



## Treasury Committee

Oral evidence: [SME Lending](#), HC 204

Tuesday 1 July 2014

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Members present: Mr Andrew Tyrie (Chair); Steve Baker, Mark Garnier, Mr Pat McFadden, John Mann, Mr George Mudie, Mr Brooks Newmark, Jesse Norman, John Thurso

Questions 657 - 785

*Witnesses:* **Tony Boorman**, Interim Chief Executive and Chief Ombudsman, Financial Ombudsman Service, **Chris Woolard**, Director of Policy, Risk and Research, Financial Conduct Authority, and **Nausicaa Delfas**, Head of the Specialist Supervision Department, Financial Conduct Authority, gave evidence.

**Q657 Chair:** Thank you very much for coming to give evidence this morning. I am sorry that we are 10 or 12 minutes late starting. Could we begin by getting a response on the question: is this SME market now adequately competitive? I do not know who would like to be the lead spokesman for this particular point.

**Chris Woolard:** I will start on that one, Mr Chairman. As you are aware, there is a study at the moment being undertaken by the Competition and Markets Authority that was started by the OFT. We have been working very closely alongside that and, indeed, we have had staff working directly in the OFT and now the CMA teams. I think it is fair to say, in terms of the statement of objections and the theories of harm that have been discussed so far in that work, there are questions around concentration in the market in terms of providing services for SMEs. In terms of where the CMA is getting to their work at the moment, they are reasonably near publication. They said they will publish something further during the summer and, therefore, there is a limited amount we can say more than that.

**Q658 Chair:** Do you know when they are publishing?

**Chris Woolard:** We would expect that to be reasonably soon and they themselves have said—

**Q659 Chair:** While Parliament is sitting or in August?

**Chris Woolard:** As I understand it, they will certainly try to do something this side of the normal definition of summer, in other words before August, but obviously the CMA's timetable is driven by them, not us.

**Q660 Chair:** Is the answer that I am getting, "We will have to wait and see what they say", and that you do not have a view?

**Chris Woolard:** I think the answer is definitely a case of wait and see what the CMA report says. In terms of the views that have been expressed so far, they clearly suggest that there may be some issues here, but I would not want to speculate on what the CMA's conclusions might be.

**Q661 Chair:** That is a pretty general reply. How deeply embedded is competition in the culture of the FCA now?

**Chris Woolard:** We have a competition division established. We have around 60 people who specialise in competition within the organisation. We have already published a series of guidelines under section 1(k), which is the part of the legislation that says we have to say how we go about our business and how we intend to do those things. We have a number of market studies already out there and launched; for example cash savings, which is the big, live, current, ongoing case. We have said that we will bring forward a range of other work, including looking at wholesale markets at a strategic level. Again, I would hope we would publish that within the next few weeks in terms of kicking off that piece of work. We have also completed a first market study, which is around general insurance add-ons. I think it is fair to say, for a relatively new organisation, we have quite a lot around competition. There is obviously still more that we can do and that we are planning to do.

**Q662 Chair:** Let me just ask it in a more precise way. When the desk officer with the lead responsibility for a medium-sized financial institution goes to see them to engage with them on regulatory issues, how different is his behaviour now as a consequence of the competition objective from prior to that of the legislative objective being put on the statute book?

**Chris Woolard:** In terms of our supervision department, we have rolled out a range of training around competition for those supervisors.

In terms of the information we provide to supervision teams before they go on a visit and in terms of how we ask them to think about doing their jobs, we provide far more information about the market as opposed to the firm that sits within that particular market.

**Q663 Chair:** It has changed?

**Chris Woolard:** There are definitely changes.

**Q664 Chair:** It might be helpful if the Committee could see how that has changed in some detail, perhaps by looking at a number of cases where we may, if necessary, anonymise the firms in question. We might know who it is but we will not publish that. That might be helpful.

Do you think that the increase in competition that is taking place with new entrants is making life more difficult for regulators?

**Chris Woolard:** I do not think it is making life more difficult for regulators and, indeed, a lot of our early work has been around trying to encourage new entry, particularly around banking.

One of the first things we did was look at the barriers to entry that are created by regulation and how we can make that authorisation process getting into the system easier. To give you a sense of scale around that, if you went back just over a year ago we had around seven potential new entrants in the system at any one point in time, roughly speaking. Since we have made a number of changes around that, we are now in a position where we have up to 20 new entrants over half of whom are genuinely new businesses. This is not people coming, for example, from other jurisdictions just as established banks.

**Q665 Chair:** Are the PRA getting on with the licensing process for new entrants?

**Chris Woolard:** The licensing—

**Chair:** Sorry to interrupt. The allegation was widespread that they were just sitting on these applications, or at least the FSA was in its old integrated guise, and this was a major impediment to competition. Indeed, I held meetings with Hector Sants about this and he was cross-examined by colleagues on the Committee about this as well; a huge number of complaints from colleagues around the House of Commons. Is this problem now resolved?

**Chris Woolard:** I think we are doing a pretty good job of tackling it. I would not say it is completely sorted in terms of all the issues that firms might identify, but I think we have gone a very long way to dealing with those.

**Q666 Chair:** You do not have backlog of applicants?

**Chris Woolard:** No, quite the reverse. In terms of the time it takes us to authorise new firms, we are bringing that down. It still takes a fair period of time if you want to establish as a bank, for understandable reasons in the sense that you are going to be taking deposits of other people's money. However, in terms of how we are working with the PRA on the authorisation process, I think we have done a lot to iron that out. Just to give you one example of the world you were referring to perhaps a couple of years ago, there were certain things in the system that were fairly nonsensical. For example, as the FSA we would not grant permission to essentially go to offering a full service unless your IT systems were tested. Equally, the Bank of England as was, the PRA as it became in terms of the particular piece dealing with this, would not let you test your systems unless you had a licence, so you found yourself in this rather bizarre world. We have removed a lot of those sorts of rather strange things.

**Q667 Chair:** I am hoping you have removed all these Catch 22s.

**Chris Woolard:** Indeed.

**Chair:** That was a classic Catch 22.

**Chris Woolard:** That was a classic Catch 22.

**Chair:** A better one than the original. They have all gone, have they?

**Chris Woolard:** Yes.

**Q668 Chair:** We are not going to find more Catch 22s in the system and applicants for licences are not going to besiege this Committee with letters explaining the latest Catch 22?

**Chris Woolard:** I very much hope not.

If I can just add quickly, one of the biggest reforms we have made is to change what we call the mobilisation phase. In other words, rather than having to do everything in one big bang, new entrants can get themselves up and running in chunks. Certainly we have had feedback from a number of firms that have said that particular reform is the difference between them starting up in business and not applying.

**Q669 Chair:** I am just going to ask Nausicaa Delfas if she wants to add anything and also Tony Boorman. There is no need to unless you want to.

**Nausicaa Delfas:** I have nothing further to add for the FCA.

**Tony Boorman:** No.

**Q670 Mr Mudie:** We have had some very strong, devastating evidence from credible sources and you have had opportunity to read them because they are out on our website. I see you are going to write something down. Does that mean you have not? It amounts to some banks having behaved disgracefully in respect of how they treated SMEs. It is not about getting the loan. It is when you have the loan and they decide that they want to change the terms of the loan and some of the disgraceful tactics they use. Are you aware of this? You have obviously not picked it up from reading the evidence, but have you picked it up, from either reading the evidence or other sources, that there is a major problem here?

**Nausicaa Delfas:** If there are loans to businesses, as you know, the majority are not regulated as commercial loans. However, if we do see instances of wrongdoing then we see in what way we can intervene. For example, we regulate complaints in banks. Our powers in this area are limited.

**Q671 Mr Mudie:** No, I am just asking you a starter for 10. Do you accept there has been some disgraceful behaviour that demands investigation? Whether you choose to investigate it or not is a secondary matter, but are you aware of it?

**Chris Woolard:** There are two points there. The first is: are we aware of a series of very serious allegations that are made both in terms of transcripts that have come out of this Committee but also, more widely, that we get from firms in the normal course of doing our regulatory business? Yes, we are absolutely aware of those kinds of allegations. In some cases where we believe that the allegations are so serious, for example in the case of questions that were raised in the Tomlinson report and those kinds of issues, where we believe it goes essentially to the heart of the integrity of the firm, in terms of the kinds of behaviour that are being alleged—in that particular instance, the idea that there is a positive intent to go out and damage businesses that would otherwise be healthy—then we have taken regulatory action in terms of opening investigations. However, it is worth saying that depending on the particular issue, there is a regulatory boundary here that no doubt we will come on and discuss in more detail. Where we are dealing with what are effectively purely commercial loans then our remit does not extend that far. Although there may be a number of issues where we have hooks into the issue—

**Q672 Mr Mudie:** I accept that. That is the excuse that is rolled out every time, that your regulatory boundaries stop. Right, you are a regulator. These are customers. These are people running businesses, often on the security of their home with their own savings. They have problems. You are aware of the problems. Now, there are two things. You can either find something in your regulatory powers to investigate them or you can push the Government to move the regulatory perimeter. Let us take the first. In the FCA's evidence to us they go through, amazingly, the first two options, which they say "prove that we cannot interfere". The third objective is integrity where they do accept where there is bad behaviour, immoral behaviour, they can investigate. That is your own evidence.

When things are happening to people where—one allegation from a team of solicitors, well-credited, well-established, that one bank, for amazingly different and small points, say you are breaching a covenant, they go in for a revaluation of the covenant and they have a tame valuer. I can tell you I am in the middle of a case that is exactly the same where their tame valuer says the property is worth 50% of what it was when the loan was taken out, despite the fact the borrower puts up two serious, credible valuations that prove it has done nothing of the sort. But they use that—they will not take any discussion—to change the loan completely and often wipe out the firm. Now, I find that immoral. I find that disgusting. Why does the FCA, under the integrity objective, not share my view?

**Chris Woolard:** I am not sure it would be right to say we would not share that view.

**Q673 Mr Mudie:** But you have not.

**Chris Woolard:** In terms of where we have issues that sit outside of the regulatory perimeter, we have a limited range of hooks for bringing things in. One of those is complaints.

**Q674 Mr Mudie:** You do not say that in your evidence to us over how you can work this integrity objective. You say, and I accept this, you may not be able to go back, but you can start putting rules in that stop this type of behaviour. Again I say to you genuinely and on behalf of a lot of people who have been badly harmed, why don't you?

**Chris Woolard:** We can place rules where we have the regulatory ability to do that, in terms of the regulatory activities that are set by Parliament—

**Q675 Mr Mudie:** You have opened it to us. You have said—it is the third objective—that you can do it, but you have said you can't go back. You can just draw the line and that is it in terms of behaviour. I just again ask on behalf of people: we asked one man here, a professional, why he was not chasing you more. He was a serious professional, in the business for a long time. He said in front of this Committee, "I have just given up". Why do you not use your powers?

**Chris Woolard:** I don't know the precise circumstances of the individual, but, depending on the kind of business we are talking about here, there are essentially two main sets of issues. Where we see activity, through the numbers of complaints that are being received from a particular firm or groups of firms, where we see issues around the number of uphold rates that might be coming from the ombudsman, then we might well take the view that when you begin to see that on scale that goes to the heart of the integrity of the issue.

**Q676 Mr Mudie:** I hope you will read the—

**Chris Woolard:** Sorry, Mr Mudie.

**Mr Mudie:** I hope you will read that answer verbatim and, on behalf of the FCA, be slightly shamed.

Martin Wheatley on one particular matter, the swaps, did accept that there was a regulatory perimeter stopping you taking certain action. He wrote to the Minister. Did he get a reply?

