SMES AND BANKS: BALANCING THE SCALES

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In this article, David McIlroy considers the implications of the FCA's announcement that it does not have the power to take action against the Royal Bank of Scotland (RBS) for the failures of its Global Restructuring Group (GRG) department. He analyses potential reforms to the law that could give additional protections to small businesses in their dealings with banks.

David is a barrister practising at Forum Chambers and is Visiting Professor at Queen Mary University of London.

by *David McIlroy*, Barrister, *Forum Chambers*

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The recent *announcement* by the FCA that, in the absence of applicable standards, it did not have the power to take action against the Royal Bank of Scotland (RBS) for the well-publicised failures of its Global Restructuring Group (GRG) department is in stark contrast to the FCA's response to the manipulation of the London Interbank Offered Rate (LIBOR). In the latter case, the FCA imposed substantial fines on banks for breaches of its Principles. In the former case, the FCA reached the surprising conclusion that, despite evidence of widespread and systematic inappropriate treatment of customers and management of conflicts of interest (as shown in the *skilled persons report* on the treatment of small and medium enterprise (SME) customers referred to GRG), there was insufficient evidence of dishonesty or lack of integrity against GRG's senior management to justify the FCA's intervention.

The behaviour of GRG has caused widespread concern in the press and in Parliament. The extraction of extraordinary revenue from small businesses that might otherwise have weathered the financial crisis and kick-started the recovery in the British economy has arguably had serious consequences beyond the damage caused to the owners of small businesses. If the FCA's current powers are insufficient, should the law be reformed and if so, how?

POTENTIAL REFORMS

Establishing a financial services tribunal

One proposal which has been advanced by the All Party Parliamentary Group for Fair Business Banking, in its *report* on fair business banking, is to establish a financial services tribunal to deal with disputes between small businesses and banks. The model for this is the employment tribunal. However, the success of the employment tribunal has been built on its ability to hear claims for unfair dismissal and of discrimination, which are not causes of action available in the ordinary courts. Unless a financial services tribunal has the power to apply different legal rules from the rules of English commercial law, which increasingly suit only the needs of big business, it is unlikely to result in superior outcomes for small businesses.

Extending the FCA's regulatory perimeter

Commercial lending currently falls largely outside the regulatory perimeter of the Financial Services and Markets Act 2000. The Treasury could make lending to small businesses, at least by large scale financial institutions, a regulated activity falling within the FCA's jurisdiction. Application of the FCA's conduct of business rules to such lending would be possible. However, the swaps and payment protection insurance (PPI) scandals show that even where an activity is regulated, widespread abuses can still occur. Small businesses have complained that the ad hoc compensation schemes established by the FCA have not been fair and compliant with the rules of natural justice.

Allowing SMEs to sue for breaches of regulatory duties

The extension of the FCA's regulatory perimeter would not, in and of itself, enable small businesses to sue for breaches of the conduct of business rules. Ever since financial services regulation was introduced in 1986, companies have been unable to sue for breaches of those rules. This leads to the paradoxical position that a bank can be fined by its regulator for breaking those rules but not held liable to the customer by a court. A simple change to the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (*SI 2001/2256*) could address this issue and would be easy for the Treasury to make. Such a reform would be especially powerful if combined with the introduction of a financial services tribunal. This would, in effect, take out of the ordinary courts responsibility for interpreting the complicated and customer-centric rules in the FCA Handbook.

Extending the remit of the FOS

The FCA conducted, between January and April 2018, a *consultation* on extending the remit of the Financial Ombudsman Service (FOS) (CP18/3). The results of that consultation have not yet been published, but are expected later this year.

At present micro-enterprises (businesses with fewer than 10 employees and a turnover or balance sheet of less than EUR2 million) are the only businesses that are able to complain to the FOS. The FOS does not have to apply the law. It can determine cases on the basis of what is fair and reasonable (*section 228(2), Financial Services and Markets Act 2000 (FSMA); R (Aviva Life & Pensions (UK) Ltd) v Financial Ombudsman Service [2017] EWHC 352 (Admin)*). However, £150,000 is currently the limit of the compensation which the FOS can award and the FCA has no immediate plans to raise the limit. Almost every small business that complains of serious unfair treatment by a bank says that it has lost more than that. Extending the remit of the FOS would be the equivalent of straining a gnat while swallowing a camel. It would provide redress in the case of minor losses while leaving major abuses unaddressed.

Codifying banking standards

Banks have historically enjoyed the prestige of a profession without being legally obliged to comply with professional standards. An article in the *Bankers' Magazine* in 1868 proudly asserted that there was no need to impose a legal duty of confidentiality on bankers because they could be trusted to exercise responsibly the trust reposed in them.

150 years later, Sir Geoffrey Vos, Chancellor of the High Court, said, when delivering the *Banking Standards Board Lecture* in March 2018 on the subject of "Integrity and Independence": "The courts have historically been over-trusting of some of the great institutions". If banks are to be worthy of the trust which they have historically claimed, the time has now come for them to be legally bound by those standards which they proclaim in their advertising and in the voluntary codes to which they say they are committed.

In their dealings with small businesses, many banks subscribed to the Business Banking Code which was in force until November 2009 and to the Lending Code thereafter. So far, the courts have generally been reluctant to give legal teeth to those codes. The exception is the decision of HHJ Havelock-Allan QC in *Thomas v Triodos Bank NV [2017] EWHC 314 (QB)*, in which he held that, although the Business Banking Code did not form part of the contract between the parties, by advertising that it subscribed to the Code the bank had assumed the duties stated in that Code. By contrast, the Australian Code of Banking Practice forms part of the contract between a bank and its small business customers. The government could, by legislation or agreement with the banks, get those banks which claim to act in accordance with the Lending Code to put their money where their mouth is by signing up to a legally binding commitment to do so.

CONCLUSION

The financial crisis and its aftermath brought into the spotlight abuses by banks that had not previously been scrutinised. The current, unsatisfactory position is that in their dealings with small businesses banks are liable to their customers neither for breaches of the conduct of business rules nor for failing to comply with the Codes of Practice that they claim to abide by. The extension of the remit of the FOS, or the jurisdiction of the FCA, or the creation of a financial services tribunal do not appear to be sufficient by themselves to enforce effectively higher standards of behaviour by banks. What is required is the ability for small business customers to hold banks legally accountable to those standards that the public expects of banks and that banks have declared they are committed to. The next developments in the courts, from the FCA, and from the Treasury are eagerly awaited.