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Dear Emmanuel,

## **DP15/7 FCA approach to SMEs as users of financial services**

The Financial Services Consumer Panel has long had concerns about SMEs as consumers of financial services, and we welcome the FCA's comprehensive discussion paper.

Existing consumer protections often treat individual consumers of financial services differently from small business consumers. There appears to be an assumption that a consumer, merely because he or she is engaged in business, is in some way more financially literate or sophisticated and thus less deserving of protection than an individual consumer. The Panel believes that deeming a firm to be 'sophisticated' is not appropriate until a firm is large enough to employ a professional in-house finance officer or accountant.

The majority of our response focusses on microbusinesses<sup>1</sup>. This group is the most similar to individual consumers, although is, in itself, diverse. The self-employed and sole traders face different issues to those faced by enterprises employing eight or nine employees, for example. Some microbusinesses will grow, others will not. The Panel's work with SME stakeholders suggests that the FCA should do more to understand these diverse needs better.

We would like to see the FCA carry out a segmentation of SMEs, similar to that which it has developed for individual consumers. This further work should explore the differences between businesses of different sizes, and whether there are specific issues relating to different ways of conducting business (e.g. sole trader, partnership or limited company). The FCA should also look into the extent to which women and particular ethnic groups may be overrepresented in certain types of SME, to assess any implications for its public sector equalities duty.

Our key concerns in relation to micro-enterprises as consumers of financial services are:

- Areas where microbusinesses lack the protections afforded to individual consumers;
- Access to finance for microbusinesses;
- The lack of suitable banking and lending products for microbusinesses; and
- Treatment of microbusinesses by financial services providers, especially in relation to terms and conditions and forbearance.

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<sup>1</sup> The FOS & the EU use the same definition of microbusiness or micro-enterprise, that is, an annual turnover of less than two million euros and fewer than ten employees

## FSCP Bank Culture Research

In 2015, the Panel commissioned research<sup>2</sup> to identify how personal bank customers and microbusinesses define a good banking culture. We sought to establish whether or not the reform promised by banks was visible to individuals and microbusinesses; to understand better the impact of bank culture on customers; and to define what culture would best serve consumers and the real economy.

We found that, for microbusinesses, changes in practices at banks since the financial crisis, such as the loss of business banking managers, are a negative step. These businesses said that bank staff were unlikely to understand the needs of their business or the importance of cash flow to their success. They often felt they were paying a lot of money for their banking and were unclear about what they were getting for it. The result is that microbusiness customers are often left feeling their custom is not valued.

Microbusinesses also voiced concern about the transfer of costs from banks to the “real economy”. They said they spend too much time queuing at branches or waiting for call centres to respond, time that is not spent running the business. Banks do not meet businesses’ expectations when things go wrong, and fail to take responsibility for solving problems.

Microbusinesses described a positive banking culture as being multi-faceted. The most important aspects for them were accessibility, especially opening hours that took account of a regular working day, and flexibility. They really wanted local branches to be able to authorise products and services. Microbusiness customers also said that customer service and transparency of fees and charges were important.

## Duty of Care

The Panel believes that the “Treating Customers Fairly” regime has not delivered fair outcomes to individual consumers of banking services, microbusinesses or the UK taxpayer. While the FCA’s “roadmap” of rules appears to provide clear guidelines for firms, firms have too often failed to follow it. The banker/microbusiness relationship is one that needs special recognition and protection by the adoption of a statutory duty of care<sup>3</sup> to be owed by bankers to their customers. If properly supervised and enforced, an obligation for banks to act in their customers’ best interest would help prevent mis-selling, for example the mis-selling of interest rate hedging products to SMEs, and would address other poor behaviour towards personal and business customers.

Yours sincerely



Sue Lewis  
Chair, Financial Services Consumer Panel

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<sup>2</sup> [https://www.fs-cp.org.uk/sites/default/files/fscp\\_banking\\_culture\\_-\\_report\\_-\\_final.pdf](https://www.fs-cp.org.uk/sites/default/files/fscp_banking_culture_-_report_-_final.pdf)

<sup>3</sup> [https://www.fs-cp.org.uk/sites/default/files/fscp\\_position\\_paper\\_on\\_duty\\_of\\_care\\_2015.pdf](https://www.fs-cp.org.uk/sites/default/files/fscp_position_paper_on_duty_of_care_2015.pdf)

## **FCA Questions for discussion:**

### **Q1: Are there specific products, services or distribution channels that are particularly associated with poor outcomes for SMEs?**

Microbusinesses tend to have to make do with ramped-up individual customer products (for example mortgages) or over-engineered larger corporate products (for example, asset-based lending products such as invoice finance).

Alternatively, they use personal accounts rather than go through the hoops required to get a business account. For those businesses or individual business owners with an impaired credit history, reverting to using a personal account that is already operating is the only option.

Access to credit is a perennial problem. A recent report<sup>4</sup> based on a survey of almost 500 firms and interviews with 77 entrepreneurs says that:

“A specific effect of freelancers’ lack of legitimacy surrounds their ability to secure finance... in basic aspirations such as mortgages or a bank account with an overdraft.”

