Banking Taskforce

Appeals Process

Independent External Reviewer

Quarterly Review

Period to End September 2013

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1. Introduction

This is the first of my quarterly reviews on the Banking Task Force Appeals Process and as such it is worth setting out how I see these in relation to the Annual Report which I will still continue to produce at the end of each financial year.

This first quarterly review covers the six months from April to September 2013 which is due to the fact that my 2012/2013 Annual Report was not produced until June so this seemed to me the sensible place to start with the quarterly review.

The reason that I decided to produce these shorter quarterly reviews was primarily due to the fact that the Appeals Process is generating both increasing interest from Governments and other stakeholders plus there are now a series of positive outcomes for both business and banks, and an increasing number of active issues being addressed or discovered. Therefore I felt that rather than waiting and trying to cram them all into one report annually it was better to produce these shorter and summarised quarterly reviews on progress.

Therefore they will be more like the Executive Summary in my annual report and address only key items and topics which have become apparent or changed over that quarter. As such they will therefore address three subjects only namely

a) Any material changes to the numbers that inform the process and the issues that come from those.
b) Progress on the action plans that I now have in place with each bank.
c) Any new issues that have become apparent over the last quarter which are worthy of mention.

Professor Russel Griggs OBE
Independent External Reviewer

November 2013

2. Comments on Numbers

In these quarterly reviews I only intend to highlight the total numbers of appeals and overturns as set out in Chart 1, and any other charts that have changed significantly since the previous report, or where we have been able to look into more detail due to the increasing strength of the data base we have.

Chart 1: Appeals Table Years 1-3 to End September Appeals

Appeals - April 2011 to September 2013	Year One	Year Two	Year Three to end Sept	Total
Total No. of Appeals Received (ALL BANKS)	2177	3311	1632	7120
Total No. of Appeals Overturned (ALL BANKS)	860	1298	583	2741
Overturn rate *(based on Appeals Received - ALL BANKS)*	39.5%	39.2%	35.7%	38.5%
Total Value of Appeals Overturned *millions*	£10.0	£18.5	£6.8	£35.3
Total No. of Appeals Received (Excluding Credit Cards)	1587	2146	1328	5061
Total No. of Appeals Overturned (Excluding Credit Cards)	518	634	437	1589
Overturn rate *(based on Appeals Received - Excluding Credit Cards)*	32.6%	29.5%	32.9%	31.4%
Total Value of Appeals Overturned (Excluding Credit Cards) *millions*	£9.7	£17.7	£6.6	£33.9
Total No. of Cases Reviewed	946	1777	870	3593
Total No. of Cases Reviewed/Total No. of Appeals (as %)	43.5%	53.7%	53.3%	50.5%
Total No. of Overturn Cases Reviewed/Total No. of Overturn Cases (as %)	49.5%	62.9%	69.5%	60.1%

NB: Cases reviewed and Overturn values based on data captured to end of September 2013

Chart 1 sets out the total number of appeals with and without credit cards and also the overturn percentage. In the 6 months April-September this year there have been just over 1600 appeals and of those 35.7% were overturned. These overturns have put a further £6.8 million back into the economy in terms of lending which brings the total of extra lending that the Appeals Process has generated to just over £35 million since the process began in April 2011.

In terms of appeals numbers on the face of the cold numbers it does not look like there has been an increase in appeals but that is not really the case. While raising awareness of the Appeals Process and therefore increasing the number of appeals that are received is a key issue for me so also is making sure that banks make decisions at the right time to ensure that customers get a good decision.

From previous reports it was made clear that both myself and my team of auditors had been concerned about both the high number of appeals and overturns in the area of credit cards and had been focussing on this with the key banks who provide the majority in this sector to ensure that they were not making the decisions too early. Last year a leading credit card provider put in place a programme to change their processes and gather more information before making a decision. This change of process has shown real positive progress with decreases in decline, appeals and the overturn rate which means that customers are getting the correct decisions earlier, and also highlighted the impact the Appeals Process is having positively on what lenders do. This drop in credit card appeals is highlighted specifically in the line graph in Chart 2 (see green line) which shows, on a 3 month rolling basis the real drop in credit card appeals, but also in Chart 3 (see green line) the real drop on overturn rate as well.

