government effectively trying to turbo-charge the angel end of the market.

Chris Lane: Correct.

Q198 Mr Newmark: Do you think that is a good idea, Chris?

Chris Lane: I think it is fantastic, yes.

Q199 Mr Newmark: Has it worked? Do you see evidence of it working?

Chris Lane: Yes.

Q200 Mr Newmark: Okay. I want to focus a little bit now, because I appreciate the Chairman has not given me much time on this, on asset-based—

Chair: It is just that we have three more witnesses, clearly, and we have the Treasury questions this morning as well.

Mr Newmark: Yes, I know. There seems to have been a lot of abuse in asset-based financing, such as factoring and invoice discounting. It is an unregulated market. I have a stack of papers here from constituents, individuals who have seen abuse, from the likes of BB, Ashley, Pulse, Close Brothers, where it seems to be that to provide lending, you get, let us say, a £40,000 commission for doing the lending, but the incentives seem to be if you terminate the contract you get £400,000. There seems to be a lot of abuse in asset-based lending. Have any of you guys come across that problem? Ron, you are nodding, so do you want to address that for me?

Ronel Lehmann: Yes, it is Ronel, but the—

Mr Newmark: Ronel, sorry.

Ronel Lehmann: Thank you. The banks did offer us invoice discount and other factoring facility ideas, but the problem was although we passed the litmus test for having it, it was an advertising agency, and at the end of the day, they want to know that if a client has booked the advert, they are locked in, they are going to pay for it, that there is a beginning, middle and end, and they could never find the end because

what happens if they did not like the advert? So of course it disappeared. They spent months looking at how we could perhaps improve a process that had been going on for 20 years of advertising with major brands, there was never anybody cancelling a booking. So the invoice finance route did not work.

Mr Newmark: Chris, have you come across this much?

Chris Lane: I have not. I am not sure I understand the abuse that you say. Presumably this is a contractual thing, where they are sort of breaking contracts?

Q201 Mr Newmark: Yes, I do not want to go into it, and if you do not want to, I do not want to delve into it, maybe it is for another period, but basically what goes on is that brokers are induced to bring weak businesses to these financing sources, knowing full well that they get a commission on it, but they make 10 times more money by forcing it into liquidation. It has been—

Chris Lane: Right. No, I had not come across that, but certainly invoice discounting is more prevalent now than it ever used to be and it is a viable source of finance for SMEs. I would not knock it. It works.

Q202 Mr Newmark: Yes. At the moment it is unregulated. Do you think it is an area that, given it is potentially subject to abuse, should be perhaps regulated, because there are other areas that are regulated? This is, at the moment, an unregulated area.

Chris Lane: I would not be in favour of more regulation, no. I think it is the brokers perhaps that you are referring to—

Mr Newmark: Yes, yes.

Chris Lane: —rather than the invoice discounters, but no, I have not come across that problem.

Peter Hollis: My clients are very heavy users of factoring and invoice discounting. It is a viable source of finance. In most cases, it works extremely well. I have not seen the abuses to which you refer. The one problem with that type of finance is if the business has a fall in turnover, if it has a fallow period where sales drop for two or three months, then the facility automatically collapses and that can pitch the business into insolvency. That is the main downside I see of it, compared to an overdraft, which does not collapse in those sorts of circumstances.

Mr Newmark: Okay, thank you.

Chair: All of us sense that we have just scratched the surface of so much that we could glean from a longer discussion, but we have to move

on, we have other witnesses to hear this morning. Thank you very much, all three of you, for coming in. It has been extremely interesting and enlightening. If you have further points that you want to make in writing, please do so. Thank you very much indeed. We will move straight on to the next section.

Examination of Witnesses

Witnesses: **Laurence Beere**, Managing Director, L&H Hotels Limited, **Tim Murphy**, Director, Seneca Banking Consultants, and **Jeremy Roe**, Founder, Bully Banks, gave evidence.

Q203 Chair: Thank you very much for coming to give evidence this morning, and particularly so because of the strike. We are reasonably pressed for time because there are Treasury questions to the Chancellor in the House today.

Could I begin by asking you, Mr Roe, we have had quite a number of submissions that businesses took out loans with embedded interest rate hedging products because they trusted their bank to give them the product that they needed. Do you think that is typical among SMEs, that they have trusted banks and ended up in products that have not been appropriate for them?

Jeremy Roe: It is certainly typical, particularly of those individuals who have been involved in interest rate hedging products proper or embedded swaps, because all of them have been asset rich, and by and large that means that they are of a certain age. That generation believed that the banks were a trustworthy partner and had confidence in their banks. In practice, that confidence has proven to be sadly misplaced.

Chair: Do you want to add anything to that, Mr Beere?

Laurence Beere: I think what Jeremy said sums up exactly how I felt. I was in a situation in the latter part of 2008 where my loan structure was with HBOS. HBOS was a bank that was becoming non-co-operative. We had commercial day-to-day facilities with HSBC and HSBC were wanting to withdraw those facilities. We met Clydesdale, who had a local relationship manager, and he spent a lot of time with me looking over my business plan for about four months and understanding my business, so I genuinely felt that here was a bank that was working in Bath, that was looking at us and understood what we were doing. I had a regular dialogue with him, so I felt a great deal of trust in that bank. I would not say that I trust him at all any more.

