Fair Business Banking for All

How to improve access to justice for businesses in financial services disputes

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FOREWORD

There has been a growing recognition for some time that SMEs are being denied access to justice in financial services disputes. This excellent report describes the nature of the problem with great clarity and makes a convincing case for the changes that it recommends. It should be essential reading for anyone who is keen to rebuild confidence in the financial services industry and is concerned about the current situation.

The two principal recommendations of the report are that rights of action under section 138D of the Financial Services and Markets Act 2000 should be extended to SMEs and that a new Financial Services Tribunal should be established for the resolution of financial disputes.

Currently, the only avenue open to an SME seeking an independent resolution of a financial dispute is to complain to the Financial Ombudsman Service or go to court. As the report explains, the jurisdiction and powers of the FOS are very limited and litigation in the courts is costly and slow. The FOS is an excellent forum for resolving large numbers of straightforward claims quickly and at little cost. There is a case for expanding its jurisdiction to extend the size of enterprise that is eligible to make a complaint and increase the compensation that it can award. But the FOS is not equipped to determine complex and high value disputes.

Moreover, its decisions are based on an assessment of what is fair and reasonable in all the circumstances of the case. It does not determine complaints in accordance with the law, although it is required to take it into account. In most small cases, this may not matter and it may promote speed and efficiency. But this will not always be the case. The alternative of issuing proceedings in the courts is unthinkable for most SMEs. The costs would simply be too great and the consequences of failure potentially catastrophic.

The case for a tribunal system to fill the gap between the FOS and the court is powerfully developed in this report. Such a system would give SMEs the access to justice that in many cases they currently do not have. It would enable them to use financial services in the knowledge that unresolved complaints could be determined affordably by an independent expert tribunal.

I unreservedly commend this report.

Rt Hon Lord Dyson, Master of the Rolls and Head of Civil Justice 2012-16

FOREWORD

Enterprise and entrepreneurship are the lifeblood of the British economy. As a nation, we rely on and celebrate the entrepreneurial spirit, and our capital is home to a world-class financial services industry. Yet to prosper further, we need banks and business to maintain a healthy, supportive relationship and to have confidence that when disputes arise, they are dealt with fairly, efficiently and effectively.

In the wake of the financial crisis, the banking sector's reputation has suffered from a number of disturbing scandals, many of which have had a catastrophic effect on thousands of individual lives and livelihoods. They have also damaged confidence, resulting in reduced demand for business borrowing and, consequently, a slowing of economic growth.

It is clear to me, and to the other members of the All Party Parliamentary Group on Fair Business Banking, that there is a systemic failure here, with many of those firms that have suffered from mistreatment and malpractice denied access to justice. Not only are our banks too big to fail, they are also often too big to take to court.

Affordable, independent dispute resolution is critical to business confidence, yet very few businesspeople would be able to fund and fight a legal claim against a bank. Although we are fortunate to have a world-leading judicial system, access to it remains out of reach for many smaller firms, something this report seeks to address and redress.

The APPG has long campaigned for a new approach to dispute resolution and we are pleased that the Financial Conduct Authority (FCA), the Treasury, the Treasury Select Committee, UK Finance and our judiciary are all persuaded of the case for reform. Indeed, this whole issue has suddenly become a very hot topic with the Treasury Select Committee currently conducting an inquiry into SME finance and UK Finance having commissioned a review into the complaints and Alternative Dispute Resolution (ADR) landscape for the UK's SME market chaired by Simon Walker CBE, the former Director General of the Institute of Directors. Both of these reports are due to be published later this year.

The APPG on Fair Business Banking has also launched an inquiry into dispute resolution in conjunction with the APPG on Alternative Dispute Resolution, entitled 'Bridging the Gap: A level playing field for financial disputes'. This inquiry was launched in January 2017 and analysed the current dispute resolution options available to businesses. It also investigated potential forms of dispute resolution that might bridge the gap into which many disputes currently fall as a result of being outside the scope of the Financial Ombudsman Service (FOS) yet not large enough to make court a financially viable option. The final publication of its results is due in September 2018, but a draft has been made available for this report.

I and the other members of the APPG believe that there is a need for a new formal dispute resolution mechanism, in addition to the courts, to fill the current gap in provision that exists between the FOS and the courts. Such a new mechanism will need to: be independent of both the financial services industry and the FCA; have clear procedural rules and the necessary legal powers to compel witness testimony and disclosure of information; take decisions in public on a strict legal basis; provide speedy and relatively low-cost access to justice for claimants; and have the necessary expertise to manage complaints competently.

We support all efforts to ensure that any disputes are resolved quickly and efficiently, and ADR has a key role to play. But we must also have accessible Primary Dispute Resolution (PDR) for cases that fall outside of the regulatory perimeter or the boundaries of the FOS. The FCA's consultation on extending the remit of the FOS still clearly identifies a gap that will exist after any proposed changes.

This report therefore focuses solely on that gap and should be seen as complementary to, and not in competition with, any recommendations for ADR.

We in the APPG are committed to working with the Government, the banking sector, regulators and our business community to develop a new approach in which banks are eager to lend to good businesses who are confident to borrow.

Kevin Hollinrake MP, Co-Chair, All-Party Group on Fair Business Banking

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1. EXECUTIVE SUMMARY

Over the past decade, the relationship between banks and their customers has been damaged by a series of high-profile incidents. Business banking scandals at RBS and Lloyds HBOS adversely affected thousands of small businesses, their owners and employees. This has led to a loss of trust between companies and banks, undermined public confidence in the financial services industry and contributed to a fall in demand for borrowing by businesses.

Most business owners understandably assumed that adequate protections were in place to deal with such problems: that there was an easily accessible form of dispute resolution if things were not dealt with satisfactorily by their bank; and that their bank would be held to account and made to rectify any poor behaviour. The realisation that this was not the case has come as a shock to many people.

Business customers have found out through bitter experience that they have less regulatory protection and fewer options for pursuing redress than individual consumers, even though they face similar problems and do not have the sophistication or resources enjoyed by larger companies. Most commercial banking and lending is not regulated and businesses do not have the same right of action that private individuals do to pursue damages for breaches of financial regulations under section 138D of the Financial Services and Markets Act (FSMA).

Of the independent means of seeking redress that are available to businesses, the Financial Ombudsman Service (FOS) aims to provide a quick, free, impartial and informal process for relatively low-value financial services disputes. However, only microenterprises with a turnover that does not exceed €2 million and no more than 10 employees are currently eligible to take a case to the FOS, while its compensation limit of £150,000 is most often inadequate to cover the losses sustained by businesses.

In any case, the FOS is a form of Alternative Dispute Resolution (ADR), which performs a valuable role, but operates behind closed doors, so does not afford the opportunity for public scrutiny. Furthermore it cannot act where a business has gone, or been forced, into administration and lacks the powers of a court, for example to require disclosure of information and to compel witnesses to give evidence. Therefore, it cannot provide the more formal dispute resolution mechanism that businesses require for complex and often life-changing disputes.

The courts are the only formal dispute resolution mechanism available to businesses and they are a tried and tested method of resolving disputes. However, there are significant barriers to small and medium-sized businesses accessing them. There is an often-insurmountable imbalance of power and resources between financial firms and their business customers and many businesses cannot afford the cost of a court case, which can be lengthy, particularly with the risk of having to meet the other side's costs if a case is lost.

It has also been accepted that the common law is not sufficient in financial services disputes, which is why we have seen the introduction of the regulations set out in the FCA Handbook and PRA Rulebook. However, businesses are barred from bringing actions for breach of the Financial Conduct Authority (FCA) or Prudential Regulation Authority (PRA) rules.

This means that there is currently a significant problem for businesses in accessing justice, which is partly due to a lack of legal rights. However, there is also a gap in provision between the disputes dealt with by the FOS, which has a claim limit of £150,000, and those claims which are large enough to attract litigation funding (claims usually of at least £5 million) and so make going to court feasible. It is estimated that businesses would need to incur at least £50,000 in legal fees and other disbursements prior to even making an application for litigation funding.

The FCA has stated that *'Only a very small proportion of SMEs take their disputes with financial services firms to court'* and the fact that the FCA is proposing to extend the eligibility criteria for the FOS is further acknowledgement that a gap in dispute resolution provision for businesses exists. Yet even if the changes to the FOS eligibility criteria go ahead, this gap will persist and the FCA still *'sees a role for both the Ombudsman and a tribunal as they meet different needs'.*

1.1 Recommendations

To create a more level playing field between financial firms and businesses, and address the twin issues of SMEs' lack of legal rights and the gap in dispute resolution provision, the APPG on Fair Business Banking recommends the following:

Enhance the Legal Rights of SMEs

Businesses are restricted from bringing actions for breaches of the FCA Principles for Businesses and the FCA rules. Primarily, the FCA Principles for Businesses 'which are high level standards' require a firm, *amongst others*, to pay due regard to the interests of its customers and treat them fairly (Principle 6). They enable the FCA to bring public enforcement action against financial firms for breaches and are not actionable by 'private persons' under section 138D of the Financial Services and Markets Act (FSMA).

Meanwhile, although most of the FCA rules are actionable and provide the right to bring an action for damages for losses suffered as a result of breaches of the FCA rules, this is currently limited to 'private persons', which excludes almost all businesses.

This has led to illogical consequences. For example, while sole traders or partnerships can bring an action for breach of the FCA rules, a company or limited liability partnership of similar size and/or sophistication is not a 'private person' and is unable to bring an action. It is unreasonable that the ability to bring an action should depend entirely on the legal form, rather than the size or the sophistication, knowledge or experience of a business.

The best and simplest way to extend the legal rights of SMEs is, therefore, by extending the section 138D right of action. This would be done by amending the 'private person' definition contained in the FSMA's Rights of Action Regulations 2001 (FSMA (RAR) 2001), which is secondary legislation, and would have the effect of giving SMEs a right of action for breach of the FCA rules.

An alternative approach would be to extend SMEs' rights of action for breaches of the FCA Principles for Businesses. These principles are broader than the FCA rules and so would afford SMEs greater legal protection, which may be deemed necessary. It is, therefore, suggested that PRIN 3.4.4R is amended to remove this restriction. In addition, PRIN Schedule 5 *Rights of action for damages*, which sets out the FCA rules which are actionable under section 138D, should be amended to reflect the removal of this restriction and this could be implemented by secondary legislation.

Extend Regulatory Protection

Not all financial services provided by firms are regulated, an example being commercial lending, including fixed-rate loans. Here the regulatory regime under FSMA does not apply, so the FCA is unable to bring enforcement proceedings and private persons are unable to bring section 138D claims. This seems anomalous given the problems that have arisen in this area, so the definition of regulated activities as set out in FSMA and FSMA (RAO) 2001 should be amended to include certain unregulated activities such as commercial lending, which could be done by secondary legislation.

Establish a Financial Services Tribunal

With the extension of section 138D, SMEs would be able to enforce their new legal rights in the courts. However, a new Financial Services Tribunal would be an additional forum in which to resolve disputes and so fill the gap in dispute resolution provision. It would be modelled on existing tribunals, such as the Employment Tribunal, with two wing members from business and financial services backgrounds to support the judge by providing knowledge and experience and the use of an inquisitorial as well as adversarial approach.

The tribunal would have full legal powers to enforce disclosure of information and the attendance of witnesses and clear procedural rules. However, it would use its procedural flexibility to deal with cases in an appropriate manner depending on their nature and complexity and ensuring simple, low-cost access to justice for claimants.

The default position would be that the losing side would not pay the other side's costs to remove this element of risk for claimants. However, claimants could apply to have this changed in cases deemed complex and, therefore, costlier. To recognise the imbalance in power and resources between banks and small and medium-sized businesses, such complex cases could be subject to 'qualified one-way cost shifting', so businesses would be able to recover their costs, subject to a cap, while financial firms would not.

It is proposed that the Financial Services Tribunal would be created under the Tribunals, Courts and Enforcement Act (2007), which gives the Lord Chancellor the power to amend the lists of tribunals in Schedule 6 of the 2007 Act. Although administrative tribunals can be established through secondary legislation, primary legislation is required for tribunals such as the Employment Tribunal.

Given that the proposed Financial Services Tribunal would hear private banking disputes, rather than hear appeals against administrative decisions, it would be more akin to the Employment Tribunal. As such, it is suggested that primary legislation would be required to establish a new Financial Services Tribunal.

The costs of running the Financial Services Tribunal would be met by the Treasury. It is proposed that this would be reimbursed via a small levy introduced on financial services companies.

Consultation on Insolvent Firms

Former owners or shareholders of insolvent businesses currently find it extremely difficult to resolve a dispute and recover losses since they cannot take their cases to the FOS. The current right of action under section 138D can be assigned by a private person. So if this right is extended to businesses, as proposed, they will enjoy that right, too, and it should be possible for administrators or liquidators, as assignees, to bring section 138D claims.

However, insolvency practitioners are very reluctant to pursue claims on the basis that the costs are likely to outweigh the benefits. This seems particularly unfair given that many businesses have found themselves forced into insolvency by poor conduct on the part of a financial firm. In light of this, the Government should launch a consultation to look at how this situation might be improved, a precedent being the existing consultation into restructuring the corporate insolvency framework. The APPG supports the principles in the consultation and encourages the Department for Business, Energy and Industrial Strategy to pursue this legislative agenda.

