berg

Banking Report: Lifting the lid off lending

JULY 2015

the imaginative law firm

berg represents hundreds of businesses across the country

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Lifting the lid off lending

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"I said at the time that the situation threatened the recovery of UK plc"

Foreword

Reuben Berg
Senior Partner, **berg**

It's been 12 months since the **berg** Banking Report helped lift the lid on the fractured relationship between small businesses in the UK and the big banks.

Whilst the myriad of fines, litigation and PPI scandals had raised awareness of bad banking behaviour, there was a distinct lack of understanding as to the sheer scale of systematic abuse and manipulation.

I said at the time that the situation threatened the recovery of UK plc.

A year on, and with a new majority Government, some of the biggest banks have pledged a public *mea culpa* and initiated campaigns to rebuild trust amongst consumers.

One bank, RBS, has even closed its controversial Global Restructuring Unit (GRG). This bank was, of course, at the forefront of the mis-selling of complex interest rate hedging products that caused untold financial problems for their customer base.

The Review into the mis-selling of interest rate hedging products is now, to all intents and purposes, closed after the FCA and banks fulfilled the terms of their brief. And it is those terms which are now under judicial review, meaning the issue is far from over.

With this in mind, the 2015 **berg** Banking Report examines how UK independent businesses have truly fared in their treatment by the banks. Have they now turned the corner to brighter times or is there much left to be done to create a more equitable balance in the banking / customer relationship?

"Its toxic aftermath could cripple SME banking for generations to come"

Alison Loveday
Managing Partner, **berg**

No financial institution embodies the crisis of SME banking in the UK more than RBS, and its now notorious GRG division.

In an interview with the FT in February this year, Ross McEwan said of GRG that "it was impossible to cope with an eightfold rise in the number of struggling businesses moved to GRG after the crisis."

This follows on from his earlier quote that

"it is about how we start rebuilding that reservoir of trust and getting it right."

These two quotes have stayed with me since that interview, as they highlight the fundamental flaw in our big banks' efforts to get back on the straight and narrow - an absolute inability to take responsibility for the SME banking crisis and to offer fair redress to the thousands of businesses trapped, destroyed and damaged by their actions.

With no apology in sight and the FCA review coming to an end, the only way to evaluate what is next for independent business owners is by lifting the bonnet and looking at the engine of our financial institutions.

For us, that is the relationship between big banks, big accountancy, and the Treasury.

Our hope is that this report is not one that bashes banks. Rather, we are avid supporters of business banking and represent hundreds of business owners who would sign new loan agreements tomorrow if it meant they could get back to work.

Yet there are some findings which will question the position of not just RBS, but all our big banks, that the problems are consigned to the past. Rather than be legacy issues, we have found the situation to be at once very current and time critical.

Time critical as thousands of businesses have been left with no resolution by the FCA led Review, and the huge costs associated with legal proceedings mean that litigation is not an option for many business owners.

And with this urgency, we need to consider how long this vicious cycle of defence and counter argument can go on for. For, if it continues as it is, its toxic aftermath could cripple business banking for generations to come. We need to find a way to honestly assess the impact that the banks' actions have had on businesses and the economy, how we can repair the damage caused and move forward positively.

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Analysis

How the FCA Review became Bank-centric

FCA Review into the mis-selling of Interest Rate Hedging Products (IRHPs)

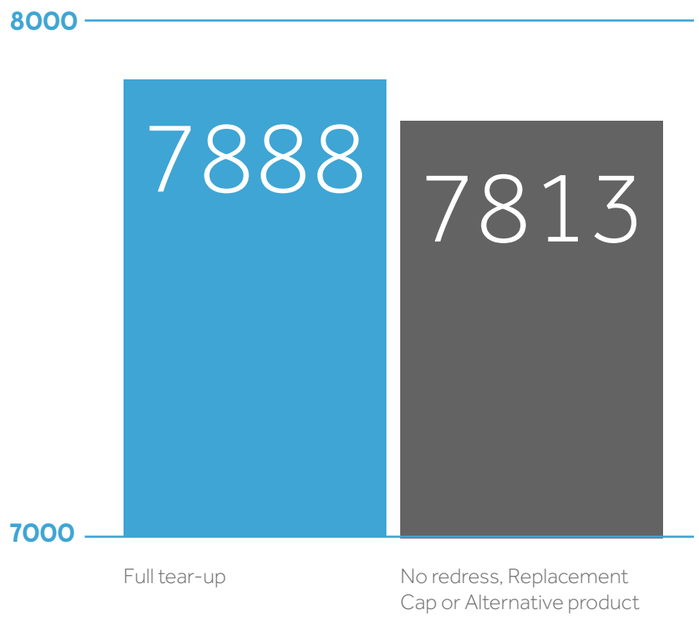
The nine banks involved

- Santander
- Clydesdale Bank
- RBS – The Royal Bank of Scotland
- Bank of Ireland
- Yorkshire Bank
- BARCLAYS
- LLOYDS BANKING GROUP
- AIB Group
- HSBC

The Winners & Losers

The FCA-led Review was first announced in June 2012. Since that date, the nine banks signed up to the process have sought to assess 30,577 IRHPs. Of these, 19,527 were deemed to be non-sophisticated and therefore within the scope of the Review. The latest figures published at the end of March 2015 confirm that 15,701 redress outcomes have been communicated to the customer.

Put bluntly, every business which has not been awarded full redress and a complete tear-up of the product, has not benefitted from being part of this process.



FCA Review stats

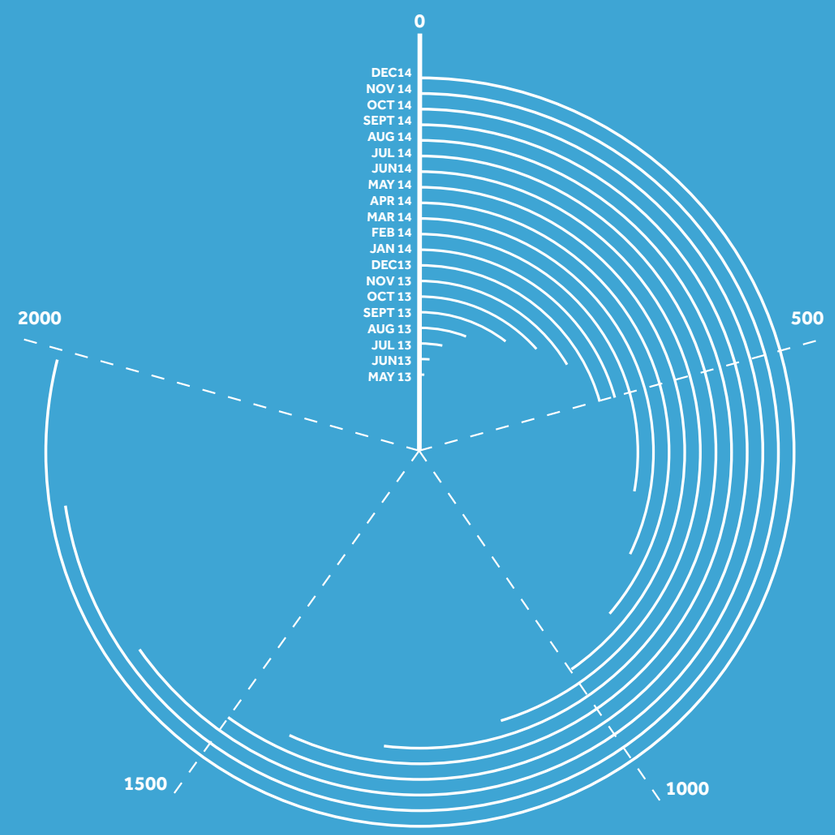
30577	**IRHPs Reviewed**
19527	**Included in review / Deemed 'non-sophisticated'**
15701	**Redress outcomes communicated as of March 2015**
11050	**Excluded from review/Deemed 'too sophisticated'**
7888	**Full tear ups**
4367	**Offered replacement caps**
1902	**Offered replacement products**
1544	**No redress**

To put this into perspective, the review pilot was completed in March 2013. It concluded that more than 95% of products had been mis-sold. Notwithstanding, only 50% of all of the offers made as at March 2015 put the customer back in the position they would have been in, had they not been mis-sold the IRHP. This was the stated aim of the Review. The other 50% seek to put the customer into an alternative position, and in all these cases the alternative position reduces the amount of redress payable - in some cases to zero.

Who have been the biggest losers?

The most common tactic of the banks (in particular RBS) since May 2014 has been the imposition of an alternative product. Customers whose cases were resolved prior to May 2014 fared much better than those dealt with later. Interestingly, by May 2014 the majority of cases outstanding were with one bank only – RBS.

Such are the concerns that the banks have been permitted to evade providing proper compensation and that there has been systematic failures within the Review process that the Treasury Select Committee (TSC) has asked the FCA to investigate. That investigation has yet to be undertaken.



The number of businesses offered an alternative product rather than a full tear up increased as the review progressed

Fair redress? What businesses experienced

Midcity – informed on the telephone by RBS that an offer of redress was in the region of £900,000. Six weeks later, after much chasing, the offer letter arrived. It now contained a swap-for-a-swap replacement product which wiped out all the compensation. The amount of redress was now nil.

West One –received a swap-for-a-swap replacement product despite evidence a cap would have been more suitable, and more affordable. This replacement product resulted in redress dropping down to £12,000 from £300,000.

Client entered into a structured collar as a direct result of sales pressure from the relationship manager. There was no requirement for hedging on the lending. Despite it not being a condition of lending, the redress team have imposed an almost identical collar resulting in redress of £90,000 instead of £600,000.

Criticisms of the Review Process

A parliamentary debate on 4 December 2014 concerning the Review raised a number of concerns regarding the lack of consistency in the application of the scheme between banks, the lack of transparency in how the scheme was being run, the lack of appeals process, and the inappropriate nature of some alternative redress offers being made to businesses.

How the Review would be conducted

berg was at the forefront of requests for the publication of the agreement reached between the banks and the FCA from the outset of the Review process. How could we properly advise clients if we did not know the 'rules of the game?' Following continual refusals by the banks, we approached the FCA, who refused to intervene.

The TSC eventually forced the publication of the agreements in February 2015 but, by then, the vast majority of customers had completed the Review process.

Who would be included

The publication of the agreements by the TSC also threw up some interesting drafting points between the first and second drafts dated 17 and 29 January 2013. Of most importance was the introduction of a cap on the customer's aggregate nominal IRHP Value - if it was more than £10million, the customer would be excluded from the Review – the so called "sophistication test."