**Chris Woolard:** I understand that there have been a couple of issues where we have written to Ministers around the regulatory perimeter and I believe we have made those letters available to the Committee. As I understand it, on the particular issue around swaps he has had a meeting with the Minister. I am not sure if there was ever a written response to that particular letter. I can go and check that fact.

**Q677 Mr Mudie:** Do you send him a reminder?

**Chris Woolard:** I believe that—

**Mr Mudie:** If you don't get a reply to a letter do you just give up?

**Chris Woolard:** No, we definitely do not give up.

**Q678 Mr Mudie:** Why did you in this case then, if he did not give you an answer on such an important point?

**Chris Woolard:** Can I just unpick a couple of things here, just so we are absolutely clear on the record?

**Mr Mudie:** Yes, okay. Go on.

**Chris Woolard:** The part of the answer I was just about to finish was: depending on the size and scale of the business they may well, if they are microbusinesses, have recourse to the ombudsman and still be able to bring complaints to the ombudsman. I do not know if Tony might want to say anything about that in a moment.

In terms of interest rate swaps, the question around interest rate hedging products, we are of the view—and indeed no one has challenged this view—that they constitute contracts for difference and they are within the regulatory boundary.

There is then the second question where Martin wrote to Ministers, which is around this issue of so-called tailored business loans. In many ways you could say they walk like a duck and quack like a duck but, legally, they are a very different product.

**Mr Mudie:** Yes, we have gone through that here.

**Chris Woolard:** That is the boundary on which Martin wrote.

**Q679 Chair:** There are further discussions taking place on this and, with a bit of luck, in a week or two we might be in a better place. Mr Boorman, is there anything you want to add at this stage?

**Tony Boorman:** Yes. Just to emphasise that if Mr Mudie's constituent is within my jurisdiction I would be very happy to look at the case. Certainly we see cases where we have expressed concern about the steps that banks have taken in relation to lending decisions. As you know, as an ombudsman I can only look at cases that fall within my jurisdiction and I am limited to looking at small businesses, the microenterprise definition, which obviously cuts out a lot of the people that often are talked about particularly in the context of Tomlinson and similar concerns. But I am very happy to look at individual cases.

**Q680 Jesse Norman:** Just a couple of factual questions. Mr Woolard, you said there are new banks coming into the market, something like 20 new banks you said. Is that right?

**Chris Woolard:** Yes.

**Q681 Jesse Norman:** When do you expect them to enter the market?

**Chris Woolard:** We have this year six that have either already entered or are entering in what we call the mobilisation phase, where they are getting ready to go out and market themselves. The others, I suspect,

will take a year or two, but that will be very much their commercial decision about whether they are going to then choose to enter at that later point.

**Q682 Jesse Norman:** Right, but let's be clear. When do you anticipate that those 20 will be in the market?

**Chris Woolard:** They have various timescales attached to them depending on their plans, but I would hope over the next two to three years we would see all of them—

**Q683 Jesse Norman:** They make commitments to you when they are applying for a banking licence and so on?

**Chris Woolard:** Sorry, Mr Norman?

**Jesse Norman:** They make commitments to you as to when they are going to enter the market, do they?

**Chris Woolard:** Yes, they will give us a sense of when in their business plans.

**Q684 Jesse Norman:** That is helpful.

The FCA made a submission to the Committee saying that it would publish its approach to banking authorisation by the end of June. I do not think we have had that. When are we going to get it?

**Chris Woolard:** We said we would look at the work we have already done in terms of barriers to entry and we would come back. I am not sure if we said June or by the summer, but certainly I would hope we would publish that in the next couple of weeks. It is in a very final stage.

**Q685 Jesse Norman:** I did not get, in a very brief way, what your answer to the Chairman's first question was. Do you think competition is adequate in the SME market or not?

**Chris Woolard:** I am not going to try to pre-empt the work that the CMA is doing and I think will be published very shortly. In the earlier stages of their work, the CMA gave an update where they identified a number of issues that they thought existed in the market. I think we would agree with that analysis.

**Q686 Jesse Norman:** How do you measure competition yourselves at the FCA?

**Chris Woolard:** We look at a range of measures when we are approaching individual particular markets. We will certainly look at things like concentration. How many players are there in the market? Who has the majority of share? You could have very many players, but if three or four have 90% of the market that clearly tells you something else about it. We also look at questions around pricing, not in terms of regulating pricing directly but in terms of what indicators that might give us.

**Q687 Jesse Norman:** Have you noticed a meaningful decline in the share of the big banks, the Big Four say?

**Chris Woolard:** No.

**Q688 Jesse Norman:** No. That is helpful.

What is happening to SME lending at the moment? Is it going up or down or staying the same?

**Chris Woolard:** Largely speaking, it is staying the same. In terms of large-bank lending, it is relatively stable. At the margin, although the percentage is dramatic the actual amount we are talking about is very small in terms of crowd funding and in terms of additional funding.

**Q689 Jesse Norman:** What you are saying is that people are locked into the current banking system. They are desperately seeking alternatives. Levels of lending are very low and, therefore, you are essentially offering support for the view that SMEs are struggling to get capital.

**Chris Woolard:** I would not go far as saying that, Mr Norman. I think we have to wait for CMA is going to say on the subject.

**Q690 Jesse Norman:** Right, but the information you have just given us—oligopoly market, Big Four share not changing, limited alternatives, lots of public concern—is consistent with the viewpoint that we have both been discussing.

**Chris Woolard:** Yes. Factually there is a large share among a very small number of the major banks and the market is in a relatively stable position at this time.

**Q691 Jesse Norman:** It has not improved for the last two years.

**Chris Woolard:** I do not think there is much you can see in there. There may be some initiatives at the margin but—

**Q692 Jesse Norman:** I will show you the form of the Bank of England lending if you want. There is no improvement at all. What about capital constraints? Do you think that is having an effect on SME lending?

**Chris Woolard:** It is quite hard to say, frankly. There is clearly a question around some capital-type issues. That applies in a whole series of different markets. On the whole, though, I think we are seeing a relatively stable picture around SME lending; indeed, slightly increasing if anything. I am not sure that that is a particular issue from our point of view.

**Q693 Jesse Norman:** Do you think the banks are being pushed into mortgages that are easy to do and not SME lending, which is more costly to do?

**Chris Woolard:** I do not think we are seeing that particular picture at this time.

**Jesse Norman:** That is very interesting.

**Chair:** That was a "yes", was it?

**Chris Woolard:** I do not think we are seeing that picture.

**Jesse Norman:** It was not a "yes" or a "no", but it was inclining towards a "no", Chair.

**Chair:** It is unclear what it was.

**Jesse Norman:** These boys are well trained.

**Chair:** It seems to be an important question.

**Jesse Norman:** Did you want to have a supplementary on that before I go on?

**Chair:** No, you go on, Jesse. I just wanted clarification on whether I heard "yes" or "no".

**Q694 Jesse Norman:** That is helpful. The British Bankers Association, perhaps unsurprisingly, has called on more proportionality from regulators, asking essentially for lowered standards for less substantial banks as they get up and running. Do you have any sympathy with that viewpoint and should you?

**Chris Woolard:** I am in danger of tiptoeing onto the PRA's turf here, but from a competition point of view, looking at proportions as opposed to absolute sums, smaller banks in many ways do face proportionately higher burdens in their early life because of the level of risk that they potentially pose within the system. The vast majority of that is set by

European standards or even international standards and, therefore, the ability of the PRA to flex on that particular territory is quite limited. However, I have to say I think there is a case for looking at—particularly for smaller firms as they are early in their life—how far we seek to create a bit of a nursery and try to foster those kinds of firms in terms of competition and how far there is a trade-off between straight capital-type requirements and buffers versus how far closer supervision or whatever it might be might deal with some of the risks that we are trying to guard against.

**Q695 Jesse Norman:** In other words, a freer, more competitive and open market would be helped with a bit of flex from the FCA?

**Chris Woolard:** I think most of the flex on those kinds of requirements sits on the PRA side of the fence rather than the FCA side. But certainly one of the things we are looking at quite closely at the moment—particularly for innovative businesses we think are in the interests of consumers, so, not just copycats, but genuinely innovative businesses—is how far we can create an environment where we have a bit of a nursery for those sorts of businesses and try to help them through the early days of regulation rather than create a barrier for them.

**Jesse Norman:** I do not know if either of the other folks here would like to say anything, otherwise that is fine. Thank you very much.

**Q696 Mr McFadden:** You have mentioned peer-to-peer lenders as players in this. What is the institutional FCA view of this? Many people are excited about the entry into the market of these new players who are still small in relation to the overall sums of lending but growing quite fast, but on the other side of the ledger there could be risks. Businesses can fall over. Lending can fail and so on. Are you, as an institution, excited or concerned?

**Chris Woolard:** I think we are neither. Clearly it is a growing area of business. I think we are interested in it from the point of view of the fact that it provides some alternatives for both those investing and indeed those borrowing and it is a new entrant within that particular piece of the market. We are interested from that point of view. We are trying to strike a balance in our rulebook between some protections for investors, which are largely about being clear on what you are getting into and having been essentially sold the proposition in an honest way that compares like for like rather than giving you all the upside and none of the downside; so how do you get that transparency of information? However, like any form of investment, it carries risk and you can't avoid that.

**Q697 Mr McFadden:** Do you think the investors are aware that they are not covered by the deposit protection that exists for depositors in banks?

**Chris Woolard:** In terms of loan-based crowd funding—this is where you are providing money for a loan as opposed to an equity investment in a firm—I think our disclosure rules are pretty clear. People have to be aware that they are not covered by FSES. As we said when we put these rules in place, given it is a relatively modest industry and given that we have provided some protection in terms of client monies within our existing rules, we do not think that it is proportionate at this moment to introduce FSES because obviously that comes at a cost to the firm and ultimately to the people investing in it. However, that is one of the things we will keep under review. If over time this grows into more of a mainstream activity one of the things we will have to think about is whether there should be membership in the FSES.

**Q698 Mr McFadden:** Jesse Norman referred to capital requirements. Are these organisations under the same capital requirements as banks?

**Chris Woolard:** They are not under the same capital requirements as banks. Certainly we do require the loan-based crowd funders to keep money available in case of the need of resolution. There are some capital requirements in place but they differ to the ones for banks. They are lighter requirements than the ones for banks.

**Q699 Mr McFadden:** The Chairman began the session this morning by talking about competition and how competitive the whole scene was. When you are looking at this do you regard the growth of this market, the growth of peer-to-peer or crowd funding, as an important part of making the overall lending environment more competitive? In other words, you are not just thinking about new bank entrants but you are also thinking about non-bank, different forms of lending?

**Chris Woolard:** Yes, absolutely. We take a rounded view. There are obviously three key types of crowd funding we are talking about here. We are talking about the equity investments and we are talking about so-called mini-bonds and those kinds of things. That range of alternative investment vehicles is an important part of the landscape. But when we think about competition we have to have it in proportion. Depending on whose numbers you use—whether you use ours, which are about £0.5 billion, or the industry's, which are about £0.8 billion—the crowd-funding industry in total is very small and nascent at this moment compared to overall bank lending, which is about £112 billion.

**Q700 Mr McFadden:** Do you think we are going to be sitting here or a treasury committee is going to be sitting here with you or your successors in a few years saying, "Why did no one foresee that lots of people would lose money on investments thorough crowd funding?" We have had periodic new products taken up in a lot of ways and then people find there is something wrong and they go to the regulators for redress. Do you think that is going to happen?