Chair: Is there anything you want to add to this particular question, Mr Murphy?

Tim Murphy: I think pre-2008, banks actively marketed themselves as a trusted adviser and tried to build that strength of relationship with clients to retain the client, so that was an active approach that they adopted to retain clients. For this size of clients, SMEs, they could not necessarily afford access to third-party professionals, so they were open to that relationship and that approach.

Q204 Chair: Okay. Do you think that we can restore trust through better-quality handling of this type of business by banks or do you think this can only be cured by competition or both? Perhaps I will start with Mr Roe and then move again to the other two.

Jeremy Roe: The first thing that has to happen is that banks themselves have to change their conduct and have to change their attitude in the process where they lend to small and medium-size businesses. I do not believe that has happened yet to any meaningful extent and I do not think our members believe that it has happened yet to any meaningful extent. The issue is that the banks have to change the way in that they conduct themselves and then it is up to various parties to ensure that their conduct is proper going forward.

Q205 Chair: Including the regulators.

Jeremy Roe: Absolutely. It is up to the regulators, all of the regulators. They each have a role to play, and truly, looking back over this whole scenario, I do not think any of the regulators have covered themselves in glory. Hopefully there is a change there, a sea change, and they are starting to recognise that they do need to monitor the banks much more effectively and perhaps be a little bit more assertive in the way that they regulate, but there is also a role for Government and there is a role for the professions within the country. The banks are Goliaths. They are on our high streets. They are out of all proportion, all scale to the parties with whom they do most of their business, and there has to be effective control over them.

Chair: Mr Beere? Then I will ask Mr Murphy, who has particular experience with one of the Goliaths, to comment.

Laurence Beere: I think if you are looking at me as just as an example representative, I am a small business person—I own a small hotel—like thousands of other people. I started out in business 11 years ago, where I had a relationship where I looked forward to having a conversation with my bank and I trusted the advice that they gave me, because I felt that they were a partner that was interested in the long-term success of my business.

I think that there has been clear deceit on their part, particularly with Clydesdale in terms of what was said to me and then what was

delivered. I think the only way you are going to change that is to put greater control around the bank and how they sell their products to SMEs. The information that we were given was sorely lacking and I can sum that up simply by saying if in the process of completing our loan they had turned around and said to me, "Do you understand that on day one, you will have a breakage cost in excess of £1 million relative to this £3.9 million loan?" do you honestly think that I would have said, "That is perfectly acceptable"? For the bank to say, "Well, we told you there were breakage costs, so you should have understood" that is to me where trust breaks down. The bank understood what it was selling and it relied upon the fact that I did not.

Q206 Chair: Is what we have just heard endemic or an exception, Mr Murphy?

Tim Murphy: In terms of bank behaviours?

Chair: Cases like that.

Tim Murphy: Unfortunately, there are a lot of those cases. It was a particular point in time when that behaviour was happening, but yes, those events do happen.

Q207 Chair: Yes, but my question is not do they occasionally happen, but do we have an endemic problem here?

Tim Murphy: I think it is changing. I think bank behaviours have changed. There was a lot of pressure on the banks to cross-sell products, which created a certain type of behaviour. It became more of a sales culture than a credit culture and a lending relationship culture. That was one of the key changes in banking through the 2000s, and that is what is behind a lot of the issues that we have now.

Q208 Chair: So you are suggesting this is a recent phenomenon that developed in the last decade and that has been flushed out as a consequence of the crash and that we are now putting right?

Tim Murphy: Putting right, not yet. I think Williams & Glyn's coming out of RBS will be a step in the right direction, because that creates more competition. I think we need to keep the Co-op alive and healthy, because again that creates more competition.

Q209 Chair: That could be quite an undertaking, but do carry on with your list of proposals.

Tim Murphy: Yes, but the cost of not doing it could be a lot more expensive, because we will back here in 20 years' time if we are not careful to put some fundamental changes into the market. I think FOS

is just not fit for purpose for SMEs. We contacted FOS yesterday and asked them, "How long will it take to get a reply?" and they said they are just picking up files that were submitted to them in June, so they have a 10-month backlog on SMEs and they are only microbusinesses anyway. An SME that is north of €2 million turnover, it has nowhere to go, apart from internal complaints. There is no third party appeal.

Q210 Chair: Did you say that the first-line response from the Financial Ombudsman Service will be, "We have a nine-month lag?" Is that what I heard?

Tim Murphy: 10 months.

Chair: A 10-month lag.

Tim Murphy: We phoned them yesterday, one of my colleagues, and the answer was he was picking up files from June 2013. That service is just not fit for purpose for the SMEs.

Q211 Chair: There are several points there. The core remedy is not working, but the market itself is highly dysfunctional if this kind of behaviour is persisting despite the fact that we understand—you want to add something, Mr Roe?

Jeremy Roe: I do. I disagree quite strongly with Tim. I do not believe the banks have changed their behaviour. I do not believe the banks have changed their attitude.

Q212 Chair: They are still in the sales culture rather than the credit culture, as Mr Murphy put it?