Martin Wheatley stated in his oral evidence to the TSC on 10 February 2015 that this "took out about a third of the total of the products that were sold". Therefore, from the outset, a third of all sales were deemed "outside of scope". There is very little right of appeal against such exclusion.

It is noteworthy that the value of the claims of that third of customers excluded from the Review was significantly higher than the remaining two thirds, as it related typically to larger customers. The introduction of the cap therefore significantly reduced the compensation the banks would potentially have to pay out from the outset.

"The Committee remains very concerned the terms of the FCA's redress scheme may, in some cases, have provided Banks with an opportunity not to provide meaningful redress. Many firms feel that this process has unfairly favoured the Banks"

Andrew Tyrie MP, Chairman of the Treasury Committee

It became apparent from the belated disclosure of the agreements that the framework the banks followed in conducting the Review is almost certainly based on the Conduct of Business and Conduct of Business Source Book Rules (COB and COBS). This is in direct contradiction to what we and the banks' customers have been told throughout the Review by the banks and the FCA.

Approximately 60,000 embedded swaps and Tailored Business Loans were also deemed "outside scope", with a similar impact on the level of compensation the banks might be liable for.

The position regarding Consequential Losses

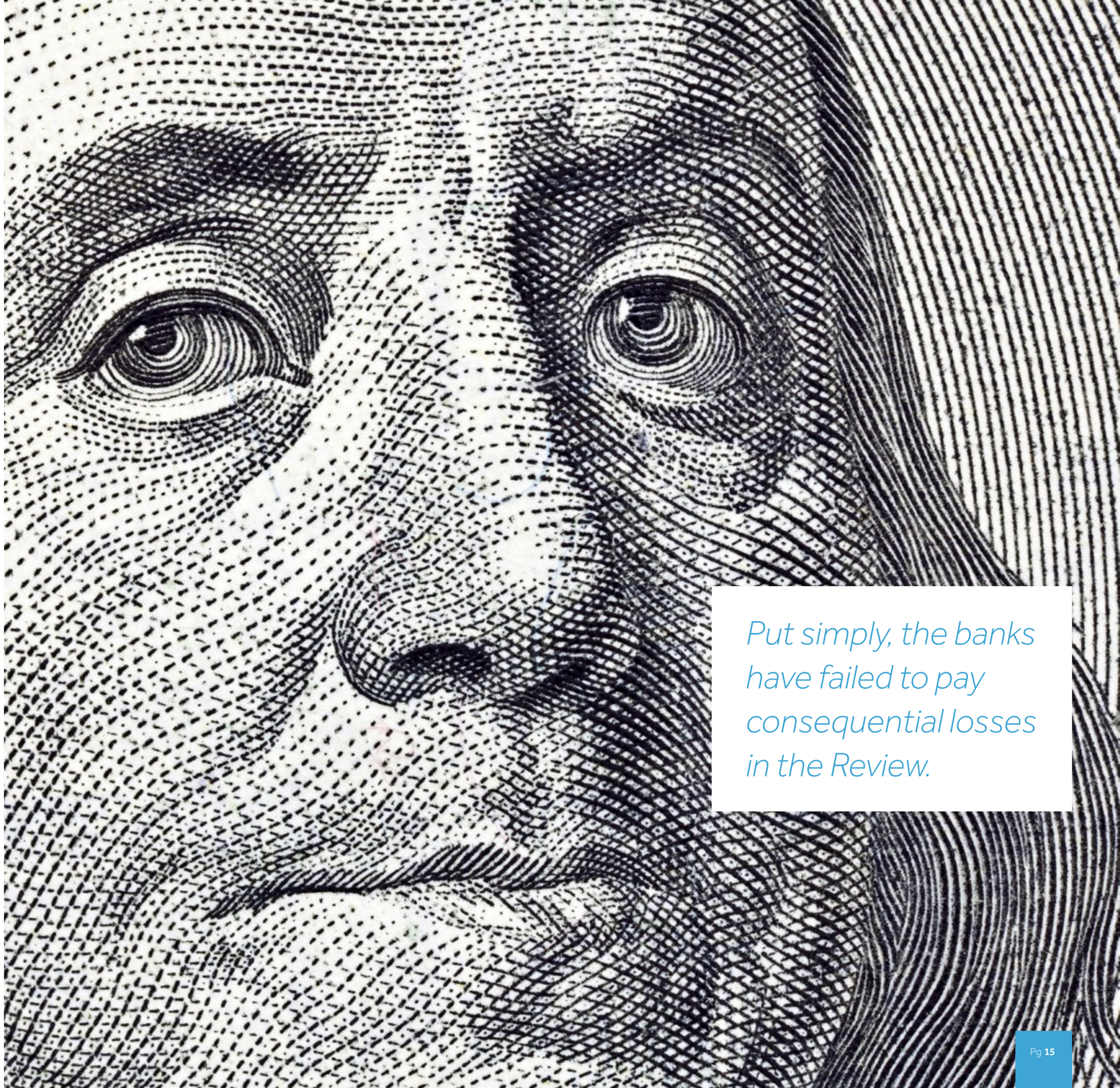
The FCA estimates that £383m has been paid out by banks to cover consequential losses, for 4,087 claims, an average of around £93,000 per claim.

Only two claims have been awarded losses of more than one million, and 1422 claims have been rejected outright – more than a quarter. Furthermore, only 30 claims have been awarded losses between £100,000 and £999,000.

berg notes that claims for additional tax liabilities are treated as consequential losses and as a result we believe the vast majority of cases were in fact tax claims and not actual consequential loss claims as normally understood.

Put simply, the banks have failed to pay consequential losses in the Review.

And, as a consequence the Review has failed. In particular, it has failed to achieve its stated aim – to put the customer back in the position it would have been in, had it not been mis-sold the IRHP product.



Put simply, the banks have failed to pay consequential losses in the Review.

Independent Reviewer. No faith, no means of challenge, rules made up by the banks mid review

Oversight of the Review was primarily through an independent reviewer. Independent reviewers are professional services firms hired by banks as "skilled persons", under Section 166 of the Financial Services and Markets Act.

Since its inception in June 2012 there have been a number of criticisms of the Review. One of those relates to the involvement of the independent reviewer. Given that the independent reviewers are typically from the big four accountancy firms (PWC, KPMG, EY and Deloitte) who already have close working relationships with the major banks, it is very difficult for customers to be able to have total confidence in the independent reviewer's neutrality/independence.

In our experience, the independent reviewer has played an entirely silent role when attending either fact-finding or redress determination meetings. Our clients have not had the opportunity to speak to them directly or to contact them and ascertain that they have been provided with all the relevant information put to the bank.

In most cases, the independent reviewer present at a meeting with the bank is not the independent reviewer overseeing that case. This is evidenced by the prepared statement read out by the majority of independent reviewers at the outset of these meetings, which confirm that they do not have knowledge of the matter and they are merely a silent observer.

The role of the independent reviewer is particularly relevant in the context of the imposition of alternative products.

In the TSC report on SME Lending (March 2015), a comment is made that "alternative product redress is determined by the Bank and the independent reviewer, he retrospectively determined what a business would have bought had a sale been compliant. It is a matter of judgement, and one not necessarily easily made by the Bank and the independent reviewer."

The problem is that the alternative products selected and substituted were often of a fictitious nature and bore no resemblance to those that had been offered to the bank customer or were even available in the financial markets at the time. For example, the imposition of a 15-year Cap. It is well known within the banking and derivative markets that such a product would not have been widely taken up on the open market. As such, how can banks be permitted to offer it as redress, purportedly with the full backing of the FCA and the independent reviewer?

The pricing methodology of such alternative products adopted by the banks is a secret kept by the banks, apparently with the full agreement of the independent reviewer and the FCA. This makes it very difficult for anyone to deal with or challenge the position.

The TSC report on SME Lending highlights the issue regarding the appeals process and the use of pricing reports. It states that "complainants are limited in what information they are allowed to present during the appeals process". The FCA noted that certain expert reports and written submissions are "unlikely to be viewed as new evidence and therefore unlikely to change the outcome".

In our view, a pricing report prepared by a derivatives expert can be an essential piece of information for the banks to consider when their initial outcomes are challenged. Given the unhelpful and unreasonable stance taken by the banks in refusing to deal with such reports, the Review process remains ultimately flawed and in favour of the banks at every turn.

"The independent reviewer will review all aspects of the proactive redress exercise and past business review. This will include methodology and review of each individual case"

FCA, Interest rate hedging product review—FAQs, February 2015

In our view the independent reviewer is not providing an effective check and balance on the banks' conduct in this Review. It cannot be said that individuals working for organisations with close existing ties with the bank can provide a truly independent service to customers within the review process.

We, like many others, will be very interested in the result of the Judicial Review, announced following a ruling by Mr Justice Parker, despite challenges in court by KMPG, Barclays, and the FCA. The case brought by Holmcroft Properties Ltd introduces the possibility of thousands of firms putting forward challenges to the Redress scheme. The decision (being one of permission only to proceed with the application for judicial review) is of significance because it widens the scope of those who might be responsible for failing to carry out the terms of the banks' agreement with the FCA. Not only do the banks arguably have an obligation to act "fairly" in determining redress but this obligation could now potentially extend to KPMG and the other big four accountants who are treated as "public bodies", for the purpose of their role in the Review process.

Independent reviewers are approved by the FCA with the aim of ensuring that they have "appropriate skills, knowledge and expertise to scrutinise the bank's review" and ensure to that there are no conflicts of interest"

(Financial Services Authority, interest rate hedging products pilot findings, March 2013)

The Impact

The refusal to release the agreements between the banks and the FCA until parliamentary pressure led to their eventual disclosure in February 2015 has confirmed the fears and views of the majority that this is a process entirely lacking in transparency and fairness. How can a business be expected to accept a decision making process when, until most recently, the procedure by which it operated was kept completely secret? This is particularly the case when "the decision" has resulted in the customer being awarded no or limited redress.

The banks have been allowed to make up the rules of the game to suit themselves, and they don't tell the other players what the rules are or when they have changed. This is notwithstanding the original objective of creating a "customer-centric" process to recompense businesses for financial mis-selling over a prolonged period of time

Prior to the formation of the agreement between the banks and the FCA and the announcement of the Review, what information can we glean as to the FCA's approach? It does appear that the FCA began with laudable intentions, but regrettably these intentions quickly became diluted.

