Banking Taskforce

Appeals Process

Independent External Reviewer

Annual Report

2011/2012

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Executive Summary

‘Are the banks open for business?’ is a question that has been asked many times in recent years. At the end of my first year as the Independent External Reviewer of the main banks Appeals Process for small and medium-sized enterprises (SMEs) I am pleased to report that in my opinion they are. However they are ‘open for business’ in a different way than they were pre the 2008 crisis, which in many respects is a better and more sustainable way for us all. However that is not to say there is not more that could be done by banks to make that better, and the Appeals Process has already highlighted issues for individual banks that have initiated change already.

To understand credit decision making today it is important to take into account the climate in which the decision making is made.

Pre 2008 there was a belief that growth was everywhere, especially in commercial and private property. This took us to a place where;

- Credit was freely and easily available and was being ‘sold’ hard by almost all financial institutions.
- Competition meant that lenders asked for a lot less information than perhaps they should have in terms of information to secure this ‘sale’.
- ‘Selling’ individual products was at times more important than looking at a business’s overall lending needs and ability to service or repay them.
- The difference between working and development capital, which is an important fundamental of lending, became blurred and in many cases disappeared.
- Optimistic or fast growth plans from businesses were accepted because everything was felt to be ‘on the up’, and
- Some businesses perhaps asked for, and were given more than they needed or - importantly - could afford.

Since 2008 everything above has changed and in many cases reversed as we have returned to what many would see as a ‘normal’ state of lending, but in a cautious rather than a confident economic climate, where risk is at the heart of any decision. Now sufficient information will be requested by any lender in order to satisfy the individual bank’s risk parameters and if the information is not forthcoming or does not satisfy the individual bank’s risk parameters then money will not be lent. That returns to the good old business philosophy, hopefully held by both business and lenders, that you should not borrow unless you can afford to do so and that you should have in place the people you need to turn your business plans into fruition.

All businesses have had to adapt to what could be seen as a seismic shift in attitudes to lending which happened very quickly. Many businesses were caught in a place where adapting to that change has been - and may continue to be - challenging for a while yet. Lender’s initial reaction to the crisis probably moved too far to the opposite end of the risk assessment decision-making spectrum than had prevailed before 2008. Risk assessments are moving back now to a more sensible place but this will take time and sentiment will play an important part in that movement. Also the highly leveraged business models that could operate in the pre-2008 financial and lending climate will not be sustainable in this new environment. There are many businesses that see this as a better way of operating because it encourages a better and more detailed dialogue and understanding between the business and its lenders (whoever they are) which will over time bring a more sustainable future and growth to both.

Neither businesses nor lenders have yet fully adapted to the changes that this shift in climate has brought and there is a lot still to do; but the Appeals Process is already contributing significantly to that process by providing good data from which we can all learn and change.

The Appeals Process which I independently oversee and review was launched by the Taskforce Banks in April 2011 as one of the 17 commitments they put forward to the UK Government in their 'Supporting UK Business – The report of the Business Finance Taskforce' report in October 2010.

The Appeals Process allows any business with a group turnover of up to £25 million which is declined any form of lending to appeal that decision - for any reason - to the participating bank concerned.

In the first year of the process there have been 2177 appeals and 39.5% have been overturned. An overturn is where the bank and the customer reach a satisfactory conclusion to a lending application. This does not mean that the business has received exactly what they asked for initially, but that they have reached a lending agreement with which both parties are satisfied.

Given that no one had any idea how many appeals we would receive I think the numbers are OK for the first year; but the banks need to ensure that all customers know they can appeal, which not all do currently and that needs to change. There is a possibility that, if more knew they could appeal, more might apply for credit in the first place.

To put these numbers into context of overall SME activity with banks, the Taskforce banks show that in the twelve months since the launch of the Appeals Process last April, the banks received 827,000 applications for all credit products (loans, overdrafts, credit cards, asset-based finance, etc.) that were eligible for appeal should the application be declined. Through the year, 114,000 applications were declined, which means that 86% of all applications were agreed and only 14% of all applications declined. Of those declined, 2% were taken to appeal, so less than 0.3% of all applications were appealed against. If 4 in 10 appeals overturned an original decline decision in favour of the customer, this equates to 0.1% of applications.