Chart 2: Total Appeals - 3 Month Rolling Average

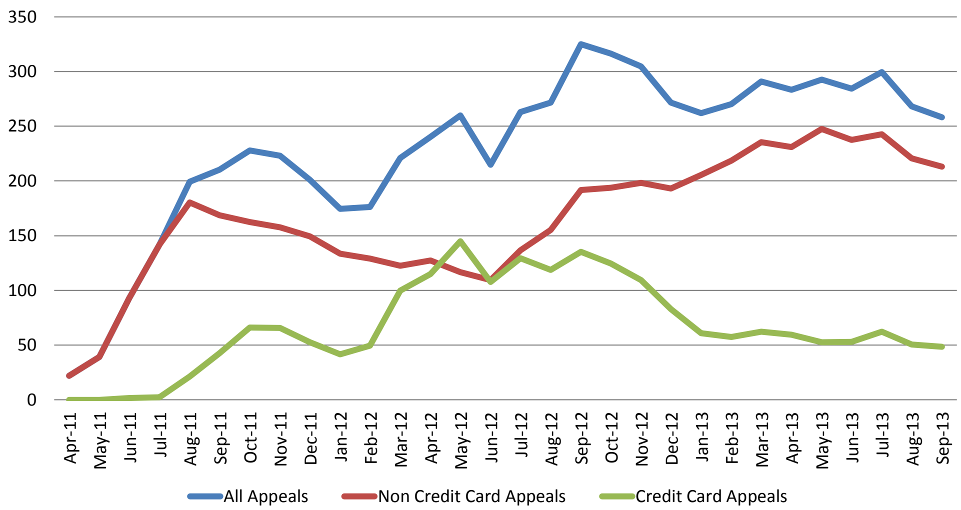
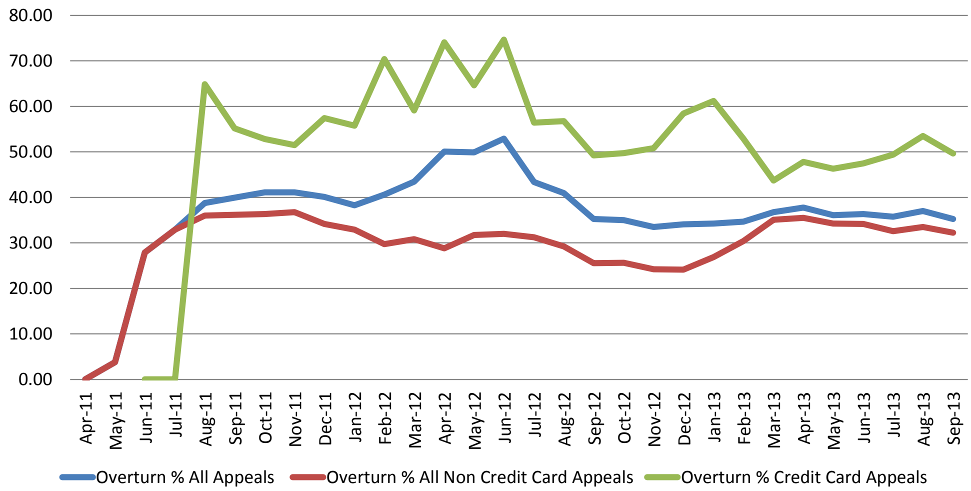


Chart 3: Overturned % - 3 Month Rolling Average



I would take this opportunity to praise the credit card provider involved who having discussed and agreed the issue with us put in place an action plan with us which focussed on the issues involved and changed how they operated which has provided benefit for all. It is still not complete but we are well on the way and the change is now systemic within the organisation.