The FCA certainly recognised in its letter dated 23 April 2012 from Adair Turner to Andrew Tyrie MP the paramount need to assess the "scale and severity of ...the Issues" in connection with the sale of IRHPs. The letter acknowledged that there was a significant imbalance of resources and bargaining power between the banks and their customers. If this was to be a fair process surely this well recognised imbalance should have been addressed in the Review process? On the contrary, the agreements and process agreed between the banks and the FCA appear to have exacerbated, rather than minimised, this imbalance. The banks have been allowed to review their own mis-selling and decide the level of redress (if any), with the full support of the independent reviewer, without the customer knowing what discussions have taken place. That is fundamentally wrong. A process that allows decisions to take place behind closed doors and with no proper means of challenge is contrary to basic principles of fairness. If the banks looked to have their misconduct legitimised through an apparent process of redress then, to dispose of transparent and clear decision making, simply serves to confirm the view of many affected by these products and interested observers, that the Review has been made to appear an adequate response to the issue it was supposed to resolve, and nothing more.

The banks have been allowed to make up the rules of the game to suit themselves, and they don't tell the other players what the rules are or when they have changed.

What should be done?

berg is of the view that in all cases where there has been a determination of no redress or an alternative product imposed, there should be a re-review by a truly independent third party, which should be conducted in an open and transparent way, with an equality of information and an explanation of the decision making process which may be open to challenge. A similar process should be adopted in relation to those businesses that have been denied consequential losses.

The 'Lloyds Effect'

In 2012 **berg** became aware that Lloyds, like RBS, appeared to be engineering defaults of lending facilities where the loans were based upon commercial real-estate. Bank customers stated that Lloyds seemed to be causing valuations to be substantially below the perceived true market value. Banking customers consistently said the same thing: Lloyds is re-valuing my business and the new valuation is a fraction of the true, fair value.

berg termed this the 'Lloyds Effect' where a business was suddenly worth substantially less. The phrase was used by Panorama - Did the Bank Wreck my Business? A Lloyds' officer appeared on Panorama and said that it would not make sense for the bank to devalue a customer's security, leading to the loan being defaulted. Contrary to this statement, there is, in fact, a real motivation for the bank to do this.

Commercial real estate with a loan to value (LTV) ratio of 70% is seen as a higher risk due to the Basel III rules (under which a bank must hold greater reserves for commercial real estate that has a 70% or greater LTV ratio). So, Lloyds is required to hold significant assets and reserves to cover such facilities. If the business with the facility were to default or become insolvent, the bank could remove it from the list of assets on its balance sheet, thereby reducing, quite drastically, the amount of revenue it must hold. That releases much needed cash to the bank to reinvest elsewhere at significantly higher profit margins. All in all, the bank is in a better place if the loan defaults.

Once Lloyds has revalued the business and it is in alleged breach of its LTV covenant, it can then apply default interest rates or increase the margin significantly, as well as charging numerous substantial fees. The profit making effect is obvious.

Another added benefit for Lloyds is that the increased margin attracts prospective debt purchasers. The bank will typically sell such loans for around 65p in the pound. If the bank makes 65% of the total loan value now, rather than 100% over 15 years, the bank can use the cash guaranteed by the sale and create more profits immediately.

The purchaser of these alleged toxic debts, for example, an organisation like Cerberus, might be thought to be taking a chance when making the acquisition. If the value of the security for the loan is substantially below the outstanding balance then, it might lose money on the deal. However if the assets of the supposed distressed businesses have already been down valued, as alleged, it is likely that the true value of the security already outweighs the price Cerberus paid for the debt. Cerberus is then able to sell such assets for significantly more than it paid for them, and profit from the transaction in a relatively short period of time.

Credible businesses at the mercy of Cerberus

berg has seen cases where businesses whose debts have been sold to Cerberus have been put under huge pressure and often, forced into administration. Once the business is in administration, the business owners lose control and are unable to pursue a claim against the bank, unless and until they secure a formal assignment of the claim. Insolvency practitioners have historically been reluctant to agree such assignments. The firm recently won a court ruling for the assignment of a claim in excess of £2 million against Lloyds, following the bank's decision to sell the debt to a subsidiary of Cerberus.

Despite running a successful and profitable business and being conscientious with loan repayments, the bank engineered a default on the loan by reducing its overdraft facility at a crucial time in the cash flow sequence, in order to place the asset rich business into Lloyds Business Support Unit, which increased costs by almost £300,000 over the course of the following year.

Lloyds' Business Support Unit sold the debt, along with others, without warning to a Dutch division of Cerberus, at a 39% discount, paying just £90m for loans with a value of £147m.

> Cerberus chose to be neither a "trusted advisor" nor a "long term partner"

Whilst Lloyds makes a great deal of its position as a "a trusted advisor and long term partner" and claims that it only allows carefully approved companies who will carry on treating customers in accordance with the terms of the original loan to buy loans, Cerberus chose to be neither a "trusted advisor" nor a "long term partner". Instead it placed the business, along with two thirds of the companies it purchased at the same time into administration. The charge is that this is happening on "the Treasury's watch", which is allowing the banks to effectively outsource this GRG type activity to third parties like Cerberus, without having to deal with the repercussions and potential reputational damage/bad publicity.

There are many further examples of this, from Lloyds and RBS, encapsulated by the Cerberus press release saying European Banks sold it $91 billion of loans in 2014 alone, which is $26 billion more than the previous two years combined. National Bank of Australia (which includes Clydesdale and Yorkshire), and the National Assets Management Agency (NAMA – Ireland's "bad bank") have entered into similar transactions with Cerberus.

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Vested relationships over customer service?

Who is protecting who?

The Global Restructuring Group

Many businesses that had been mis-sold IRHPs found themselves transferred to RBS's now notorious Global Restructuring Group (GRG). Its activities were highlighted in the report of Lawrence Tomlinson.

A decision was made to close the GRG division in August 2014, following the adverse press coverage of the evidence provided to the TSC by senior bank officials at the time, Chris Sullivan, Deputy Group Chief Executive, and Derek Sach, Head of GRG. It was claimed that GRG was not a profit centre.

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In due course, RBS was forced to apologise for this inaccuracy and accepted that GRG was an "internal profit centre".

The press continued to challenge RBS, and in particular the myth propagated by RBS that there had been no benefit to the bank arising out of GRG's activities.

It is now very clear that the removal of loans from RBS's balance sheet and the imposition of extraordinary fees have helped to substantially improve the bank's liquidity ratio and augment its profitable activities. The disingenuous approach of the bank to its earlier parliamentary scrutiny has led to renewed calls from Andrew Tyrie MP to recall senior executives of RBS for further questioning by the TSC.

How did GRG generate profits?

The calling cards of GRG, as it was:

Engineering a Breach

RBS has been accused of artificially engineering breaches of covenants in order to justify placing SMEs into GRG.

Excessive Fees/Increased Interest Rates

Once the bank has placed an SME into GRG they are often subjected to increased rates and excessive fees for business reviews, security reviews and valuations.

Alteration of Facilities

There has been a suggestion that RBS looked to target SMEs on advantageous terms with a view to penalising them into refinancing on terms more profitable to the bank.

Property Participation Agreements (PPAs) /West Register

It is alleged that the bank would purposefully distress a business in order to allow West Register to purchase the assets at a significant undervalue or force the SME into a PPA, so that the bank could share in any profits.

Sale of Assets at an Undervalue

SMEs have complained that GRG/the administrators would sell their assets at a significant undervalue either to related parties or customers of the bank.

"IPs have a code of conduct. One of the fundamental principles of which is that an IP "should not allow bias, conflict of interest or undue influence of others to override professional or business judgements"

Further tactics used by the banks

During the course of our work over the past 12 months or so there have been several other new trends that we have identified that relate to RBS and GRG, Lloyds and its Business Support Units, as well as other banks.

Invoice Financing

Banks are accused of putting pressure on businesses to enter into invoice discount financing with their recommended provider and receiving referral fees as a result.

Relationships with Insolvency Practitioners (IPs)

Banks in general have a very close relationship with IP's which lends itself to potential conflicts of interest.

Given the interwoven nature of real world business relationships, the perception of undue influence can be hard to avoid for IPs appointed by the banks.

Given that the small number of very large, bank panel, IPs get a significant portion of their work and income from a very small number of clients (the banks) it is easy to see why any apparent reluctance by an IP to bring claims against the appointing Bank can be perceived as a conflict of interest or an example of undue influence.

This was seen as one of the contributing factors in Ernst and Young's refusal to assign the claim against RBS to the Hockins until the court forced it to do so (see case studies section).

berg has seen this reluctance replicated in a number of cases, but following the Hockin decision, we have noted that more and more IPs are now agreeing to either assign potential claims or alternatively step aside and allow a replacement IP to take office.

Relationships with Accountants

Similar criticisms of conflict of interest can be directed towards the large firms of accountants, who rely heavily upon their relationships with the banks for the generation of new business.

berg believes that it was these long standing relationships that stood in the way of the true extent of the banks activities being exposed earlier. In this regard, we would refer to the profession's accounting standards themselves.

Accounts – Lack of Transparency

On 13 March 2013 the Financial Reporting Standard ("FRS") issued a single coherent financial reporting standard replacing old UK GAAP (Generally Accepted Accounting Practices).

The FRS 102 Rules became effective on 1 January 2015. They are relevant in the context of banking as they have been amended to ensure that contingent liabilities caused by Interest Rate Hedging Products (IRHP) are now added to business' balance sheets.

A contingent liability is one where the outcome of an existing situation is uncertain, and this uncertainty will be resolved by a future event.

Prior to the accounting rules change it was necessary for contingent liabilities to be accounted for on business' balance sheets. However, the previous UK GAAP Rules did not categorise IRHP's as contingent liabilities, despite the banks being fully aware that when they sold an IRHP to a customer, this immediately caused a contingent liability in respect of the potential breakage cost of the IRHP.

The requisite change suggests that there was a flaw with the previous rules. It is apparent that this flaw was being exploited by the banks and the large accountancy practices (and others) who clearly understood how IRHPs were operating in practice, and the fact that a contingent liability had been created at the point of sale and would be noted in the bank's records and accounts. Notwithstanding this knowledge, there was typically no attempt by the accountants to obtain disclosure of the extent of the contingent liability from the banks.

These accountants not only acted for the banks but were also acting as auditors and advisors to many independent businesses, hence the concern regarding conflicts of interest. In whose best interest were the accountants acting?