In the first year my objectives in terms of what I needed to do as the Independent Reviewer were as follows -

1. Make sure that each of the participating banks had put in place an Appeals Process that was both fair and transparent and satisfied the criteria and principles they had set out for themselves. Since no one had ever done this before in this way, it did take some time to put in place a process in each bank that satisfied the review's requirements. I am happy to say that all have in place the key components to satisfactorily process appeals and any things that remain to be done are in process and will be completed within an agreed timescale.
2. Use the data we collected to examine where are the challenges and issues that need to be addressed and how those could be tackled. I have always seen this process as being as much an educational exercise as a scrutinising one. The issues that have been raised in this first year are described below.

The four key issues that have come from the review of this year's Appeals Process are as follows,

a) The need for banks to 'retrain' or refocus their own staff on the changes that a more holistic and sustainable form of lending brings to them and their customers. This covers everything from understanding what information is required from customers to better internal and external communications within the banks. All of the banks are now working on programmes to make sure that those who lend are qualified and trained to do so but there is still more that could and will be done to make the dialogue with customers better - both before an application for credit is made and afterwards if it is turned down. Understanding why their application was not successful is critical to SMEs, and indeed banks, to ensure that if/when the businesses applies for credit again it knows what is required. Also all staff within banks need to take ownership for the reason for decline and not blame others if that is not the case which it rarely is. Furthermore the external communication about the Appeals Process needs to be enhanced to ensure that all potential and current customers are aware of the process.
b) The need for businesses to understand and, where necessary, be re-educated on how the changes the new financial climate affect them. This is not something the banks can do so other organisations need to understand their role in this as well.
c) The main reason for credit being declined, with almost 40%, is credit scoring with affordability (which is the ability of the customer to repay any new credit provided to them) being the next largest. Credit scoring as a reason for decline is also higher for start-ups and those switching banks because you as a person are examined just as much in terms of credit scoring as your business is in those situations. Therefore it is personal credit scoring (which, in the main, is done externally to the banks) rather than the banks own credit

scoring process that is the issue. I am not convinced that any of us understand how these scores work and how we are judged on them so I am facilitating a process between the Credit Rating Agencies and the banks to see what can be done to make the understanding and use of personal credit scoring more applicable to the new environment we find ourselves in. If we could make this better understood and bring it in line with the current credit climate then it could well help us all. In terms of affordability, credit scoring also features as part of that decision making process, especially at the smaller lending end of the market that is linked also to personal finance.

d) The need for early and continued dialogue between lenders and SMEs.
All the above three points hinge on banks having good information on which to base their decisions; and customers understanding what banks need. This goes beyond pure financial information which in itself does not tell the whole story; and it is important that Relationship Managers ensure they have what they require for their own internal processes as understanding the story behind the numbers, which in many cases paints a different picture than the figures would do on their own. Therefore encouraging early and continued dialogue between lenders and SMEs is critical if we are to move forward on lending and the role of the Relationship Manager is key in making sure that takes place.

At the end of this first year of the Appeals Process we (banks, businesses, and Government) have successfully embarked on this new journey and have already put in place changes which will benefit all. However there is still much more to do to make the lending environment for SMEs operate as smoothly as any lending environment ever can or has. Over the coming year all parts of this lending equation (business, lenders, and Government) will work together to make this so.

Professor Russel Griggs OBE
Independent External Reviewer
May 2012

1. Introduction

When I agreed to take on the role of Independent External Reviewer for the Task Force Banks SME Appeals Process, I did so on the understanding that, as well as making sure that all the banks had in place good and effective Appeals Processes, we should all (banks, business, and Government) look on this as an education process. We need to use it to highlight issues that appear to be hindering banks or SMEs in the credit process. That will never be a perfect marriage as there have always been disagreements between them throughout time; but if we can reach a place where each understands the other's viewpoint, and rationale for doing things, and what information is required, then we will have moved a long way forward.