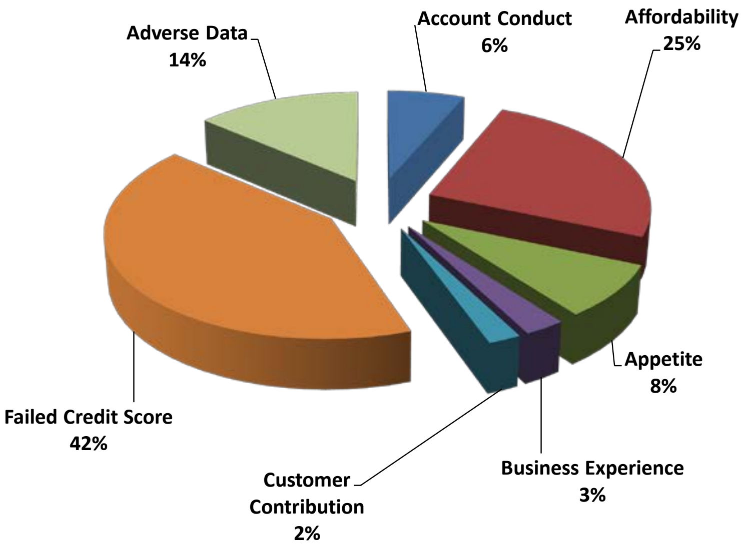
Appeals numbers therefore without credit cards have risen on a comparable year on year basis which shows the impact of the awareness programmes and new tools already put in place to increase awareness of the Appeals Process by the banks and others is already having. However the overturn rate has increased which, again on the face of it, is not good but there is an underlying reason for that which mitigates that view.

One of the issues myself and my team continue to focus on is ensuring that banks include all SME businesses (turnover up to £25 million) who request lending as within scope of the Appeals Process and those businesses who are eligible to appeal have the opportunity to do so. That may sound odd to those who work outside the banking environment but since all the banks operate differing systems and structures that fit their business model when a customer is deemed to have officially applied can be different across the banks. These are referred to as ‘declined at source’ applications and we have tried as much as possible to equalise that without interfering incorrectly into how a bank operates. This, we are pleased to say, has brought in more of these ‘declined at source’ businesses into the Appeals Process. These businesses will only have provided a minimal amount of information to a bank which could make them more likely to be overturned on appeal. We are working with those banks on how those processes operate and if it progresses as well as the programme we pursued with the major credit card lenders last year we would hope to see a drop in the overturn rate and perhaps also a slight drop in their appeals as the lender makes the decisions in a more effective way for both.

In summary therefore while the appeals and overturn numbers on the face of it look like there may be issues, I am happy that appeals are rising in areas where I would want to see them and that there are actions in place to reduce the number of overturns again where that is appropriate.

Chart 4 sets out the reasons for decline which shows some changes to that published in the Annual Report in June.

Chart 4: Decline Reasons All Banks Year 3 only



The major reason for the change is that we have been able to define the decline reasons even further which allow me now to focus in on what the specific challenges are. In previous reports I have highlighted the dominance of failed credit scoring in this area. Credit Scoring data though is widespread and some of it is more open to review and change than others but up until now we have been unable to differentiate. Due though now to some changes we have made in the record sheets that banks complete for us and also the amount of more granular data we have, we have now been able to split credit scoring into two parts namely Adverse Data and Credit Scoring.

To explain the difference Adverse Data are things like notices of bankruptcy, County Court Judgements (CCJs), actual credit defaults where the debt has been written off, exclusions as a Director, etc. Many of these will be written into the policy of the banks and for example include written off debt that will exclude a customer from borrowing from some banks for 6 years. As such therefore that makes it unlikely that any business with any or all those defaults included in Adverse Data will be able to borrow anything other than in exceptional circumstance or where other mitigating factors exist.

Credit Scoring now, in our definition, therefore covers only those issues which a customer could appeal against where a bank on reflection could change its decision. Therefore at the end of year 2 credit scoring accounted for 47% of all decline reasons. In the first six months of this year using the same parameters the percentage would be 56% but we now split that into 14% Adverse Data and 42% Credit Scoring.

The credit scoring literature which I announced in my Annual Report to help businesses understand better how they as individuals are judged and how they can help mitigate, that is now being distributed by all the banks. As that literature on preparing yourself for credit scoring begins to get to customers and hopefully take effect then it is that last percentage that we will be focusing on in terms of change. Other than that specific change by us in the declines reasons then nothing else has materially changed.