Address Time Limitations

Many business cases go back many years and so their claims have run out of time. Generally, the limitation period for bringing a claim is six years in England and Wales, and five in Scotland. Even if no agreement has been reached with a bank to extend the limitation period by entering into a 'standstill agreement', Section 32 of the Limitation Act 1980 does postpone the running of any applicable limitation period where:

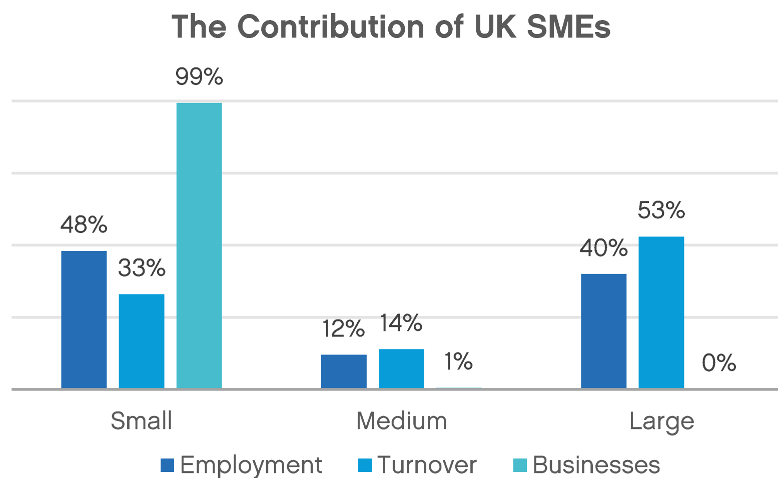
- The action is based on the fraud of the defendant.
- Any fact relevant to the claimant's right of action has been deliberately concealed from him by the defendant (including the deliberate commission of a breach of duty in circumstances in which it is unlikely to be discovered for some time).
- The action is for relief from the consequences of a mistake.

In any of the above cases, time only runs when the claimant discovers the fraud, concealment or mistake; or could have done so with reasonable diligence. This could provide grounds for some claimants. However, the APPG calls on the UK Government to see what else could be done to ensure that those who have suffered from historic banking abuses, within the past 10-15 years in some instances, will be able to take their case to the Financial Services Tribunal.

2. BANK LENDING TO SMALL AND MEDIUM-SIZED ENTERPRISES IN THE UK

2.1 The Importance of SMEs to the UK Economy

Small and Medium-sized Enterprises (SMEs) are enormously important to the UK economy - as Rishi Sunak MP set out in his recent Centre for Policy Studies Report 'A New Era for Retail Bonds'[1]. It quotes Department for Business, Energy and Industrial Strategy figures showing that SMEs account for 99.9 per cent of businesses, generate £1.8 trillion in turnover, employ more than 60 per cent of people in the private sector and are responsible for almost 70 per cent of all moves from unemployment into private sector work.



Source: BEIS

2.2 Banking Scandals

The relationship between banks and their customers has not been helped by the series of high-profile scandals which have emerged over the past decade or so. This has led the Financial Conduct Authority (FCA) to take action, as detailed by Ned Beale in a recent article for the *Journal of International Law and Banking*[2]:

'One example is the mis-selling of Payment Protection Insurance (PPI). According to the FCA, banks have handled over 12.5 million PPI consumer complaints and paid approximately £20 billion in compensation. Another is the mis-selling of Interest Rate Hedging Products (IRHPs). According to the FCA, banks have reviewed around 30,000

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[1] Rishi Sunak MP 'A New Era for Retail Bonds', Centre for Policy Studies, November 2017
https://www.cps.org.uk/publications/a-new-era-for-retail-bonds

[2] Ned Beale Article in Journal of International Law and Banking
https://www.trowers.com/uploads/Blogs/Beale_2018_JIBLR_Issue_5_Press_Proof_(3).pdf

potentially mis-sold IRHPs and paid £2.2 billion in compensation. A further example is the conduct of the Global Restructuring Group (GRG) of Royal Bank of Scotland plc (RBS). A report prepared in 2013 by Lawrence Tomlinson, the Entrepreneur in Residence at the Department for Business, Innovation and Skills, suggested that there were occasions when RBS had engineered businesses into default in order to move them out of local management and into GRG.'

Over the last few years, debates in the House of Commons have highlighted instances of the mistreatment of business customers by banks[3]. These and other scandals such as the fraud at HBOS in Reading, which resulted in bankers going to jail and left many businesses in severe financial difficulties, have caused enormous distress to many people and undermined public confidence in the financial services industry[4]. In turn, they have focused attention on the regulatory framework and dispute resolution options available to consumers of financial services products.

2.3 Case Study

This example is taken from the Berg Banking Report July 2015 and is typical of the type of problems experienced by businesses up and down the country in relation to the mis-selling of an IRHP and pursuing a claim when the company has been put into administration.

The Hockins

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

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

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

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[3] Hansard 15th December 2016 **https://goo.gl/4Da6Qr**; Hansard 18th January 2018 **https://goo.gl/JEZw57**

[3] Telegraph, 30th November 2017, 'Lloyds settles with fraud victims who helped uncover HBOS Reading scandal **https://www.telegraph.co.uk/business/2017/11/30/lloyds-settles-fraud-victims-helped-uncover-hbos-reading-scandal**

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

The Hockins were forced to take the administrators to court to force the assignment of the claim. Having finally won the right to take the case to court, RBS settled the claim prior to any action. The Hockins were fortunate to have the resources to take the administrators to court as many do not.

2.4 Business Borrowing

The provision of financial services to SMEs is essential to enable them to grow and fulfil their potential, and none more so than funding. Lack of access to the capital they need is a longstanding issue for SMEs and has knock-on effects for the UK economy. As Rishi Sunak explains:

‘Without access to capital, growing enterprises cannot scale up by expanding operations, investing in new products, or exploring new markets.

‘This helps explain one of the great puzzles of the UK economy. We have a world-beating record when it comes to creating entrepreneurial start-ups. Some 21 per cent of UK firms are less than two years old, a higher figure than even the US (19 per cent).

‘Yet when it comes to growing those businesses – the stage at which access to capital is most crucial – Britain’s record is dismal. In a ranking of 14 OECD countries, the UK comes a lowly 13th in terms of the proportion of start-up businesses that grow to having 10 or more employees within three years.’

This affects the productivity of the UK economy with *‘British firms investing less than their rivals in improving their performance’.*

According to Sunak’s report, UK firms are far more reliant on banks for their financing than American businesses which have a wider range of potential funders from which to choose. And within the UK banking sector, an ‘*investigation by the Competition and Markets Authority (CMA) showed that the ‘Big Four’ banks account for some 90 per cent of business loans’.*

‘Such limp competition is likely to result in less availability of credit, higher prices and poor service for SMEs. That makes it unsurprising that 40 per cent of SMEs report being unsatisfied with their bank, while only 13 per cent trust their bank to act in their best interests.’

This lack of competition has led to an imbalance of power between key providers, the main clearing banks, and business customers of all sizes. This has adverse consequences for businesses, which may have little option but to accept unfavourable and onerous contractual terms in order to access funding needed to develop their business. Equally, once committed to facilities which involve borrowing, it can be difficult to change suppliers even if a better alternative could be found.

A recent article in *The Times*[5] looked at the SME Finance Monitor, a survey which is funded by the high street banks and conducted by research firm BDRC, and which showed the lack of trust in banks felt by SMEs. In 2017, only one in six companies not using external finance said they would be willing to do so, down from a quarter in 2015. Furthermore, only one in three SMEs were willing to borrow to finance growth in 2017 compared to a half in 2015 and only 5 per cent of companies reported making a new loan or overdraft application in the previous 12 months, a figure which has more than halved since 2012.

All of this has knock-on effects for the UK economy. As Suren Thiru, head of economics and business finance at the British Chambers of Commerce, commented in the same article in The Times:

'Companies need finance to support growth plans. Ultimately it means not getting that new factory, not going on that export drive.'

A wider range of potential funders, as suggested by Rishi Sunak's report, would help to improve this situation. However, it also highlights the need for effective and accessible means of resolving disputes between businesses and banks and other finance providers in order to build a better relationship based on trust and confidence.

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[5] Times Article 15th March 2018 ' Small Firms Say No to Bank Loans'
https://www.thetimes.co.uk/article/small-firms-say-no-to-bank-loans-mfqhx26nc

3. CURRENT METHODS OF RESOLVING DISPUTES

The general framework for financial services legislation and regulation in the UK, including the relationship between consumers and providers of financial services, is set out in the Financial Services and Markets Act (FSMA). Further, the Financial Services Act 2012 made the Financial Conduct Authority (FCA) the regulator of conduct in the retail financial services sector. Amongst other things, the FCA:

- Protects consumers by enforcing their rights under FSMA.
- Issues guidance and rules for those authorised under the FSMA through the FCA Handbook.

However, it should be noted that there is limited regulatory protection for business customers since many of their financial transactions fall outside the scope of current regulations. Even where the sale of goods and services are covered by regulations, breaches may not be actionable in law by businesses.

Under the current framework, there are four main options for businesses seeking to resolve a dispute with their financial services provider and these were examined by the inquiry into dispute resolution conducted by the APPGs on Fair Business Banking and Alternative Dispute Resolution.

3.1 Financial Firms' Internal Complaints Procedures

The starting point for most disputes between banks and their business customers is the bank's internal complaints process and any complaints that are referred on to the FOS have to start with a complaint to the bank. The FCA Handbook, in the DISP section, sets out rules and guidance on how firms should deal with complaints promptly and fairly.

The banks maintain that they have put effective systems in place, and RBS, in their submission to the Treasury Committee's SME Finance Inquiry[6], commented:

'The bank's complaint process is rigorous, structured and designed to promote fair outcomes for customers. Underpinning this process, the RBS Complaint Management Policy requires the bank to:

- *Resolve complaints promptly, consistently and fairly.*
- *Meet or exceed any relevant legal, regulatory, voluntary code and alternative dispute resolution (ADR) provider requirements; and*
- *Use complaints data to identify and to correct the causes of complaints to improve products, processes, systems, services and policies.'*

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[6] RBS Written Evidence to Treasury Committee Inquiry into SME Finance
http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/sme-finance/written/82255.html

In contrast, other evidence given to the Bridging the Gap inquiry did not support this view of the effectiveness of their complaints procedures. Claire Collinson of Claire Collinson Legal noted that of 154 clients, only 12 cases were resolved by the bank without involving other forms of dispute resolution. This is less than 8 per cent of the complaints her firm handled despite the fact that many went on to achieve some form of resolution in other ways. Crucially, none of the complaints relating to IRHPs were resolved through complaints procedures, when the FCA found that more than 90 per cent of the sales of these products involved breaches of regulations. It is also unclear if the banks would have resolved those 12 cases as they did if the clients had not had legal help.

She further stated:

'My experience is that it is highly unusual to receive any acceptance of wrongdoing by a firm in response to a complaint, even in cases of clear and obvious wrongdoing and that there seems to be a culture of routine declinature of complaints across the banking sector, most probably on the basis that of a pool of complaints a fairly high proportion will not be pursued further if an issue is raised and immediately rejected by the bank at the first stage.'

She went on to cite the example of IRHP mis-selling:

'I was involved in raising complaints/claims for clients in relation to IRHPs from the autumn of 2009 onwards, i.e. well before it became clear that the issue was a systemic problem. Right up to mid-2013, I received strenuously worded denials of mis-selling from all banks on products which were subsequently accepted to have been wholly mis-sold within the IRHP review.'

There are clearly conflicting views about the effectiveness of internal complaints procedures. What cannot be disputed is that financial firms' internal complaints systems failed to deal with the many issues that have generated complaints since 2007, such as the mis-selling of IRHPs, fixed rate loans and EFG loans; unfair treatment of businesses by RBS's Global Restructuring Group and other banks' special measures divisions; and PPI.

This suggests that, at the very least, such internal systems are not operating effectively and there is significant room for improvement, although there are also issues with the way in which the FCA captures, monitors and analyses complaints data from firms. There is also a perception issue because internal complaints procedures, by their very nature, lack the independence needed to inspire confidence among small business customers that if something goes wrong their complaint will be handled fairly and impartially.

UK Finance is currently looking at this element of the complaints process.

3.2 The Financial Ombudsman Service (FOS)

To resolve certain disputes, the FOS was established by the FSMA. It was set up to provide an impartial, informal, free service and customers can refer a complaint to the FOS if they are not satisfied with the response of financial services providers to their complaints. This means that any complaint must go through the providers' internal complaints procedure before it can go to the FOS.

FOS decisions will in each case be based on an assessment of what is fair and reasonable in all the circumstances of the case. As such, the FOS is required to take into account the relevant law and regulations, regulators' rules, guidance and standards, codes of practice and (where appropriate) what the FOS considers to have been good industry practice at the relevant time. The customer has the choice of whether to accept the adjudication or not. If they do not accept the initial adjudication, the complaint can be referred on to an Ombudsman. If customers do not accept that decision, they are then free to take the case to court.