It appears a "tick box" mentality was adopted and, because IRHPs and derivatives had not been classified as contingent liabilities at the time, they were not brought up by the auditors of the business in the preparation of its accounts. This allowed the true nature of IRHPs and the break costs to remain hidden from business owners and third parties and meant that anyone looking at the accounts did not gain a true understanding of the financial position of the business.

We do not believe the mis-selling of IRHPs could have continued for so long if the accountants had adopted a more proactive stance and had pressed the bank for details of the break costs (i.e. the contingent liabilities), or as a minimum highlighted the true position to business owners.

Who is protecting the business bank customer?

How has RBS responded to the criticisms?

Given the sustained criticisms of RBS you may wonder what action it took.

RBS appointed Clifford Chance, one of its panel solicitors, to undertake what it described as a 'thorough and independent review' of the central allegation made by Lawrence Tomlinson in his report that the bank, through its GRG Division, was guilty of systematically setting out to defraud its small business customers.

Clifford Chance published its findings in April 2014 after having interviewed 138 GRG customers and reviewed 130 cases. Somewhat unsurprisingly, the report found that there was no evidence to support the allegations that RBS and GRG artificially distressed otherwise viable businesses.

The report stated that there was no evidence to suggest that RBS/GRG were guilty of "engineering a default" or selling assets at an undervalue to West Register or other interested parties. Furthermore, on the allegation that GRG was being run as a profit making centre the report denied this and found that the "bank has no financial incentive to unnecessarily bring about the customer's insolvency by imposing unaffordable interest and fees".

These findings were in stark contrast to the experience detailed by numerous RBS/GRG customers, who alleged that the bank ruined their otherwise viable businesses. There are concerns that this supposed independent investigation being carried out by one of the bank's panel solicitors has deliberately concealed or otherwise chosen to ignore evidence damaging to the bank.

Nowhere is this better highlighted than in Clifford Chance's findings that GRG was not a profit centre due to a lack of financial incentive. This finding has been discredited by the bank's own admission in November 2014 that GRG was being run as a profit centre. Sir Philip Hampton, RBS Chairman, in an apology letter to the TSC, admitted that it was "not correct" for Chris Sullivan and Derek Sach of the bank to have stated that GRG was not being run as a "profit centre" and that this description was "reasonable and correct".

Clearly this raises the question that if RBS have admitted GRG was a profit centre, how could Clifford Chance have found to the contrary? This calls into question the rest of Clifford Chance's findings. The Clifford Chance report is said to have cost in excess of £1million to commission and had already been undermined in its probity and neutrality when it was revealed that a draft form of the report had been checked twice by Derek Sach prior to its publication.

The Clifford Chance report is said to have cost in excess of £1million to commission and had already been undermined in its probity and neutrality...

And so it is fair to say that we have a situation where customer complaints have been down played or ignored by the bank, and business customers have no confidence in the supposed independent report commissioned by the bank. This is a further example of the banks being allowed to control the process of challenge – as they did with the FCA Review into the mis-selling of IRHPs.

What about the Regulator? Can customers rely on the FCA?

We have already highlighted concerns that the FCA allowed itself to be heavily influenced by the banks when agreeing the FCA Review process designed to compensate businesses who had been mis-sold complex IRHPs. How has it fared in its dealings with GRG?

Section 166 Investigation

On 17 January 2014, the FCA announced that it was conducting an independent investigation into RBS's treatment of business customers in financial difficulty. It is expected that this investigation will perform the task previously undertaken by Clifford Chance and which has been heavily criticised.

The investigation is being conducted by Promontory Financial Group and Mazars, pursuant to Section 166 of Financial Services and Markets Act 2000 (FSMA) ("the Report"). The Report was expected in 2014 but has been delayed. There is currently no definite publication date but it is expected in "late summer 2015".

RBS has previously stated that GRG was not used to make profits from businesses; that loan defaults were not engineered by the bank; that West Register was not used to siphon off assets from businesses and that RBS did not deliberately put viable businesses into administration. However, many of GRG's customers will disagree with these assertions and we hope that their views will be properly articulated in the Report.

We hope that the investigation will recommend that a redress scheme will be set up. However, there are no guarantees that any compensation will be made available to GRG customers. Therefore if business owners intend to seek compensation, they may need to consider litigation through the Civil Courts. As such, it is essential that they are mindful of the legal time limits that apply to such proceedings. The ongoing delay is unhelpful and can only be to the benefit of the bank.

This is only one of numerous reports that have been undertaken since 2008. We question the impact they have had and whether this is a good use of taxpayers' money.

See our in depth timeline of reports and investigations on pages 32 – 33

Key players and regulators

Basel Committee on Banking Supervision

The BCBS is committee of banking supervisory authorities that was established by the central bank governors of various countries. It created the Basel III rules.

"Basel III" is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector.

http://www.bis.org/bcbs/

British Banking Association

The UK's leading association for the banking sector, representing more than 240 member organisations with a worldwide presence in 180 countries

www.bba.org.uk

Competition and Markets Authority

The Competition and Markets Authority is a non-ministerial government department which is responsible for increasing business competition and preventing anti-competitive activities.

https://www.gov.uk/government/organisations/competition-and-markets-authority

Financial Conduct Authority

An independent regulatory body formed as one of the successors to the Financial Services Authority (FSA) Providing regulation of conduct of both retail and wholesale financial service firms providing services to consumers.

www.fca.org.uk

Financial Ombudsman Service

An independent service in the UK for settling disputes between businesses providing financial services and their customers

www.financial-ombudsman.org.uk

Financial Reporting Council

The FRC exercises regulatory responsibilities and sets the standard framework within which auditors, actuaries and accountants operate in the UK

https://www.frc.org.uk/Our-Work.aspx

Parliamentary Commission on Banking Standards

The Commission was appointed by both Houses of Parliament to consider and report on:

Professional standards and culture of the UK banking sector, taking account of regulatory and competition investigations into the LIBOR rate-setting process

Lessons to be learned about corporate governance, transparency and conflicts of interest, and their implications for regulation and for Government policy and to make recommendations for legislative and other action.

http://www.parliament.uk/bankingstandards

Serious Fraud Office

An independent government department that investigates and prosecutes serious or complex fraud and corruption

www.sfo.gov.uk

The Treasury

The Treasury is the government department responsible for developing and executing the British government's public finance policy and economic policy.

https://www.gov.uk/government/organisations/hm-treasury

Treasury Select Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration and policy of HM Treasury, HM Revenue & Customs, and associated public bodies, including the Bank of England and the Financial Conduct Authority

http://www.parliament.uk/business/committees/committees-archive/treasury-committee/

Timeline of Key Banking Industry Reports and Recommendations

2008/2009

March 2008
The Department of The Treasury Blueprint for modernized financial regulatory structure.
http://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf

25 February 2009
De Larosière Report: The High-Level Group on Financial Supervision In the EU.
http://ec.europa.eu/finance/general-policy/docs/de_larosiere_report_en.pdf

March 2009
The Turner Review: A Regulatory Response to the Global Banking Crisis.
http://www.fsac.org.uk/pubs/other/turner_review.pdf

21 April 2009
Treasury Select Committee Report - Banking Crisis dealing with the failure of the UK banks.
http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/416/416.pdf

17 June 2009
US Treasury: "Financial Regulatory Reform - A New Foundation: Rebuilding Financial Supervision & Regulation."
http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf

June 2009
Turner Review: A Response from the Financial Services Research Forum.
www.nottingham.ac.uk/business/businesscentres/crbfs/documents/researchreports/paper61.pdf

22 June 2009
SN05100 UK Government Review: Proposals to reform Financial Regulation.
researchbriefings.files.parliament.uk/documents/SN05100/SN05100.pdf

September 2009
FSA "A regulatory response to the global banking crisis"
http://www.centerforfinancialstability.org/forum/fsa_feedback_on_the_turner_review_200909.pdf

26 November 2009
Walker Review: "A review of corporate governance in UK banks and other financial industry entities" http://www.iod.com/~/media/Documents/PDFs/Influencing/Big%20Picture/BP%202009/Sept/The%20Walker%20Review

2011

24 March 2011
Treasury Select Committee - Ninth Report Competition and choice in retail banking.
http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/612/612i.pdf

June 2011
UK Treasury: White Paper "A new approach to financial regulation: the blueprint for reform."
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81403/consult_finreg__new_approach_blueprint.pdf

19 July 2011
Treasury Select Committee Review into the recommendations of the Independent Commission on Banking.
http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1069/1069.pdf

September 2011
Independent Commission on Banking: Final Report & Recommendations – The Vickers Report.
researchbriefings.files.parliament.uk/documents/SN06171/SN06171.pdf

December 2011
Financial Services Authority Report into the Failure of RBS.
http://www.fsa.gov.uk/pubs/other/rbs.pdf

2012

10 January 2012
Treasury Select Committee Report into the proposed creating of the Financial Conduct Authority.
http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1574/1574.pdf

19 January 2012
Treasury Select Committee Report - Accountability of the Bank of England: Response from the Court of the Bank.
http://www.publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1769/1769.pdf

March 2012
UK Government: Boosting Finance Options for Business.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32231/12-669-boosting-finance-options-government-response.pdf

September 2012
The Wheatley Review of LIBOR
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191762/wheatley_review_libor_finalreport_280912.pdf

16 October 2012
Treasury Select Committee Report - The FSA's report into the failure of RBS
http://www.publications.parliament.uk/pa/cm201213/cmselect/

2013

4 April 2013
Parliamentary Commission on Banking Standards 4th Report "An accident waiting to happen The failure of HBOS"
http://www.publications.parliament.uk/pa/jt201213/jtselect/jtpcbs/144/144.pdf

May 2013
CBI Report - Ripe for the picking: A guide to alternative sources of finance.
http://www.cbi.org.uk/media/2072014/cbi_alternative_finance_guide_for_growing_businesses_embargoed_0001_200513.pdf

12 June 2013
The Parliamentary Commission on Banking Standards: Changing banking for good (Volume I)
http://www.parliament.uk/documents/banking-commission/Banking-final-report-volume-i.pdf

12 June 2013
The Parliamentary Commission on Banking Standards: Changing banking for good (Volume II)
http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/27ii.pdf

3 July 2013
The Government's response to the Parliamentary Commission on Banking Standards.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/211047/gov_response_to_the_parliamentary_commission_on_banking_standards.pdf