Chart 5 shows the same expanded chart for declines under £25K where the majority of credit scoring takes place.

Chart 5: Decline Reasons All Banks for all Lending up to £25K Year 3 only

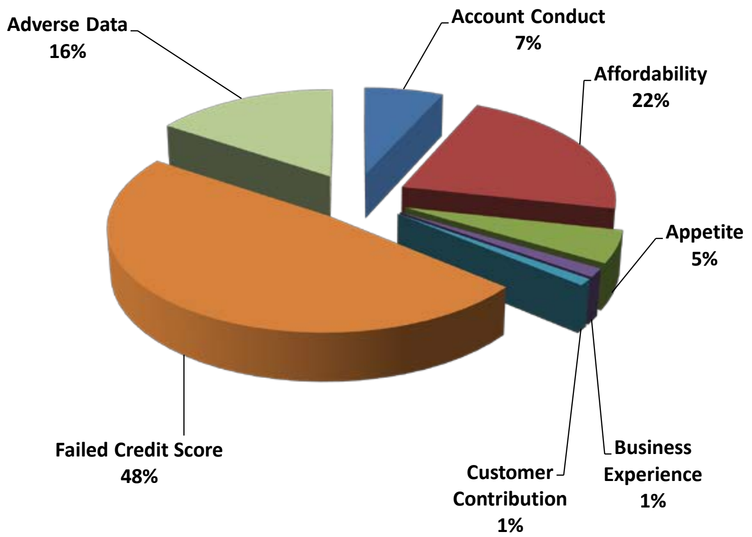
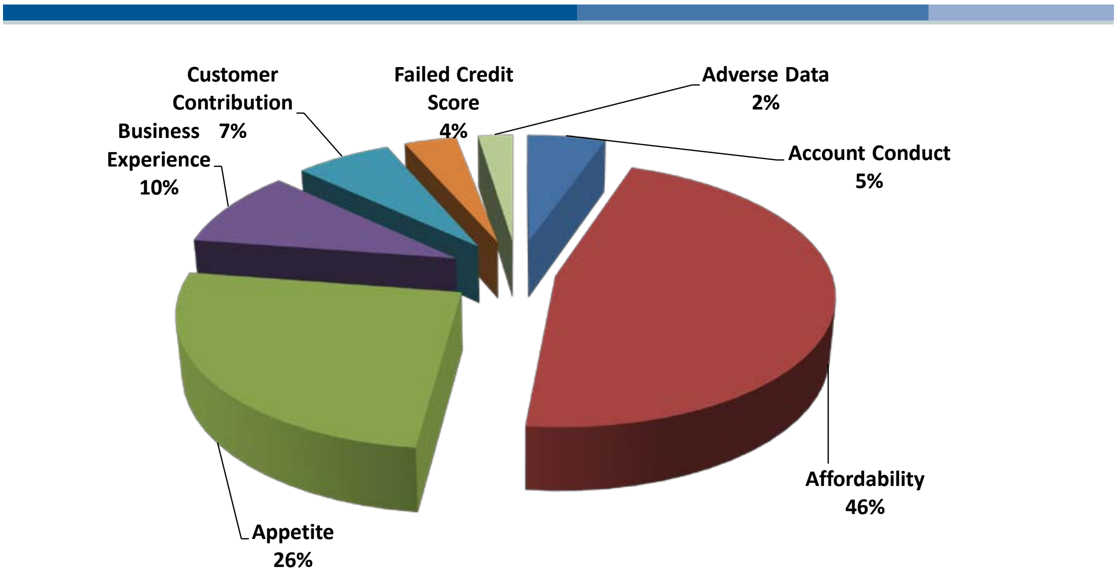


Chart 6 is the same decline reasons but for lending above £25k where credit scoring plays a much lesser role. In the first six months of this year there have been some changes in this chart in terms of affordability falling, appetite (which is a combination of deal structure and sector preference) increasing.

Chart 6: Decline Reasons All Banks for all Lending above £25K Year 3 only



Since this is the first time that we have run these charts with the more defined data I am not going to draw any conclusions at this time but will look again in January and more fully at the end of this year.