Financial firms are expected to take note of any decisions taken by the FOS and, based on those decisions, to make changes to their complaints procedures and other aspects of their organisations.

At present, only microenterprises can take their cases to the FOS – those with a turnover that does not exceed €2 million and have no more than ten employees. Further, the FOS cannot deal with complaints about unregulated bodies, e.g. in instances where debt has been sold on to an unregulated third party, and the compensation limit of £150,000 is often inadequate to cover the losses sustained by businesses.

More than 96 per cent of businesses are eligible to take cases to the FOS, but they only represent 18 per cent of turnover in that sector. The remaining 3.7 per cent not covered by the FOS employ 67 per cent of the workforce in the private sector (over 17 million people) and generate 82 per cent of total turnover.

The Bridging the Gap inquiry took both written and oral evidence relating to the service provided by the FOS. The evidence from representatives of the FOS pointed to the fact that it is a free service and, therefore, accessible to financially distressed businesses where eligible. Costs for claimants are also reduced because representation is not necessary. However, Nick Stoop of Warwick Risk Management felt that a case was more likely to be successful if third party representation was used. Even with these additional costs, the FOS is still a relatively low-cost option, particularly when compared to litigation.

Claire Collinson of Claire Collinson Legal stated that in her experience the FOS was a cost-effective option for smaller and less complex claims and could sometimes, although not always, produce better results for businesses than might be achieved through the courts.

Further, decisions are not solely based on breaches of law or regulation but on what the adjudicators and ombudsmen consider 'fair and reasonable'. Another positive aspect of the FOS is that final decisions are published although this does not apply to cases which never progress from the initial adjudication to an Ombudsman or are withdrawn before a decision is reached.

The misgivings expressed in relation to the FOS mainly concern its suitability to deal with complex and high value disputes.

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[7] Section 228(2) FSMA 2000 and DISP 3.6 Determination by the Ombudsman
https://www.handbook.fca.org.uk/handbook/DISP/3/6.html

[8] FCA Handbook DISP 3.6.4R
https://www.handbook.fca.org.uk/handbook/DISP/3/6.html

A key concern is the variability in knowledge and experience of some FOS employees. In their evidence to the inquiry, the FOS witnesses were questioned in detail about whether there were people in their organisation with in-depth knowledge of complex financial products, how skills, knowledge and expertise are developed within FOS and the extent to which FOS would seek help from outside the organisation if knowledge of a particular product was not available in-house. Some of the responses to this line of questioning were as follows[9]:

'We have a range of experience, qualifications and backgrounds so there isn't a particular qualification that someone has to have to be an adjudicator or an Ombudsman.'

'There will be people across the organisation who have got lots of different experience.'

'We have lots of online and technical resources people can access. We have things called practice groups, made up of our most experienced, knowledgeable people and responsible for making sure that the organisation understands the way that it needs to think about particular cases… so we put quite a lot of effort into making sure people have the right information to resolve cases but equally we have in place systems for checking the quality of the work that people produce and making sure that we are getting the right outcomes.'

One of the FOS witnesses confirmed that when faced with complaints about novel and complex products, *'If as an organisation [we] felt that we didn't have sufficient knowledge or ability to deal with it then we would seek outside help.'* However, it was not confirmed whether this had happened in the case of IRHPs.

A further key concern about the FOS was the issue of disclosure of information, since it is vital in most business disputes to obtain certain documents from the bank – in particular, internal credit committee reports.

In their evidence, the FOS representatives confirmed that they can request information and will seek help from the FCA if financial firms do not co-operate. However, they have no power to take action against firms if they don't comply; only the FCA can do that.

This lack of disclosure powers is combined with a view among complainants that not all information provided by the bank is shared with them. In contrast, information that a complainant provides will be passed on to the bank and if the complainant requests that it isn't passed on then it will not be considered in the decision-making process.

However, the FOS disputes the claims of complainants and believes that it treats both banks and complainants in the same way and it is only in *'quite exceptional or unusual'* circumstances that they can't share with the customer information provided by the financial company.

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[9] Transcripts from APPG on Fair Business Banking Inquiry 'Bridging the Gap'
http://www.appgbanking.org.uk/wp-content/uploads/2018/06/Transcripts-from-Bridging-the-Gap-inquiry.pdf

The FOS provides an important and accessible service for those businesses that meet its eligibility criteria, although that is currently a limited range of businesses. The FOS is a form of ADR and lacks the powers of a court. So it is unable to require witnesses to give evidence and investigations are held in private so that there is no public scrutiny of cases that may involve, for example, mistreatment or malpractice. There is also a widely held view that the FOS does not have the legal expertise or resources to deal with the more complicated cases – although this is something that the FOS disputes. The APPG understands that an extended FOS would look at resourcing and capabilities in order to deal with an expanded case load of a more complex nature. However, as the FCA makes clear in its consultation, there will still be a limit and a gap will remain.

3.3 Ad Hoc Redress Schemes

Redress schemes were set up by banks to deal with particular instances of mis-selling of a product or service or other cases of common mistreatment of customers. The most notable examples relating to business customers are the review of the selling of Interest Rate Hedging Products (IRHPs) by the FCA in 2012 and the measures proposed by RBS for some businesses in its Global Restructuring Group (GRG) between 2008 and 2013. Such schemes examine one particular issue, even though problems often result from a series of instances of wrongdoing which need to be investigated together.

The Bridging the Gap inquiry only looked at the IRHP review. It found that the advantage of such a scheme is that redress can be achieved at lower cost than having to go to court and the compensation payments are higher than are available through the FOS. By exposing the shortcomings of banks in this particular area, such a review performed a useful function since it is uncertain whether they would have been exposed if cases had been presented individually to the FOS or the courts. The inquiry found that this was:

'Partly because the breaches of regulation on which the review scheme focused would be less likely to be exposed by the FOS or examined in court, but there were two other important aspects.

1. *It was not up to the customer to prove wrongdoing (theoretically at least). The onus was on the banks to demonstrate that they had complied with the regulatory rules and where they did not have sufficient evidence to demonstrate compliance then it was assumed that a breach had occurred.*

2. *Although each case was examined separately, as in other dispute resolution forums, of major significance is the fact that data was collected on the same specific criteria in each case which enabled comparisons to be made between cases and statistics compiled which highlighted that regulatory breaches had occurred in over 90 per cent of the IRHP sales that were eligible to be reviewed'.*

Such an ad hoc redress scheme can serve to highlight the scale and reach of particular instances of misconduct and, therefore, start the process of initiating changes in behaviour within financial institutions.

However, in their ‘Conduct and competition in SME lending’ report, the Treasury Committee identified flaws in the redress process, which they asked the FCA to address.[10] In particular complaints were made relating to:

- A lack of independence.
- A lack of transparency in terms of how the review process was being progressed.
- Inconsistencies in how the review process was being progressed between the banks.
- Possible conflicts of interests of those involved in reviewing customer files; and
- The lack of an appeals process.

The main problems with this and other similar schemes stem from their lack of independence. The schemes were set up by voluntary agreement between the banks and the FCA, although the regulator did have the powers to impose a statutory scheme for IRHP mis-selling. As far as businesses are concerned, the review processes were controlled by the banks with no mechanisms for proper sharing of information as would have been the case if cases had gone to court.

For example, businesses complained that certain of the banks would not provide information which formed the basis of their redress decisions, including telephone call recordings, call transcripts and pricing methodologies for alternative products. Further to the Treasury Committee’s investigations, it appeared that the banks refused to either engage in dialogue with customers, discuss the basis of their assumptions, or provide documentary evidence for the conclusions drawn.

The fact that many of those businesses seeking redress will be insolvent also denies them access to justice.

The whole process is also too dependent on the willingness of banks to engage and work constructively with customers. In his evidence to the Bridging the Gap inquiry, Lord Cromwell explained why ad hoc redress schemes do not provide an effective and fair means of redress for businesses:

‘The tools that the banks have tended to go for is to set up an internal process with an ‘independent’ – who if they’re appointed by the banks nobody on the other end is going to ever believe is independent – person at the top of the process. And I think that is probably what you’re up against, what you’re trying to replace here, is an internal process that nobody is going to believe in, even if it’s entirely honourable.

‘With an external process, if it is transparent and it has these…a greater equality of arms, if you have a better spread of representation on the panel of experts. So I think perhaps… that’s where we’re trying to take it, is outside the castle walls within which the bank exists, into the public arena and to me that is the most compelling part of all this, is that, no matter how good the banks’ internal process, if the transparency and belief isn’t there, they might as well not have bothered.’

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[10] House of Commons, Treasury Committee, Conduct and competition in SME lending Eleventh Report of Session 2014–15
http://www.parliament.uk/documents/commons-committees/treasury/Conduct_and_Competition_in_SME_lending.pdf

3.4 Litigation

For many businesses that do not meet the FOS eligibility criteria, the courts currently provide the only means of resolving disputes with their banks. The English common law courts have some obvious advantages in that they are a tried and tested method of resolving disputes renowned throughout the world. This means that they can provide a level of consistency and certainty not always seen in cases adjudicated by the FOS.

However, there are significant barriers to small and medium-sized businesses accessing such courts. One is financial and highlights the imbalance of resources between large lenders and their business customers, exacerbated by the length of time court cases can take. The other is the way in which the common law operates and the fact that businesses are barred from bringing actions for breach of the FCA rules.

One crucial advantage of the courts compared to the FOS is that, as several witnesses to the Bridging the Gap inquiry stated, for most business owners litigation presents the best chance of obtaining disclosure of the relevant information. One witness, Abhishek Sachdev of Vedanta Hedging, commented:

'I think one can't overestimate how important information disclosure is in these disputes. And I would say one difference between litigation and say the FCA review process or the Financial Ombudsman process or even a complaint process is that through litigation, by hook or by crook one eventually does get most of the important relevant information one needs and… I don't think I've seen a single litigation dispute whereby once the full and proper internal information has been presented that the claimant's case hasn't got stronger; it's always got stronger.'

However, there are a number of significant reasons why many businesses, and particularly small and medium-sized ones, will think twice about taking their bank to court even when they have a very strong case.

The cost of legal proceedings is one factor. To get to the point where a litigation funder would even consider a claim, a claimant will need to get forensic accounting reports, barrister's opinions and have a solicitor put together the heads of any claim. It is estimated that this could cost close to £50,000 in England.

Claire Collinson of Claire Collinson Legal set out the costs of going to court in her evidence to the Bridging the Gap inquiry:

'The potential for huge adverse costs orders in litigation creates an insurmountable barrier to access litigation for the majority of my clients, unless they are prepared to put their businesses at significant risk of further financial loss, created by the litigation process itself.

'By way of further explanation, for a claim with a maximum recovery of, say, £250,000:

i. Each side's costs are likely to be over £100,000, with no effective way of ensuring that potential liability for the bank's costs is capped in any way.

ii. Proceeding with no CFA, ATE insurance or funding gives the best chance of maximising the recovery if the case is won, but if lost, puts the business at extreme financial risk, at the minimum in the region of £300,000, which is a commercially untenable risk for most small to medium-sized businesses.

iii. *Protection against that risk can be achieved by entering into a CFA and ATE insurance, but for insurance cover of say £200,000 and a CFA, the recovery is likely to be discounted by at least 50% if the case is won and if lost, the business would still face a liability for disbursements and partial solicitor's fees.*

iv. *If funding is required, whilst the business is well protected against costs risk, it becomes almost impossible to achieve a meaningful recovery if the case is won, after payment of funding costs, ATE premium, CFA success fees and irrecoverable costs, making the litigation process commercially pointless for the business.'*

According to witnesses, such costs are fairly standard and do not vary much according to the size of claims. In his evidence, Abhishek Sachdev explained why:

'Generally speaking, a lot of the court process is the same. You should still be instructing a QC. You should still be going to a good law firm, because remember the banks don't differentiate that much. So RBS is still going to instruct Dentons or MAB, no matter who you're using.'

This problem of cost is compounded by the lengthy and stressful nature of the litigation process which can affect people's lives and the ability to run their businesses. There is a clear imbalance between the resources of financial firms and those of small and medium-sized businesses and few of those businesses can afford to fight cases over a number of years. Banks can do this and so they are in control of the process. In his evidence to the Bridging the Gap inquiry, M Ali Akram of Lexlaw highlighted how he felt banks used this to control which cases went to court. He stated:

'That is one of the major problems that we see in our litigation cases: precedent. The cases that have gone to court have been modelled and shaped by the banks. They're legally and financially sophisticated so they can overwhelm their opposition and what they do is pick off the good cases and settle them... We've had dozens and dozens listed in the past and not one ever went to trial. So what they do is, if a carefully constructed claim is put against them, they will settle it. If a badly managed and badly constructed set of pleadings faces them, they'll take advantage of that to create a precedent and to maintain tactical control…'

This process has been described by John Day of law firm DaySparkes as '*Unnatural Selection*'. It is compounded by the fact that the courts rule purely on the basis of freedom of contract despite the fact that there is an enormous amount of regulation, set out in the FCA Handbook, governing the relationship between financial services institutions and their customers. This is an acknowledgement that freedom of contract is insufficient when it comes to retail financial markets. Yet legal rulings as to what constitutes a 'private person' have denied businesses the right to pursue damages for breaches of financial regulations, such as those in the Conduct of Business Sourcebook (COBS) which forms part of the FCA Handbook. Private individuals do have that right.