Therefore the tone and structure of this first annual report will be with that education and development objective in mind as much as the scrutiny which any review or audit process demands. The report is broken down into specific parts namely

Background – Where the Appeals Process came from and why it is there.

Context – The economic and financial conditions which inform credit and business decisions now and before the crisis in 2008.

The Audit Process – The process we have established to ensure the banks deliver what they said they would.

The Results – The data coming from the Appeals Process.

The Issues Raised – The specific issues that I feel banks, business, Government, and others need to address as the result of what we have learned.

The Future – What is to be done next?

Inevitably, Annual Reports like this one can become very numeric with a sole focus on the numbers. Appeals though are about interaction between business and banks so we must not forget that and therefore are based on real situations. To try and bring this home strongly a series of real case studies has been added in Annexe G so that real situations can encompass the numbers.

I would like to take the opportunity at the outset to say thank you to everyone I have worked with throughout this our first year. Both the banks and business have made this a great start to the journey we are all on to re-adapt to what is now a very different world. All parties have worked with me with the outcome of making this better for us all, and therefore the economy, and there are signs that this is already happening.

2. Background

The financial crisis and subsequent recession of 2008 had many features that were similar to previous recessions but in one sense it was unique, at least in my lifetime, namely the speed at which it happened. Previously good businesses and indeed good financial institutions could see a recession coming towards them and adapt what they do and how they operate, so that when it comes they are in a position to cope with it or at worst ride it out. This was not the case in terms of the events of 2008 which you could argue happened literally overnight and were not planned for. Therefore everyone was caught in a state of unpreparedness which has had ongoing consequences.

At the time of the 2008 crisis I was Chair of the CBI's UK National SME Council so recall vividly the meetings we had between Government and the financial institutions as this all happened. There was a real sense of shock across all parties at the scale and the enormous consequences of what was happening and how that would affect everyone. There was a period, probably lasting for several months, where everything appeared to stop until we all caught our breath and could see a way forward, albeit at first an interim solution to give us the time to develop a sustainable one.

Since then much has happened on all fronts, with many reports and views being produced on the past and the future. The banks themselves presented, in October 2010, 'Supporting UK Business – The report of the Business Finance Taskforce' which set out their plan for being part of the recovery process.

Annexe A sets out the list of 17 commitments they made and number 4 stated they would

'Establish transparent appeals processes *for when lending applications are declined, with processes independently monitored by a senior Independent Reviewer, who will publish the results of their review, to ensure each bank has a fair and equitable appeals process'*

In the body of the report the above is expanded to state:

'The banks want to be more helpful to customers, including those customers who have loan requests declined. We have agreed to provide a fair and effective review process when a loan application is turned down. Business customers will be able to make a formal appeal of a declined loan application decision – either appealing the lending decision, or appealing because the lending decision process was not dealt with according to the Lending Standards.

We will ensure the review process is transparent, available to all customers and designed to allow any business whose application has been declined to seek a *second opinion from a person not involved in the original decision in the bank concerned.*

Each bank will establish an appeals process, based on a transparent set of common standards, to give small business customers a means of appeal if they believe their loan application has been unfairly rejected. The appeal process will ensure that the appeal will be carried out fairly and promptly, usually within 30 days, by a suitably qualified member of staff not previously involved with the loan application. The customer will get the result of the appeal, and an explanation of the findings, in writing.

Relationship managers will receive appropriate training to ensure awareness of: the standards required under the Lending Code; best practice principles; and the appeals process. We will subject our appeals processes to scrutiny by an independent External Reviewer on a regular basis. Results of the independent review will be published.'

It is on the basis of the above that I and my team of Operational Reviewers from Promontory have based our work and the processes we have put in place to do so.

However, before going on to define how we have done that and what has been the outcome, it is important to set our work in context.

3. Economic and Financial Context

The world post 2008 has changed for us all. There is no doubt that the period from the millennium to 2008 was one of significant growth and rising values in almost everything. While a lot of that did bring benefit some did not.