**Chris Woolard:** In terms of the crowd-funding market, we have been quite careful to say there are potentially risks. There are clearly higher risks depending on the type of crowd funding that you are engaged in. If you are investing in a firm on an equity basis and you are taking a stake in that firm there have been cases where firms have gone bust and taken all of the investors' money with them. There is yet to be a scheme where people are seeing a return because it is a long-term investment and it is a relatively young industry. Other parts of it, though, particularly loan-based, there is, relatively speaking, less risk; although if you are using one of those vehicles, as you pointed out, you do not have certain cover, including FSES.

**Q701 John Thurso:** Can I come to you, please, first, Chris Woolard? You and I met in company with Martin Wheatley a short time ago and I asked you and Martin, in relation to what are called embedded swaps—but we know they are not, they are TBLs—whether the fact that the FCA's legal advice says they cannot regulate it is a matter of regret in that you would like to be regulating this, are keen to but feel constrained by the law and can't; or whether in fact the fact that you can't is something that is quite good news for you because you do not want to do it. Do you want to do a regulatory job or are you happy to be protected by the definition the lawyers have given you?

**Chris Woolard:** That is a particularly fine way of asking the question, if I may say so. Martin is on the record. He wrote to the Treasury. Back to the "if it quacks like a duck" question, I think we are of the view that this is a product that appears to be so close to one where we have had significant regulatory questions it would be better if we had the ability to regulate it. Equally, I suspect if the Treasury were sitting here, and they may well be behind me at this moment—

**John Thurso:** Good Lord, so they are.

**Chris Woolard:** —indeed they will be sitting in this seat in a moment, I think the test they would set is the one that was very much pushed back to us when Martin wrote. That question was: is there significant evidence here of harm? At the moment, it has to be said I think, the numbers of complaints we are seeing and the number of ombudsman cases are relatively low. From the FSA perspective clearly we would prefer to have some tool to deal with this.

**Q702 John Thurso:** You have taken a slightly longer time to give me the answer that Martin Wheatley gave me, which was, "Yes, please. We would like to be able to regulate this and it is up to Parliament to change the law accordingly to allow us to do it". Would that be broadly what he said to me?

**Chris Woolard:** I think that is probably what he said to you, yes.

**Q703 John Thurso:** Can I then come to another issue, which is that in evidence to this Committee the chief executive of Clydesdale, David Thorburn, talking about the process of how these products were sold, made clear that a member of the treasury department of National Australia Bank was called into the sales process and undertook the work. What he said was, "That is all these people did, representatives of our parent company. They were trained to sell this product range. They were regulated." The inference was quite clear that they were brought in because they had the competence. The relationship manager did not. They were trained to sell the product, whether that is good or bad, and they were regulated. In his view they were regulated. Has the FCA looked at the possibility of talking to NAB since, in fact, it would seem that the product that was being sold was an NAB product about which Clydesdale seemed to have relatively little knowledge?

**Chris Woolard:** I am going to ask Nausicaa to fill in some of the detail in a moment but, in terms of the question of whether they were regulated or not, my understanding is these were financial advisers who were regulated for the sale of products that were within our regulatory boundary. They were what were known as CF30s. What you can't do is simply say here is someone who is qualified to sell regulated products and they are going to take what is effectively an unregulated product and somehow they are regulated while they are selling that. There is a bit of a misnomer in terms of what was said on the record there. Nausicaa, do you want to add some detail?

**Nausicaa Delfas:** Yes. As mentioned earlier, the product in this case was an unregulated commercial loan and the swap was entered into by the bank.

**Q704 John Thurso:** I understand all that. Take that as read; I completely understand that. My point is this, which we had not understood before that evidence. The actual sale of the swap element or its implications was undertaken by an employee of NAB, from their treasury department, who accompanied the relationship manager. In the sale process you have a Clydesdale employee/relationship manager who says, "This is a jolly good thing and this is how we will fix it for you". You then have an NAB employee who is explaining how it all works. The fact

that when you accumulate that you might think it is an unregulated product is not the point. The point is that a separate institution selling a separate product—it is back to our duck and all that—is there. It seems to me at least it would merit looking into how that process worked to find out if in fact it did fall within regulation.

***Nausicaa Delfas:*** Our understanding is that it does not fall within regulation.

**Q705 John Thurso:** Were you aware that it was a separate bank with a separate licence and that it is a separate employee that was making the sale?

***Nausicaa Delfas:*** I have read the evidence of Mr Thorburn, but obviously Clydesdale—

**Chair:** Sorry, was that a “yes” or a “no”.

**John Thurso:** That is a “yes”.

***Nausicaa Delfas:*** That is a “yes”, sorry.

**Chair:** We got that one.

***Nausicaa Delfas:*** But obviously Clydesdale/National Australia Bank have set in place a proactive review for the complex products and are dealing with others through the complaints process. So they are addressing that.

**Q706 John Thurso:** But in the light of that evidence the FCA has not decided to have another look to see if it is worth checking whether in fact there was some regulated activity being undertaken?

***Nausicaa Delfas:*** We believe the activity is unregulated.

**Q707 John Thurso:** You did before, but I am asking post that evidence.

***Nausicaa Delfas:*** We have not changed our view.

**Q708 John Thurso:** Okay, so nothing has changed there. Thank you very much.

Can I just ask you one last question, either of you, before I move on to FOS, which is regarding the sophistication test? Would you confirm that as a matter of law your sophistication tests are in fact just guidelines and in fact the legal interpretation of sophistication is quite separate to those you put in place—apart from obviously FOS, which is a different one—but in regards to who is or who is not a sophisticated customer?

***Nausicaa Delfas:*** We based our sophistication test for the interest-rate hedging products review on the Companies Act definition. We found through the pilot study that the boundary did not work in some cases, so we have tightened that up. We were challenged in the Administrative Court as to where we landed, but the court supported our view and explained that it is acceptable for us as a regulator to set these thresholds as a way in which to have a workable scheme for redress, to deliver redress quickly to consumers and deliver our consumer protection objective.

**Q709 John Thurso:** That is a very interesting answer and it is absolutely right in setting the parameters for what you do. But as to what constitutes sophistication in terms of the law it is not the answer because, in actual fact, if a company were to undertake a legal action the sophistication test would not be the test that you have applied but the test of what is a sophisticated customer. Is it not in fact the case—if one looks for example, at publicly-available evidence from the Guardian Care Homes case and other evidence—that it is quite probable that virtually every single one of these transactions would have been considered as unsophisticated before you get pretty much up to a plc level?

***Chris Woolard:*** Depending on the circumstances in which you find yourself and depending on the particular piece of jurisdiction you are operating under, you can have varying levels of sophistication. For these practical purposes, as part of going through the process around interest-rate hedging products, the piece around sophistication has been used very little in determining whether someone qualifies for a review or not. I think it is in a very small number of cases that it has come into play. But clearly it is open for anyone to test this before the courts.

As far as we are concerned, in terms of the definition we are using now to try to make this scheme work, it has been tested. The judge took the view that it was a perfectly normal proxy in financial services to use a limit as a substitute for sophistication or a proxy for sophistication. This is one of those questions where I suspect we both may be right in terms of our answers, which is that there are clearly a number of different definitions of sophistication used in different pieces of legislation. For the purposes of this scheme we have one in place that has been tested by judicial review.

**Q710 John Thurso:** To be clear, for the purposes of this scheme it is considered to be adequate, but for the purposes of an actual court case as to whether or not somebody was sophisticated under financial legislation in all probability it would not be: that is broadly where we are.

**Chris Woolard:** I am with you all the way up to the words “would not be”. Others may wish to test different definitions of sophistication in court. We would hold the position that ours is adequate.

**Q711 John Thurso:** I will not go any further. I will just quickly, if I may, come to Mr Boorman.

You had a number of complaints come into you regarding Clydesdale about TBLs at an early stage. In the early stages many of them were rejected for a variety of reasons. More recently, FOS, if I can paraphrase, is well up to speed and there have been quite a lot that have been found in favour of the client as opposed to the bank, the latest one being the one that I think will appear on your website under the heading of “Business K”. My question is this: would you accept that in the early stages some of the decisions made by the adjudicators were not in fact in full possession of the facts and if those cases came before you today a different conclusion might be arrived at?

**Tony Boorman:** Yes. I will just quickly say where we are.

**John Thurso:** Yes, okay.

**Tony Boorman:** It is with some difficulty, obviously, that I talk about individual cases and individual firms, but we, as you are aware, have a number of cases outstanding in relation to these hedge-like products; the ducks that are not ducks in the words of my FCA colleagues. From our perspective they are very firmly within our jurisdiction, subject to the limitation around the size of the business and all this stuff about sophistication and unsophistication does not apply to the tests that are relevant for us.

Broadly speaking, the analysis that my ombudsmen have done suggests that our outcomes for the tailored business loans will be very similar to the analysis that we are undertaking in relation to the swaps cases. You will recall that the lead decision I issued personally on our swaps cases just over a year ago was clear on how we thought about all those issues. Have some new facts emerged into the picture about the behaviour of banks in relation to these sales processes? I think the honest answer to that is yes. Work that Bully-Banks and others have done, and the regulator has done in its investigations, has drawn our attention to a set of more systemic concerns about the way in which a number of these transactions were undertaken.

I was listening and observing thoughtfully your points around the particular engagement of regulated persons in the context of Clydesdale. I have to say, when I am speaking with my ombudsman colleagues who are dealing with these cases, they say sometimes the

situation is more difficult for the customer to understand in the case of these hedge-like products because they just speak to their business relationship manager—the ordinary guy or lady that they have been speaking to about the loan—who suddenly says, “There is this slightly complicated little bit of this story”, and explains it well or, often, does not. At the least in the case of pure hedge products what usually happens is that the business relationship manager says, “I now have to introduce you to somebody from the regional headquarters who will talk to you about something odd”. So at least the customer is very clearly put on alert that there is something different happening there.

I am expecting we will issue a final decision on the particular case and the other cases will follow on from that. That is a set of issues, of course, that we keep our regulatory colleagues in line with, but about half of the cases that I now have and am dealing with—out of about 500 or so on our desks—relate to non-hedge products; so the hedge-like tailored loans, those sorts of products.

**Q712 John Thurso:** You started your answer with the word “yes”. Can I take you back to that? What can we do for those people who had a decision right at the beginning that if that same case were to come before it today might receive a separate decision given that there is no review from the review by FOS. Is it just “tough luck”?

**Tony Boorman:** I am going to give you one of those terrible depends answers. What can I do other than apologise right at the beginning for a depends answer?

If one of my ombudsmen has made a final decision then I fear that is the end of my process. If we have not made a final decision then there may be something we can do to look at that again. There have been a few cases in the context of the pure hedge process that have gone back through the review—some cases that we did very early on in the process that have gone through the FCA review—and an outcome has emerged out of the FCA review. I think Nausicaa was describing a world where Clydesdale in particular is looking at the more complex products it produces. Certainly if they were involved they would go through the review process.

**Q713 John Thurso:** My final question to you, if I may. It is quite clear that now your guys are up to speed and are producing some very interesting adjudications but you are limited by the size of the business and the amounts involved and the amount of compensation. In the Banking Commission we looked at this and, from memory—the Chairman will correct me—I believe we recommended it should be put up. The Treasury Committee has looked at this and believes it should go up. How

high should we go before we get outside of the genuine SME and into somebody who should know better? Should we be looking at £250,000 or £0.5 million or what?