On all the other charts that I highlighted in my Annual Report there has been no significant change so have not produced them for this report.

3. Action Plans

Since the publication of my Annual Report we have been working with each of the Taskforce Banks to prepare individual action plans that for each contain some of the generic issues that we had all identified as being key and also individual issues that we need each bank to address. We have also included some other issues that had come from other stakeholders involved in the process which seemed sensible for us all to include. One of these to do with decline sampling I will discuss in more detail in section 4 of this review.

The two key elements of the reports that applied across all the banks were increasing awareness and the internal governance of the Appeals Process within the individual Taskforce Banks. The latter was on the basis of best practice that we had observed in at least one bank where the Appeals Process was being driven and managed in a structured way.

In terms of raising awareness the banks and all the other stakeholders had already committed to up their game on raising awareness and it is pleasing to report that

i) The Appeals Button[1] on a variety of web sites that quickly takes the customer to where they can appeal to their bank is up and running and already producing appeals.

ii) Letters have gone out from appropriate Government Ministers at Westminster and Holyrood to parliamentarians and others which will raise more awareness on the ground. I have met with both the Welsh and Northern Ireland administrations and each will announce its own plans in the coming months.

iii) Trade Associations have increased their activity with their members to raise awareness and have made or are making the Appeals process more visible on their web sites

iv) Each of the banks has increased their own external and internal activity and I have done articles or video interviews for most of the banks which appear on their web sites for their own internal and, in some cases external communication, as it has been accepted that raising awareness within banks is as key as with their customers.

However to ensure that we know whether all that is and will be done to raise awareness is working I, like others, am of the view that we need to put in place a better metric than we have currently for measuring awareness.

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[1] https://www.betterbusinessfinance.co.uk/appeals-for-borrowing

Currently the number that is being used to judge the awareness of the Appeals Process is mainly the answer to a question in the SME Finance Monitor which shows awareness at around 13%. However this question is towards the end of a long questionnaire and is asked of all SMEs, many of whom never seek to borrow. From a research point of view this will not give a good robust and trustworthy number, and is always likely to underestimate the real awareness level of those who are currently in the market for lending which is where the awareness test needs to be focused.

Therefore myself, the banks, and the British Bankers Association, with Government are working to put in place a metric that better reflects awareness of those who are or have just been in the market for lending. One of the banks already has in place what I believe is a piece of best practice on a metric which may be a way of producing that metric for all banks but it is still in discussion. They have sampled a selection of customers who have applied for lending, been declined, but are now just past the appeals deadline. In the research that they did, the awareness level they recorded was over 80% and they also obtained some useful insight which they have shared with us on why customers did not appeal. One solution therefore for all the banks may be to give each quarter a sample of those customers that have just been recently declined but not appealed to an independent market research company to ask similar questions that are asked by the bank already doing it for themselves. Not only would this give us a better metric for judging awareness of the Appeals Process but also hopefully some further data on why customers do not appeal.

In terms of governance of the Appeals Process this has become more important for two reasons.

a) The success of the process means that with more focus then its success could be further enhanced.
b) The Appeals Process has effected change in all the banks and this will mean that these changes have to be driven through effectively which means that individuals with access to the main Board need to be involved in the process to make sure that all issues are managed and delivered properly.

Therefore each bank has now appointed an ‘Appeals Champion’ who in effect is the Senior Responsible Officer for all things to do with the Appeals Process within that bank and therefore for everything within the action plan. While that individual will obviously not do all the tasks they will allocate who will be responsible for each so that every action plan we now have with a bank has against each action a person responsible for it and timescales to produce it. We review those each quarter and have now been round the first cycle with each bank and I am pleased to report that all the banks have responded positively to their own plans and progress is being made on all the actions that are contained within them. I will meet as often as is appropriate for each bank with the Appeals Champion and more often if the action plan begins to produce issues that need to be addressed.

One issue that is not part of any of the bank's action plans is the issue or issues around credit scoring which formed a significant part of my Annual Report. That is mainly because I am tackling that issue with a variety of people so is not relevant as an action plan for a specific bank. However I want to highlight one piece of best practice, which I have seen since I wrote my Annual Report, from one bank which highlights the benefit of a different way of doing things.