All of this means that the common law courts do not act to expose poor behaviour and so do not help to change that behaviour in future. This is a point that has been made by Professor Iain MacNeil of Glasgow University who is quoted in Section 11.26 of the Law Commission report on Fiduciary Duties of Investment Intermediaries as saying that:

'The courts should be more involved in setting standards for the financial sector: There is also an argument to be made that the courts have for too long been sidelined in setting standards of conduct in the financial sector and that there is no reason in principle why the financial sector should be treated differently from other areas of commerce where the courts are involved in setting fiduciary standards (e.g. agency, partnership, companies).'

A further problem facing businesses is that, as a general rule, there is a time limitation of six years (five in Scotland) to take court action. Although this seems like a reasonable period, many businesses do find themselves 'out of time'. They can apply to the financial firm for a standstill agreement to keep their option to go to court open. However, this is at the discretion of the banks and will usually only last for a short period of time.

3.5 The Need for Reform

The FCA Consultation on SME Access to the FOS[11] sets out the differing attitudes towards individuals and businesses:

'Businesses generally have greater resources than individual consumers, and their owners often have limited liability. They also tend to have more experience of assessing their product needs, negotiating with suppliers and reviewing contract terms. As a result regulators, the courts and the law have traditionally treated them differently from individual consumers. In practice, this means that, across the economy, protections available to businesses are often more limited than those for individual consumers. For example, a business might not be protected by our rules on banking business conduct.'

However, the FCA consultation goes on to point out that:

'Not all businesses are the same and SMEs often have more in common with individual consumers than larger businesses. Many SMEs that buy or use financial products behave similarly to individual consumers, and can experience harm in similar situations. We have seen this happen because of:

- *Differences between what an SME expects from a financial services firm and what the firm believes is required of them.*
- *A gap between the capabilities and resources that firms assume SMEs have and their actual financial and legal expertise.*
- *A lack of accountability for the way products perform between the firms that manufacture products and those that sell ('distribute') them.*
- *Gaps in the protection that regulation provides, including access to redress.*

[11] FCA Consultation on SME Access to the FOS (CP18/3) Jan 2018
https://www.fca.org.uk/publication/consultation/cp18-03.pdf

‘When things go wrong the impact on businesses and their owners can be severe. Where they have suffered harm, SMEs have fewer options than individual consumers for pursuing redress, relying primarily on the courts.’

However, taking cases to court can be difficult for businesses, as is highlighted in the FCA consultation:

‘When things go wrong only a very small proportion of SMEs take their disputes with financial services firms to court. The World Bank estimates that taking a dispute to court might cost an SME in the UK up to 44% of its claim. Not all legal action requires a court hearing, or costs this much, but even starting legal proceedings can be very expensive. Businesses gave us examples where simply starting proceedings for a medium-sized commercial insurance claim might cost about 5% of the claim’s value. The court fee alone for starting a claim of over £10k is 5% and fees are only capped (at £10k) once the value of the claim goes over £200k. SMEs might also be discouraged from taking issues to court by the prospect of having to cover the other party’s legal costs.

‘Even well-resourced businesses might find it difficult to take legal action. This is because financial services disputes often coincide with cash flow stresses and other threats to the business. In these circumstances the cost and speed of redress is often critical to an SME’s ability to stay in business.’

The FCA has acknowledged the difficulties businesses face in taking financial services firms to court and the fact that it is consulting on extending SME access to the FOS is further acknowledgement of a gap in dispute resolution provision for businesses. In particular, there is a gap between the FOS, which has strict eligibility criteria and is set up for smaller cases, and the courts, which are not accessible to many small and medium-sized businesses. This gap has also been a recurring feature in the work undertaken by the APPG on Fair Business Banking, which has identified a number of factors which can restrict access to dispute resolution for businesses.

Business structure

Limited companies in particular can face additional barriers in litigation, even where they are very small and financially unsophisticated and may have only incorporated for tax reasons. They do not have the same right of action that private individuals do to pursue damages for breaches of financial regulations. The FCA made this point in its Consultation on SME Access to the FOS. It stated:

‘SMEs that do take disputes to court have more limited grounds to do so than individual consumers. For example, a private person who has suffered loss as a result of a firm breaching our rules generally has a right of action for damages under section 138D of the Financial Services and Markets Act 2000 (FSMA). A company acting in the course of business does not. Instead companies must rely on the general law or contract terms.’

The Issue in Dispute

The type of product or service at the heart of the dispute can affect whether or not a business can access one or more dispute resolution mechanisms. A key factor is whether or not the product or service falls within the regulatory perimeter. Most commercial banking and lending is not regulated.

One very clear example of how this can affect the possibilities for dispute resolution is the difference between those customers sold stand-alone IRHPs, for whom a bespoke dispute resolution forum was eventually created – the IRHP review – and those customers who were sold fixed-rate loans who have no access to such a scheme. This is because those products are considered to be unregulated by the FCA even though they have comparable features and risks to IRHPs and a similar sales process was used to sell them.

Eligibility

Eligibility limits prevent many businesses from having access to one or more of the current forms of dispute resolution. These can include banks' internal complaints processes and the FOS, both of which are only applicable to 'eligible consumers', and for businesses there are limitations on business balance sheet, turnover and employee numbers.

Ad hoc schemes, including the IRHP review and GRG review, have similarly used eligibility limits based on business value or size and product value in lieu of genuine financial sophistication criteria. Such arbitrary limits can unfairly penalise successful and/or labour/capital intensive businesses and those that may have suffered large losses, but which may be otherwise small and/or financially unsophisticated.

Costs

As set out earlier in this chapter, the FCA's Consultation on SME Access to the FOS and Claire Collinson's evidence to the Bridging the Gap inquiry both highlight the prohibitive cost of litigation as a major barrier. It effectively excludes large numbers of business owners from access to justice in circumstances where they must commit to not only their own side's escalating costs, but also the uncertain and frightening risk of having to meet their opponent's costs in the event that their claim does not succeed.

The cost of expert advice and representation may also be a barrier to some businesses having access to other forms of dispute resolution outside of litigation.

Insolvency

Former owners or shareholders of insolvent businesses currently face almost insurmountable difficulties in trying to resolve a dispute and recover losses through any current dispute resolution mechanism, particularly since disputes involving dissolved businesses or businesses subject to insolvency proceedings cannot be taken to the FOS.

Time

The expiry of the legal limitation period has prevented and continues to prevent many businesses from litigating against their bank.

There have also been time limits applied to certain aspects of ad hoc schemes so that, for instance, issues that occurred outside certain dates and claims not made within a certain time may be excluded.

Power Imbalance

Even where businesses do have access to more than one of the current dispute resolution mechanisms, they often find that they cannot satisfactorily resolve their financial disputes within a reasonable time period and at a reasonable cost due to challenges they face and the inadequacies of the current system of redress.

The work of the APPG on Fair Business Banking has found that most of the problems that businesses face trying to resolve financial services disputes stem from the imbalance in power between large financial institutions and their private business customers.

Many of these disputes have arisen in circumstances where a business customer's perception of the relationship with their bank may have differed fundamentally from the legal reality. Prior to experiencing any problems, many business customers mistakenly assumed that the bank owed their business a duty of care or would act in good faith, or at the very least that it would not encourage or require customers to enter into products or services that would be harmful to their businesses. Even if a bank did not behave well, it was thought adequate protections were in place that would ensure that banks would be held to account and made to rectify any poor behaviour.

When seeking redress, businesses find themselves at a significant disadvantage. They have: limited legal rights compared to individual consumers; inadequate regulatory protection; fewer resources with which to fight lengthy cases; severe difficulty in obtaining necessary information from banks except through litigation; and many have been forced into insolvency due to the poor conduct of a financial firm. At that point, the ex-directors of the company are relying on the administrator to bring a claim against the bank, which rarely happens.

4. OPTIONS FOR REFORM

The problems identified in the previous chapter have convinced the members of the APPG on Fair Business Banking that there is a need to reform the provision of dispute resolution services available to private businesses in financial disputes. With a view to levelling the playing field between businesses and their financial services providers, there is a need to address:

- The legal rights and regulatory protection of SMEs.
- The gap in provision between the smaller disputes dealt with by the FOS and those where it is feasible for businesses to go to court. This gap, although narrowed by the proposed extension of the FOS, will still exist even if the limits are extended.

The aim of reform of the dispute resolution system is to successfully stem and repair damage in individual cases, while also driving better conduct in the future by financial institutions. This is partly a matter of extending the legal rights and regulatory protection afforded to businesses. However, the APPG on Fair Business Banking believes that there is also a need for a new formal dispute resolution mechanism, in addition to the courts, to fill the current gap in provision and it will require the following key features:

Independence

A better relationship between businesses and financial institutions requires confidence and trust. This will only be achieved if there is a belief that if something goes wrong any method of resolving a dispute is strictly impartial. In order to achieve this any dispute resolution mechanism must be independent of both the financial services industry and the FCA. As the Bridging the Gap inquiry found, this is the main problem with the financial firms' own internal complaints procedures and the various voluntary ad hoc redress schemes since they will never be fully trusted by businesses.

Fairness and Transparency

The procedural rules of any new system should be fair, clear and transparent, with parties to the dispute having the opportunity to present and argue their case and the right of appeal. As the evidence to the Bridging the Gap inquiry showed, a swift, powerful, legally binding method of disclosure of information is essential to ensuring the fairness of any new system. Therefore, compulsory disclosure and inspection of documents should be implemented to enable parties to carry out an investigation of the core documentation at an early stage of the process. To further ensure the transparency of the process, any proceedings should be held in the open and as many dispute outcomes as possible should be published to set precedents and improve future conduct.

Accessibility

Any new system must be widely accessible to businesses in order to reduce the imbalance of power between financial firms and their business customers. Therefore, any new method of dispute resolution must be low cost for complainants and provide speedy resolution of complaints.

Effectiveness

The mechanism should have an appropriate level of expertise to manage complaints competently. All parties to any dispute are looking for a rigorous system that delivers consistent and conclusive decisions.

It is against these criteria that this report assesses potential reform options.

4.1 Alternative Dispute Resolution (ADR)

The Bridging the Gap inquiry described ADR mechanisms as follows[12]:

'Alternative Dispute Resolution (ADR) mechanisms are a range of procedures that serve to resolve disputes generally involving the intercessions and assistance of a neutral third party to promote a binding settlement or decision. ADR is recognised as a confidential, cost-effective and faster alternative to litigation. In being, on the whole, less adversarial than court it helps businesses preserve commercial relationships despite contractual difficulties. Its authority is derived from private agreement, with the courts having an important enforcement role.'

Very little evidence was presented to the Bridging the Gap inquiry about the current use of ADR mechanisms, such as mediation, arbitration and adjudication, in resolving disputes between businesses and financial institutions. Where evidence was presented, it was generally positive about mediation. For example, Claire Collinson of Collinson Legal stated that:

'Often, mediation proves to be a very effective method of dispute resolution, in bringing both parties into a forum where they are effectively required to address the issues in dispute and where the unique environment of a mediation can cut through what may have appeared to be an impossibly entrenched position on one or both sides.'

RBS, in its submission to the Treasury Committee inquiry into SME lending, was equally positive about ADR processes. Its submission stated that:

'The bank is committed to encouraging the use of formal and informal methods of ADR in appropriate cases, such as engagement in direct party-to-party settlement negotiations

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[12] Bridging the Gap Inquiry February 2017
http://www.appgbanking.org.uk/wp-content/uploads/2017/05/APPG-FBB-Bridging-The-Gap.pdf

and in mediation. Provided both sides agree to participate in ADR, there is no other barrier to access and it can offer a swift, low-cost route to achieving a mutually acceptable resolution. As such, the bank would support greater market and industry recognition and use of ADR as an effective and efficient means of resolving SME disputes.'

In England and Wales, solicitors have a duty to advise their clients about mediation. This, coupled with ADR requirements in the pre-action protocols, the Civil Procedure Rules and court guides, along with certain court schemes, means that mediation is something which must be considered in every case.

Failure to comply may result in adverse costs orders. The aim of the protocols is to enable parties to avoid litigation wherever possible by agreeing a settlement of the claim even before the commencement of proceedings. The protocols[13] require the parties:

- To consider whether ADR would be suitable and, if so, to agree which ADR procedure to attempt.
- To provide evidence, if required by the court, that ADR was considered.

These are sensible rules and should be applied in other jurisdictions in the UK. For example, in Scotland the Court of Session brought in new requirements in March 2017 to consider ADR in commercial actions at an early stage and advise the court on steps taken to achieve settlement. This would push the system more into line with England and Wales and further moves in this direction would be helpful.

When looking at ways of improving the dispute resolution process for businesses, Marion Smith QC, in her evidence to the Bridging the Gap inquiry, pointed to the success of ADR mechanisms in resolving disputes in other areas such as construction, tax, employment and shipping and the general commercial world.