**Tony Boorman:** Can I make a couple of observations on that? First of all, the scope of my jurisdiction is not my decision. That is for my friends in—

**John Thurso:** No, that is for us to do. I am asking for your advice as to what we should do.

**Tony Boorman:** Technically it is for my friends in the FCA to decide immediately and I believe they are consulting on that issue later on in the year and I am sure that is one of the questions that they will ask. As I said to the commission, there is a very rich tapestry of business customers. We are talking about 150,000 or so businesses, perhaps 200,000 businesses, who might in some context be described as “small” who fall outside my jurisdiction and, of course, they—

**Q714 Chair:** Sorry, just for clarification, we are talking about the Banking Commission here, are we?

**Tony Boorman:** Yes. Apologies, Chairman.

**John Thurso:** That is you, Chairman.

**Chair:** No but it is for people outside. They would not know what on earth is—

**Tony Boorman:** Yes, it is the commission that has now completed its very helpful work.

There is a rich tapestry of customers in that context. I think that is a genuinely difficult issue. My concern, if I may put a very parochial concern, is, no, my award limit is £150,000. That nearly buys an averagely-priced house nowadays. Perhaps not. What it certainly does not do is provide me with award powers that cover most of these swap and swap-related cases, even some that fall within my jurisdiction. The lead decision I made a year ago probably cost the bank concerned about £3 million. It did not technically have to follow my decision, but it agreed to meet my recommendation obviously because it closely followed the views of the review.

We can't entirely take separately the question of the scope of the ombudsman service and the powers that Parliament and the regulator decide to give to the ombudsman. I think my board and I have two sorts of concerns. One is that we do not give with one hand but not with the other. Saying that I can involve myself in disputes for £25 million turnover businesses but my award limit is £150,000 is perhaps

a slightly strange offer to make. I am all in favour of making clear offers. The other concern is clearly at some point from my perspective a business-to-business dispute is one that is better resolved in court with court procedures rather than through an ombudsman service that is invited by Parliament to be informal and to make decisions on the basis of what is fair and reasonable.

I think there is a slightly philosophical question about how high would you like the ombudsman to go as well as broadly across what sectors.

**Q715 John Thurso:** But you would agree to setting it higher both in terms of size and award than where you are now; ideally?

**Tony Boorman:** As an ombudsman I always keen to offer our assistance to as many customers as we can.

**John Thurso:** Thank you.

**Q716 Chair:** Just before we leave that subject—how shall I put this? When you are sitting in your office on a quiet day do you ever jot down on the back of an envelope the powers and remit that you would like?

**Tony Boorman:** I have to say I can't remember such a day where it was that quiet or I took the time to do that. I think genuinely we are content with the powers that we have. The ombudsman has quite extensive powers not just to make awards but to issue directions to firms. I am pleased to say that in general, certainly in the banking sector, our decisions are well-respected and followed.

**Q717 Chair:** I just want to clarify this one key point. When you say you are content, is that you saying, "I am prepared to live with what I have", which is one end of the spectrum of contentedness, or is it saying, "This is what I want"? That is the question I am asking you.

**Tony Boorman:** I am certainly content with what I have, Mr Tyrie.

**Q718 Chair:** All right, that is the base case.

**Tony Boorman:** The base case is established.

**Chair:** Now, what about the other end of the spectrum?

**Tony Boorman:** Not so much in the context of this. But there is a question mark that we have raised with the FCA in the past about the scale of our award limit. £150,000 is a lot of money and, again, we make an award on the basis of what is fair and reasonable and that is

often controversial in the sector, but when you think about a fairly typical house burning down—

**Q719 Chair:** We have rehearsed this point. If you want to write that down on the back of an envelope or not or in more detail, this inquiry by this Committee is an opportunity for you to put those in the public domain.

**Tony Boorman:** Thank you.

**Chair:** We are not going to demand it of you, but it is available to you. I want to put one last question in this area and then one very quick question from Steve Baker, because we are running behind time and then I know Mark Garnier has one or two quick questions as well.

**Mark Garnier:** Or three or four.

**Q720 Chair:** Three or four. You have said in earlier evidence just now, I think to John, that the courts are the correct place to sort out company-to-company disputes. Has anybody in the FOS given any consideration to the overall economic or welfare benefits to a quicker resolution procedure that can be called upon, which after all was one of the purposes for the creation of ombudsman services in the UK in 1960 whenever it was?

**Tony Boorman:** Certainly we are firm believers in there being significant benefits to that. We have not conducted much economic analysis of it, I confess, and it is quite difficult to construct some of the counterfactuals that you would need to do.

**Q721 Chair:** But is it not a crucial judgment that you need to make in order to come forward with the view, “Well, that should be for the courts”? If the courts end up log-jammed with heaps of very complicated cases, is that where you could cut the Gordian Knot?

**Tony Boorman:** You are very tempting as to the suggestions I might make in response to your invitation, Mr Tyrie.

**Chair:** I am having a go, yes. It is my job.

**Tony Boorman:** It is. I am just reflecting equally the nervousness of my board, and I have to say of myself as the ombudsman, about taking the ombudsman, with our powers of resolving matters on a fair and reasonable basis, into very sizeable financial disputes.

**Q722 Chair:** The social scientists tell us that bureaucracies have inherent in them a tendency to expand and your restraint is noted and

admirable. I am pointing to a set of economic arguments that it could be argued are pointing in another direction.

**Tony Boorman:** I am very much in favour of those economic arguments, but I do believe that an ombudsman service provides those values.

**Q723 Steve Baker:** When we are considering the range of scope you all have sometimes I think it would be very easy to forget that we are all agreed that you and the market participants ought to be bound by the rule of law. When Mr Mudie mentioned to you a specific example of how a property might be undervalued in order to obtain an advantage by a bank—and it is something that came out, Mr Boorman, while you were speaking as well—I wondered what arrangements you all have in place to detect and prosecute simple fraud, where criminal activity has taken place among banks.

**Chris Woolard:** The FCA does not on the whole engage directly in those kinds of prosecutions. We do work quite closely with people like the Serious Fraud Office and indeed the police on occasion and we will pass and refer different issues if we come across them in the course of a case.

**Tony Boorman:** If we see serious issues of any sort that require regulatory or legal intervention that is outside our powers we will refer those in the first place to the FCA.

**Q724 Steve Baker:** Just finally, if I may, if two parties were to conspire together deliberately to undervalue a property, might that be a fraud that you would see was prosecuted? Might it be a fraud?

**Chris Woolard:** I would like to take a proper opinion on that, but, in theory, in the ordinary and natural definition of it, it sounds as if it is something you would want to go look at. Yes.

**Q725 Steve Baker:** Do you think it is conceivable that you are possibly too slow to pursue criminal sanctions when they might be available?

**Chris Woolard:** I think, on the whole, we pursue criminal sanctions around those areas where we are the lead criminal authority. There are fairly regular contacts between ourselves and other law enforcement agencies, particularly the police, where we have those kinds of issues.

**Q726 Mark Garnier:** Members of the FCA, to what extent do you oversee and regulate banks' internal complaints procedures?

**Chris Woolard:** For pretty much most complaints that banks deal with we have the ability to ensure that they have to abide by our wider rules around complaints procedures. One of the main points of entry we have to wider banking businesses that are outside of our remit is around the complaints process that they follow in dealing with their customers.

**Q727 Mark Garnier:** How do you oversee that? Do you go in and dig around and get it out in the open and that kind of stuff?

**Nausicaa Delfas:** There are a couple of aspects to this. First of all, we use transparency. A lot of the banks publish their complaints data and we have that on our website. We look at complaints. We have done in the past through a thematic review, after which we fine some banks. We use the complaints data and the intelligence we have on the handling of complaints for primarily three key indicators: first, how many complaints a bank is receiving; secondly, how many complaints are upheld; and, thirdly, how many are referred to the ombudsman. Of the back of that we may look to identify whether or not customers are being treated fairly in the complaints process and whether or not the banks are also looking at the root causes of the issues of those complaints.

**Q728 Mark Garnier:** That is quite an interesting point because on the Banking Commission we almost came to the conclusion that a lot of the Big Four banks are using FOS as an outsourced complaints department because they were just simply not dealing with it.

Ms Delfas, you mentioned transparency in terms of the complaints process and yet there is a huge amount of dissatisfaction among those people who are involved in the interest-rate hedging product scandal that the agreements between the banks and the regulators is absolutely secret when it comes to the redress schemes. Do you have anything to say about that?

**Nausicaa Delfas:** Referring to the statutory restriction that we are operating under as the FCA, we cannot disclose information between us and the firms, but we have produced a great deal of information on interest rate hedging products on our website and through discussions with MPs, campaign groups and media. There is a great deal of information about the review in the public domain.

**Q729 Mark Garnier:** I would certainly endorse that as vice chairman of the APPG. On this particular point you have engaged very well. I think it is laudable. Nonetheless there is a lack of transparency about things like alternative product redress offers and, having been involved in this quite heavily, I cannot see what the benefit is of keeping

these agreements secret. Given this opportunity for public scrutiny into this whole area, it seems there would be a huge benefit of revealing what the agreements are and what the expectation between the FCA and the banks are themselves.

**Chris Woolard:** It is probably worth saying we would be the first to recognise there is a tension here at the heart of this question, which is on the one hand the ability of this Committee, like any committee in the House, to call for papers and documents and evidence and on the other hand the operation of section 348 in particular, in terms of primary legislation and where it sits at this time. From our point of view we have tried to be as transparent as we possibly can within those constraints and tensions. There are absolutely issues around that. The banks could, in theory, consent. Indeed, I think last time you had Mr Adams in here as a witness one of the things he undertook to do was to have a series of conversations. We do not have that consent and, therefore—

**Q730 Mark Garnier:** Do you think the banks are sending a very bad message about the whole of this redress process, that they are not prepared to reveal the details of the agreements they have reached?

**Chris Woolard:** Personally, I think it is creating an area of mystery around it that is not particularly justified. I think the agreements themselves are relatively straightforward. They are relatively standard between each of the institutions and to some extent I think it is creating a situation in which there is a bit of a distraction, frankly.

**Q731 Mark Garnier:** The answer is “yes”; basically you think it would be a good idea. Just one final question, if I may, Chairman. All of these reviews and redresses have been conducted on a voluntary and mutually-agreed basis between the banks and the regulators. Have you ruled out any enforcement action against the banks on this or is that still an option open to you?

**Nausicaa Delfas:** We have not ruled it out but obviously our focus is to follow through with the redress scheme and make sure that redress is delivered to customers as soon as possible. That is the focus of our attention.

**Q732 Mark Garnier:** Sure, but once that is done that will leave you a big amount of space in order to try to start that, I guess.

**Nausicaa Delfas:** We will have to assess that at that time but our focus is on the redress scheme at the moment.

**Q733 Mark Garnier:** Speaking as a banking commissioner as well as a member of the Treasury Select Committee, obviously what we are trying to do is to see how your interaction with the banks is going to drive better behaviour for the banks. Clearly this is a sorry story of appalling behaviour by the banks who were basically trying to make a bit of—there are a lot of reasons why it went on and I will not go into the details. Without having any enforcement action, what alternative method do you have to drive the banks to behave better if they think they can do this and the worst that will happen is they will simply have a moderately expensive redress scheme?