As the Business Finance Taskforce stated in its report:

'*Starting in the mid 1990s, bank lending to UK businesses grew at a rapid rate. The most buoyant period was in the five years immediately before the financial crisis. The main drivers of this were growth in the commercial real estate market; the preference among many businesses for debt over equity; a ready supply of credit from foreign banks and non-bank financial institutions; the provision of credit to borrowers who had previously struggled to get loans; and the accommodating monetary policy adopted by many central banks over this period.'*

This resulted in a general feeling of confidence from both banks and business, a rise in credit applications and availability, in what some have called a 'feeding frenzy'. For SMEs seeking credit from the banking sector this demonstrated itself in:

- Some banks becoming 'aggressive' sellers of credit and products to gain market share for their own institution and to 'get money out' to the customer almost come what may. Money was freely available to both banks and businesses and if there was irresponsible lending so must there have been irresponsible borrowing on occasion as well.
- Relationship Managers in some banks having more discretion, even though no authority in real terms, to give credit to customers. This was based in many cases on a limit that the bank had decided in advance it could risk on this customer which Relationship Managers did exercise their discretion on.
- The difference between working capital, usually funded by overdraft, and development capital, usually funded by loan or equity, becoming blurred or non-existent. This resulted in the size of overdrafts in relation to the turnover of the company rising way beyond what had been the norm previously as it was the 'easy' way for a bank to satisfy a request for credit. Ratios of around 50% and beyond in terms of overdraft to turnover at the extreme end were seen.
- Some banks asking for less information than they should have as everyone was carried along by the feeling that everything was on the rise and would be OK. There was an aura both in banks and business that 'nothing could go wrong', and near vertical growth profiles in areas like property were not questioned or challenged. Many banks also viewed their customers in the same light and, since failure was not in many people's minds, repaying debt was therefore not seen as a problem, so affordability was not assessed as robustly as it could have been in many cases.
- Businesses themselves asking for, and getting, more finance than they really needed in some cases.
- Both banks and business owners investing in the commercial and 'buy to let' property market for short and long term gain.

- Banks not enforcing covenants and other terms with customers as rigorously as they should.
- Banks pricing loans and other charges to gain business rather than to make profit on the transaction. Supplies of money were readily and cheaply available therefore the cost of borrowing was low.
- Banks being prepared to take much more of the total risk so not seeking significant cash input from business owners.

Since 2008 all the above has changed so now SMEs are faced with banks who:

- Are much fewer in numbers. Almost half of the financial institutions who were lending to business in terms of amounts of credit advanced to business pre 2008 are no longer there as independents or have gone altogether.
- Are being more cautious and only wanting to give if it is the right thing to do and it can be repaid. Businesses are also being more cautious in general and specifically more cautious in taking credit.
- Do not sell in the sense that this would have been applied pre 2008 but have returned to what has been referred to as ‘good old fashioned banking’.
- Many of the buoyant sectors who were prime areas for credit before 2008 are no longer in vogue e.g. construction, retail.
- Have returned lending ratios in respect of lending products to traditional norms which in the case of overdrafts for example is generally in the region of 5-10% of turnover.
- Are looking for the business owner now to put in a larger cash stake into the business so to spread the risk. Whether the size of the stake is correct is difficult to comment on from the information available but that businesses should share the risk with banks, or indeed any other investor, in the funding of their business again appears to be just returning to traditional principles of lending.
- Ask for all the information they need to make a decision on which therefore means in general it takes longer and appears tougher. This is not just true of the banking sector but also in angel and venture capital and is all part of the general caution that pervades everything.
- Involve more people within the bank in making that decision partly due to reduction in some banks of authority or discretion levels, but also so that they can take a more holistic view of what and how the bank should provide in terms of credit to this SME.
- Now see affordability being the first driver with the ability to repay the credit now the key decider for all banks. It is not just the banks who are driving this but also the Office of Fair Trading who - in its enhanced guidance on irresponsible lending issued last year which apply by law to all credit provided under £25K - sets strict standards under which institutions should check customers for before lending.
- Have as the other main driver, second to affordability, the ability of the management of the business to deliver what they say they are going to.

Before 2008 their positive case was usually believed. Now banks take more care to decide if the entrepreneur or management team of a business can deliver what they say they will. Security is there now only as an insurance policy which relates to the bullet below in terms of reducing the amount needed to be ‘put away’ against each credit transaction in terms of risk.