Jeremy Roe: Yes, and I think a change of culture begins with a wholehearted acceptance of responsibility and that has not happened.

Q213 John Thurso: Can I come to you first, Laurence? By the way, Chairman, I should perhaps say that Laurence and I share a qualification. We are both Master Innholders. Nice to see you.

Laurence Beere: Thank you.

John Thurso: What I am interested in trying to work out is whether the cases like yours are instances of bad luck and timing or deliberate or perhaps even accidental mis-selling by the banks. Can I ask you, when you went through the process with the trusted bank manager who you thought was going to be helping you and advising you, how was the facility referred to? Was there, at any time in the dialogue, reference to embedded swaps or hedges, things of that nature?

Laurence Beere: I would start by saying I think there was deliberate intent to sell what was best suited to the bank. I think the gentleman that I worked with, Ian Harris, was very positive and took a lot of time to understand the business, write up his report and put it to credit and so on. It was the final process of how we moved into a fixed rate that gives me the greatest cause for concern.

I had always taken a relatively conservative approach to how we run our business. We do not have large financial resources. We had taken on a high level of debt and so what I wanted to create was effectively a mortgage payment. I wanted to know at the end of every month what I was going to be obligated to pay and then build my business model around it and ensure that I could meet that obligation. We said we had taken fixed rates before and we were interested to take a fixed rate.

What happened was we were then told, "Well, when we move into a fixed rate, that is a specialist service and we will need to introduce you to our treasury department to do that". We had a telephone—

Q214 John Thurso: But the terminology was always "fixed rate"?

Laurence Beere: Yes. I know, notionally, in my head, you are paying a higher interest rate for accepting it is a permanent amount of money. It is not explained—the methodology by which that is done and the complex nature of what you are entering into. They make it very simple and very straightforward. When I spoke to Graeme Batstone, who was the gentleman at treasury, he basically presented me with three options, saying there was a 10-year rate, a 15-year rate and a 21-year rate, and the difference on the margin on those three rates was 10 basis points. It was nominal. His advice, and it was advice, was, "You should take the 21-year rate because interest rates at half of 1% at this point in time. This will protect your business from rate rises. It is the best thing to do".

Q215 John Thurso: Just to get this straight, you have a facility for how long?

Laurence Beere: We took a—

John Thurso: You still have the facility?

Laurence Beere: We still have the facility. We are still in business, but we have 16 years left to run on the original term of that loan.

Q216 John Thurso: If interest rates do go up then for a large part of that loan that will have proved to have been a good decision.

Laurence Beere: Yes, it would. The problem comes when your relationship breaks down with your bank and your bank then starts putting pressure upon you. When I originally met with Ian Harris it was, "We know we are in this, as your partner, for the long term; for good and for bad. We understand that." That relationship fundamentally changed when NAB decided to exit the UK market and put Clydesdale up for sale. The Bath office was closed and so on. We now no longer have a positive relationship with the bank. The relationship got so bad as to be moved over to their specialist banking services because they felt that there was concern over our ability to meet cash flow requirements. We have lived under that structure—we were transferred to them with 48 hours' notice before the VAT—

Q217 John Thurso: What you did could have been construed as a good business decision if you were having a constructive relationship with that bank for the next 16 years. The core of the problem, if I have it right, is that you have been sold something that linked you irrevocably to their fortunes and the only way of doing something about it is for you to pay 30% of the loan in a penalty charge. That is basically the problem.

Laurence Beere: That is basically it and at no point we were given an understanding that that was the risk that we were taking on in that structure.

Q218 John Thurso: The critical point is that while the arrangement was a perfectly sensible one and could look good, all the fine print that makes it something you would not touch with a bargepole was simply not explained to you.

Laurence Beere: That is my point.

Q219 John Thurso: Can I come to Jeremy Roe? Through both Bully Banks and the NAB Support Group this will be a story you are very familiar with, is it not?

Jeremy Roe: Yes.

Q220 John Thurso: Is the tale that Laurence is telling one that you see consistently across all the other complainants?

Jeremy Roe: Every case is individual and is specific, but in broad terms yes. We have done a survey of our membership and, of those with hidden swaps, 68% of those loans were put in place to replace variable rate facilities. The individuals had borrowings and a decision was taken to change to a fixed rate. In 77% of those cases the banks were warning individuals that interest rates were going to move higher. In 89% of those cases it was the bank's idea to fixed rates. In 84% of

the cases the banks pressurised the businesses to fix rates. In 97% of the cases the customers were unaware of the commission structure. In 96% they were unaware of the breakage costs that they were entering into. There is a consistent pattern of the banks promoting at best, pressuring at worst, businesses to enter into fixed rate commitments without properly explaining the financial implications of the break costs.

Q221 John Thurso: This would fulfil the classic definition of mis-selling?

Jeremy Roe: In my view it does.

Q222 John Thurso: Absolutely. Does it surprise you, therefore, that the Treasury and the Government seem decidedly uninterested in the idea and the FCA does not want to have anything to do with it?

Jeremy Roe: I find it extraordinary. We are in a situation where two years ago Bully Banks raised an issue about the sale of a specific product, interest rate hedging products. That was dismissed. We pressurised. We campaigned.