**Nausicaa Delfas:** Obviously this is an expensive redress scheme. It shows the costs of mis-selling and the costs of not treating customers fairly. Obviously, through our supervisory approach, we look at the culture, business models and strategies of banks. We have powers that we can use through supervision, as well as through enforcement, to require action and we have seen certain improvements as we have adapted our approach in becoming the FCA. We have taken action, for example, on financial incentives and the way that firms pay their sales staff and that has caused a number of banks to change their schemes already. There is movement in right direction. Obviously there is still a way to go.

**Tony Boorman:** I wonder if I could drop in at this point because complaints is an issue we are interested in.

I do think the whole notion of the regulation of complaints is a fairly difficult and balanced judgment. If I can go back to the Committee's earlier questions about competition, one would hope in a competitive market that people would be responding thoughtfully and constructively to their customers' concerns. That is how some of those models work, isn't it? It is a disappointing feature of this market that regulation seems to be so required in the handling of customer complaints. I manage to deal with lots of retailers about lots of difficult things. It does not need much active supervisory regulation to achieve that.

As the Banking Commission, I think, considered itself, a lot of this is about culture and the culture of the leadership of these organisations. I have to say, from my discussions with the chief executives, certainly of the major banks, it is a point that they have very much taken to heart. One can—and I suppose I do because I am kind of paid to do so—treat that with a degree of cynicism given some of their past record. But I have to say some of the messages coming down very clearly from boardrooms—thanks to the pressure that this Committee and the regulator have placed—is beginning, in my judgment, to make a bit of a difference. It is early days, but I do think there are positive signs that are now evident in some of the major banks that they are looking again at this issue.

If I were to have an area of concern, I suppose that the SME sector and those engaged with SMEs have been, in my experience, some of the least customer-focused of the people that I meet in the banking sector. I think that is one of the challenges that the review process and all of us have been facing.

**Q734 Mark Garnier:** Can I just make one final point? I entirely agree with you that I think the will from the senior management of these banks is absolutely sincere in trying to drive better standards. I have no doubt that that is the case.

What troubles me, though, is the interaction between the regulator and the banks when you have enforcement actions. I think the best example of this is the fine levied on Lloyds for the mis-selling of these insurance products. This was very much a new crisis. It was 2010 to 2012 when this happened, so well after the banking crisis and well after there was this resolve by the banks to tidy up their act. This was clearly a new type of scandal.

What troubled me was Mr Wheatley's evidence that he gave to this Committee where he said that none of the people who were doing the mis-selling—only the managers that had been incentivising them—were brought to any account with the regulator. I think they referred to it at the time as a post-modern Nuremburg defence: they were only obeying their bonus incentive scheme. It troubles me that if you want to try to drive standards you have to do it in the line of defence. You have to do it absolutely with those people who interface with the ignorant customer, or maybe less ignorant these days. If you let those people off the hook you are not going to get the push-back to the managers to question whether what they are being asked to do is the right thing or the wrong thing.

I do not necessarily need a response to this, but the point I would make is this: do not hesitate to bring enforcement action against those people absolutely in the front line who, for some reason, think selling their goldfish an insurance product is a good idea to meet targets. Clearly they think something is going wrong and they should be doing the push-back and incentivising them with a bit of stick and carrot is a way of making sure that you are driving better standards right from the first lines of defence, that interface with the customer.

**Chair:** No response at all to this last statement?

**Chris Woolard:** I am very happy to give you a response. I know you are pushed for time.

**Chair:** We are always pushed for time but if you have something concrete you want to put on the record please do.

**Chris Woolard:** I will just say, very briefly, clearly the banking format gives us new powers around senior persons and indeed the regime that flows down from that. As we have said publicly, we expect to consult on that very quickly but, in terms of the points you have made, Mr Garnier, we are very aware of those.

**Q735 Chair:** The Banking Commission was—and this Committee is too—particularly concerned about certification and the application and implementation on which there was some initial foot-dragging and we are still concerned about it. That was a statement. Mr Boorman?

**Tony Boorman:** I spend a bit of my spare time, when I should be writing envelopes for the benefit of the Chairman, as a non-executive of my local hospital and I think the steps that the health service has taken to remind us that frontline staff have some responsibilities for whistle-blowing when the wrong pressures are in place are an interesting comparator model for us to have a little think about.

**Chair:** That is very helpful. Thank you very much indeed for giving evidence to us this morning. We are going to take a five-minute break and resume at 11.28am.

### **Examination of Witnesses**

*Witnesses:* **Andrea Leadsom MP**, Economic Secretary, HM Treasury, **Alison Cottrell**, Financial Services, HM Treasury, and **Jeremy Pocklington**, Director, Enterprise and Growth, HM Treasury, gave evidence.

**Q736 Chair:** Thank you very much, all three of you, for coming to give evidence this morning and thank you in particular to a former colleague of ours for coming. It is very good to see you again and it is always good news to discover that promotion is possible from this Committee into the ranks of Government. I felt that to describe it as a promotion would be the right thing to do but in time, Andrea, you are going to tell us whether you think it is indeed a promotion. Can I begin by asking you whether you have found that your enthusiasm for competition in financial services, which was very much in evidence when you were with us, has in any way been dampened now that you are in the Executive?

**Andrea Leadsom:** Thank you, Mr Chairman, for inviting me here today. The first thing I would like to say is I am very much missing the Select Committee. I am delighted to be back even though not in my usual place, which is now taken over by Mr Baker, very admirably.

The second thing I wanted to say is that the four years on the Treasury Select Committee is the most astonishing preparation for ministerial office in the Treasury.

The last thing I want to say is that on arriving in this role—where, as you know, I have been for just over two months—it is incredibly impressive to see the influence that the Treasury Committee and others have had on the way that thinking has developed in the Treasury. My early observation is that the system works, that the Treasury Committee does a fantastic job. If I can flatter you, without at all hinting that I might want you to be kind to me in the questioning, then I will do so.

But specifically in answer to your question, no, my enthusiasm for competition is stronger than ever. I certainly think that the influence of this Committee on the competition agenda has been felt. There are a number of measures that the Government has taken—I am not sure to what extent they have been fully explained to the public as a whole—not only on competition but also on transparency to try and promote greater competition. These are two features of what I have seen on arriving in office. I am happy to expand on that if you would like me to.

**Q737 Chair:** Why don't you say just a few more words on that since you have obviously given some thought to that point before you arrived?

**Andrea Leadsom:** Well, specifically on transparency, which is so important, as we know, we have 80% of all SME lending is done by the Big Four banks.<sup>1</sup> The Herfindahl Index of Concentration suggests that the BBA's latest estimate is that SME lending is just over 2,000, which is extremely concentrated, versus other measures on, for example, credit cards at just the concentrated level. SME lending is a particular problem. Obviously we cannot suddenly magic a whole bunch of new challenger banks overnight, although good progress is being made. So what the Government has been doing is looking at measures to improve the data sharing. For example, in the Small Business Bill last week we have announced that credit histories will be required to be made available through credit ratings agencies so that challenger

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<sup>1</sup> *Note by witness:* meant to say '80% of SME's main banking relationship is with one of the big four banks'

banks, with permission, will be able to look for new opportunities for lending. We are also consulting on requiring the big banks to make referrals. So where they do not make a loan, they will be required to refer to challenger banks to give them the opportunity. We have also got the postcode lending data, which requires the big banks to demonstrate by postcode where they are lending so that challengers can see where the gaps are.

Another new initiative, which I launched just a couple of weeks ago, is the business banking insight, which is a quarterly survey of a random group of SMEs that will rate them according to service, availability of funding, terms and conditions in all different categories. So it is, if you like, an SME-led insight, which first of all enables banks to look at themselves and areas they can improve on but also for challengers to see what they could do, where the gaps are and so on. So all of those things are I think are really important in improving the competitive outlook.

**Q738 Chair:** Do you feel overall that the regulators have done enough to push forward the competition objectives that we gave them—for which you were a great enthusiast, and indeed instrumental—in getting further action on the statutory objectives of the PRA?

**Andrea Leadsom:** That is a really difficult question to answer. Regulation has been a bit of a moving feast, as we know, since 2010 where we completely changed all the regulation and things have moved on. As you have just heard, the Financial Ombudsman Service is now looking at whether it should go up the scale.

**Q739 Chair:** Why don't I put the question slightly differently and in an easier form: are you able to give us a commitment you are going to help us hold their feet to the fire in making sure they do this and make it effective?

**Andrea Leadsom:** Absolutely. Yes, absolutely. I certainly think one area where there has been enormous improvement is in the provisional authorisations for new banks. I think we were all quite taken aback in 2010 when we discovered that Metro Bank was the first new full service banking licence in 100 years. Now the PRA is in talks with over 25 new banking applicants and they have had something like 47 pre-banking authorisation discussions. So that is a raft of difference, but, yes, I can certainly give you that assurance.

**Q740 Chair:** Someone in the Treasury is keeping an eye on making sure that another logjam doesn't develop and making sure there are no Catch-22s in the system?

**Andrea Leadsom:** Absolutely, yes.

**Q741 Chair:** One last question before I pass the questioning on to Jesse Norman. There is quite a lot of unregulated lending, not by volume but by type, developing in the market. How much unregulated lending do you think we can accept?

**Andrea Leadsom:** There are particularly new diverse sources of finance such as peer-to-peer and crowd funding, and in those new markets—peer-to-peer we already know is being brought under a regulated environment and crowd funding is being considered for that and consulted on<sup>2</sup>—where new and completely diverse sources of funding are emerging it is important that we stay on top of it and have a close look at it and make sure that it does not become either a systemic or, indeed, a mis-selling risk. I think it is important that we stay on top of things as they change, however there is this fundamental principle that business lending itself is not regulated. It is provided normally by regulated entities but business loans themselves have not traditionally been regulated and I think according to the industry, there is not an appetite for general business lending to come under regulation.

Do you want to add anything to that, Ms Cottrell?

**Alison Cottrell:** No, I think that is absolutely right and one of the balances we always have to strike is when we get the innovative sources of lending and other sources of funding developing, at a point you do get a demand from those firms for regulation. Generally that is because it helps them reputationally; it makes sure that everyone in the market is behaving well on a level playing field. But what we have to be very careful about and work very closely with the regulators on is to ensure that regulation when it is brought in is proportionate so that it does not just protect the incumbent and keep other new entrants out. That is what we have seen, as the Minister referred to there with respect to peer-to-peer and crowd funding.

**Q742 Jesse Norman:** I must say that last sentence is not what I would have expected a Treasury official to say. I am very pleased to hear you say that: proportionate; keep barriers to entry low, encourage the competition. That seems thoroughly good.

Minister, may I say, we have gained a son but we also lost a daughter and we are very much missing her? May I also say how thrilled I am that your transition to the Treasury has not affected your trenchancy of

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<sup>2</sup> *Note by witness:* meant to say that ‘the FCA has recently published details of its approach to regulating crowd funding’

language at all? The Committee, as you can appreciate more than anyone, enjoys crisp answers.

**Chair:** And questions.

**Jesse Norman:** Thank you for that, Chairman. I look forward to your interventions on my questions. Minister, I take it that you still think competition in this area is pretty inadequate.

**Andrea Leadsom:** Absolutely, yes. In the area of SME lending, absolutely, yes. There are improvements but there is a long way to go.

**Q743 Jesse Norman:** Would you also share my view that competition is not antithetical to safety; that competition and safety sometimes go together because you have, as it were, a more spread-out, more resilient market and not quite as—

**Andrea Leadsom:** Yes, and I would add a third, which is transparency. I think if everyone knows what is going on, they know what is on offer, they know when they are being given a bad deal and they know where they can get a good deal, that also keeps things safe and is as good as regulation in many ways.