- Have to strengthen their Balance Sheets to make sure that the events of 2008 will never occur again. The regulator and the market are requiring banks to raise minimum capital levels, something which most would be doing anyway. This manifests itself in them having to put some money into reserve any time they lend to anyone to cover default and the amount to be set aside based on the risk of the type of credit and the customer. Increased liquidity and stronger balance sheets is therefore a key driver for banks as they now must operate under strict guidance with penalties if they fail to do so.
- Having to price credit solely on a basis of making a realistic return for the bank based on risk and meeting the new capital and liquidity requirements from the FSA and other regulators, which in itself has a real cost to bank customers.
- Worry as much about things going wrong as they do about things going well, because of the above. It is probably not realised by the general public or indeed many who work with banks and other lenders that if only 2 or 3 loans or other credit products out of every 100 go into default then the whole 100 will be unprofitable.

All the above constitutes two totally different economic and lending environments pre and post 2008 with real consequences for everyone. Given also, as I state above, that this change happened very quickly many companies were caught in an overleveraged situation or in a sector whose risk changed materially. Therefore, having been ‘safe’ or ‘good’ customers to a bank pre 2008, many moved into areas of ‘concern’ for all the banks.

It is clear that the pre 2008 situation, with the wonders of hindsight, was never sustainable either for banks or business in terms of the ease of credit availability and many of the old but true ‘lending questions and parameters’ were forgotten which have now returned. While today’s financial environment is more challenging, it is one on which we can all build soundly. Going back to the pre 2008 situation in its totality is not one we should consider.

Given the change set out above, how banks make decisions will have changed as well; so we have taken the above as our basis for the way we have judged how the banks have approached and operated the Appeals Process in today’s environment.

4. The Appeals Process

In setting out how we have audited the Appeals Process which the individual banks put into place, it is worth remembering that no one had ever done this before in the way that was being proposed. I had also to make sure that I was delivering a process that would be as beneficial for the SME as much as it would be for the banks.

I believe the journey that this has taken us on in terms of the auditing process itself, which is set out below, has enhanced understanding for everyone and it has been a new experience for many of the banks having someone like myself and my team watching what they are doing independently and they have all used that positively.

While section 5 of this reports goes through the results of the first year in terms of numbers I feel that showing now what the total number of appeals was for the year and how that had built up would help the understanding of the process we have put in place.

Table 1:

Total Appeals between 1st April 2011 and 31st March 2012	2177
Percentage overturn rate	39.5%

An overturn has been defined for the purposes of the Appeals Process as not necessarily the customer getting exactly what they asked for but reaching a credit agreement between the bank and customer that the customer is happy with and has accepted it. Given, as will be seen in the tables below in Section 5 of the report, a lot of appeals were for overdrafts or commercial credit cards the issue in many cases will be around the amount of the overdraft or the limit on the credit card.

While the appeals numbers, and the issues arising from them are examined in greater detail in the two sections 5 and 6 of this report it is sensible now to put the number of appeals into the context of what we know about SME lending from elsewhere and also whether everyone is appealing who could.

The SME Finance Monitor found the following from independent research interviews with 15,000 SMEs throughout 2011:

a) Around 9% of all SMEs applied formally for overdraft facilities in the twelve months prior to interview. The majority of applicants ended up with facilities, but of the 392,000 SMEs applying, 65,000 had their application declined.

b) Around 4% of all SMEs formally applied for a loan in the twelve months last year. 63% of applicants ended up with a loan, but of the 162,000 SMEs applying, 53,000 had their application declined.

In the context of those application eligible for the appeals process data collected by the BBA from the Taskforce banks show that in the twelve months since the launch of the Appeals Process last April, the banks received 827,000 applications for all credit products (loans, overdrafts, credit cards, asset-based finance, etc) that were eligible for appeal should the application be declined. Through the year, 86% of those applications were approved, while 114,000 applications were declined - some 14% of all applications. Of those declined, 2% were taken to appeal, so less than 0.3% of ALL applications were appealed against. If 4 in 10 appeals overturned an original decline decision in favour of the customer, this equates to 0.1% of applications.[1]

From looking also at all the cases we have (decline upheld or overturned) we also believe that where the appeal has not been overturned we concur with the rationale that the bank has used not to overturn.