In future, ADR mechanisms could play a greater role in resolving disputes between businesses and financial firms since they are generally agreed to be effective. The APPG on Fair Business Banking is aware that UK Finance is looking carefully at forms of ADR and looks forward to its proposals. However, the whole point of these mechanisms is to be an alternative to the formal dispute resolution provided by the courts. It is the lack of a formal legal means of redress other than the courts which is the problem and ADR mechanisms cannot fill this particular gap.

Therefore, while the current ways of encouraging the use of ADR mechanisms should be applauded and encouraged as a way of expanding the range of options open to businesses, they cannot be the central and sole solution to the problems businesses face in accessing justice. Access to primary dispute resolution must also be addressed.

[13] CPR Pre-Action Protocols
http://www.justice.gov.uk/courts/procedure-rules/civil/protocol

4.2 Increasing Access to the Courts

The English courts provide a high-quality dispute resolution service which meets most of the criteria identified by the APPG on Fair Business Banking. The Business and Property Courts, which began operating in October 2017, provide a single umbrella for the specialist civil jurisdictions across England and Wales. It has specialist courts in a range of different areas including a Financial List and a Business List, which form part of the High Court. The Financial List generally deals with claims of over £50 million and these are not usually the cases brought by small and medium-sized enterprises. However, the Business List, which has sub-lists dealing with financial services and regulatory or pensions issues, might be a suitable forum for such disputes since it hears claims with a value of £100,000 and above. The court fee for commencing claims in the High Court is currently £10,000.

The main problem, as evidence to the Bridging the Gap inquiry and the FCA consultation on SME Access to the FOS both identified, concerns costs which are out of the reach of most businesses. Partly, these are costs associated with the court process and the length of time that court cases take which drives up costs. However, there is also the risk associated with bringing cases to court. Ned Beale in his article for the Journal of International Banking Law and Regulation explained why this is a problem[14]:

'The general rule of English civil litigation is that the unsuccessful party will be ordered to pay the costs of the successful party, but the court may make a different order.'

This presents barriers to accessing justice for two reasons.

'First, the risk of having to pay the defendant's costs discourages claimants from pursuing claims. This is particularly the case where an SME brings, for example, an IRHP or a GRG related claim. A claimant will have a degree of control over its own costs. This is not absolute control because, unless it is able to negotiate a fixed fee with its lawyers at the outset (which is rarely offered), the claimant may face a choice between paying more to its lawyers or having them cease to act.

'However, the claimant does have control in the sense that it can decide how to run the case, and so limit costs, and ultimately act as a litigant-in-person or discontinue if its own costs become prohibitive. Conversely, a claimant has much less control over the defendant's costs, being limited only by the rules as to recoverability.

'Secondly, the prospect of recovering costs from the other side can act as a driver to increase costs. Once legal costs become part of the damages sought, then it can make economic sense for a party to invest more in its own costs in the hope of maximising the prospects of recovery.'

There have been some notable attempts to address these issues through the review of civil litigation costs led by Sir Rupert Jackson, the court modernisation programme and the disclosure pilot scheme in the Business and Property Courts.

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[14] Ned Beale, Article in Journal of International Banking Law and Regulation 2018
https://www.trowers.com/uploads/Blogs/Beale_2018_JIBLR_Issue_5_Press_Proof_(3).pdf

Civil Litigation Costs

The FSB, in its evidence to the Jackson Review of Fixed Recoverable Costs, stated that:

‘Small businesses in England and Wales are labouring under £11.6 billion in annual Total Resolution Costs (TRC) as a result of commercial disputes.’

It went on to say:

‘FSB research, described in our report ‘Tied Up: unravelling the dispute resolution process for small firms’, found that 19% of small business commercial disputes end up in a court. While over a fifth of that 19% end up in the higher (‘Fast’ and ‘Multi’) tracks where cost recovery issues are most salient. The small businesses involved in cases in the ‘Fast’ and ‘Multi’ tracks are likely to be incurring considerable costs. Consequently a proportion of the £11.6 billion of TRC is made-up of litigation costs.

‘Therefore, one important way of reducing the TRC bearing down on the small business community is to cut the direct costs of litigation for smaller businesses through more extensive use of fixed recoverable costs. The latter will reduce the costs incurred by some of those small businesses already ending up in the courts to resolve a commercial dispute.’

The FSB backed the proposal for fixed recoverable fees for commercial cases up to £250,000 and although this was proposed, it was not in the end implemented.

Court Modernisation Programme

The court modernisation programme will see HM Courts and Tribunals Service, in collaboration with the senior judiciary and the Ministry of Justice, investing £1billion to reform the English courts and tribunals system to try to make access to justice quicker, easier and fairer. The reform programme intends to make use of available technology, particularly digitalisation. Paper-based processes will be replaced with digital ones to increase efficiency and help to reduce the time and cost of litigation. For example, an e-filing system has been introduced in the Business and Property Courts in London, which now require that all documentation is filed and exchanged digitally.

Disclosure Pilot Scheme

In May 2016 a working group was established to examine the disclosure process in civil proceedings in response to concerns raised by litigants and the legal profession regarding the excessive costs, scale and complexity of the disclosure process. The working group, which comprised lawyers, experts, judges, representatives of professional associations and users of the High Court, concluded that a ‘wholesale cultural change’ is required, which could only be achieved by the adoption of completely new guidelines on disclosure.

The most important change is that standard disclosure will no longer be regarded as the default form of disclosure. Instead, basic disclosure will normally be the first stage in the disclosure process. Basic disclosure will involve key or limited documents relied on by the disclosing party and necessary for other parties to understand the case they have to meet, at the same time as the particulars of claim or defence. There will also be five proposed models for extended disclosure which parties may request in addition to, or instead of, basic disclosure.

The Disclosure Pilot Scheme in the Business and Property Courts is expected to commence at the end of 2018 or beginning of 2019. It is proposed that the pilot will take place over a two-year period.

The reforms to reduce the high and unpredictable costs of litigation and modernise the courts are welcome. However, it remains to be seen how effective they will be in closing the existing gap in the provision of dispute resolution services for small businesses. It is the APPG on Fair Business Banking's view that this gap needs to be filled urgently and requires a new forum for dispute resolution to fill it. The modernisation of the courts will also do nothing to affect the current limitations on the legal rights of SMEs which mean that they are barred from bringing actions for breach of the FCA rules.

4.3 Extending Eligibility to FOS

A further proposal to reform the dispute resolution process is to extend the eligibility rules for complaints to the FOS. The FCA's consultation on SME Access to the FOS[15] stated that:

'We propose to change the definition of an 'eligible complainant' so that it includes a new category – 'small businesses'. We propose to define this as businesses that are too large to be 'micro enterprises', but have annual turnover below £6.5m, an annual balance sheet total smaller than £5m and fewer than 50 employees.'

In its written evidence to the Treasury Committee's Inquiry into SME Finance[16], the FCA set out the difference this would make. It stated:

'The consultation proposals will make a significant difference to a large number of SMEs who may currently have difficulty resolving disputes with financial services firms. The proposals should result in around 160,000 more SMEs being able to refer unresolved disputes with financial services firms to the Ombudsman. This will mean around 99% of all SME businesses in the UK will be eligible, with only the very largest SMEs remaining out of scope. We estimate this could mean up to 1,500 more disputes involving SMEs being considered by the Ombudsman each year.'

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[15] FCA Consultation on SME Access to the FOS (CP18/3) Jan 2018
https://www.fca.org.uk/publication/consultation/cp18-03.pdf

[16] FCA Written Evidence to Treasury Committee Inquiry into SME Finance
https://www.fca.org.uk/publication/consultation/cp18-03.pdf

We believe our proposals will lead to more SMEs receiving appropriate redress when they have suffered harm due to the actions of a financial services firm. Over time, we hope the changes will contribute to better services to SME customers in the first place, leading to fewer complaints and better outcomes for SMEs, as well as contributing wider benefits to the real economy.'

The FCA consultation on extending the FOS also mentions the possibility of increasing the binding award limit from the current £150,000 to £600,000. This recognises the fact that the larger businesses that would be eligible to complain could increase the number of claims in excess of £150,000. As the FCA recognises in its Treasury Committee evidence:

'If the Ombudsman had a significantly higher award limit, then the parties to the highest value complaints might expect the basis for decision making and the investigation process to more closely resemble those of a court, perhaps with representation, hearings and appeals etc.'

This highlights the central issue that would remain. The FOS is a form of ADR and not a court, so does not have the same powers as a court and its determinations do not create binding legal precedent. Therefore, for the same reasons as other forms of ADR, it cannot fill the gap that exists for a formal means of resolving disputes in addition to the courts.

Although broadly supportive of the plan to extend access to the FOS to SMEs, RBS highlighted a further concern in its written evidence to the Treasury Committee Inquiry into SME Finance.

'One key issue for consideration if access to the FOS is widened to encompass SME customers is whether the FOS will, within its current model, be equipped to manage the larger, more complex complaints that are likely to be referred to it. From our experience of SME litigation and of cases referred to the GRG complaints process, it is likely that the FOS may be asked to review complex technical matters, voluminous documentation and, in some cases, expert evidence.

'It is likely that such cases will require to be adjudicated by staff with relevant experience in SME lending and/or restructuring and that new principles will have to be developed by FOS against which to determine 'fairness and reasonableness' in such cases. The challenge that the FOS will face in considering SME complaints will be particularly acute in an unregulated context, where there is currently no universally agreed view across the industry of what 'good practice' looks like.'

It seems likely that the proposed extension of the FOS's eligibility rules will go ahead. While this should be welcomed, on its own it will not create the transformation in dispute resolution provision that is required as acknowledged by the FCA.

4.4 A Financial Services Tribunal

Even if the proposed extension of the FOS eligibility rules goes ahead, a significant gap in provision remains. Ned Beale identifies this in his Journal of International Banking Law and Regulation article[17]. He states:

'The current upper limit for FOS claims is £150,000. That has been identified as being too low to allow resolution of some claims by SMEs, for example, IRHP claims which involve consequential losses. Raising the threshold to £600,000 has been mentioned in a recent FCA consultation paper.

'However, that would still leave a large distance not only between that and the lower limit of Financial List claims (£50 million) but, perhaps more pertinently, the lower limit of claims which can feasibly attract a package of third-party funding and adverse costs insurance, thereby allowing claimants to pursue them without having access to funding.

'This lower limit is generally seen as around £5 million. Although new entrants to the expanding litigation funding market may drive this figure down, for funders and claimants each to make the necessary returns, this is likely to remain in the millions of pounds.'

It is this gap, in what Richard Samuel describes as the 'middle market', which needs to be filled. In an article for the Capital Markets Law Journal[18], Richard Samuel explained that:

'The FCA tried to extend its reach into that space when it created its ad hoc redress scheme, overseen by s166 skilled persons, which would keep IRHP disputes out of the County Courts and general lists of the High Court. The FCA identified the right space to occupy with a 'mass dispute resolution system' but has not yet found the right system with which to occupy it. The FCA should not lose heart, but look at different ways of filling that gap with an alternative redress system.'

The alternative he proposes is a financial services tribunal system, modelled on employment tribunals. This would be a genuinely independent body with legal powers and would meet the key criteria for a dispute resolution system set out by the APPG on Fair Business Banking. As Richard Samuel states in his article such a tribunal would:

'Enjoy the confidence of the public as a robust mechanism for resolution of disputes' and 'provide for easy low-cost access to justice for claimants.'

He believes that a tribunal could have a dramatic effect on the power imbalance inherent in disputes between businesses and large financial institutions, echoing the transformation in employer/employee relationships brought about by the introduction of employment tribunals.

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[17] Ned Beale, Article in Journal of International Banking Law and Regulation 2018
https://www.trowers.com/uploads/Blogs/Beale_2018_JIBLR_Issue_5_Press_Proof_(3).pdf

[18] Richard Samuel, Article in Capital Markets Law Journal April 2016
https://academic.oup.com/cmlj/article/11/2/129/2366021

There has been plenty of support for a financial services tribunal from businesses and politicians as well as the FCA. The FCA's written evidence to the Treasury Committee Inquiry into SME Finance argued that the FOS and a Financial Services Tribunal performed complementary roles:

'Within the financial services dispute resolution system, we see a role for both the Ombudsman and a tribunal as they meet different needs. For example, the Ombudsman provides a quick and informal process for relatively low value financial services disputes. A tribunal, on the other hand, would provide a more formal, court-like approach for higher value disputes, or disputes involving complainants above the Ombudsman's eligibility thresholds.

'A tribunal would also meet the demand of some complainants to have their 'day in court' – so that their case is heard in public with the parties giving oral evidence. While the Ombudsman can hold oral hearings, it does not generally do so. The Ombudsman does not have the power to compel the attendance of witnesses, take evidence on oath or test evidence by cross-examination.'

The most common concerns from the industry and government about the proposal for a Financial Services Tribunal were set out by Michel Reznik in an article for the *New Law Journal*. These are that:

'(1) the claims brought against financial institutions in FSTs will add significant costs to the supply of credit to SMEs, which they will ultimately themselves have to bear; and (2) the increased number of claims faced by banks will mean credit will become more scarce and expensive for SMEs because the providers will withdraw from the market.'