**Q744 Jesse Norman:** So the model we evolved was an oligopoly banking system that was supposed to be safe but turned out to be not at all safe?

**Andrea Leadsom:** I completely agree.

**Jesse Norman:** Also rather poor on service.

**Andrea Leadsom:** Absolutely.

**Q745 Jesse Norman:** Thank you. Obviously it is a source of great concern to this Committee that SME lending has been so subdued. How would you value the Bank of England's performance on that? Obviously they have ultimate responsibility for the regulation of the system.

**Andrea Leadsom:** Following the financial crisis and the regulative changes, the new capital requirements and so on, it was completely inevitable that banks could not be in a position to just carry on lending as if nothing had happened. Equally, of course, as we know, there is a huge raft of SMEs—something like 80% of SMEs—who are not borrowing for whatever reason. So SME lending has been very poor on a net basis—on a gross basis it has been growing, on a net basis reducing—ever since 2008, 2009 and that is a function of a huge number of things.

I do not think it would be right to say that it is simply that the banks have not made finance available. Equally there is a question to be asked about why SMEs are not borrowing and that has, I presume, quite a bit to do with confidence in the economy and so on.

**Q746 Jesse Norman:** I should also ask the question whether you think the Bank of England was very slow to pick up the issue of SME lending and to try to think about how it could support that or boost it?

**Andrea Leadsom:** Yes. I think as we all recall at the time we were urging the Bank of England to look at SME lending and they were saying it was not in their remit to pick sectors. So the Funding for Lending scheme came in as a Government solution to facilitate the finance being made available to the banks and the carrot was, the more you lend to SMEs the more funding you will get. In other words, what the Government were trying to do was to facilitate that lending but the Bank of England, I think, still remains adamant that they are not there to pick sectors.

**Q747 Jesse Norman:** But the point where the Bank did start to accept that it was responsible in the SME area and was specifically trying to target small and medium-sized enterprises, that has been pretty slow and pretty ineffective, hasn't it?

**Andrea Leadsom:** It has been slow. The Funding for Lending Scheme has been rather successful, there is evidence—

**Q748 Jesse Norman:** No, but in the SME sector particularly.

**Andrea Leadsom:** No. The FSB has said that they believe that the Funding for Lending Scheme has kept costs of lending to small businesses down, and there is evidence that gross lending has grown. I would agree with you that the Bank of England was slow, but subsequent to that we have had a massive shock to the system and banks are still trying to sort out their balance sheet. So there have been all sorts of headwinds against an improvement in the lending environment that is not just about slow-to-act regulators.

**Q749 Jesse Norman:** Just to be clear, would you be comfortable with—obviously we heard from the FCA earlier—and would you support, a reduction in capital requirements; easier and more cost effective access to the Funding for Lending Scheme for these challenger banks?

**Andrea Leadsom:** I would not necessarily say I would go for smaller capital requirements. I think that is very rightly, properly, a regulatory issue that is about safe lending. But in terms of access to Funding for Lending, access to funding for challenger banks to be able to on lend to

SMEs is absolutely critical, as is data sharing, referrals access and so on to enable them to access who wants to borrow.

**Q750 Jesse Norman:** Do you think the Government ought to consider a specific further scheme that is designed to support challenger banks in the process? You now have a raft starting to get going; you might be able to get five, ten, 15 of these banks to draw on specific funding arrangements that would allow them a more rapid entry into the market?

**Andrea Leadsom:** It is a very interesting idea but it is not clear to me that you would need a specifically challenger-bank targeted measure. As I tried to outline in my opening remarks, there is a huge raft of opportunities that are there specifically to support getting challenger banks to be able to identify where the potential demand is for loans, through postcodes, through credit referrals, through direct referrals and so on. Those kinds of measures are specifically targeted to support challenger banks. It is just not clear to me that they need some other specifically financial incentive. But it is worth considering.

**Q751 Jesse Norman:** But you might consider it if the other schemes were not panning out as quickly—

**Andrea Leadsom:** Yes, definitely worth considering.

**Jesse Norman:** —or if FLS gets withdrawn then you might consider that?

**Andrea Leadsom:** Definitely worth considering.

**Chair:** Very helpful and interesting exchanges. Mark Garnier.

**Andrea Leadsom:** Ms Cottrell has a comment to make.

**Alison Cottrell:** I think it is a very good point and, as the Minister says, we are always open to new ideas, but also as the Minister has said this is just one piece of the jigsaw. You have mentioned transparency, you have mentioned specific schemes but it is also about awareness among SMEs themselves of what the schemes are and what they are doing. What we are continually trying to do is raise awareness of these schemes. One of the latest SME finance surveys suggested that about 22% of SMEs who were borrowing or interested in borrowing thought that the FLS had made it more likely that they would go and try to do that borrowing. As with the FLS and with lots of other schemes, we need to make sure that SMEs know what is out there because part of the schemes is aiming at the lender and part of it is aiming at the confidence of the borrower. It is both of those things. We

need the credit register, we need lots of other things, to bring all these pieces together.

**Q752 Chair:** I have done a straw poll at the local Chamber of Commerce and awareness, even among people you would expect to know, is we have a plethora of schemes—

**Alison Cottrell:** Absolutely, which is also where the business bank may be able to help.

**Q753 Mark Garnier:** Can I add my congratulations on your moving sideways from the Treasury Committee to the Treasury itself? Promotion.

Can I just carry on with one point of Mr Norman's? This is some sort of funding for challenger banks. The British Bankers' Association—and I know one or two other people have also mentioned this—have said one of the problems that a challenger bank has is that they can't compete on the same basis in terms of their funding costs so the bigger banks, where there is still this implicit guarantee, fund cheaper than the smaller banks can do.

One or two people have suggested that some sort of system whereby the smaller banks could have available funding at the same price as the bigger banks would be very helpful for competition. Do you agree that would help or do you think it is a bit of a red herring?

**Andrea Leadsom:** No, I certainly do not think it is a red herring. I guess I am simply saying that it is not clear at the moment that the evidence is that challenger banks are failing to lend to SMEs on the grounds of their funding cost. It seems to me that the issues are more structural around knowledge. If I am a sole trader and I never heard of—take Handelsbanken, for example—I have never heard of them and I will not think to go and ask them for money. So it is those issues as opposed to when I do find them they then cannot afford to lend to me.

I absolutely take that on board and will go away and think about it.

**Q754 Mark Garnier:** One of the issues that slightly perplexed me about bringing more competition into the banking market has been that where you tend to get a lot of competition among banks is in aiming for that very simple type of loan where you have a decent asset, maybe a factory or something, backing a loan. It is the other area of the SME market that is proving to be much more of a problem for banks, so where you have something slightly more esoteric, like the property rights on a game where you wanted to borrow money in order to try to market that. How do you see competition in the banking market being able to direct itself at that much more complex area of the SME lending rather than the traditional area?

**Andrea Leadsom:** Again, this is an argument for competition and diversity. For example the asset-leasing organisations are doing a dramatic increase in their loans to businesses, some phenomenal sum, some 13% increase in asset-backed financing and leasing financing. There are specialist organisations that are looking at more complex areas of business lending and, of course, more competition will lead to different expertise in different areas.

One quite interesting initiative: Santander has just set up an arrangement with the Funding Circle, which is a peer-to-peer group, where they will mutually refer to each other. So if Santander turns someone down because of complexity or because it does not meet their credit scoring targets or whatever, they will refer it to the Funding Circle, which may have individuals who have a bit of spare cash who would be interested in that loan. All that competition diversity is intended to promote a diverse range of availability of types of finance as well as just different lenders.

**Q755 Mark Garnier:** Are you happy that the diversity element of that is working as well as you would have hoped?

**Andrea Leadsom:** No, I don't think it is. We are still at an early stage. The continual net reduction in lending to SMEs is very regrettable and the day that net lending is up will be a day for celebration. But, equally, that has to do with confidence in the economy; it has to do with businesses wanting to borrow and whether they want to just borrow a straightforward term loan or a short-term loan or an overdraft or asset-based financing. That is all a function of supply and demand. We need the economy to be growing as it is and we need lots more competition and diversity. We are getting there. We are all heading in the right direction but there is a long way to go still.

**Q756 Mark Garnier:** Any significant barriers to entry, to diversity, that you can think of?

**Andrea Leadsom:** No. I think the Chairman's point about regulation of new sources of funding is important, that the regulators stay on top of any new emerging area that could become problematic. But otherwise, what the Government wants to do is to encourage more innovation. Just literally a couple of weeks ago I was speaking at the 50th anniversary of the Credit Union Movement— a very longstanding group of organisations but doing a fantastic job, and a diverse source of funding—which encourages people to save as well as to borrow. So encouraging those diverse types of organisations as well is very important in the overall mix.

**Q757 Mark Garnier:** My final question, if I may, Chairman? There is a lot of talk about regional banks, local banks and that kind of stuff: do you think this is something where the regulator should try to create legislative space in order for regional banks to develop? Or do you think this is something that the market should try and develop in its own way as part of that general mix of new types of banks coming into the place?

**Andrea Leadsom:** As you know, Mr Garnier, I am a big believer in the free market's making its decision. We are already seeing that regional banking is becoming more attractive. We are seeing some of the existing players basing themselves in the regions, like Virgin Money, TSB with their new IPO and so on. That is to be encouraged and facilitated rather than state or regulatory engineered.

**Mark Garnier:** Fantastic, thank you very much.

**Q758 Mr McFadden:** Minister—

**Chair:** You will have to put up with this, I am afraid for another couple of hours.

**Andrea Leadsom:** Yes, I know, I know. I am trying not to take it as an insult.

**Mr McFadden:** Welcome back. Some of this is not for Government—some of it is for banks or for lenders and so on or maybe for regulators—but there is a part of this that really is affected by Government, which is the tax treatment of different forms of finance. There has been a long debate about the different tax treatment of debt and equity. The Banking Commission looked at this quite a lot. I do not think it is a secret to say that the former Chancellor, Lord Lawson, was particularly interested in this area when we did the Banking Commission's work. Can you tell us anything about the Treasury's thinking on this debate because the argument is that the traditional model of financing business through debt is encouraged by the way that these things are taxed?

**Andrea Leadsom:** Yes, I am very aware of that argument and I am slightly cautious because this treads very firmly into the Exchequer Secretary's portfolio and it is not something that I am very up to speed on where the Government's thinking is. I share your interest in the unintended consequences of the favourable treatment of debt over equity from a tax perspective, but at the same time I do very firmly believe that the mix of the actions taken by the Government, by the banks themselves, by the international regulation is changing in itself the incentives vis-à-vis equity and debt. It is encouraging much more capital. We are looking, as you know, at bail-inable bonds and we are looking at different means of achieving greater safety in the banking

system. So I think that the tax system will in due course be another way of looking at this but I don't have any specific pointers to give that we are looking at something very specific.

I don't know if Ms Cottrell wants to add anything to that or Mr Pocklington? No?

**Q759 Mr McFadden:** Officials must have had a run around the course on this. Would neither of you like to elaborate?

**Jeremy Pocklington:** This is an issue that has come up time and again over decades. There are arguments for it. There are arguments against it; against equalising the treatment. One of the great challenges is how would you transition from a world where you have debt having a favourable tax treatment to a world where it does not. That would create all sorts of challenges. It is an issue that periodically comes up.