We have now a situation in which over 10,000 businesses have had results from the banks' determinations and over 80% of those were found to have been substantially mis-sold. We are in a rerun. We now have another product that is on the table. We learnt earlier this month that there are some 70,000 of those products that have been sold—70,000 people have these products and we are saying a number of members are saying that they have been mis-sold. Why on earth would the regulator not investigate that? Why on earth would the Treasury not demand that the regulator investigate it? It is an issue of profound economic and social importance.

You have a series of institutions who, it is alleged, have mis-sold this product. We are standing here and saying that two years ago we said the same thing about interest rate hedging products. Our claims were modest and have been wholly substantiated. We are repeating the same issue now. There is a problem in the way in which these products were sold. Many thousands of small businesses have these products. We do not know how many of them have been mis-sold but it is probable that a large number have been mis-sold. Therefore, the regulator should investigate the sale of those products.

Q223 Chair: When I raised these issues informally some 18 months ago, I was given what appeared to be wholly misplaced assurances that these problems were either exaggerated or non-existent. What you have said is consistent with my own anecdotal experience.

Before passing the questioning on to Stewart Hosie, Mr Murphy, is there anything you would like to add about how we tackle and address these problems? You have had experience on the other side of the counter. You can now offer us suggestions on what to do about it.

Tim Murphy: On the TBLs, I think, with a standalone bank facility letter, it is difficult for a non-financially-aware person to understand all the nuances of that facility letter and it is skewed towards the bank. It is in the bank's favour. There are clauses in those facility letters that are standard clauses that the bank can use to put the facility into default and then drag them through the recovery teams. You have that issue with the facility letter on its own, as a standalone document, but if the likes of Yorkshire Bank then embed in that a treasury document, it almost makes the thing completely unintelligible. It looks at them as two isolated situations. You have your swap and a loan and then you have the TBL as two separate companies, two separate products. You would say the SME has more chance of understanding the swap and the loan as a standalone product than it has of ever understanding that TBL with an embedded swap. If you sit down and read one, and I have read a few of them—

Chair: So have I.

Tim Murphy: —and I am experienced in the documents, they are very difficult—

Chair: Unintelligible.

Tim Murphy: They are unintelligible. It is completely lost in the small print what these people were signing up to. To keep them out of any form of redress scheme is just completely wrong and for the FCA to hide behind legal loopholes around what a contract for difference is, then it is just wrong.

Q224 Chair: We are getting very clear advice.

Jeremy Roe: Could I pick up—

Chair: It will have to be very quick because I have four more colleagues who want to come in and we have to get on to the floor of the House this morning.

Jeremy Roe: If I could just pick up on the point about legal loopholes, there is an issue about whether the hidden swaps are regulated products. It has to be investigated. I believe there is a very good argument that says they are regulated products. What I found extraordinary is we had Clive Anderson of the FCA say to the APG the other day that they have not taken external advice upon whether these

are regulated products or not. The regulator should take that advice and should publish it so that people can debate the advice sensibly.

Chair: You are giving clear evidence. It is extremely helpful.

Q225 Stewart Hosie: I will come back to that last point in just a moment. Before I do that, the FCA has said that, from a customer perspective, the embedded IRHP products have similar features to standalone ones. What difference is there between the standalone interest rate hedging products compared to the embedded ones? In practical terms for the customer what is the difference?

Jeremy Roe: In practical terms there is not a lot of difference. You get a double payment structure within a swap, so what is happening to you is very visible and I think that is one of the issues in a hidden swap; there is a single payment. It is a flat payment and people do not understand what is happening. I suppose the big difference is the swap and the associated loan are two distinct products. With the hidden swap, you have a loan and then, within it, you have a breakage mechanism and it is the breakage mechanism that is the swap element. Most people do not experience that until they terminate or attempt to terminate their loan. That is the derivative part of the transaction. That is what makes the transaction a regulated product in my view.

Q226 Stewart Hosie: Which makes the embedded product, the TBL, more opaque, if I understand you.

Jeremy Roe: In some ways, yes.

Q227 Stewart Hosie: Was there a difference to anyone's experience in the way these products were sold or were they sold on fundamentally the same basis?

Jeremy Roe: The big difference is that with the swaps there was a treasury adviser in every case. Looking at the survey data we have, I would say that the pressure from the bank manager was the same and the representations made about interest rate movements was the same. The encouragement to enter into the transaction because the bank personnel were heavily rewarded was the same. What was different is that in the swaps they were always referred to a treasury person, usually as an adviser, "I can't deal with this, I have to refer you to someone in the bank who can advise you"; where, with the hidden swaps, the relationship manager plays a far greater part and often there was not a treasury person involved. Again, I think that raises issues about the legality of the actions of the relationship managers. If these products are regulated products there is a problem.

Q228 Stewart Hosie: Just to move that on a little further then, what is the difference in terms of end result for the customer? We understand the practical difference. We understand there was unlikely to be a difference in the way it was sold, other than the inclusion of a treasury person, but what was the end-result difference for the customer? If there was a breakage, for example, would there have been an additional penalty with the embedded swap as opposed to a standalone one or would the end result have been the same?