His article goes on to summarise Richard Samuel's argument that a Financial Services Tribunal will benefit business. He states:

'Consumer demand is dictated in large part by consumer confidence. No small part of consumer confidence is driven by the consumers' perception of: (1) the likelihood of something going wrong; and (2) what will happen if it does.'

He goes on to describe two historical examples used by Richard Samuel to show how the City understands that an unsatisfactory answer to the question of 'what happens if something goes wrong?' can inhibit consumer demand. Therefore, it is in the industry's interests to ensure that if something does go wrong the consumer gets a fair hearing so as to reassure them.

The first example is that of direct debits. As he says:

'It did not require a huge leap of the imagination for the leaders of the banks' sales teams to appreciate that when a consumer was asked to sign a mandate that permitted a third party to remove cash direct from its account, the first thing that would come to their mind would be: 'what happens if this goes wrong?' In response, the industry moved to engender consumer confidence in the critical aspect of the sales process-dispute resolution-by creating the 'direct debit guarantee'. In essence the 'guarantee' is a promise that when a mistaken payment is identified, the customer can get a full refund, no questions asked.

'This 'guarantee' (ie attractively packed dispute resolution terms) instilled the necessary consumer confidence to allow the Direct Debit scheme to enjoy a huge uptake among consumers. In August 2015 The Guardian reported that since the first direct debit was processed in 1968, Bacs, the not-for-profit organisation that processes direct debit payments, has processed more than 110 billion direct debit transactions for British bank customers.'

As he concludes, direct debits are a win-win for consumers and banks.

The second example is consumer credit cards. When the government introduced the Consumer Credit Act 1974, it included section 75 which:

'Created a liability on the issuer of the credit card to the user of the card for the misrepresentation or breach of contract of the supplier of goods or services bought on the credit card. One might well ask: why? A lender does not guarantee the goods a borrower buys with the money it lends … except it does, when the customer uses a credit card, thanks to s75. On the face of it, that provision is grossly unfair to the credit providers. And putting fairness aside, credit providers could surely have complained that all these claims would drive up the cost and reduce the supply of consumer credit. For those reasons the banks could have argued that, whatever good intentions lay behind s75, it was bad policy.

'In fact, the credit providers did the exact opposite. They resisted their instinct to lobby that provision out of existence. Samuel explains why. He observes that in the 1970s there was a lot of moralising and negative publicity around the use of credit cards-as there is today. Consumers would be inhibited from their uptake if that was the only public narrative. Counter-narratives would be needed to ensure that consumers adopt credit cards and banks fully exploit this new market. So instead of closing s75 down, the industry was smart enough to pause, reflect and match costs of s75 to the revenues it would create.

'On a true match, s75 would actually drive up revenues and profits for banks, even after taking account of the costs. How? The right to sue an established credit provider over a 'here-today, gone-tomorrow' trader has clear benefits to the consumer so would help drive spending from cash to credit cards. But few consumers would ever actually use s75. The banks therefore embraced s75 as one of a suite of incentives-like rewards schemes-designed to migrate spending to credit cards.'

So the lesson is that effective dispute resolution mechanisms instil confidence and that will be good for both the financial services industry and businesses.

4.5 Bridging the Gap

The APPG on Fair Business Banking recognises that the proposed extension of the FOS eligibility criteria and the reforms to the courts should improve access to justice for small businesses. However, it believes that further reform is required. There is a need to give SMEs greater legal rights and to provide a new formal dispute resolution forum – a Financial Services Tribunal – to fill the gap in provision that the APPG believes exists, and will continue to exist, between the FOS and the courts. This gap affects the businesses that are the major employers and revenue generators in the country.

5. LEGISLATIVE CHANGE

The legal rights of SMEs under common law have not proved sufficient to provide businesses with adequate means of redress in courts. It has been accepted that the common law is not capable of delivering an adequate degree of consumer protection in the financial services industry. Equally, the common law is not sufficient to protect consumers in financial services disputes, which is why we have seen the introduction of voluminous regulation in this area as set out in the FCA Handbook and PRA Rulebook. However, businesses are currently barred from bringing actions for breaches of the FCA rules.

In his evidence to the Bridging the Gap inquiry, Richard Samuel set out the process by which a tribunal is established and operates effectively to create a more level playing field in dispute resolution. He stated:

'Parliament creates a right, for example, not to be unfairly dismissed. You create the tribunal which allows the private individuals to enforce the right. It's not the state or the regulator trying to do it; private individuals are empowered.'

Following this process, the starting point for legislative reform is, therefore, Parliament addressing the legal rights of businesses.

5.1 Enhancing the Legal Rights of SMEs

As Shazia Khan Afghan explained in a recent article for the Journal of International Banking Law and Regulation[19]:

'The right to bring an action for damages for losses suffered as a result of a breach of regulatory rules was first introduced by the Financial Services Act 1986 (FSA 1986). This right of action accompanied the introduction of the Securities and Investment Board (SIB), a new regulatory authority for investment businesses and the SIB's Conduct of Business Rules (CBRs).

'In particular, s62 (Actions for damages) of the FSA 1986 stipulated that a breach of the CBRs is actionable at the suit of a person who suffers loss as a result of the breach, subject to the defences and other incidents applying to actions for breach of statutory duty… However, the investment industry expressed concern that the unlimited liability contained in s62 would lead to increased litigation risks. In particular, some larger firms predicted that smaller competitors would bring actions for tactical advantage.'

To prevent this, the industry sought a high level of detail in the CBRs. However, instead government restricted the right of action to 'private investors'. This was originally envisaged to prevent only 'professional investors' from bringing Section 62 actions for damages, but this was never set out in any secondary legislation. So a private investor has been defined broadly which has meant hardly any cases have been brought and has

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[19] Shazia Khan Afghan, Article in Journal of International Banking Law & Regulation May 2018
https://login.westlaw.co.uk/maf/wluk/app/document?&srguid=i0ad832f20000016432a918d67cabcff0&docguid=I7A420320397A11E8A291F33894F42024 &hitguid=I7A420320397A11E8A291F33894F42024&rank=2&spos=2&epos=2&td=5&crumb-action=append&context=14&resolvein=true

prevented it from becoming an effective remedy for breaches. Nonetheless, the same restriction was included in section 138D of the FSMA, which provides that a breach by an authorised person of an FCA rule is actionable by a 'private person' who suffers loss as a result of the breach. As Shazia Khan Afghan explains:

's3(1) of the Regulation prescribes that a 'private person' means (a) any individual, unless he suffers the loss in question in the course of carrying on any regulated activity… and (b) any person who is not an individual, unless he suffers the loss in question in the course of carrying on business of any kind…'

Her conclusion is that:

'In essence, the "private person" restriction, which was introduced nearly three decades ago to prevent tactical competitive claims by professional investment businesses, is being employed to protect financial services firms from actions for breaches of the FCA rules by SMEs, which either do not carry on any regulated activity; or lack the necessary sophistication, experience and knowledge of financial transactions. In conclusion, the basis upon which s138D of the FSMA 2000 and s3(1)(b) of the regulation are drafted should be revisited.'

The private person restriction was supposed to prevent an excessively litigious approach in the financial markets. However, Shazia Khan Afghan argues that the restriction has not succeeded in this purpose. Whilst the restriction *has* limited the number of section 138D claims being brought in the courts, there has been a momentous shift from traditional court-based proceedings towards other means of regulatory redress which have proved unsatisfactory to SMEs.

The current restriction makes it very hard for any company to bring a claim since most, if not all, companies will be in a business of some kind. It also leads to illogical consequences for SMEs as Shazia Khan Afghan explains in her article:

'For example, a sole trader or English partnership that does not have separate legal personality from its owners could bring an action for breach of the FCA rules, unless it carries on business in financial services. By contrast, a company or limited liability partnership (LLP) of similar size and/or sophistication is not a 'private person' and is therefore unable to bring an action for breaches of the FCA rules. It appears unreasonable that the ability to bring an action for breaches of the FCA rules should depend entirely on the legal form, rather than the size or the sophistication, knowledge or experience of a business.'

She goes on to set out the extent of the problem. She states:

'The unprecedented volume of reported complaints by SMEs to the FOS, ad hoc voluntary redress schemes, consumer redress schemes and reported mis-selling litigation brought before the English courts have clearly demonstrated that a large proportion of SMEs entered into complex financial transactions without the requisite financial sophistication, knowledge and experience. Indeed, the Financial Services Consumer Panel has challenged the notion that a company engaged in business is more financially literate or sophisticated and thus less worthy of protection than an individual or 'private person'.'

Extending the legal rights of SMEs by removing the current restrictions will give them the ability to bring claims for breaches of rules in the FCA Handbook and so would help to ensure that in future firms behave more responsibly towards their customers.

Section 138D *Actions for damages*

The best and simplest way to extend the legal rights of SMEs is, therefore, by extending the section 138D right of action. This would be done by amending the 'private person' definition contained in the FSMA (RAR) 2001, which is secondary legislation.

This would have the effect of giving SMEs a right of action for breach of the Conduct of Business Sourcebook (COBS) rules. The COBS rules form part of the FCA Handbook[20] and set out in detail a regulated firm's conduct of business obligations, which stem from FCA Principle 6 which states that, 'A firm must pay due regard to the interests of its customers and treat them fairly.' However, these COBS rules (examples of which are COBS 2.1 Acting honestly, fairly and professionally in accordance with the best interests of its client; and COBS 4.2 Fair, clear and not misleading communications) are distinguishable from the FCA Principles for Businesses and currently give rise to a right of action by a 'private person' under section 138D of the FSMA.

The issue then becomes defining an SME. One possible approach would be to provide all SMEs classified as 'retail clients', as distinct from 'professional clients', with a right of action. This distinction derives from the Markets in Financial Instruments Directive (MiFID) and has already been adopted in the FCA Handbook's Conduct of Business Sourcebook to define the level of protection which a regulated firm must provide to those clients. Retail clients are considered the least experienced, knowledgeable and sophisticated investors and have the highest level of regulatory protection.

Meanwhile, professional clients are considered more experienced, knowledgeable and sophisticated and more able to assess their own risk. So they have fewer regulatory protections. Many SMEs will be classified as retail clients and will receive additional protections under COBS rules and should have equivalent rights of action to enforce those protections. A retail client is a client who is not a professional client or an eligible counterparty.[21] An SME will be considered to be a professional client if it meets any of the following conditions:

- A body corporate or LLP that has (or any of whose holding companies or subsidiaries has) called up share capital or net assets of at least £5 million during the previous two years.
- An undertaking that satisfies (or any of whose holding companies or subsidiaries satisfy) two of the following:

[20] FCA Handbook Conduct of Business Sourcebook
https://www.handbook.fca.org.uk/handbook/COBS

[21] COBS 3.4 Retail clients FCA Handbook Conduct of Business Sourcebook
https://www.handbook.fca.org.uk/handbook/COBS/3/4.html

- o balance sheet total of €12,500,000;
  - o net turnover of €25,000,000;
  - o average of 250 employees during the year; or
- A partnership or unincorporated association that has (or has had at any time during the previous 2 years) net assets of at least £5 million.

Such an approach may be too arbitrary though. The Promontory Financial Group's report for the FCA into the treatment of SMEs by RBS's Global Restructuring Group[22] described the diversity of SMEs with which banks have to deal. On page 297, it stated:

'The SMEs in our sample illustrate the variety of SMEs that banks have to deal with. They included some SMEs with a reasonable level of financial sophistication who had available to them expert advice; but they also included SMEs without access to independent advice, and with little financial experience.

'Even when a SME had some reasonable understanding of financial issues, this was not necessarily sufficient for the increased complexity of the issues which often arose once the SME was transferred to GRG, where the situation could be complicated both by general legal issues such as the different protections and treatments offered to limited companies and to sole traders, and by the complexity of the solutions which GRG on occasion brought forward.

'There were other important differences. Some were in effect sole traders or owner managers where the sickness of a key individual could have catastrophic consequences for the business. For some smaller customers the lending was closely intertwined with personal financial arrangements, so that when things went wrong in the business the consequences were personal as well as professional.'

The report went on to say:

'We believe that policies and practices for the SME sector need to be based at least in part on an appreciation of differing customer capabilities, if the SME customer is to be treated fairly. This is not readily defined by arbitrary limits such as amounts of debt or even turnover. But it will be relevant to take account of the stage in the banking relationship reached by the customer, to ensure that products, services and communications are appropriate for the needs of the SME customer.'

This suggests an alternative approach may be required and the Financial Services Consumer Panel has called on the FCA to carry out a segmentation of SMEs, similar to that which it has developed for individual consumers. This should explore the differences between businesses of different sizes, and whether there are specific issues relating to different ways of conducting business (e.g. sole trader, partnership or limited company).

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[22] Promontory Report on RBS Global Restructuring Group
https://www.parliament.uk/documents/commons-committees/treasury/s166-rbs-grg.pdf

The Financial Services Consumer Panel thinks that decisions on whether a firm is sophisticated cannot be made solely on the basis of figures for turnover or number of employees since it will depend on the type of business. Other factors such as whether a firm is large enough to employ a professional finance officer or accountant need to be taken into account. A study which uses both quantitative and qualitative ways of deciding whether a business is sophisticated or not may well be the best way forward.