October 2013
The FCA's response to the Parliamentary Commission on Banking Standards.
https://www.fca.org.uk/static/documents/pcbs-response.pdf

25 November 2013
RBS Independent Lending Review
http://www.independentlendingreview.co.uk/RBS_ILR_Full_Report.pdf

25 November 2013
Lawrence Tomlinson Report – Banks' Lending Practices: Treatment of Businesses in distress.
http://www.tomlinsonreport.com/docs/tomlinsonReport.pdf

December 2013
Nesta, University of California, University of Cambridge: The Rise of Future Finance, The UK Alternative Finance Benchmarking Report
http://www.nesta.org.uk/sites/default/files/the_rise_of_future_finance.pdf

30 December 2013
SN06171: The Independent Com on Banking The Vickers Report.
researchbriefings.files.parliament.uk/documents/SN06171/SN06171.pdf

2014

30 April 2014
Kelly Report into Management & Systemic Failings At the Cooperative Bank
http://www.co-operative.coop/PageFiles/989442031/kelly-review.pdf

May 2014
Grant Thornton – Alternative Lending: A regulatory approach to peer-to-peer lending
http://www.grant-thornton.co.uk/Documents/financial-services/Alternative-Lending-regulatory-approach-to-Peer-to-Peer-lending.pdf

21 October 2014
Treasury Select Committee - Project Verde
http://www.publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/728/728.pdf

28 October 2014
Treasury Select Committee Report Implementing the recommendations of the Parliamentary Commission on Banking Standards
http://www.publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/768/768.pdf

4 December 2014
Transcript of Parliamentary Debate
http://www.publications.parliament.uk/pa/cm201415/cmhansrd/cm141204/debtext/141204-0002.htm

2015

13 January 2015
SNBT-6204 "Banking executives' & company director remuneration in the UK
www.parliament.uk/briefing-papers/SN06204.pdf

Febuary 2015
Ernst & Young – Moving Mainstream, The European Alternative Finance Benchmarking Report.
http://www.ey.com/Publication/vwLUAssets/EY-and-university-of-cambridge/$FILE/EY-cambridge-alternative-finance-report.pdf

Febuary 2015
FCA and PRA: Whistleblowing in deposit-takers, PRA-designated investment firms and insurers
https://www.fca.org.uk/your-fca/documents/consultation-papers/cp15-04

11 Febuary 2015
Treasury Select Committee: Implementing the recommendations of the Parliamentary Commission on Banking Standards.
http://www.publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/1102/1102.pdf

March 2015
HM Treasury: Budget 2015.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/416330/47881_Budget_2015_Web_Accessible.pdf

March 2015
Treasury Select Committee: Project Verde: Government Response to the Committee's Sixth Report.
http://www.publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/1104/1104.pdf

16 March 2015
Treasury Select Committee: Conduct and competition in SME lending.
http://www.publications.parliament.uk/pa/cm201415/cmselect/cmtreasy/204/204.pdf

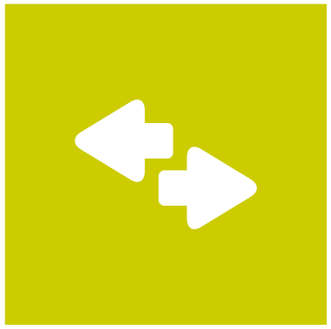
June 2015
Office for Budget Responsibility Fiscal sustainability report.
http://cdn.budgetresponsibility.independent.gov.uk/49753_OBR-Fiscal-Report-Web-Accessible.pdf

June 2015
FCA, Bank of England & HM Treasury "Fair and Effective Markets Review"
http://www.bankofengland.co.uk/markets/Pages/fmreview.aspx

4

Who Can SMEs Turn to Now?

Who can SMEs turn to now?



Alternatives to Redress, Financial Ombudsman Service, Civil and Criminal Proceedings

Financial Ombudsman Service

The broad remit of the Financial Ombudsman Service (FOS), namely to consider what is "fair and reasonable in all the circumstances", has theoretically equipped it to effectively hold banks and financial institutions to account. In the context of reviewing the sale of IRHPs, it is clear that the FOS was not the vanguard of SMEs. Barclay's statement on 29th June 2012 evidences this. It provided that

"To date, 48 complaints have been ruled on by the Financial Ombudsman Service [out of almost 5000 IRHP sold by Barclays]. Nearly 90% were decided in favour of Barclays".

The FCA announced the results of its initial pilot in March 2013. This found that over 95% of IRHPs had been mis-sold. One might question therefore how the FOS could have come to such conclusions and whether anything has changed?

Customers had expected to receive fair and appropriate redress via the FCA Review. Those dissatisfied with their redress outcome are invited to submit a complaint to the FOS.

Complainants can now expect a much fairer substantive airing of their complaint, following a decision in which the Ombudsman decided that where a bank customer could show they had been misled, the Ombudsman was empowered to make a decision in their favour.

The FOS is only open to individuals and micro enterprises. The test of what constitutes a "micro enterprise" is applied strictly by the FOS, taking into account not simply the company complaining, but all other companies linked to the complainant.

This is an artificial categorisation which often has the effect of avoiding a legitimate reference to the FOS. This is not a purposive interpretation of the rules, when proper regard should be had to the sophisticated nature of the business making the complaint that requires a fair and relatively simple means of redress.

For some businesses a complaint to FOS is the most effective, if not the only, viable remedy – particularly if the claim is out of time to litigate, or the business cannot afford the associated costs. As can be seen, however, the FOS route is only available to a very limited section of the business community.

How litigation became tougher for SMEs

Many businesses will not fall within the jurisdiction of the FOS, and so they will be forced to consider litigation.

It is important not to underestimate the link between the Civil Proceedings and Family Proceedings Fees (Amendment) Order 2015, and the options available to businesses in dispute with the banks.

As of 9 March 2015, the Order saw court fees rise by as much as 600% as the Ministry of Justice pushed through its last piece of legislation before the general election.

The rise is expected to bring in as much as £120m a year to the Treasury but many critics argue it could deter claimants and reduce the number of cases.

"As of 9 March 2015, court fees rose by as much as 600%"

This latest rise in court fees is yet a further barrier to SMEs obtaining access to justice – having been failed by their bank and the regulator, litigation may be their last resort. Many business owners may find that too much time has elapsed for them to be able to commence a claim in the civil courts. Even if they are within time, very few business owners can afford the costs associated with complex litigation of this type. Even fewer are prepared to put their lives on hold and face the mental challenge of fighting a high street bank, with limitless funds. Ironically, in the case of publicly owned banks such as RBS, the bank's defence of such claims is being funded by the tax payer.

For many, they feel the odds are against them before they even start.

There are, however, now many legal claims which have been commenced against all major banks and which are listed for hearing in the courts in the coming months.

Definition: a micro enterprise is a business (including its connected entities – which is any subsidiary and any business that has a common shareholding of 25% or more through the company or its directors) that has a combined annual turnover of €2 million or less (which is c. £1.41 million but is subject to variation) and has 10 or fewer employees.

Legal Landscape

2014 and 2015 have proved to be fertile ground for high-level decisions with wide reaching implications for customers and banks/financial institutions alike. The common law has been challenged in a number of cases, with an appeal decision into the efficacy and proper categorisation of contractual basis and exclusion clauses due in early 2016.

The legal landscape is set for change and **berg** intends to be at the forefront of driving that change.

Section 130D (formerly section 150 - Financial Services and Markets Act 2000 (FSMA)	Allows a private individual (not a company) to bring a claim against an unauthorised person (including a bank) for breaching its regulatory duties
Titan Steel Wheels Ltd v Royal Bank of Scotland [2010] [EWHC211 (comm)	Where a corporation is carrying on business of any kind it cannot bring a statutory claim under FSMA
Crestsign v Royal Bank of Scotland [2014] EW HC 3043[CH]	Although as a matter of fact the claimant had been the subject of negligent advice, and misrepresentations, this did not affect the efficacy of non-reliance and understanding clauses, the effect of which was to create contractual agreement between the parties that no advice had been given and no reliance had been placed upon any information, recommendations or guidance provided by the bank.
Carlyle v Royal Bank of Scotland Plc [2015) UKSC13	The Supreme Court found in favour of Mr Carlyle, who successfully argued that certain verbal warranties provided to him regarding the provision of additional development funding, were a freestanding binding legal arrangement
Judicial Review Holmcroft Properties Ltd	The ruling by Mr Justice Parker in the case brought by Holmcroft Properties Ltd introduces the possibility of thousands of firms putting forward challenges to the Redress scheme. The decision (being one of permission only to proceed with the application for judicially review) is interesting and of significance because it widens the scope of those who might be responsible for failing to carry out the terms of the banks agreement with the FCA. Not only do the banks arguably have an obligation to act "fairly" in determining redress but this obligation could now potentially extend to KPMG and the other Big Four accountants who are treated also as "public bodies" for the purpose of their role in the Review process.

The criminal process

The FCA penalised firms a total of £1.47bn in 2014 a significant increase from £474.27m in 2013.

In June 2012, Barclays was fined £290m over LIBOR rigging following a US led investigation. This led to Antony Jenkins, the then Group Chief Executive, telling staff that they must "adapt to new values or leave Barclays". Yet, in May 2015, Barclays was fined £1.5bn by five regulators, including the FCA, for rigging foreign exchange markets – were these the "new values" Mr Jenkins had in mind?

The criminal process

Many small businesses have failed to recover proper compensation via their complaints to the bank, and/or having gone through the FCA Review. They may not be eligible to pursue a claim via the FOS, and be unable or unwilling to commence legal proceedings in the civil courts. What about the criminal courts? Are they relevant and can they help?

Police (white collar crime)

Whilst individual business owners have made formal complaints to the police regarding the sale of IRHPs and instances of serious banking misconduct/fraudulent activities, to our knowledge none of these cases have led to the arrest of any bank employees. This does, however, remain a future possibility as can be seen from the comments of Mr Clive May which reveal that with sustained pressure, the police can be persuaded to investigate.

Serious Fraud Office

Following the financial collapse in 2008, there has only been one significant prosecution of a banking chief, namely Mr Peter Cummings, formerly of HBOS and Bank of Scotland. The enquiries into the collapse all consistently found that Peter Cummings had acted in a fashion so grossly negligent, that prosecution was both appropriate and necessary. Fred Goodwin the former CEO of RBS avoided prosecution, although he endured the ignominy of being stripped of his knighthood.