Jeremy Roe: No, in a breakage situation it is the same result.

Q229 Stewart Hosie: Now, to come back to the point you were making before about whether or not these are regulated. The FCA have written to the Treasury noting they did not have sufficient powers to look at these embedded IRHPs. You think they do have the powers, that they are regulated, and, certainly from a commonsense point of view, if there is a mis-selling, whether it is as standalone product or an embedded one, surely the mis-selling itself is what they are investigating. Where do you think we are with this and if the FCA do not have the power, if they are not regulated, I presume you would argue that Treasury should give them that power.

Jeremy Roe: The Treasury should give a person that power. There needs to be an investigation. This is a problem or a potential problem. There are allegations that are very serious. For goodness' sake, the Government have to get in and investigate the issue. Frankly, who does it is secondary to that but, logically, it should be the FCA. Our response to the FCA's statement that it is not within their jurisdiction is very simple. There is a lot of literature from the FCA about how they have moved to principle-based regulation and that deals with issues about the conduct of the banks.

We are saying, "Two years ago we came and said there was a problem about the conduct of the banks and we have demonstrably been proven right. Over 80% of the people have had their product effectively torn up." We are saying, "Again there is an issue about the conduct of the banks. If you have a principle-based regulation system the conduct of the banks, the propriety of that conduct, is something that you have authority to investigate so do so."

Then you move to a technical argument where the FCA—we know they have professed to be a principle-based regulator—are taking a technical issue and saying, "No, this prevents us dealing with this matter." I think there is a very good argument for saying that the technical argument they are making is defective, but it is not up to a small business and the half a dozen lawyers I have spoken to. It is up to the regulator to ensure that that argument is effective. Get an opinion from

a topflight silk, publish it and everybody can understand what they are saying.

When I go through the Financial Services and Markets Act 2000, the Regulated Activities Order and the Markets and Financial Instruments Directive I think there is a very good argument for saying these are regulated products, but I am not the one to determine it. Someone appropriately qualified is.

Q230 Stewart Hosie: Very briefly, because others have questions, why do you think the FCA are taking this approach?

Jeremy Roe: Why do I think the FCA needed to be pushed into reviewing—

Stewart Hosie: No. Why do you think they have not jumped into this and investigated it?

Jeremy Roe: In our submission Bully Banks refers to the DNA of the regulator. We think that is an issue. In our experience the FSA/the FCA approach an issue with a very friendly attitude towards the banks. Their DNA, their natural approach, is that the banks are responsible, sober, contributing citizens.

Q231 Chair: I have to say it is not what the regulators here tell us and, of course, it is particularly not what the banks tell us about the conduct of the regulators.

Jeremy Roe: It is what we see.

Q232 Chair: It is a fascinating triangle in which each party sees the other two in a completely different light.

Jeremy Roe: It is a very strange but a very simple issue which is indisputable. When the FSA announced their scheme they put in place a concept that you would get 8% simple interest if your product was cancelled and you were refunded money. You would separately receive consequential loss. We have Barclays Bank insisting that that 8% covers consequential loss and effectively pressurising people to whom they mis-sold a product to accept it. The regulator stands back and allows that to happen. That is wholly wrong. The regulator does not have the approach to regulation that the banks' conduct requires.

Chair: Well, we are not going to form judgments on all this right now, but I am sure the Committee is taking note of what you are saying. We must give other witnesses an opportunity to chip in and with that in mind, and I am sure he does have it in mind, I pass you to Brooks.

Q233 Mr Newmark: Yes. I am highly sympathetic to what the friends of Bully Banks have certainly gone through and, notwithstanding the point highlighted by the Chairman, the vast majority of people out there probably have not been abused, but that does not negate the point that there is a significant minority of people that have faced abuse, whether it is swaps or invoice discounting and so on, and something does need to be done about this.

Now turning to you, Mr Roe, a survey by Bully Banks suggested that the average fees charged due to entering a special situation division such as GRG was £327,000 per business. This does not sound like chopped liver to me. It is a big number. Does this match your experience from cases presented to your firm?

Jeremy Roe: We have complained about the conduct of the special management groups within each of the banks. RBS and GRG have been a particular focus of attention. We have had 177 of our members reply to a survey, which is still in draft—still in process. We have found that there is an average charge to these businesses—and some of them are quite modest businesses, so the average is very important—of £345,000. These are businesses who are in financial distress, according to the bank. They are moved into a specialist management function, the principal consequence of which is that the bank charges very significantly more fees, more costs.

Q234 Mr Newmark: Why do you think these fees are so high? It seems to be a pattern here.

Jeremy Roe: I believe that the special situation groups have become a profit centre of the banks and, as a result of that, they take the opportunities they have to make profit and they do that by imposing charges on businesses. We have businesses who have as many as eight different levels of charge that have been imposed upon them.

Q235 Mr Newmark: You note that business reviews that SMEs are often forced to pay up for in special situation divisions are often not even made available to the business. Can you give an example of that?