FCA Principles for Businesses

An alternative approach would be to extend SMEs' rights of action for breaches of the FCA Principles for Businesses. These principles are broader than the COBS rules and so would afford SMEs greater legal protection, which may be deemed necessary.

The FCA Principles for Businesses[23] require a firm, amongst others, to conduct its business with integrity (Principle 2) and due skill, care and diligence (Principle 3); and to pay due regard to the interests of its customers and treat them fairly (Principle 6). Breaches of the FCA Principles for Businesses do not give rise to actions for damages by a private person under section 138D.

In particular, section 138D(3) states that if an FCA rule provides, section 138D will not apply to a breach of a specified provision of the rules. The FCA rule, PRIN 3.4.4R[24], states that breaches of the FCA Principles for Businesses do not give rise to a right of action by a private person under s138D in accordance with s138D (3). It is, therefore, suggested that PRIN 3.4.4R is amended to remove this restriction. In addition, PRIN Schedule 5 *Rights of action for damages*[25] which sets out the FCA rules which are actionable under section 138D, should be amended to reflect the removal of this restriction. Section 137A FSMA confers upon the FCA powers *to make rules applying to authorised persons with respect to their carrying on of regulated and unregulated activities* to protect the interests of consumers.

Broadly speaking, the rules and guidance set out in the FCA Handbook are constructed using this rule-making power. In light of the FCA's general rule making powers, these suggested amendments to PRIN 3.4.4R and PRIN Schedule 5 *Rights of action for damages* would not require primary legislation and could, therefore, be implemented by secondary legislation.

[23] FCA Handbook Principles for Business
https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html

[24] PRIN 3.4.4 R FCA Handbook
https://www.handbook.fca.org.uk/handbook/PRIN/3/4.html

[25] PRIN Sch 5 Rights of action for damages
https://www.handbook.fca.org.uk/handbook/PRIN/Sch/5/5.html

Insolvent Firms

The current right of action under section 138D can be assigned by a private person. So if this right is extended to businesses, as proposed, former owners or shareholders of insolvent businesses will enjoy that right too and it should be possible for administrators or liquidators, as assignees, to bring section 138D claims.

However, insolvency practitioners are very reluctant to pursue claims on the basis that the costs are likely to outweigh the benefits. This seems particularly unfair given that many businesses found themselves forced into insolvency by poor conduct on the part of a financial firm. In light of this, the APPG on Fair Business Banking believes this is an issue on which the UK Government should consult further in order to find solutions to the problem. There is an existing consultation into restructuring the corporate insolvency framework. The APPG on Fair Business Banking supports the principles in the consultation and encourages the Department for Business, Energy and Industrial Strategy to pursue this legislative agenda.

5.2 Extending Regulatory Protection

In addition to extending the legal rights of SMEs, the UK Government needs to look at currently unregulated activities. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (FSMA (RAO) 2001) defines what constitutes a regulated activity for the purposes of FSMA. However, not all financial services provided by firms are regulated, for example commercial lending, including fixed-rate loans. As a result, the regulatory regime under FSMA does not apply. This means that the FCA is unable to bring enforcement proceedings; and private persons are unable to bring section 138D claims.

This seems anomalous given the problems that have arisen in this area and so the definition of regulated activities as set out in FSMA and FSMA (RAO) 2001 should be amended to include certain unregulated activities such as commercial lending, including fixed-rate loans. This could be done by secondary legislation.

Consideration must also be given to ensuring that businesses have access to resolution and redress in respect of entities that fall outside the regulatory perimeter. The sale of debt to unregulated entities and shadow banking present significant risks to businesses in the UK, and they should be able to access a dispute resolution system in cases where they do not qualify for the FOS or any self-regulating scheme.

The Promontory Financial Group's report for the FCA into the treatment of SMEs by RBS's Global Restructuring Group sets out the FCA's description of the current position in respect of regulation and SMEs on page 56. It stated:

'Whether or not the provision of financial services to an SME client is regulated under FSMA (and thus whether the provider of the service needs to be authorised) depends on whether the financial services firm is carrying on a regulated activity by way of business in the UK, as set out in the RAO [the Regulated Activities Order]. Whether this is the case depends in part on the services provided: for example, whether the SME client is seeking to operate a current account, borrow, insure or invest.

'Although many financial services provided to SMEs are within this regulatory perimeter, lending to SMEs for business purposes is mostly outside the regulatory perimeter. For example, unsecured lending to an SME borrower for the purposes of their business will only be regulated if the SME is unincorporated and the amount being borrowed is £25,000 or less; mortgage lending for the purposes of a business will only be regulated if (among other things) the borrower is an individual or a trustee.

'In general, the boundaries of the regulatory perimeter are determined by FSMA and various pieces of secondary legislation, primarily the RAO, and also EU law. They can therefore be changed by HM Treasury and Parliament and, where applicable, by EU legislation, but we cannot alter the regulatory perimeter by changing our rules.'

The report also suggests a possible solution:

'One option would be to extend the regulatory perimeter to bring lending to SMEs within the scope of FCA's regulated activities, to ensure that regulatory action can be taken to guard against the unfair treatment of customers and that the principles for business and standards of good governance and personal responsibility apply to this sector as they do to other parts of retail banking.'

It has recently been suggested that the Senior Managers Regime (SMR) might provide a solution to this anomaly. Under the SMR, both individuals and senior managers are required to observe high level standards of conduct which are set out in the Code of Conduct for Staff sourcebook (COCON).[26] In particular, Individual Conduct Rule 4 in COCON requires individuals to *pay due regard to the interests of customer and treat them fairly*. This rule applies to all employees of firms, except staff performing ancillary functions including receptionists, data controllers and HR administrators.[27]

Examples of breaches of Rule 4 in COCON include: failing to inform a customer of material information, including the risks of an investment to a customer or details of the charges or penalties of investment products; or recommending an investment to a customer which is not suitable for that customer or without an understanding of the risk exposure or liability of the product to a customer. Meanwhile, Senior Manager Conduct Rule 2 (SC2) in COCON requires senior managers to *take reasonable steps to ensure that the business of the firm for which they are responsible complies with the relevant requirements and standards of the regulatory system*. Examples of breaches of SC2 in COCON include: failing to take reasonable steps to monitor compliance with the relevant regulatory standards for the activities of the firm in question.

The FCA are entitled to take enforcement action against a firm's employees where their conduct falls short of those standards, however, similar to the PRIN, there is no private right of action under section 138D for breach of the COCON rules.[28] Meanwhile, the FCA does have the power to apply to the courts for a restitution order under section

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[26] COCON 2.1 *Individual conduct rules*
https://www.handbook.fca.org.uk/handbook/COCON/2/1.html

[27] COCON 1.1 *Application*
https://www.handbook.fca.org.uk/handbook/COCON/1/?view=chapter

[28] COCON Sch 5 Rights of action for damages
https://www.handbook.fca.org.uk/handbook/COCON/Sch/5/5.html

382 of the FSMA (and other similar provisions) for the purposes of providing redress to customers. However, it is expected that the FCA will rarely exercise its restitution powers. In light of the above, the SMR is unlikely to prove satisfactory in resolving the anomaly of unregulated activities.

5.3 Establishing a Financial Services Tribunal

The extended legal rights given to SMEs would be enforceable in the courts. However, the APPG on Fair Business Banking thinks that the additional platform of a tribunal is required to fill the current gap in dispute resolution provision. One way to create such a tribunal is set out below although there will, no doubt, be other means to achieve the same end.

Create a New Chamber for Financial Services Disputes

Specialist tribunals have a history which goes back more than a hundred years. However, they had developed in a piecemeal fashion and the Tribunals, Courts and Enforcement Act (2007) provided a new, simplified statutory framework for UK tribunals. This brought together the then existing tribunal jurisdictions and provided a structure for new jurisdictions and new appeal rights.

The unified structure created by the 2007 Act comprises two tribunals, the First-Tier Tribunal and the Upper Tribunal.

Section 37 of the 2007 Act gives the Lord Chancellor the power to amend the lists of tribunals in Schedule 6 of the 2007 Act by either: addition to a list; removal from a list; removing a list from the Schedule; or adding a list of tribunals to the Schedule. However, this power is constrained by subsection (2), which provides that a tribunal created otherwise than by or under enactment (for e.g. a private tribunal of some kind) cannot be brought within the new structure. Therefore, unless a tribunal has been established through either primary or secondary legislation, it cannot be added to the lists of tribunals set out in Schedule 6 and brought within the jurisdiction of the 2007 Act.

Of the tribunals listed in Schedule 6 of the 2007 Act, all bar seven administrative tribunals were established through primary legislation. These administrative tribunals hear appeals against administrative decisions and, therefore, secondary legislation was more appropriate for establishing such tribunals.

Meanwhile, the Employment Tribunal and Employment Appeals Tribunal, which hear private employment disputes, were established under primary legislation. Given that the proposed Financial Services Tribunal would hear private banking disputes, rather than hear appeals against administrative decisions, it would be more akin to the Employment Tribunal and Employment Appeals Tribunal. As such, it is suggested that primary legislation would be required to establish a new Financial Services Tribunal.

6. THE STRUCTURE OF A FINANCIAL SERVICES TRIBUNAL

The proposed Financial Services Tribunal will be an additional forum in which to resolve disputes, so providing an alternative to the traditional courts and filling the current gap in provision. It would also be distinct from forms of ADR, including the FOS, since they are seeking to avoid primary dispute resolution mechanisms. Individuals and businesses would have a choice about whether to take their complaint about any activity by a regulated financial institution to the FOS, if they were eligible, or to make a claim through the Financial Services Tribunal or through the courts. A complainant could take their case to the Financial Services Tribunal or a court if they were not happy with a FOS decision. However, if they had already accepted a determination, that option would not be available.

When considering what a new Financial Services Tribunal would look like and how it would act, the current Civil Procedure Rules[29] (the "CPR") in England and Wales are a good starting point since they provide the basis for how a case should be conducted in court. The fundamental purpose of the CPR is set out at the very outset in CPR rule 1.1 *The overriding objective, is to enable the court to deal with cases justly and at proportionate cost*. This includes, so far as is practicable:

(a) Ensuring that the parties are on an equal footing.

(b) Saving expense.

(c) Dealing with the case in ways which are proportionate—

(i) to the amount of money involved;

(ii) to the importance of the case;

(iii) to the complexity of the issues; and

(iv) to the financial position of each party.

(d) Ensuring that it is dealt with expeditiously and fairly.

(e) Allotting to it an appropriate share of the court's resources, while taking into account the need to allot resources to other cases. And

(f) Enforcing compliance with rules, practice directions and orders.

The CPR set out those steps that need to be followed before proceedings begin in a series of pre-action protocols and then how the proceedings will be conducted once they are started, including how the case will be managed and the taking of evidence.
The stages in a litigation are broadly as follows:

- Complying with pre-action protocols.
- Drafting statements of case.
- Evidence; which includes disclosure and inspection of documents; and factual and expert witness statements.
- Trial. And
- Enforcement of judgment.

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[29] Rules for Civil Proceedings in England and Wales
https://www.justice.gov.uk/courts/procedure-rules/civil/rules

The rules governing disclosure of documents are particularly important in disputes between businesses and financial services institutions. Where standard disclosure is ordered by the courts, parties are required to disclose all documents, including electronic documents, upon which they rely; which are adverse to their own case; adverse to the other party's case; or support another party's case. This will often involve confidential documents.

It is important for tribunals to ensure that cases are conducted in a proper manner as set out in the CPR. However, one of the benefits of tribunals is that they have greater flexibility in their procedures as compared to the courts.

6.1 Procedures

The defining feature of tribunals is that they are specialist judicial bodies which decide disputes in a particular area of law and the 2007 Act provided a new, simplified statutory framework for UK tribunals[30]. The 2007 Act also sets out the rules governing tribunal procedures. It states:

'Tribunal Procedure Rules are to be made by the Tribunal Procedure Committee' and

'Power to make Tribunal Procedure Rules is to be exercised with a view to securing–

(a) That, in proceedings before the First-tier Tribunal and Upper Tribunal, justice is done.

(b) That the tribunal system is accessible and fair.

(c) That proceedings before the First-tier or Upper Tribunal are handled quickly and efficiently.

(d) That the rules are both simple and simply expressed.

(e) That the rules, where appropriate confer on members of the First-tier Tribunal, or Upper Tribunal, responsibility for ensuring that proceedings before the tribunal are handled quickly and efficiently.'

Subject to provisions in Schedule 5 of the 2007 Act, tribunals do have the flexibility to adopt procedures that suit the needs of the particular client group. This is vitally important as a way of shortening the process of reaching a decision by keeping things simple and so keeping costs as low as possible.

The different procedures adopted by existing tribunals provide a good basis for devising the rules of the proposed Financial Services Tribunal. The Employment Tribunal is a particularly good model since it deals with disputes between two private parties as would a Financial Services Tribunal. For example, the overriding objective of the rules governing employment tribunals is *'To deal with a case fairly and justly. Dealing with a case fairly and justly includes, so far as practicable –*

(a) Ensuring that the parties are on an equal footing.