One of the Taskforce Banks at Relationship Manager level insists that if you want to borrow from them you have to meet a Relationship Manager before submitting any application. In the case of start up in the small lending space some of the Relationship Managers insist that the person sends them their business plan before meeting them so they understand their business before they meet them. This means that when they do meet they can better balance the business against any challenges that an analysis of the person might bring. This also means that compared to other banks (and perhaps even other parts of their own bank as I have yet not verified whether this is local or overall bank practice) they have a lower decline rate, fewer appeals, and less overturns and shows how gathering the information first pays dividends for the bank.

There is one further issue on credit scoring which has arisen which I will deal with in section 4.

4. New Issues

In terms of specific issues that have come out of our visits to banks or further examination of the data since my Annual Report there are two main areas on which myself and my team are conducting further work.

As I have explained earlier in this review and in my previous Annual Reports, Credit Scoring continues to be the major reason for decline but we are investigating also whether how it is conveyed to the customer as a decline could reduce the number of appeals as well which I need to explain.

Banks access the data on which they make their credit scoring decisions in various ways from the Credit Reference Agencies. In terms of personal and other basic information they can do that in two ways

i) They can purchase the raw data and feed that into their own modelling framework which each bank will have and forms the basis of their credit risk calculations.

ii) They can purchase a score only which the Credit Reference Agency will calculate for them.

If they buy the raw data they own it and therefore can see and use what key bits of it are affecting an individual's score. This has two advantages. First, the relationship manager may realise there are mitigating reasons for the low score which, if referred to an underwriter, may result in a positive decision without the need for appeal. Secondly, if a decline letter is issued, it can be more specific in terms of why they have been declined which allows the customer immediately to see what they need to rectify or provide further information on.

If they buy the score only the raw data remains the property of the Credit Reference Agency, the bank cannot see the underlying reasons causing the low score. Therefore, all the bank can tell the customer is that they have a low score and direct them to the Credit Reference Agency concerned to obtain their credit reference file which they can then discuss with the bank.

The latter way is more onerous, takes more time and there is a cost to the business (all be it minimal) to do that and we have a concern that where that occurs that may decrease the desire to appeal.

We need to delve deeper into this and do a lot more work especially how material the numbers involved are that use ii): so I will report on this in my next Quarterly Review. However if the numbers are material then it could be a hurdle to appealing that some have but others do not purely because of the way the bank conducts its relationship with the Credit Reference Agency.

Apart from that issue above another specific issue was raised with us by one of the stakeholders involved in the process who asked whether I knew if those that were declined but were not appealing were any different from those who did appeal.

It is an interesting and sensible question and tests the assumption that those who do not appeal do so for different reasons i.e. in many cases they know it is not worth appealing.

I had not previously looked at that and to do so I and my team of auditors would need to work with individual banks to put in place a process, if it is not already there, that allows both the banks and myself to look at a sample of those who are declined (including those cases termed “declined at source”) but who choose not appeal to assure us that they are not the same as those who do appeal. This also has to be done in the initial stages at least in a way that does not involve re-contacting the customer which would be a waste of their time.

I am therefore engaged in a process with each bank of putting that sampling process in place. The good news is that the majority of the banks already review in some way those who have been declined so there is a basis there to expand that further to meet my needs. One of the banks indeed has already done exactly what is required for themselves and produced substantive and robust data and another is not far behind them. The good news from those 2 is that it looks like those who might have had an option to appeal are well under 5% of those who were declined but did not appeal which is what would be expected.

The outcome though with each will be that for each bank we will put in place a process that tests those who were declined but did not appeal and then assess whether the shape of them is not the same as those who were declined but did appeal. As is indicated above, each bank is at a different place in terms of how much work will have to be done but I have completed my discussions with each and am confident that by the time I report in February I will have, at worst, plans in place for the other 3 banks who are not already as advanced as the 2 that already have or almost have that analysis complete.

I will then check that sample as appropriate in each bank over time going forward. This will add an extra dimension and test which along with hopefully the extra data we will get from the awareness testing outlined in section 3 will give us an even wider and more rounded data set to examine for issues in lending declines.