Jeremy Roe: Yes. Again, it is something like 40% of the businesses that have access to the reports for which they are charged. Again, this is RBS/GRG specific. I should say we are going out to the other banks as well and investigating their conduct, but with RBS/GRG we have the results in draft form. The majority of businesses, in other words, do not see the reports that they pay for.

Q236 Mr Newmark: Just moving on because I have a lot of questions here, unfortunately. To what extent do the high fees charged in the special situation division contribute to the business ultimately collapsing?

Jeremy Roe: A tremendous contribution. In our survey the GRG's annual charges were over 10% of the turnover of the business in 32% of cases. They were over 40% of net profit in 38% of cases. In 20% of cases GRG charges accounted for 100% of or more than net profits. These charges are a very substantial burden on a business that has been moved into what is laughingly called a support function because they have financial issues.

Mr Newmark: God, I do not have enough time.

Chair: No, I am glancing at it, Brooks. Keep going for a bit.

Q237 Mr Newmark: It is a philosophical question. Why do you think it is that banks, which are in the business of helping businesses because keeping a business alive should be a long-term proposition because they can earn fees over 10 or 20 years—why do you think we have come to this situation in which at least the perception is there according to evidence from you guys and others that the culture changed, where it is easier to make a quick buck by pushing a business into distress and ultimately forcing it to collapse?

Jeremy Roe: It is improper incentivisation. If you incentivise this group on the basis that they have to get maximum fees out of the fees for which they are responsible that is what they will do, but that should not be the proper incentivisation of individuals within the bank. Of course the bank should look at incentivising its staff so that they nurture, they nourish, they assist businesses to develop.

Chair: A very interesting point that the Banking Commission went into in some depth. Sorry, Brooks.

Q238 Mr Newmark: A submission to the commission from the legal firm Bird noted that broad wording of covenants and contractual provisions have allowed RBS to "find fault where none on a commonsense analysis exists." Do you agree with this assessment?

Jeremy Roe: In certain cases the answer is yes. Statistics are wonderful. The data is out there. 47% of our survey individuals were not told that they were being transferred to GRG. 90% were not in default prior to the transfer to GRG. 33% were never told of the reasons for the move to GRG. Each one of those statements I find extraordinary.

Chair: We are going to have to move on. One last question. We have couple more colleagues to get in.

Q239 Mr Newmark: Of the cases you have seen where businesses are unhappy about their treatment after being placed in a special situation division, how many are from GRG and how many are from the rest and do you think this is a reflection of RBS's—I am assuming it is the majority.

Jeremy Roe: We have focused on GRG/RBS because of certain events required us to focus upon them. I think they are likely to have been worse than the others, but the conducts complained of are complained of by customers of all of the banks and I believe that you will find, when we do surveys of each of the other banks, data that is broadly similar.

Q240 Mr Newmark: It just happens to be because RBS is particularly big that you are seeing more from RBS, but is it a consistent theme throughout the industry?

Jeremy Roe: It is also the Lawrence Tomlinson report, the independent person who has been appointed by the FCA. That has prompted a focus on RBS/GRG and we are reflecting the results of our efforts to respond to that focus.

Q241 Chair: Before passing the questioning on to George Mudie, I am going to ask Mr Beere and Mr Murphy if you have anything you want to add to what you have just been hearing. You are not obliged to, but anything you do say will be taken down in evidence.

Laurence Beere: Again, I talk around my own business, so take of it what you will. In answer to the point about a reason behind why the banks behave in the way they do, I know from conversations I had with my bank the conditions of banking were one of the things that changed. When we took our loan of £3.9 million, it was pre-Basel III. What happened, as far as I understand it, is the bank has lent £3.9 million, then there is then a European banking directive that says, "Now you have to assess that loan in this risk-weighted sector and we now need you to put additional capital into your balance sheet." The problem for my business is then the bank sits there and goes, "Well, the ROI on £3.9 million was X but now it is £6.9 million and this loan is underwater." The relationship with your bank has fundamentally changed, not through fault of your own and not necessarily through fault of the bank. The simple truth is they now look at my loan as something that costs them and it is of greater value—

Q242 Chair: It is the fault of the bank for having got their balance sheet so weak.

Mr Newmark: If I can say, that sounds like a financial form of Stockholm syndrome.

Jeremy Roe: You should not be making excuses for the bank's behaviour, seriously.

Q243 Chair: But, anyway, we have the point. Mr Murphy.

Tim Murphy: On the TBL point and the rights and wrongs of the FCA's approach to it, I think the bottom line is that no regulatory authority is looking at TBLs currently on behalf of the consumer. That is what needs addressing. It has been lost between organisations and people keep talking about it. This has been going on for two years and nothing is happening with it. The only recourse for those people with a TBL is to go via a lawyer and incur very expensive legal fees. That cannot be right.

Q244 Chair: We are taking a look at it right now.

Tim Murphy: On GRG and costs of underperforming assets, that is a topic all on its own. I do not recognise the numbers.

Chair: We should not have to play this long-stop role, but it does seem to have become part of what the Treasury Committee does these days.