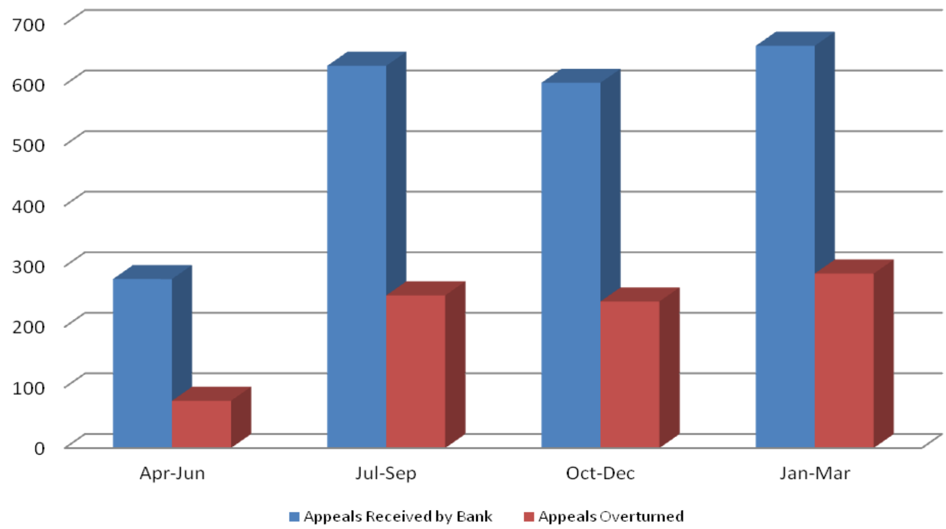
Also to put some quantum into the overturn numbers they equate to extra funding of over £10 million of lending going to SMEs that would not have which averages out at about £5,000 per SME overturned.

Therefore while the number appealing is small in comparison to all declines it is not clear whether that is due to the fact that only those appealing think they had a case, or whether many SMEs who were declined were not aware of the Appeals Process, even if the bank had informed them of such. As is examined in more detail later there is evidence to suggest that not all SMEs, even those who have been declined, are aware of the Appeals Process as SMEs do not always read everything that is sent to them in full. Also some research conducted by one of the banks individually would suggest that if SMEs were aware of the rate of overturn it might encourage more to appeal, as some believe that the Appeals Process is not a real one. This is substantiated by the most recent SME Finance Monitor where only 19% of respondents said they were made aware of the Appeals Process but none of them appealed, typically citing the view that they did not think it would change anything. Therefore more work needs to be done to enhance communications to SMEs regarding the Appeals Process and also into the reasons that SMEs appeal, and indeed do not.

However it should also be stated that one of the reasons that SMEs generally may not respond to this or other initiatives communicated to them by a plethora of organisations – public and private – is the number that are put in place. In recent years SMEs have been bombarded by many schemes and products to help them with their business which means that many are missed, or are so complex that they are not understood. It would be good over the coming few years if we all focussed on some key schemes that brought benefit to SMEs which would then allow them to respond better to them.

[1] (Source:SME Finance Monitor http://www.sme-finance-monitor.co.uk/)

Table 2: Appeal Volumes - Overturns in Favour of the Customer



	Apr-Jun	Jul-Sep	Oct-Dec	Jan-Mar	*Average*
Overturn Rate	28%	40%	40%	43%	*40%*

Table 2 shows, as the process has become more embedded in the banks and customers have become more aware, how the number of appeals has increased.

The Appeals Process originally applied only to those banks and their trading entities that formed part of the Banking Task Force. They are Royal Bank of Scotland Plc, Lloyds Banking Group Plc., HSBC Plc, Barclays Bank Plc, and Santander UK Plc. Since the start of the Appeals Process in April 2011, Bank of Ireland (UK) Plc, First Trust Bank, and Northern Bank Plc have applied the Appeals Process to their SME lending in Northern Ireland. Ulster Bank Limited was already part of the process as a member of the Royal Bank of Scotland Group.