**Q760 Mr McFadden:** Let me ask you this from a different angle then. Do you think that the debate about this might be given greater urgency by the parallel but related debate over the weaknesses of the corporation tax model as it stands at the moment whereby multinationals in particular appear to be able to shift things around? Your boss, the Chancellor, has made a big issue of this at G8 meetings and so on. If corporation tax is a tax on profits, which seems to have weaknesses in term of people being able to avoid it, might looking at debt and equity be given greater urgency by that debate?

**Andrea Leadsom:** I am struggling to see why by focusing on equity you would change the issue—

**Q761 Mr McFadden:** Well, if you have a lot of debt payments every year it will reduce your headline corporate.

**Andrea Leadsom:** Yes, but that is not affected by the onshore, offshore point that you are making about companies booking profits elsewhere in a lower tax regime. I do take the point that debt is offsetable against tax and it is definitely something that the Government looks at from time to time but not in my department. I am very wary of straying into that.

**Mr McFadden:** Okay, I think I will stop there.

**Q762 Mr Mudie:** Welcome, Minister. The Treasury's gain is our loss. You are very much in favour of competition—this is one answer I will not like—and I think that is a good thing but why do we only have one

regulator? When you see their performance this morning, "It is not in my remit": people are being hurt, it is in their field but they have some narrow point that they seem pleased it is not in their remit. It takes you back to Lord King when the crisis broke. "Nothing to do with me, it is the FSA."

We were in the States and you would not have this situation arise in the States because if one regulator does not go in, the state does not go in, the Fed goes in or the Attorney General goes in. There is nowhere to hide in the States but here you have a very cosy, happy—the Ombudsman, "I don't want any more powers". Don't you think we could do with more competition?

**Andrea Leadsom:** I am not sure—

**Mr Mudie:** I knew you would say no but it is worth thinking about.

**Andrea Leadsom:** Yes, I know Mr Baker will be delighted with that idea.

In principle, I think that competition in regulation, as in all areas, is advantageous in the sense of then you do get regulators falling over each other to take up an issue. The downside of course is lack of certainty to the industry. In your previous hearing, one of the very interesting things that came up was the gentleman from FOS who was saying that unlike in lots of other retail sectors, banking appears to require a lot of regulation and punishment in order to make them behave at least normally. The issue that we have in the UK is around a culture that got out of hand and is now righting itself. Competition in the delivery of service is absolutely vital. I think where regulation is concerned you need certainty of regulation; you need fairness and you do need perimeters. I noted Lord Thurso's points about the definition of sophistication and completely accept, as he say, that the beauty is in the eyes of the beholder. Sophisticated is what you make of it. There are always going to be grey areas.

I would also agree with you that there must be times where the regulator should say, "Well, okay, it is not technically our area but we are going to comment anyway" and I completely accept that that would be a legitimate thing for them to do. But my underlying thesis here is that we live in a western democratic capitalist society where we need wealth generation in order to pay for the public services we all want. So what we cannot do is to regulate things to the point where they can no longer be profitable and successful organisations.

There is always going to be a fine balance. That is probably not the answer you want to hear but I would not therefore advocate pure competition in regulation.

The other thing I would say is that with the tripartite system the problem was a lack of accountability. While you are saying there is now a

lack of accountability because they will not go outside their remit, at least there is accountability in that there are not three different people looking at bank regulation, new bank approvals, market misconduct and so on. In that sense each of those regulators is entirely accountable for their area and that is a very good thing.

**Q763 Mr Mudie:** That was what the problem was or seemed to be when the recession came, that the FSA said, "This is our remit", the banks said, "This is our remit" and there was stuff in the middle that they were content to just let go because, "It was nothing to do with me, Guv".

**Andrea Leadsom:** Exactly.

**Mr Mudie:** You have obviously read the evidence we have received, by the sound of it, or you have read some of it. I have said some stuff today that I can read you, but can you defend the regulators not being willing to accept there was a grave problem that was affecting a vital part of the economy because it was not in their remit?

**Andrea Leadsom:** Can you just expand on exactly what that part of the economy was?

**Mr Mudie:** The small businesses.

**Andrea Leadsom:** So the small business lending? Why they did not intervene more to, what? To force banks to lend to SMEs?

**Mr Mudie:** Well, no. I plead with you to get Berg in and Bully-Banks and sit with your officials and go through and question them. We have not had the opportunity to question Berg. I could go through a whole list of what they do and why they do it. They are doing it to get their hands on the capital that is involved in there. They do some dreadful, dreadful things. Let me just give you an example, when John McFall was here in the last Administration we took on consumer rights and we had a real battle over the five or so years with the banks but we got somewhere. What is crying out now is for someone to look after small businesses' rights because they can do it so easily: a drive-past valuation on your property; call you in; loan-to-value; it's out.

If you consider a mortgage that goes through in a recession and goes into negative equity, you would string up a bank if they called the mortgage in because it was loan-to-value deficient, but they do it for small businesses. They finish them off or they bring them in, they change all the terms, they put them into this corner of the bank, that corner of the bank, all paying fees and they have done that. Berg's report on their experiences and their cases say it is not limited to RBS. Barclays, HSBC,

Lloyds, they are all at it, destroying viable businesses because they want to get their hands on capital.

**Andrea Leadsom:** Yes. From my own experience, I have a lot of businesses obviously in my constituency near Silverstone and we have lots of high-tech performance engineering businesses. I have had some of my businesses say to me that it is not so much the availability of funding or the assessment as what happens once you have the loan and they appear to just help themselves and charge you these huge renewal fees and so on. I have taken up a lot of these issues and certainly I do have a residual concern about the way that banks handle internally the complaints procedures.

Just in my couple of months in the job I have answered a lot of correspondence from colleagues who have individual grievances from businesses. Obviously no one is ever going to legislate to say, "You, bank, have to lend to this trader because ultimately if the loan goes bad then it's my fault because I made you lend to them". We cannot obviously do anything about that but what we can do is look more carefully at how the banks manage those complaints procedures.

Certainly as an MP myself, I have had issues with that. I know I have heard colleagues on the Treasury Committee talk about that too. I do think that that is an area we could look at. Having said all of that, you see, that is within the regulator's remit. It is not true to say that they cannot look at banks internal complaints procedures because they regulate the banks. I would just simply disagree that the regulator can say, "That's not our problem" because I think that that is within their remit to do that.

**Q764 Mr Mudie:** That is very fair but if we were to list in the evidence in our report all the areas where evidence has been given that the banks have behaved badly—and I could list them for you here, I have one of the reports here—would you be willing to look at it and have your officials run down those and tick off those that can and should be dealt with the regulator and ask the regulator why they are not doing it? And secondly, for those that are not ticked off, take an urgent look at legislation?

**Andrea Leadsom:** Certainly, if there are specific examples that you wanted my department to look at we would certainly do that. I would not predict the result of it but certainly would be very happy to look at them.

**Q765 Mr Mudie:** No, but, Minister, you did say that you thought that there were areas where they could be looking at it, were able to

within their perimeter. If we listed areas where evidence has been given to us and your officials say, "They can do it" then I presume the Treasury would be willing to ask the FCA formally why on earth they are not taking action or have not taken action. But those areas where your officials say, "They are right, they do not have the power" surely the Treasury—not you and I understand the position I may be putting you in—should be looking to see—

Last week we had the Governor of the Bank of England in and I asked him about exports and about rebalancing the economy and he was all over the place. Small businesses are failing; exports are failing; the sector is not growing or not growing as fast as you would wish. This is supposed to be rebalancing but here is a vital part of that rebalancing being sabotaged by banks. Surely they cannot get away with this.

**Andrea Leadsom:** Yes. I will happily look at anything you want to send me, Mr Mudie, and go it through it very carefully. But, as I said at the start, I am an absolute believer in free enterprise and there is a lot going on in the SME world, including SMEs thinking, "I don't want to export at the moment because the economy doesn't look good enough to me". There are all sorts of reasons. It is very difficult to pin down exactly why things do not happen. In answer to your specific question, if you wanted to send me some examples—

**Mr Mudie:** The Committee have put it in their report.

**Andrea Leadsom:** If the Committee wanted to send me some examples and there were cases that the regulator should be, could be, looking at, then of course the Treasury would certainly pass them on.

**Q766 Chair:** The consumer interest is right at the heart of what Mr Mudie is trying to achieve and has been for years.

**Andrea Leadsom:** Exactly, yes, yes.

**Chair:** Of course, we did the cheques inquiry where the banks, on a quiet day, it seemed were intending, effectively, to withdraw cheques. We find all sorts of similar practices going on in the SME market as part of this inquiry. All I will say with respect to that is we are intending to report as a Committee. I do not know what we are going to report but it will be useful having you in the Treasury to take a look at it when we do.

**Q767 John Thurso:** Minister, I am enjoying the delicious irony of the fact that you and I persuaded the Committee to kick this report off and you are now answering for the Government on the other side. May I say that, as a former gamekeeper, you make an excellent poacher?

**Andrea Leadsom:** I am hoping I am consistent; internally consistent is my aim.

**John Thurso:** On the TBL side I want to ask you, as I am sure you were expecting, why has the Treasury so far refused to engage on that issue or have anything to do with it?

**Andrea Leadsom:** I am not aware that the Treasury has refused to engage in the issue. The point is that there will not be retrospective legislation on issues beyond those that are the sale of regulated products that have been mis-sold. The interest-rate hedging products, where they have been found to be mis-sold and they are, therefore, regulated by the FCA, are part of that inquiry. I know that the Committee has been impatient with the slowness of their kick-off but I hope the Committee is now happy that things have speeded up, a lot of customer redress has been made and the process is now well underway and drawing some conclusions.

**Q768 John Thurso:** When did the Treasury first become aware of the TBL problem?

**Andrea Leadsom:** Ms Cottrell, can you—

**Alison Cottrell:** I do not know precisely. You have mentioned the letter that Martin Wheatley wrote to the then FST, Greg Clark, and certainly that focused on that area. I cannot tell you if it was before that or if that was there but it would be around that time.

**Q769 John Thurso:** What response has the Treasury made to Martin Wheatley? What have they written in response to his letters and concerns?

**Alison Cottrell:** I am not aware—and this is just from memory—if we replied to Martin’s letter as such. Certainly, he would have had frequent meetings with the then FST, so it would have been discussed there in the context of TBL.

**Q770 John Thurso:** The FCA had raised what they considered to be a pretty big problem, which the Treasury initially was not going to release under freedom of information, but this Committee got that correspondence and here we are a year and a half on and there is no response. I would suggest to you that that does not show a particular willingness on the part of the Treasury to engage or deal with what an awful lot of people think is a pretty serious issue.

**Alison Cottrell:** The specific issue of the NAB loans, as you know, was brought voluntarily into the FCA scheme, which was the issue that, as far as I am aware, Martin was talking with the then FST about.

**Q771 John Thurso:** The point that Martin Wheatley was making in his letter was that it appeared that these products were not regulated and, therefore, they did not have jurisdiction. The first question: do you buy into that legal advice because there is opposing legal advice that has been given by eminent counsel that says it is regulated?

**Alison Cottrell:** I would accept the FCA—

**Q772 John Thurso:** Has the Treasury got its own legal advice on that? Does the Treasury share the point of view that this is not regulated?

**Alison Cottrell:** Yes.

**Q773 John Thurso:** Does the Treasury believe it should be regulated?

**Alison Cottrell:** That would be a question for Ministers if they wish to change it but at the moment, in terms of the scope, it does not come into the FCA scope.