The 'prosecution' referred to above belies the true nature of the steps taken. This followed an investigation by the Financial Services Authority who banned Mr Cummings from ever holding a senior position and fined him £500,000. However, the sanction was regulatory and not criminal.

One might question therefore whether the SFO is carrying out its stated purpose to "protect society by investigating and, if appropriate, prosecuting those who commit serious or complex fraud ...?", or if it is being given sufficient resources to do so.

The investigation of mis-selling of IRHPs could clearly come within this aim and yet so far as we are aware there have been no prosecutions by the SFO. The LIBOR and FOREX rigging scandals have demanded the effective intervention by Government agencies and criminal proceedings are now underway with regard to LIBOR rigging. For many, however, simply fining the banks is not enough. Yes, it will hit their bottom line, but fines appear to have no deterrent effect whatsoever. This is clearly shown by the response of Barclays to its LIBOR fines.

One might question therefore whether the SFO is carrying out its stated purpose to "protect society by investigating and, if appropriate, prosecuting those who commit serious or complex fraud ...?"

"Having had little progress in engaging the North Wales police on the issue of my mis-sold EFG loan and allegations of dishonesty by the Bank, through persistence and with the help of my MP the North Wales Financial Crime Unit have now told me they will be investigating my complaint. Whether this ultimately results in a positive outcome, at least in terms of a proper, thorough and transparent investigation, remains to be seen"

Clive May

5

Case Studies

The Hockins GRG

This is a claim brought by Mr and Mrs Hockin (and their vehicle company Lonwest Limited) against RBS/NatWest. It relates to the mis-selling of an interest rate swap product which was entered into in July 2008 by their family company London and West Country Estates Limited which they had built up to a number of business parks over many years, representing their lifes' work.

Mr and Mrs Hockin had built up a successful family company called London and West Country Estates Limited which owned and ran a number of business parks. This was their lifes' work, which has been taken from them as a result of the actions of RBS.

The Hockins were mis-sold a complex interest rate hedging product which they did not want or understand. The Hockins were also unaware that the bank could flip from LIBOR to base rate if it suited them partway through the term. They were told that they could exit the swap without charge, which was untrue as the exit charge within a few months would already have been several million pounds and around the time the facility was coming to an end in 2011, it had reached over £10 million. The bank also failed to mention that the swap would be taken into account when assessing the company's loan to value covenant.

But far worse was to come. Despite London and West Country Estates Limited being a growing and robust business, the bank used the increased costs under the swap, and the alleged breaches in loan to value covenant, to put the company into the hands of its notorious Global Restructuring Group.

Then, in January 2012, the bank sold the business loan at a 30% discount to Isobel, a fund partly owned by RBS (75%). Two months later, Isobel put the company into administration and at this point, Mr and Mrs Hockin lost control of the business. Although they wanted to pursue a claim against RBS in relation to the sale of the swap, they could not do so as ownership or conduct of the claim sat with the administrators, Ernst & Young. The administrators refused to pursue the mis-selling claim against the bank, nor would they assign the claim to the Hockins to enable them to do so.

With our help, the Hockins won a Court application ordering the administrator to assign the claim. Proceedings were then commenced and are well underway. The Hockins have been advised that their claim is worth in excess of £30 million but as might be expected the bank are seeking to thwart the claim at every stage. Tax payers money is thus being used to defend this claim vigorously, when in reality the bank should accept its wrongdoing and compensate the Hockins for the loss and damage they have suffered as a result of the bank's actions.

The Hockins have been advised that their claim is worth in excess of £30 million but as might be expected the bank are seeking to thwart the claim at every stage.

Midcity Estates

Midcity Estates provides student accommodation in Sheffield. All was well with the business until they made the mistake of entering into a loan facility with Natwest in 2006 which came with a condition of lending that they take out a base rate swap.

Midcity transferred its lending portfolio to Lloyds a year later. At this time, Midcity was required to enter into a new, restructured swap. This saw Midcity become locked into a new IRHP with a term of 15 years. The new Lloyds IRHP had more fixed rate risk than its previous Natwest IRHP. It also came with an increased margin on its lending, together with a large administration fee of £150,000. What's more, a break cost of £670,000 was created from the breaking of the original Natwest swap. This sum was added to the new IRHP.

Due to the crippling nature of the new IRHP, it was cancelled on 11 July 2011 and Midcity took out a fixed rate loan. Break costs of £981,500 were created by this new arrangement.

We have pursued Midcity's claim against both Natwest and Lloyds through the FCA Review. The process has been far from straight forward.

On 24th October 2014, we were informed by telephone by Natwest that a redress offer was to be sent out for the sum of £912,124.79. After almost two months, we finally received a letter from Natwest. To our surprise the letter stated that, despite the earlier telephone call, the bank had decided that no redress was payable. There was no explanation as to why they had changed their minds, apart from the bank's mention of introducing a 'swap for a swap' (i.e. substituting an alternative product), which meant Midcity would receive no compensation.

Despite numerous complaints to the Chairman and CEO of the bank, the FCA and MPs, no further clarification on the point has been received other than to direct queries to Lloyds bank, who took over the lending in 2009. Natwest have stood by their offer of no redress.

Midcity fared slightly better with Lloyds. Its decision was that hedging was a condition of lending for only 50% of the loan and the fixed rate ought to have been 3.56% as opposed to 5.05%. As a consequence, Midcity has been offered £1.2m compensation from Lloyds. Whilst Lloyds is seeking to partially refund Midcity in respect of break costs, the amount of £981,500 remains embedded into the Fixed Rate Loan. The offer therefore looks artificially better than it is.

Midcity are still subject to horrific break costs on the fixed rate Loan that was entered into as a direct result of the now admittedly mis-sold Swap of 2009, which we calculate to be in the region of £1.1million. Lloyds have resolutely refused to deal with the fixed rate loan as part of the Review on the basis that fixed rate loans are outside the strict scope of the FCA Review.

We are now at the stage of consequential losses in the Review. The banks continue to pressurise the business – refusing to suspend payments pending the outcome of the Review, and in the case of Natwest, refusing any extension of time for Midcity to file its claim for consequential losses – despite its own huge delay in dealing with the claim.

The battle goes on. The business owners who are two pensioners have had to push out any plans for retirement and are determined to continue to press the banks for compensation which reflects the true cost to the business.

We have pursued Midcity's claim against both Natwest and Lloyds through the FCA Review. The process has been far from straight forward.

Clive May Brickwork

Clive May began his career as a self-employed bricklayer in 1982. Twenty one years later he had gone on to create Clive May Brickwork Limited - a company that had grown to employ over 100 people, with a turnover of £3.2 million.

In August 2010, Mr May met with his bank, NatWest, to discuss the Company's end of year accounts. Unfortunately, they had recorded a loss for the year due to extreme bad weather that had forced them to cease operations for a short spell.

The company's relationship manager suggested that they consider an EFG Loan. How the EFG scheme would work in practice was never fully explained. As a result, Mr May did not know that he was personally liable for 100% of the loan or that the submission of his asset statement would be altered to ensure eligibility.Once the EFG loan was drawn,

Once the EFG loan was drawn, NatWest utilised this money to pay off the company's existing facilities, rather than to provide further investment

NatWest utilised this money to pay off the company's existing facilities, rather than to provide further investment, which was the stated purpose of the government funding. On the very same day, the loan was drawn down the company was transferred to the bank's specialised relationship department. The situation deteriorated from there.

The bank reduced the company's overdraft further, forcing it to enter into voluntary liquidation in December 2013.

Mr May is still battling for compensation and is considering action through both the civil and criminal courts.

Elysia Partnership

Elysia entered into business in 2004 with HSBC as its banker. The bank sold the Partnership a structured collar. When trade dropped in 2008/09 and the payments under the structured collar increased, the Partnership began having financial difficulties. The structured collar was taking £120,000 a quarter out of the Partnership, which was unsustainable and eventually the Partnership lost its franchise agreement, rendering it effectively at an end.

The Partnership submitted its claim to the FCA Review. The three hedges that the Partnership had entered into, including the structured collar, were torn up and a full cash redress offer made and accepted. The Partnership thought that the bank was actually taking responsibility for its failures of the past. That was not the case.

A detailed forensic accountants report was prepared to explain the true impact the structured collar had had on the business and to identify the Partnerships consequential losses. However, when the banks decision arrived, the offer was circa £20,000. This was predominantly refunds of bank fees. The additional £7 million that the Partnership claimed in consequential losses was dismissed. The bank averred that even though the Partnership's cash flows had been destroyed by the structured collar, the bank did not deem that it had caused the Partnership any additional losses.

When we reviewed the decision by the bank, we noted to our surprise that the bank's s. 166 independent skilled person does not actually appear on the FCA's panel of s. 166 Independent skilled persons. We complained to the bank, who said it did not matter, and we complained to the FCA who did not think the issue worth responding to.

Essentially the bank found that taking almost £350,000 from a small partnership during the economic down-turn caused no damage. The independent skilled person, who is a large law firm that predominantly works in the Far East - Hong Kong and Asia – where HSBC predominantly works, did not think that the bank could be blamed for any of the financial difficulties the Partnership was caused. That is not surprising if you think that the independent skilled persons are largely overseen by the banks. The FCA thinks that this kind of connection between the bank and the reviewer is unlikely to have caused the independent skilled person to be swayed.

The Partnership has appealed. The grounds have been substantial. The principal question is "How could the Partnership NOT have been damaged by the loss of such a substantial sum of money?" We await the decision.

Essentially the bank found that taking almost £350,000 from a small partnership during the economic downturn caused no damage.

6

The Financial and Political landscape for SMEs

Many business owners believe that because they are individuals they are essentially afforded the same protection as consumers. This is most definitely not the case.

Why isn't SME lending protected like consumer banking?

Theoretically there should be no major difference between the rules governing Consumer Banking and those governing Commercial Banking, given the reciprocal interests of customer/banker in each instance i.e. a customer wishes to borrow money and the bank wants to make a profit out of that transaction.