Q245 Mr Mudie: Since we started this inquiry, I have been just totally puzzled by the phrase "commercial lending is not covered by the regulator". Mr Murphy, Bird, who are a reputable specialist firm, in the evidence they have given us quote at least 10 themes where the banks are deliberately screwing small businesses. Finishing them off, interfering with their contacts, manoeuvring them, engineering defaults, pretending to comfort them but, by comforting them, they change and finish them off, overdrafts into loans with fees and so on—all designed to finish them off and they pull the money back. Why is that not a straightforward matter for the Financial Conduct Authority if they are living up to their names and the banks' conduct is within their remit?

How do they come with this magic "commercial lending is not dealt with by the regulator"? They are the Financial Conduct Authority. All those things might be legally challengeable if you wish, and that is what some of the companies are told to do, incredibly, small business, but it is morally and economically quite disgraceful conduct by the banks. They are happening bank after bank after bank. Tell me why these complaints are not immediately taken by the Financial Conduct Authority and investigated and, if it needs legislation for the Financial

Conduct Authority, demand legislation from us? It is disgraceful. We are having good, hardworking people—and we need to be hardworking people—coming here and saying their businesses are sterilised, controlled or wiped out because of disgraceful behaviour by banks. I have seen it first-hand.

Tim Murphy: I agree and we regularly ask the FCA and challenge the FCA on their role in this and they regularly just bat it back. Where a lot of companies have been caught out is when a bank has taken a negative-sector view, whether it be hotels or property or whatever that may be, and then they have picked up the facility letter and they have used that facility letter to exit businesses from the bank because they are not in a sector that they like. That is fundamentally wrong and this is where the behaviours cross the line and they do start using subjective clauses in facility letters, which the FCA should remove. You have either breached the financial covenants in a facility letter or you have entered administration.

All these weasely words around “material adverse change” and “dropping of values in businesses” should be stripped out of facility letters. I am doing a deal at the minute, because I am on both sides of the fence, and we are borrowing off NatWest. We are supposed to be completing this deal this week and their argument, when we are trying to get these clauses changed and we have only recently had the facility documentation, is, “You have to go back to credit to get that changed.” In other words, “We will go back to credit but you will not hit your Friday completion date.” These weasel words, and we are professionals at this, stay in the facility letter. They have these material adverse change clauses and they are not that material.

Q246 Chair: On that point, do you think it is common for banks to take advantage of the knowledge of the completion date in order to change terms or tighten terms as the sand is running out of the hourglass?

Tim Murphy: It was common in interest rate mis-selling undoubtedly. That was a common feature because it came in late. This is the fundamental point. When a bank is bidding for business—and we have three banks lined up, we are comparing terms and trying to get the best deal—you will get term sheets out of the banks and they are quite woolly around key points. The company then narrows down to one bank and it runs into completion. Whether he is buying his property, buying his business, whatever he is doing, re-banking, the final facility letter comes out and the terms in that are different in the sense that the nuances in the legal wording is much more favourable to the bank. That is where you get caught out and then you do not have time to get that

changed and the bank turns around and says, "Well, tough. Take it or leave it."

Q247 Mr Mudie: We have gone through this with the consumers, the bank customers. In the last Parliament they came and we had the same sort of tales. The banks were brought in here and the banks were told and the regulators were told and things changed. Now, why are you not demanding the same sort of status as the individual customers have? I will give you an example. I get a mortgage on a £100,000 house. The market goes down. I am in negative equity. I never heard of a bank pulling me in and saying, "The loan to value has changed so therefore," but it happens with you. Why? And why do you put up with it?

Tim Murphy: If you think of it, it is not logical. If a bank offers a 10 or 20-year property loan, they have taken a 10 or 20-year view on property prices and they know that it goes up and down. To pick a point in the cycle to pull the loan when it has dropped is just completely counter to the actual point of the loan.

Q248 Mr Mudie: Exactly and if you know that, Mr Murphy, why on earth are you not screaming at us as legislators to do something about it?

Tim Murphy: I think you give up. The regulators are the FCA, as far as I am concerned, and the regulator does not respond to these things, "It is not my problem." Where do you go? If there was a FOS/SME entity that was responsible for SMEs, then perhaps that is the proper voice and that is where we need to go.

Q249 Mr McFadden: What we have had for the last however long you have been sitting here, three-quarters of an hour or so, is a tale of where you think redress stops or cannot be accessed by banks who have mis-sold these products. I just want to ask you to make some recommendations to us as to how to fill in these gaps. We heard from Mr Roe earlier about what the regulator will do and will not do. The other piece of this you just mentioned, Mr Murphy, is the Financial Ombudsman's Service. Can you just recommend to us what change you would like to see in the Financial Ombudsman's Service remit that would allow them to play the role you want?

Tim Murphy: There are two legs to that. I think internally banks need complaints procedures that have teeth and are viewed as independent. That is difficult because they are being paid by the bank.

Q250 Mr McFadden: How do you view this Russel Griggs process?

Tim Murphy: I have not looked at it in depth but we have no faith in the internal procedures now. We just do not get anything out of

internal bank procedures. They have just disappeared. Then you are into FOS, but FOS is for micro-businesses. My point is that the vast majority of SMEs and businesses have no recourse to an independent external body.

Q251 Mr McFadden: What would be the change in the FOS remit you would like to see?