Since the financial crisis, microbusinesses have struggled to access the banking and finance products that they need. Lending contracted even when Funding for Lending was refocused, supposedly to help finance SMEs. At the same time, banks’ lending margins increased.<sup>5</sup> While this is partly due to a lack of suitable products, and lower demand, there are other factors at play:

- Lengthy terms and conditions and small print mean many microbusinesses find financial services providers do not speak to them in a language they understand;
- Microbusinesses lack the skills to produce financial information and business plans acceptable to financial services providers; and
- Microbusinesses often cannot demonstrate financial history in support of applications for finance - this has become significant since the demise of “self-certification”.

The self-employed and microbusinesses also find it harder to get access to mortgages. Brokers and intermediaries’ sourcing systems cannot always cope with ‘non-vanilla’ applications. As a result, for those who pay themselves in dividends rather than a salary, or who receive income from several sources, the choice of mortgage advice and products can be limited.

Problems with access to finance are driving microbusinesses to non-mainstream sources of funding such as peer to peer lending, which may or may not be right for them. Traditional and new-entrant banks all need to be encouraged to make credit available to microbusinesses and to develop ways of doing so that are safe for the borrower and worth doing for the lender.

The Panel’s research found that ease of access is particularly important for microbusinesses. This tends to mean multi-channel, with location of branches and opening hours being of particular importance to those handling cash.

We believe that suitable financial services products for microbusinesses should be provided on readily-available simple and clearly expressed terms and conditions which

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<sup>4</sup> <http://www.brightonfuse.com/wp-content/uploads/2013/10/The-Brighton-Fuse-Final-Report.pdf>

<sup>5</sup> Lewis, S., and D. Lindley. 2015. Financial Inclusion, Financial Education, and Financial Regulation in the United Kingdom. ADBI Working Paper 544. Tokyo: Asian Development Bank Institute. Available: <http://www.adb.org/publications/financial-inclusion-financial-education-and-financial-regulation-united-kingdom>

are fair to both parties. Failure to do so falls short of the FCA's "treating customers fairly" principle.

The Panel would also like to see lenders give microbusinesses greater breathing space and fairer and more structured forbearance when they get into difficulty. Microbusinesses should be treated at least as well as personal customers in this respect. Instead, banks often charge undisclosed fees and force microbusinesses to secure personal assets against their debts.

The Fuse report<sup>6</sup> says:

"There is a lack of sensitivity to their common business difficulties, such as late payment by clients – one of the most important barriers identified by freelancers."

The Panel believes that better signposting to Business Debtline would help<sup>7</sup>, as would a debt management tool similar to that available to SMEs in Scotland<sup>8</sup>.

*Case study 1*

*The director of a limited company (Mr A) sold his micro-enterprise business and then resigned as a director. Some years later the business closed. Mr A had given a personal guarantee on a bank debt for the limited company which was subsequently called in.*

*There was an issue with how the debt had been calculated by the creditor and so Mr A raised a complaint with the bank. The bank did not uphold the complaint and so Mr A referred the case to the Financial Ombudsman who was unable to consider the case. This was because Mr A was no longer a micro enterprise and was not the customer. This meant that Mr A had nowhere left to raise the complaint.*

*Whilst the issue of personal guarantees and the lack of access to the ombudsman service affects domestic and business clients alike, Business Debtline sees many cases where directors of micro business limited companies are being asked to give personal guarantees on business lending. As such this issue has a significant impact on directors, many of whom are one man bands.*

*Reference: A Business Debtline Caller*

*Case study 2*

*A sole trader (Mrs B) had a retail business that had experienced a trade shortfall. Trade was however improving and the business was again operating at a profit. However, the business bank overdraft was called in and the business account frozen.*

*Mrs B needed a business account so that she could trade on and start to make payments to her debts. However, as her credit reference file showed she had a lot of debt, opening a basic business account was proving difficult. Mrs's B's business took a lot of payments by card and also needed to purchase stock online. A business account was therefore essential.*

*The business was profitable but unable to trade on without a business account. When this caller last contacted Business Debtline, she was still trying to find a bank that would give her an account and was using an expensive pre-paid card to buy stock.*

*Reference: A Business Debtline Caller*

<sup>6</sup> <http://www.brightonfuse.com/wp-content/uploads/2013/10/The-Brighton-Fuse-Final-Report.pdf>

<sup>7</sup> Business Debtline is the only charity offering free, expert, professional debt advice over the phone for small business and self-employed people in England, Wales, Scotland and Northern Ireland.

<sup>8</sup> <http://www.debtarrangementscotland.co.uk/debt-help-for-scottish-business.html>

**Q2: How and where should we draw the line between SMEs that should benefit from the consumer safeguards in our Handbook and those that should not? Should we aim to treat all SMEs in the same way where possible?**

Microbusinesses should have the same protections as individuals. Merely being in business does not denote sophistication. It often means the customer needs more, not less, help and understanding from its bank.

In an ideal world appropriate consumer protection should be available to all who need it. This usually means those that are "unsophisticated", but, because this is difficult to measure, decisions are made on the basis of size in the case of SMEs or wealth in the case of individuals. Whilst these tests have the benefit of certainty which is valuable to banks all the time, and consumers occasionally, they frequently lead to injustice.