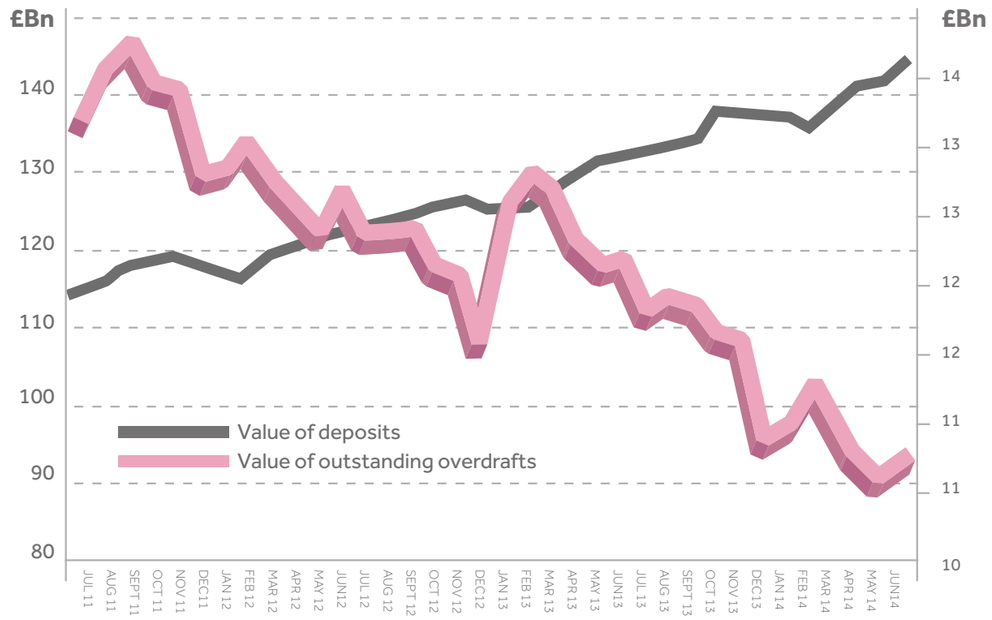
By consumer banking we refer to the 'man on the street'. Business banking is generally referred to as retail banking, which is sometimes applied to consumer banking in the media. Technically there are three types, consumer, corporate, and investment banking.

Many business owners believe that because they are individuals they are essentially afforded the same protection as consumers. This is most definitely not the case. The systems applicable to consumer banking and commercial banking are fundamentally different. Consumer banking is governed by a plethora of rules, notably the Consumer Credit Act 1974. Commercial banking in contrast, is subject to relatively limited statutory control and regulatory intervention. Recent Court decisions have affirmed the primacy of contract in defining the rights and obligations of the parties to a banking relationship. The inequality in bargaining power ensures that at negotiation stage, the boiler plate clauses that protect and enhance the bank's position are invariably included with few or no amendments accepted and we see the imposition of non-negotiable and highly onerous contractual provisions in an exploitative fashion - hardly a "level playing field".

That said, previous buoyant economic times and in particular in the property sector, meant that banks were readily lending substantial sums of money, without proper credit checks, security and due diligence considerations. The focus was hitherto upon the inherent "value" in the banker/customer relationship. The Basel III regime introduces a minimum "leverage" ratio, such that the amount of assets and commitments of a bank should not represent more than 33 times its regulatory capital, regardless of their risk weighting and of the credit commitment being drawn down or not. This requires a bank to establish that in the event of an increase in the cost of borrowing, and a corresponding fall in the value of its assets held for security purposes, it would still meet the relevant solvency ratio. As such, banks are having to re-examine their "lending book" and re-assess the value placed on its commercial banking relationships with business owners.

SMEs are net lenders to the banks

Stock of overdrafts and value of deposits



source: Ismail Ertürk, Manchester Business School. Data source Bank of England, 2015

Legitimising the actions of GRG – the new RCR division.

RBS Capital Resolution Division (RCR) is part of the internal "bad" bank that was set up on 1 January 2014 as part of this "reassessment". It was set up to manage RBS's high risk and capital intensive assets and to remove these from the balance sheet by the end of 2016. We have seen that these aims are not motivated necessarily by prudential management and with a view to reducing risk but in the clear pursuit of profit. The true motivations behind the engineered premature termination of long term lending arrangements have now been exposed.

RCR was established in consultation with the Prudential Regulation Authority and HM Treasury with the stated objectives of:-

removing risk from the RBS balance sheet and in an efficient, expedient and economic manner;

reducing balance sheet volatility; and

accelerating the release of capital through the management and exit of the RCR portfolio.

What does this is mean in practice?

RBS state their preferred approach is to encourage a "consensual exit", irrespective of the customer being compliant with their facility terms. Businesses with a commercial and contractual expectation of long term funding will find themselves under significant pressure to redeem their loans. The alternative is for RBS to sell loans to a third party. The original lending bank who understood the aims of customers and promised to support them in business will be replaced at best with an unconnected third party with no interests in that business, or at worst with a predatory vulture fund looking to extract value out of the business' assets by whatever means available.

Indeed, in October 2014 RBS said in a trading statement that it had "benefited from selling assets from its so-called "bad bank", RBS Capital Resolution (RCR), more quickly and at better prices than it had expected." This included releasing £500m from £4.5bn it had put aside to cover losses in the bad bank, and £300m in provisions against bad debts it had earmarked for its Irish unit, Ulster Bank.

Sir Philip Hampton, the chairman of RBS, said at this year's AGM in June that the bank had run down its portfolios faster than expected, and had taken £900bn of gross assets off the balance sheet between 2009 and 2012. Sir Philip Hampton noted that this was "a truly astounding scale of change", but went on to identify "commercial real estate [as] the most risky under Basel III". The increase reported in tier 1 capital from 8% (2009) to 11.2% shows that RBS has either massively increased cash or capital held, or it has removed substantial risky lending.

RCR already shows alarming similarities in terms of the outcomes for those businesses placed in GRG, save for the legitimacy ostensibly afforded to RCR's aims on the back of the prudential requirements arising out of the banking reforms that came into effect in 2015.

RCR is also part of a wider process undertaken by various banks and building societies who are writing to customers stating that upon the expiry of current arrangements they will not renew the same. In practical terms customers will need to ensure they factor-in sufficient time to look for alternative funding well before the expiry of facilities occurs. Customers should not and cannot rely on the possibility of negotiating favourable new facilities - this is unlikely to happen in reality.

The broader issue of concern here is that the effect of the Basel III risk weighting of assets and lending has provided banks with a justification for removing their own risk, when this runs contrary to existing long term lending arrangements that are being serviced perfectly well and without any issues. The process of forcing the sale of assets which was previously kept largely hidden is now given public legitimisation. Fears in that respect would be allayed if the banks approach to lending was consistent across the board but recent statistics show that in the name of prudential management the banks will restrict lending to smaller businesses but not to larger corporates, being yet another example of the far from level playing field that is commercial lending in the UK. Irrespective of the attempted policy justification behind the imposition of LTV requirements, one is forced again to examine the inherent unfairness of the bank's actions. Even where a facility provides a predictable and defined acceptable range of LTV/ covenant compliance, it appears that the primacy of a commercial contract can be ignored when it suits a bank for its own commercial needs, to ignore the terms of the contract.

The creation of the RCR division of RBS is, therefore, a classic example of how a bank unilaterally decides that a contract is unworkable, where it is no longer profitable from their perspective alone. The whole basis of a contract would be undermined if all contracting parties were permitted to behave in this way.

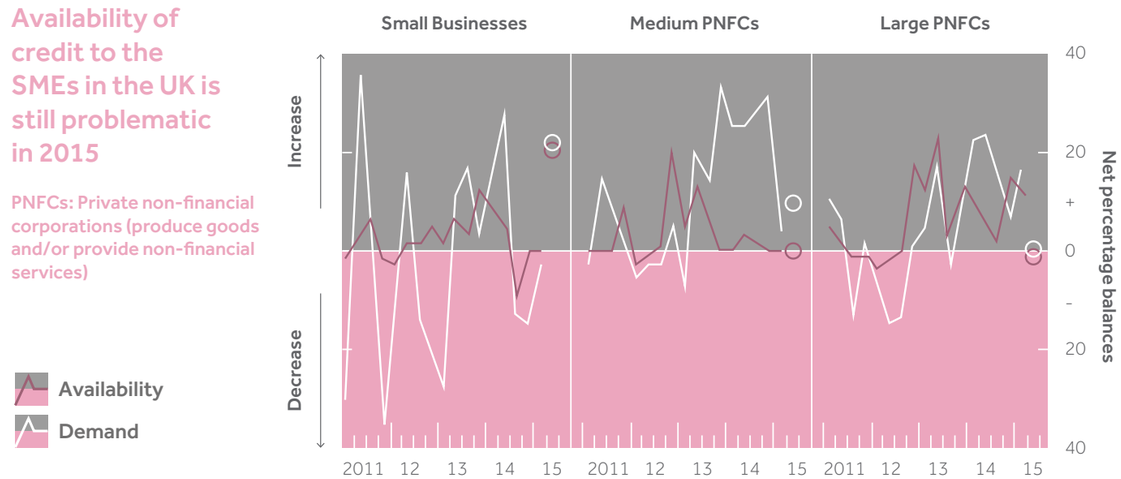
The inescapable irony is that before the advent of the Basel III regulations the "de-risking" of lending was done in secret through the likes of RBS' GRG division and Lloyds BSU division. Now the banks are openly directed and encouraged to minimise perceived "risk-laden" lending - but this is at the expense of supporting independent UK businesses. This has created a charter of legitimising the behaviour of banks in deeming lending to businesses uneconomic. The tension and scope for abuse are obvious and need to be addressed.

In practical terms, the imposition of Basel III means that only in very rare circumstances will a bank offer a loan with an LTV ratio of 70/30 or more. Commercial loans going forward will now be more likely to offer LTV ratios in the order of 50-66% maximum.

Whilst the leveraging of the wider economy is a highly important requirement, the design of the Basel III regulations restricts the role of the banks in redistributing financial risk and funding trade, such that there will be greater reliance upon alternative means of lending (e.g. crowd funding) and we are likely to see the rise of "challenger" banks.