Tim Murphy: I think they are different businesses. Where FOS is now up to €2 million turnover, fine, keep that, but then you have FOS Mark 2 that that goes up to, say, £25 million turnover sterling for an SME—so it tracks SMEs—and that will hopefully keep banks' internal procedures on their toes. At the minute they know you have nowhere to go.

Q252 Mr McFadden: Because they do not fear an appeal to FOS, you think they can just dismiss appeals. Is that what you are saying?

Tim Murphy: Well, you cannot go to FOS. If you are outside €2 million turnover you have nowhere to go.

Q253 Mr McFadden: What about the regulator? What would be the change you would want to see in the regulator's remit? If the regulator is saying, "On one type of interest rate hedging product we have a locus to act but on another, which from the customer's point of view can look quite similar, we don't," what is the change there then?

Tim Murphy: The regulator to me is hiding behind loopholes in what is regulated and unregulated. He just has to get off the fence and act commercially and if it walks like a duck and quacks like a duck it is a duck and he can damn well get on with it and get it in the scheme, instead of just hiding behind words, frankly.

Q254 Mr McFadden: As Mr Mudie said, with or without any legislation that might come from this place. Mr Roe, same two questions: what would you like to see from the FOS remit and the regulator's remit?

Jeremy Roe: I think you have to put in place a holistic system, if I use that terrible word. You start with a bank's complaint process that is open to assessment and that means publication by each bank of the date about what is happening within its complaint processes. You put that in place to encourage the banks to have an effective complaint process. The next step is you put in place a FOS that has appropriate jurisdiction levels and those need to be substantially increased and the FOS have to also give detailed information not only about their conduct but about the conduct of the banks. One of the problems with anything going through the ombudsman at the moment is the delay that is

created by the banks regularly being very dilatory in meeting obligations to disclose documents and make submissions. So you have an effective disclosure. It is all about measurement of performance.

Q255 Mr McFadden: What size of business do you think? Mr Murphy mentioned a figure of £25 million annual turnover compared to the €2 million at the moment. Would you think that is the right ballpark or is there a number of employees? How should the FOS draw this line?

Jeremy Roe: I think you would look at the European legislation. You talk about £250 million. You talk about 250 employees. You put in place a jurisdiction that enables small and medium-sized businesses to challenge these goliaths. The banks have immense power. Like all power, it corrupts and it has created a set of relationships that is not equitable, which is not fair, which is not helpful to this country. They damage the economy of this country through those relationships. Put in place a series of processes that give power back to the people, power back to the small businesses, so they can conduct themselves with their banks on a more even scale.

Q256 Mr McFadden: From the regulator?

Jeremy Roe: A change in culture from the regulator so that they become much more assertive. Now, they stand back and say, "Our powers are not sufficient". Right, give them the powers.

Q257 Mr McFadden: It is the powers thing that I am focused on. I am looking for a specific from you beyond change in culture. What is it that you would like to see in the regulator revamp that you think is needed?

Jeremy Roe: Well, if they say commercial banking is outside their jurisdiction, for goodness sake put in place a set of provisions that is absolutely clear that if they see misconduct by the banks in any area, it is within their jurisdiction. They are the Financial Conduct Authority. That is what they are supposed to do.

Q258 Mr McFadden: Okay, thank you. Mr Beere, the same questions. Shall we start with the FOS? What do you think their remit should be in this?

Laurence Beere: I think all of this comes back to the question you asked me about is there trust between business and banking, and at the moment there is not. What would I want to see from FOS? Imagine how I feel when I sit just above the threshold of €2 million and I have nowhere to go. I do not trust my bank and I do not trust that, at the moment, Government legislators and so on are listening to the needs of

the SMEs. It gets highly frustrating when you hear constant rhetoric saying how important SMEs are to the recovery of this economy and then you say, “Well, where is my—”

Q259 Mr McFadden: I am giving you an opportunity to make a concrete recommendation to regulators or the FOS remit.

Laurence Beere: As Tim and as Jeremy have said, create a FOS that takes in SMEs.

Q260 Mr McFadden: I am not expecting you to write the legislation here, but what ballpark of turnover or employee numbers or—

Laurence Beere: I am not the person to answer that question. I am here representing my own small business, to talk about what happened to me. There are others that have far greater knowledge, but I think it is appropriate to hear that you have a small business saying, “Why am I excluded?” It is wholly unfair that our business is dragged through this situation and we have no source of redress and banks are allowed to get away with it, and they are getting away with it.

Chair: It is extremely valuable evidence that we have heard again this morning from our second panel and we are very grateful to all three of you. What we are hearing is a set of problems that the Treasury Select Committee hoped would at least be partly addressed and we still think can be partly addressed through competition. We put forward a set of proposals to deal with it that way, but we were then hit by or shocked by a series of appalling conduct scandals that have led to the standards commission that was created—the Parliamentary Commission on Banking Standards. What you have described in microcosm is only more of what we heard in the extensive evidence that that commission took. This is unfinished business. There is a heap of work to be done to put banking back together again in a form that can help the small business sector and you have given us some interesting evidence to further the cause to take some action. Thank you very much indeed for coming today.