**Q774 John Thurso:** In other words, is this an accident that it is not regulated or is it on purpose?

**Andrea Leadsom:** My understanding is that the business-lending element of those TBLs is not regulated and that there is no appetite from the industry—

**Q775 John Thurso:** Forgive me, Minister; that is not the point.

**Andrea Leadsom:** Yes.

**John Thurso:** The point is that in all the evidence we have received a TBL looks like a duck, quacks like a duck, paddles like a duck and, therefore, for our purposes it is a duck.

**Andrea Leadsom:** Yes.

**John Thurso:** The fact that there is a technical difference, that the way that the contracts for difference is written may exclude it from being under the auspices of the FCA, is one that has only just come to light or more recently come to light. Most of us would have thought it was regulated. The question, therefore, is this: I know the historic position as it is seen; is that intentional or unintentional?

**Andrea Leadsom:** My problem is not knowing the historic intention. What I can say is that business lending should not in my opinion fall under regulation. Interest-rate hedging products should fall under legislation and the extent to which you combine one with the other—and it walks like a duck and quacks like a duck—then I would say you should not combine them. You should sell them separately or—as is, I

understand it, now the case—you should make extremely clear in words of one syllable exactly what the implications are if you repay that loan early.

**Q776 John Thurso:** Can I help you? My understanding is that this is an entirely unintended consequence—that nobody thought this product particularly existed—and having discovered the fact that it is not regulated is something of a complete accident. Martin Wheatley, in the meeting I referred to with him with Chris Woolard last week, said they would very much like to regulate this. Their position is they think it should be regulated and they would like to regulate it. Chris, on the record, did not quite give the same but he came very close, given that it was evidence.

**Andrea Leadsom:** Yes.

**John Thurso:** You can talk to Martin Wheatley and I think you will find that they would be very keen to see this properly regulated. At the very least, going forward, could we not get this situation resolved so it is clear, that if you do something that ought to be regulated, it will be regulated?

**Andrea Leadsom:** I am obviously not making myself clear. I think that a business loan should not be regulated.

**John Thurso:** I am happy with that.

**Andrea Leadsom:** But if you turn it into a term business loan by fixing the interest rate then the only way to make the product itself—so the tailored business loan or whatever you want to call it—regulatable is by splitting out the swap from the loan. What you would be doing then is you would be saying that the small business who wants a three-month, six-month loan has to have a short-term loan with a three- or six-month interest-rate swap attached in order that the interest-rate swap becomes regulated.

Then the question is, is that complicating things extraordinarily, both for the bank—because it is having to individually hedge every single loan it makes—and for the customer, very importantly, because they're like, "I don't know if I want to buy an interest-rate swap. What on earth is that?" That, I think, is the problem. I was talking to officials about this last night. Unless you were to stray into the territory of saying there are certain types of business loan that will in future be regulated—which, as I understand it, consultation with the industry suggests that the industry trade bodies do not want—

**Q777 John Thurso:** Nobody is arguing that. Nobody wants to regulate loans; that is not the point. The point is the contracts and we have the contracts and can I refer you to the evidence that Laurence

Beere, among others, gave us and your officials, I am sure, could do so too. The fact is you have a contract that lays off the entire risk of the swap that the bank has taken to book out their position. That entire consequence, the loss of that, is placed into the loan by way of the contractual paragraphs in the loan relating to the fixed element.

The problem is that it is not six months and £20,000; it is £750,000,000 and 10 years and that is where we have the difficulty. There are two things. People have been sold a product that they are told is a fixed-rate loan and, as you and I know, there is no such thing. What they do not know and do not understand is the fine print and it is not explained to them. That, to me, should be regulated. The FCA thinks it should be regulated. The law appears not to regulate it. Will we do something about it?

**Andrea Leadsom:** Just to come back once more on a point of clarity because, of course, what happens is if a bank is making, say, 20 £500,000 loans for six months then it may well aggregate the sum that it has lent out and hedge the entire lot on its book.

**John Thurso:** It may be an aggregated swap.

**Andrea Leadsom:** It may be that because it has already got other swaps on its books—

**John Thurso:** But it is what is in the contract that counts.

**Andrea Leadsom:** —that it in fact does not hedge it at all because it is already over-hedged so it may simply allay an overly-hedged position on their book.

So my question for you is, how would you split out the consequences for the bank's book? Obviously banks might sort out to perfection their hedge once a week; they might not do it on a loan-by-loan basis or even an hourly or even a daily basis. So how would you allocate? In terms of regulation what are you regulating, their entire swaps book or the piece of it that relates to that loan and how do they know which piece that is?

**Q778 John Thurso:** If I may, Minister, you miss the point. I am completely uninterested in what the banks do. What I am interested in is the impact on the consumer and that can be found in the contract between the bank and the consumer. The kick-in is whether or not the negative or positive impacts are felt by the consumer. In other words, does the bank lay off its risk in the contract so the consumer pays the break cost or not? That is all that you need as a definition.

**Andrea Leadsom:** Effectively, what you are looking for is for the FCA to regulate the breakage costs of a term loan.

**Q779 John Thurso:** No, that is oversimplifying it. It is where a loan is given such that it is not a simple fixed interest rate and there is a series of clauses in the contract that tie it to whatever swapping mechanism is behind it and, therefore, the small business ends up unaware—because it has been mis-sold and he doesn't understand this—of the consequences and suffers loss as a result. That is the core of the issue. I will happily come and see you. It might be easier to talk about it separately.

**Andrea Leadsom:** Yes, this is kind of a several-cups-of-coffee because—

**John Thurso:** Maybe I can come and meet with you on that because I want to quickly move on.

**Andrea Leadsom:** Yes, yes, okay.

**Q780 John Thurso:** The key point here is the FCA told me privately—and Chris said quite clearly when he was here—that they are, far from being averse to regulating: yes, they believe it should be regulated properly and it is up for us in Parliament to give them that.

The second thing was on the FOS and I know you have heard the evidence. Broadly my reading—and this is a terrible paraphrase of a lot of evidence but I am forced by time to do it—is a view that for small businesses do we need to look at both the scale at which they can intervene and the size of the award they can make. It seems we are all agreed on that. My question is this. Do you accept that and what will Government do about it?

**Andrea Leadsom:** Right, as I understand it FOS are consulting now<sup>3</sup> and will be reporting on that by the end of this year. Is that not right, Ms Cottrell? Yes.

**Alison Cottrell:** Yes, the FCA will have a review in the autumn.

**Q781 John Thurso:** How will Government give effect to either of the propositions I am putting forward, which are FCA regulation or FOS?

**Andrea Leadsom:** To FOS increasing their remit and scale of business, is that secondary or primary legislation?

**Alison Cottrell:** I don't know but certainly in relation to the point, if the FCA were to come and say, "This is the way we would recommend we go forward with FOS" then we would certainly consider that.

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<sup>3</sup>Note by witness: meant to say 'the FCA will be consulting'

**Q782 John Thurso:** Can I come in to you with a possibility? It is that number one in the Queen's speech is a Small Business, Enterprise and Employment Bill, the purpose of which—which I suspect will be the long title—is, "To build a stronger economy by supporting small businesses as they compete and show that they are not disadvantaged by those that do not play by the rules"—sounds good—and that the main elements of the Bill are two and that the first bullet point says, "Make it easier for small businesses to access finance". That would be an excellent vehicle to deal with all of those things and we can do it in short order.

**Andrea Leadsom:** In very short order, I completely agree with you.

**John Thurso:** On which happy note I conclude. Thank you, Minister.

**Andrea Leadsom:** Thank you.

**Q783 Mr Mudie:** I hate to be in a minority of one but I feel I am in terms of the phrase everybody is against regulating commercial lending. I do not think that I am in the place or you are in the place or anyone in this building is in the place where we can tell banks who to lend to. They take the commercial decision. But once they have taken a commercial decision the contract they enter into with the individual should be clear, should not be mis-sold, and the consequences of actions all throughout that contract must be understood by the borrower.

What is happening now—and we get waylaid by the technical problem of swaps—to property companies, hoteliers and so on, is that the banks just decide. There is a case in one of the papers where the fellow didn't pay his paper bill for two weeks. The bank heard about it and used that as the opportunity to tear up the contract and renegotiate. There was a case where somebody goes in—and you can imagine it, Minister—they get a £1 million loan, right, and in the contract and in six months' time they will get a second £1 million. So they go and they spend the money and then the bank blithely turns round and say, "No, we're not giving you the second £1 million".

I refuse to believe that we would allow that to happen to a consumer. The bank is in the strong position, it can negotiate the terms, it does negotiate the terms, the person agrees the terms. Then the bank unilaterally changes its terms within the term of a loan without good reason. That is where we are pleading for the regulators to come in, as they would with any other contract, to defend the weaker party.

Does that not stir you to start questioning? It is not the actual lending, it is once you have lent and you are the bank. You know the consequences; you have all the experts; you sign that contract only with good reason and in line with the contract: should you be able to alter that contract?

**Andrea Leadsom:** Yes. In terms of your example I completely agree with you. Banks absolutely should not be just moving the goal posts, all things being equal.

**Mr Mudie:** They are doing that.

**Andrea Leadsom:** It is absolutely right that they are regulated by the regulators who are there and supposed to ensure that they treat their customers fairly, that they have a properly instituted complaints procedure.

**Mr Mudie:** Yes, that is all we are asking for.

**Andrea Leadsom:** On that I completely agree with you.

**Q784 Mr Mudie:** But these characters who were here before you say, "The fact that it is commercial lending, we don't regulate that". They turn their backs on what is happening to good citizens who are trying to earn a living and say, "We don't do it". We are not interfering with the banks' right to lend. It is that the contract they enter into must be fair, honest and clear.

**Andrea Leadsom:** What I heard them say is that they would look at trends; that they would not look at an individual case. They would look to see that a bank was properly implementing its own complaints procedure and that there weren't systematic failures to treat customers fairly. That is certainly what I heard them say, which is right. It is very difficult for any one of us to say, "That was unfair treatment and that was not deserved".

But at an aggregate level it is entirely right that those banks are regulated entities. They should have systems. There should be the means by which to appeal where they are not being fairly treated. But then, equally, there is another side of this argument, which is that for those bigger businesses we do not want to just be a nanny state and make them not suffer the consequences of their own decisions either. To interfere in the commercial arrangements is a mistake but the regulators absolutely need to ensure that they have proper complaints procedures and that they implement them fairly.

**Chair:** My colleagues are reluctant to let you go. John Thurso has got a rejoinder

**Andrea Leadsom:** Okay.

**Q785 John Thurso:** Just one point. I do not ask you to answer but following on from what George said, nobody is asking the Government or anybody else to regulate a simple loan product. We are asking for the regulation of the conduct of the people engaged in the selling and

managing of it. That is where we agree. Nobody wants to regulate lending per se but lending that is sold inappropriately. The problem is that if you ask the FCA, their definition of what they can regulate is based on whether it is a regulated product. That is the lacuna at the moment, if I may leave you with that thought.

**Andrea Leadsom:** Yes, that is a very interesting point. Yes, thank you, definitely.

**Chair:** You can hear the frustration, Minister, coming out of a good number of colleagues. I have seen some of these cases in my constituency and some of them are very bad and something needs to be done. We shall be reporting in due course and no doubt then we will have exchanges of which we should consider this one to be the first of many. It may be more awkward next time when we have firm recommendations on the table. But in the meantime, welcome to your new job. You have given lucid answers, just as you always asked lucid questions, and we are very grateful to you for your evidence, what is now this afternoon.

**Andrea Leadsom:** Thank you.