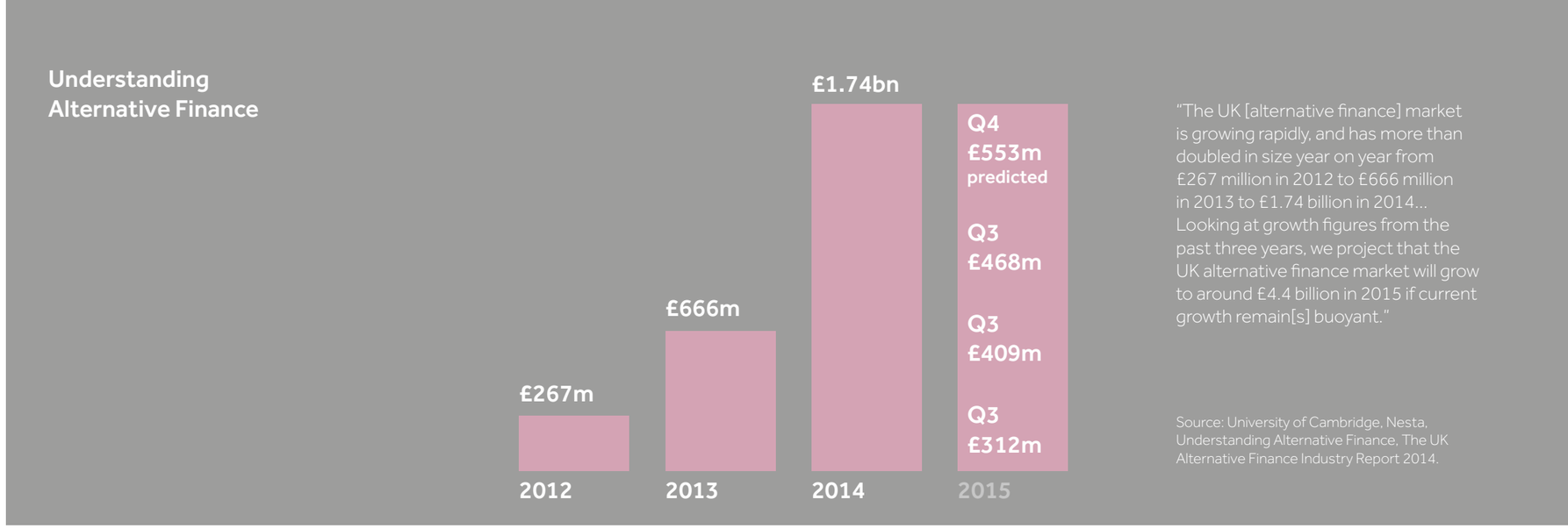
Availability of credit to the SMEs in the UK is still problematic in 2015

PNFCs: Private non-financial corporations (produce goods and/or provide non-financial services)



source: Ismail Ertürk, Manchester Business School. Data source Bank of England, 2015

Alternative Finance



The political landscape for SMEs

According to EY's moving mainstream report (February 2015) , access to finance remains one of the most pressing challenges facing businesses today. In fact, most managers of European SMEs feel that availability of bank loans has not improved since the financial crisis, and may even have worsened or deteriorated. This situation has resulted in many businesses not investing in their own growth. This reluctance to borrow appears to come from a perception that the banks are unwilling to lend, coupled with the impact recent banking scandals – PPI and IRHP mis-selling, LIBOR manipulation and so on, have had on the traditional bonds of trust between business owners and traditional lenders.

This combination of a lack of lending, and an unwillingness to lend from traditional sources has brought about a paradigm shift in how small and medium sized businesses access funding to grow.

To address the situation, the UK market is now changing to meet the demands of business lending, with new challenger banks and the emergence of alternative finance options such as crowd funding, peer to peer lending, virtual currencies and invoice trading. The alternative finance models are growing quickly and predictions are that the market will have grown to £20 billion by 2020.

The financial markets as we know them will be changed forever, and the banks and institutional investors are desperately trying to understand the level of disruption that the alternative funding models will bring. Some are even looking to invest themselves in these alternative models.

The former business secretary, Vince Cable, has stated that alternative finance is playing an increasingly important role in helping businesses access the finance they need to grow and contribute to the economy. As such, the Government has resolved to take further long-term action to ensure the availability of finance to growing businesses, with the announcement of a state-backed Business Bank and direct capital investment through the Business Finance Partnership. The Government is also considering including peer-to-peer lending within the tax-free ISA allowance.

"We need to realise that lending will never get back to the pre-2007 days. Small business owners need funding to grow and must take clear advice on what is now available in the market, and that market has moved on at pace"

berg's managing partner, Alison Loveday, believes whilst the big banks had become too dominant and had abused their position by selling inappropriate products and services to some clients, it is important to "move the debate on".

"It is also important that the high street banks over dominant position is addressed"

The latest review of the position is detailed in the TSC report into the conduct of SME lending published in March 2015. In light of the difficulties facing businesses in accessing funding, it is unsurprising that the TSC report highlighted the current inability of challenger banks and alternative funding models (including crowd funding) to challenge the dominant lenders and the report specifically referred to the need for the Competition and Markets Authorities' investigation into lending to SMEs. This investigation could not be timelier, although the current deadline for finalising the report is as late as May 2016, and it is noteworthy that the scope of the investigation has already been restricted by bank lobbying.

It is important to note that whilst the new opportunities are a welcome 'disruption', we must be mindful that the problems caused through previous and existing banking models are not repeated. It is also essential that there is a fit for purpose regulatory and support structure for any investment and lending model.

The pace of change is rapid and the financial markets and regulator cannot afford to be left behind.

RBS Sell-off

The Chancellor of the Exchequer confirmed in his annual Mansion House speech given in June 2015 that the Government is selling off the Government's shares in RBS.

Is this a shock?

Well, no, not exactly. The Chancellor stated in his budget that the Government would sell its stake in Lloyds and RBS and allow both banks to go back to being subject to the markets. His Mansion House speech claimed that it is better for the Government to sell RBS shares at a loss than to hold back the bank by keeping the shares.

Gordon Brown and Alastair Darling agreed a bail-out package in 2008 for RBS. In a number of acquisitions (because they found that the first bail-out was insufficient) the Government bought £45.5 billion of shares at 500p a share. RBS shares are trading at 360.3p a share as at 10am on 11th June 2015. The loss will be approximately £13.5 billion. As at the date of the sale, the price of the shares could be higher, or could be lower.

The timing of the share sale could be propitious for RBS. The results of the FCA's investigation into GRG are due imminently. A negative report from RBS' perspective could easily damage share values, so there may well be some foresight in the decision to sell now.

What does this mean for business owners?

The reasoning behind the timing of the sale may be significant, or it may simply be that the Government thinks it is time that the banks are left to their own devices. The sale will provide the treasury with in excess of £30 billion, which can only be good news for the economy. RBS has been under substantial pressure to restructure its balance sheet and remove "toxic" loans. Given the admitted "success" of this strategy, which has been achieved ahead of schedule, we would hope that the pressure being exerted by the banks on business owners will be relaxed – good news for independent business.

As with every silver lining there is always a dark cloud. We anticipate that fines will continue, regulatory and criminal prosecution of bankers will ensue and findings of misconduct will be an ongoing feature of UK banking for some time yet.

7

The end game

The end game

What does the immediate future hold?

1. Given the inadequate response of the regulator and the cost and risk of civil proceedings, it is likely that more disgruntled bank customers will look to the criminal process for some sort of relief. If a criminal conviction is secured then this could be used to pursue a damages claim in the civil courts. Criminal trials are already under way in relation to LIBOR rigging and following the recent bank fines arising from FOREX manipulation then criminal action here is likely to follow.

2. Current settlements reached between the banks and their customers could be torn up on the basis that they are "tainted by fraud." A challenge is already underway by Wingate Associates against Lloyds bank on the basis that a 2010 settlement over the mis-selling of an interest rate swap should be overturned because of the bank's involvement in fixing LIBOR. (A similar argument has already been used successfully in the Graisley Property (Guardian Care Homes) case against Barclays, at the "strike out stage" of proceedings). If this case is successful, many others may follow at huge potential expense to the banks.

3. RBS is also in the firing line once again following an admission in January this year that there were instances of Enterprise Finance Guarantee loan mis-selling.

4. Banks in general are likely to face ongoing claims in relation to fixed term loans, tailored business loans and embedded swaps. This particularly affects Lloyds and the National Australia Bank – Clydesdale and Yorkshire.

5. The FCA has already announced that it is looking into the sale of insurance products and we await with interest the results of their investigations.

6. **berg**'s work in relation to commercial banking disputes has also resulted in our being instructed in relation to individual consumer claims.

Consumer claims

a. Mis-sold investments

b. Pensions

c. Currency mortgages

d. Tax schemes

It is noteworthy that Coutts private bank wrote to many customers stating that their records could not confirm whether or not their investment products had been correctly sold, and as a result compensation is being offered. There is no explanation, however, as to the nature of the mis-selling, the appropriateness of the products sold (or otherwise), how compensation has been calculated and how any consequential losses have been taken into account. This is a further example of how a compensation scheme designed to benefit the customer fails to meet basic transparency tests and leaves customers with more questions than answers.

It is likely therefore that the past misconduct of the banks will continue to keep the FOS, the regulator, the civil courts and the criminal courts busy for some time to come.

No end in sight?

Our financial markets have suffered from many scandals since 2008 and there will be more cases brought to light for businesses which have suffered from the impact of Foreign Exchange and LIBOR manipulation, a fact raised at the RBS 2015 AGM, to which Philip Hampton said "scandals such as LIBOR-rigging can no longer be tolerated".

Yet when we see some of the new tactics used by the banks in this report, and the complaints against the actions of RCR, his words ring hollow and trust ebbs further away.

Ultimately, neither fines, reports nor the actions of our big banks have restored the broken relationship between them and independent businesses.

The FCA has missed its opportunity to restore trust, and even Martin Wheatley, in May 2015, said that it was not the FCA's job to "put heads on sticks", which came after he admitted the FCA chose not to chase some firms in its probe into FOREX manipulation.

This lack of accountability, and that of the wider banking sector, means that for now there is going to be claim and counter claim, with money that could be used to reform and improve the business banking sector, being spent on fines and litigation.

The business sector is driving demand for alternative investment models and this will require a worthy regulator to oversee and protect it. Most of all, it needs an understanding from the wider business community that its complaints do not come from a position of "bank bashing" but, from a desperation to trade and succeed - working with banks, not against them.

If our biggest lenders cannot support business growth, then challenger banks and alternative finance models will fill this void.

Finally, the government must lead a new culture of transparency by admitting our big banks did institutionally fail our small businesses, and lay out how it will stop this from being repeated – starting with an independent and fair redress scheme to compensate businesses to the true extent of the damage caused by the banks actions and which learns from the mistakes of the FCA Review.

Until this happens, the growth and recovery of the economy will continue to be hampered and the process of rebuilding trust cannot truly start.

The business sector is driving demand for alternative investment models and this will require a worthy regulator to oversee and protect it.

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