The Panel believes this perceived sophistication is not appropriate until a firm is large enough to employ a professional in-house finance officer or accountant.

**Q3: Is the current treatment of SMEs in our rules broadly correct? What do you see as the most important benefits and shortcomings of our current approach?**

We believe that greater clarity and consistency in the treatment of SMEs is needed. Microbusinesses often find it more difficult to get the information they need and when they do, they have no way of working out whether they're being treated fairly – nor do they see the benefit of switching in an attempt to get a better service.

*"The bank would never phone to say how to save money on new or existing products. All they do is send you standard terms and conditions... there's no heads up as a business owner... there's nothing to help you". (Micro-enterprise customer, Bristol)*

*"I have no idea how my charges compare with a similar size business down the road... It would be nice to know that it was all fair" (Micro-enterprise customer, Glasgow)*

*"I don't want to go anywhere near changing, because I know it will end up being a nightmare and the banks know that, they know" (Micro-enterprise customer, Bristol)*

*Taken from the Panel's research – [https://www.fs-cp.org.uk/sites/default/files/fscp\\_banking\\_culture\\_-\\_report\\_-\\_final.pdf](https://www.fs-cp.org.uk/sites/default/files/fscp_banking_culture_-_report_-_final.pdf)*

The Panel is concerned that banks and professional advisers encourage microbusinesses to become incorporated for potential tax benefits. Regardless of legal status, protections for microbusinesses should be the same. It is the fact that they are a small business that should matter for consumer protection purposes, not the way in which they choose to do business.

**Q4: Should we expand the eligibility criteria of the ombudsman service? How and where should the line be drawn?**

FOS eligibility should be significantly expanded. As we say above, the Panel believes that deeming a firm to be 'sophisticated' is not appropriate until a firm is large enough to employ a professional in-house finance officer or accountant and this should be reflected in the FOS's eligibility criteria.

**Q5: Should the ombudsman service's award limit be increased from its current value of £150,000 for some or all SME complainants? Would it be fair for different award limits to apply to eligible complainants depending on whether the complainant is a business or an individual consumer?**

The losses that may be suffered by SMEs can be far larger than for individual consumers. Further, the interruption to businesses caused by, for example, failure of an insurer to pay a claim on time can cause a business to fail. The ability to access redress quickly is essential. If a business fails before the FOS has been unable to make a decision in its favour, the compensation awarded should reflect all consequential losses, including business interruption losses.

We believe the limit for microbusinesses should be £1,000,000. This would cover the vast majority of potential losses and act as a deterrent to financial services firms to treat microbusinesses unfairly in the first place.

We also know that some firms do not take a complaint forward at all for fear of ruining the relationship they have with their financial service provider. If the FOS is able to offer sufficient compensation to cover all losses, SMEs might be more willing to complain, thus exposing poor practice.

**Q6: Should we make our rules more consistent, to the extent possible, across the products and services used by SMEs.**

Yes, but as we have said above, it is necessary to deal with the 'deemed sophistication' issue.

**Q7: Should we encourage the development of voluntary codes of practice in the manner discussed in Chapter 6 of this Discussion Paper?**

In principle, we agree, but only to the extent that it is not possible to achieve sensible regulation. Whilst the FOS does take voluntary codes into account in its decision-making, codes are still not enforceable.

As noted above, we believe that legislation is needed to require the FCA to develop rules specifying what constitutes a reasonable duty of care that financial services providers should owe towards their customers. This would address many of the issues raised in the discussion paper.

The introduction of a duty of care would oblige providers of financial services to avoid conflicts of interest and act with the best interests of the customer (both personal and business) in mind. The Panel envisages that rules on a duty of care would take account of both the complexity and risk of the product or service being offered, and the level of financial knowledge and understanding of the customer.

**Q8: Should we issue guidance to firms on particular aspects of their dealings with SME clients, and, if so, which aspects.**

Yes. The FCA should establish standards of conduct, outlining how the regulator expects all financial institutions to behave when dealing with small businesses.

*One business person in the motor trade told us they had banked with NatWest for many years. Post-financial crisis they've seen less and less of a business banking manager and now feel that the bank doesn't know their business well and doesn't always give a perception of working with the customer's best interest at heart e.g. there is no flexibility for the local branch to tailor solutions to his business, or to easily accommodate the peaks and troughs of the business:*

*"Your business is so much pivotal to your life, you pay your mortgage from it and you pay for your kids if you've got them. But you can't walk into your branch unless you've got a relationship manager because they'll just pass you on. They say this is a business banking issue [so] we can't help you". The old days of an individual bank manager in branch who knew you and knew your account and knew your business has long, long gone" (Micro-enterprise customer, Bristol)*

*Taken from the Panel's research - [https://www.fs-cp.org.uk/sites/default/files/fscp\\_banking\\_culture\\_-\\_report\\_-\\_final.pdf](https://www.fs-cp.org.uk/sites/default/files/fscp_banking_culture_-_report_-_final.pdf)*