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[30] Tribunals, Courts and Enforcement Act 2007
https://www.legislation.gov.uk/ukpga/2007/15/contents

(b) Dealing with cases in ways which are proportionate to the complexity and importance of the issues.

(c) Avoiding unnecessary formality and seeking flexibility in the proceedings.

(d) Avoiding delay, so far as compatible with proper consideration of the issues; and

(e) Saving expense.'[31]

These rules are particularly relevant to financial services disputes which involve an imbalance of power between the respective parties and the need to give the weaker party proper access to justice.

The procedures of tribunals are focused on delivering justice more quickly and in a less costly manner. For example, they try to use ADR and arbitration if possible as Section 3 of the Tax Chamber rules[32] demonstrates. It states:

'(1) The Tribunal should seek, where appropriate –

(a) To bring to the attention of the parties the availability of any appropriate alternative procedure for the resolution of the dispute; and
(b) If the parties wish and provided that it is compatible with the overriding objective, to facilitate the use of the procedure.'

It is important that the starting process for making a claim in the Financial Services Tribunal is kept as simple as possible. The Employment Tribunal is a good example here as a claim only requires a form to be completed and submitted and there is no need to go through the protocols required in a civil court. This process can take months, adding to the length of time and cost of a court case.

In the Employment Tribunal, the next stage is for the form to be sent to the respondent. The procedures state:

'Unless the claim is rejected, the Tribunal shall send a copy of the claim form, together with a prescribed response form, to each respondent with a notice which includes information on –

(a) Whether any part of the claim has been rejected; and
(b) How to submit a response to the claim, the time limit for doing so and what will happen if a response is not received by the Tribunal within that time limit.'

An initial consideration of the claim form and the response is then undertaken by the Judge as soon as possible. The claim or the response may be dismissed by the Judge at this stage and, if not, it proceeds to the case management stage.

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[31] Employment Tribunals Rules of Procedure
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/429633/employment-tribunal-procedure-rules.pdf

[32] The Tribunal Procedure (First-Tier Tribunal) (Tax Chamber)
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/357075/tax-chamber-tribunal-procedure-rules.pdf

The powers of disclosure are particularly important in financial disputes and so a Financial Services Tribunal would need the power to order people to disclose documents or information and Employment Tribunals have powers similar in this respect to a county court or sheriff in Scotland. Equally, to be effective it would have to have powers to compel people to give evidence, produce documents or produce information. While powers of disclosure, in particular, add to the cost of proceedings, they are essential to ensuring justice in cases of this kind.

Robust case management powers are essential to reduce time and costs and a Financial Services Tribunal would need powers similar to those of an Employment Tribunal, which allow for the striking out of a claim or response at any point. They state:

'(1) At any stage of the proceedings, either on its own initiative or on the application of a party, a Tribunal may strike out all or part of a claim or response on any of the following grounds –

(a) That it is scandalous or vexatious or has no reasonable prospect of success.

(b) That the manner in which the proceedings have been conducted by or on behalf of the claimant or the respondent (as the case may be) has been scandalous, unreasonable or vexatious.

(c) For non-compliance with any of these Rules or with an order of the Tribunal.

(d) That it has not been actively pursued.

(e) That the Tribunal no longer considers that it is no longer possible to have a fair hearing in respect of the claim or the response (or the part to be struck out).

(2) A claim or response may not be struck out unless the party in question has been given a reasonable opportunity to make representations, either in writing or, if requested by the party, at a hearing.

(3) Where a response is struck out, the effect shall be as if no response had been presented.'

The preliminary hearing is crucial to determining the approach to be adopted in each case to issues such as disclosure, witness statements and expert evidence. The procedures adopted by a Financial Services Tribunal require sufficient flexibility to deal with different cases in an appropriate manner depending on their nature and complexity.

The norm would be that a final hearing would determine the outcome of the case and would be essential in more complex cases. However, if both parties agreed, a case could be decided on the papers presented.

As is common with tribunals, it is envisaged that a Financial Services Tribunal would combine both an adversarial and an inquisitorial approach as well as powers to aid litigants in person. The rules in Employment Tribunals in this regard are as follows:

'The Tribunal shall seek to avoid undue formality and may itself question the parties or any witnesses so far as appropriate in order to clarify the issues or elicit the evidence. The Tribunal is not bound by any rule of law relating to the admissibility of evidence in proceedings before the courts.'

This means that it is not essential to have a legal representative in tribunal proceedings, although this would no doubt be advisable in the more complex financial cases. This is helped by the fact that another feature of tribunals is the specialist expertise of its members. For example, the panel on an Employment Tribunal consists of a judge, someone from the employer's side and someone from the employee's side to make use of their practical experience of the work environment when coming to decisions. Such wing members would be equally important in financial services disputes, as representatives of business and the financial services industry would be helpful in applying the regulatory standards of conduct.

Independent expertise would also be essential in areas such as insolvency and forensic accounting and procedures need to allow for the appointment of such experts to help in coming to judgements in often complex cases.

However, there are no doubt areas where the current procedures of tribunals could be improved. The British Government addressed some issues in relation to Employment Tribunals in its consultation paper, 'Reforming the Employment Tribunal System', published on 5th December 2016[34].

This consultation looked at four particular areas:

- Modernising the handling of employment tribunal claims.
- Delegation of judicial functions to caseworkers.
- Tailoring the panel to the needs of the case.
- Proposed approach to implementing reform in the employment tribunal system.

These proposals are designed to make greater use of digital technology within employment tribunals as a means of increasing efficiency and are in line with proposed reforms to the wider justice system. It certainly makes sense to make more use of digital technology in the processing of cases and dealing with case management issues, while moving towards digital contact with the parties or virtual hearings would be well worth considering when drawing up procedures for any future Financial Services Tribunal. It would speed up the process and reduce cost, although such procedures might not be appropriate for more complex cases.

The other proposals also relate to speeding up the process and making it more efficient. The most controversial is delegating the power to decide the composition of Employment Tribunal panels to the Senior President of Tribunals. This extends the flexible approach which is such an important feature of tribunals and would mean the panel was adapted to suit the particular case. However, the APPG on Fair Business Banking believes that a future Financial Services Tribunal would benefit from wing members with specialist knowledge and experience in business and the financial services sector, particularly since most cases are likely to be complex in nature.

6.2 Basis of Decisions

A Financial Services Tribunal modelled on the existing procedures of tribunals would have guaranteed judicial independence under the 2007 Act. It would take legally binding decisions, subject to appeal, in public based on common law and the enhanced legal rights for businesses under section 138D set out in the previous chapter. Depending on which regulatory route is chosen, these rights could be the COBS rules set out in the FCA Handbook or the FCA's Principles for Businesses. Any decisions taken by the Financial Services Tribunal would be on a strict legal basis and not the subjective fair and reasonable basis used by the FOS.

However, such decisions must also take account of any voluntary standards that a firm has adopted since these are likely to be actionable by claimants following the recent case of Thomas v Triodos Bank[33]. In this case, the bank had:

'Advertised to the claimants that it subscribed to the [Business Banking Code (BBC)]. The Fairness Commitment [set out] in the BBC included a promise, directed to the customer, that if the bank was asked about a product, it would give the customer a balanced view of the product in plain English, with an explanation of its financial implications. There were no disclaimers, 'basis' clauses or exclusions in the terms and conditions which applied between the claimants and the bank which would lead to the conclusion that the bank was not willing to assume responsibility for honouring that promise.'

In his judgement, Judge Havelock-Allen QC stated that the courts should be more ready to infer that a financial institution has assumed responsibility to its customer for adhering to those principles, where there are no relevant disclaimers, 'basis' clauses or contractual exclusions to contradict that inference.

Further, firms must not be able to exclude liability from these standards through the use of basis or exclusion clauses. The recent Court of Appeal decision in First Tower Trustees Ltd v CDS (Superstores International) Limited[34] means that where previously financial institutions could use arguments based on such clauses in contracts and expect to win, now they will have to prove the use of such clauses was reasonable.

In any event, businesses would be able to take advantage of COBS 2.1.2R *Exclusion of liability* which states that a firm must not, in any communication relating to designated investment business, seek to: *(1) exclude or restrict; or (2) rely on any exclusion or restriction of; any duty or liability it may have to a client under the regulatory system.*

Most importantly, decisions taken on this basis would enable the evolution and development of case law in relation to financial services disputes which would provide legal certainty to both financial services providers and businesses.

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[33] Thomas v Triodos Bank Case
http://www.bailii.org/ew/cases/EWHC/QB/2017/314.pdf

[34] First Tower Trustees Ltd v CDS (Superstores International) Ltd Case
http://www.bailii.org/ew/cases/EWCA/Civ/2018/1396.html

6.3 Costs Regime

It is vital in any reform of the dispute resolution system that it increases access to justice for small and medium-sized businesses. A major barrier to businesses accessing justice in the courts is the risk that they will have to pay a bank's costs if they lose their case and this is not a risk that most businesses wish to take.

In contrast, a great advantage of tribunals is that they are not normally allowed to award costs unless a party has unreasonably brought, defended or conducted proceedings. However, this means that businesses will not be able to recover their own costs if they win. Although these costs would usually be lower in a tribunal, they might still be significant.

While a no-costs regime should be the default position in a future Financial Services Tribunal, it should have some qualifications to recognise the imbalance in power between the respective parties to these disputes. The Employment Tribunal can award costs against a losing party in exceptional circumstances. Further, the Tax Tribunal has a default no-costs position, but this can be shifted on an application and where the Tribunal is satisfied that the case is a 'Complex Case'. This recognises that some claimants with larger or more complex claims that required legal and/or accounting input would want to recover those costs.

It is proposed that a Financial Services Tribunal would adopt the Tax Tribunal system of no-costs except in cases deemed complex. However, to recognise the imbalance in power and resources between banks and small and medium-sized businesses, this could be subject to 'qualified one-way cost shifting'. Businesses would be able to recover their costs, subject to a cap, while financial firms would not.

This proposal attempts to strike a balance between fairness to the business claimant – since bearing their own costs in a more complex case might prevent them from accessing justice – and ensuring that claimants bear some cost to discourage unmeritorious claims.

6.4 Funding a Financial Services Tribunal

It is envisaged that the Financial Services Tribunal would be funded by the Treasury in the same way as other tribunals. However, it would introduce a small levy on financial services companies to meet the cost which would require legislation. The administrative costs of running the Financial Services Tribunal would depend on the number of cases, but Richard Samuel has stated that the Employment Tribunal costs about £80 million per annum to run and it is unlikely that the cost of a Financial Services Tribunal would exceed that. This represents good value for money when you consider that the IRHP redress scheme cost the banks £141.5 million in 2012-13 alone.

6.5 Time Limitations

Many business cases go back many years and so their claims have run out of time. Generally, the limitation period for bringing a claim for breach of contract is six years from the date of breach or five years in Scotland. For claims in tort, the limitation period is six years from the date of damage. In which case, time runs from the date on which the damage is sustained. It does not run from the date when it is discovered by the claimant, if that is a later date.

Parties may agree to suspend the running of time by entering into an agreement effectively to extend the limitation period, known as a 'standstill agreement'. Businesses without legal advice are often unaware of this option though, and it is, in any case, at the discretion of the banks.

However, section 32 of the Limitation Act 1980 does postpone the running of any applicable limitation period where:

- The action is based on the fraud of the defendant.
- Any fact relevant to the claimant's right of action has been deliberately concealed from him by the defendant (including the deliberate commission of a breach of duty in circumstances in which it is unlikely to be discovered for some time).
- The action is for relief from the consequences of a mistake.

In any of the above cases, time only runs when the claimant discovers the fraud, concealment or mistake; or it is deemed that they could have done so with reasonable diligence.

This could provide grounds for some claimants. However, the APPG calls on the UK Government to see what else could be done to ensure that those who have suffered from historic banking abuses, within the past 10-15 years in some instances, will be able to take their case to the Financial Services Tribunal.

6.6 Conclusion

In summary, the proposed Financial Services Tribunal would have the following key features:

- Independence from both the financial services industry and the FCA to ensure impartiality.
- Fair, clear and transparent procedural rules, including:
  - Summary disposal of vexatious or unmeritorious claims.
  - Robust case management powers to reduce time and costs.
  - Powers to require (or restrict, as the case may be) disclosure and inspection of documents.
  - Power to adduce witness evidence.
  - Greater use of inquisitorial techniques and powers to aid litigants in person.
  - Independent experts on insolvency and forensic accounting.
- Transparency. Proceedings held in public and as many dispute outcomes as possible published.
- Decisions taken on a strict legal basis, with a right of appeal and taking account of any voluntary standards that a firm has adopted.
- Simple, speedy and low-cost access to justice for claimants.
- Expertise in applying the legal, regulatory and voluntary standards of conduct.

As such, it would meet all the key requirements set out by the APPG on Fair Business Banking for a new dispute resolution mechanism. It does not duplicate provision because it is filling a gap that has been identified in the work done by the APPG and identified by the FCA in its consultation on extending the FOS. For this reason, the APPG thinks that the UK Government should legislate for such a Financial Services Tribunal as soon as possible.

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