The Process

The Appeals Process by the Task Force Banks was established on the basis of high-level Principles of transparency, accessibility, fairness and promptness. These high-level principles are aimed at providing consistency of approach across all the banks; and each bank has had to put in place an Appeals Process that satisfies those. In simple terms any business with a group turnover of £25 million or less, including potential start-ups can appeal to their bank if they are turned down for credit. They can appeal for any reason. It applies to all types of lending products that a bank can offer them, and now includes the terms and conditions of the offer as well, which all the banks agreed to add during this first year.

No one had done this before so we have all learned from the creation of what we now believe is a robust and sound process for the customer and the banks. That has taken time and it was probably only by the end of the first six months that we were all content that we had a defined system in place which operated well to give us all what we require. I would like to thank all the banks for approaching this exercise so positively and spending the time and resource to get it right. I think the banks have learned as much from this process as we all have, as it is unusual for them to have someone outside of the bank working with them in such a way.

This has not been a simple process to put in place. Depending on the size and type of lending product being sought, there are several different ways in which a business customer can access finance. These include telephone, on-line, and via local relationship managers or specialist lending units for certain industries/products, so the banks have had to create processes for each of these different channels to ensure that they were all appropriately consistent with the high-level principles that had been agreed.

While all of the banks had existing processes to assist customers, including those where a lending request may be turned down, the introduction of the common Appeals Process with standard principles and definitions required each bank to make adjustments, including changes to their systems, be they paper or IT-based. A key part of the implementation was to ensure that the new processes were understood across all the different parts of the banks where there were interactions with SME customers. Given the size of each bank's operations, this was no small task.

It is important to emphasise the decision as to whether to lend to a customer remains with each of the banks as part of their own commercial risk appetite. The aim of the Appeals Process is to give customers who had been declined lending the opportunity of a full review of the case by an experienced lender who had not been in any way involved with the original decision not to lend. The independent review team's mandate was to verify that each bank had followed the agreed process. The review work did not in any way seek to question or challenge the outcome reached by each bank when assessing individual appeal cases although they were aware that we would have a view on how they were performing that task.

Annexe B sets out the “Principles and Definitions” which were agreed by the Task Force banks. This document formed the basis of our approach to reviewing the Appeals Process. While much has been said about lack of competition in the banking sector, our experience of working with each of the banks is that competition is alive and well within the 7 banks involved in this process as they all do things differently to a material degree. The initial approach of the reviewers was to look at the various processes devised by each bank for the various access channels customers could use to request lending facilities. The team also looked at the ways in which banks had publicised the new process, including a review of any website content. Most of the process review work was completed during April 2011, based on desk-top reviews and discussions with the project teams overseeing the implementation in each bank. It was never expected that everything would be up-and-running from the outset, and we all had set ourselves the first six months to get the process right. What also became clear was that the processes which had been developed could only be properly tested when assessed using actual experiences from appeal cases. With the initial cases, although the banks dealt with them diligently and showed from an early stage a willingness to overturn the original decline decisions, and to deliver the right outcome for customers in a timely way, there were inevitable teething troubles with a new process

Annexe C details the tests that the review team established as a way to provide reassurance that the processes would be compliant with the agreed Principles and Definitions. The first appeals from customers that had been through a full process to appeal outcome decision did not begin to emerge until the second half of May 2011; and even then there were only a few cases spread across the banks. Not surprisingly, it was possible for the banks to be broadly consistent in their implementation of the Principles and Definitions that underpin the Appeals Process yet different in the way in which they were applied to each bank’s business. Indeed, it became clear there were necessary differences in approach within each bank depending on the method in which a customer chose to apply for borrowing, or for that matter, the amount being borrowed. For example, there is less information required to consider a request for a small amount of borrowing that is requested on-line or even by telephone. Any company can only spend the amount of time it deems sensible and prudent in terms of resource when gauged against the possible return it gains from it. For example credit scoring, which is discussed more widely in section 6 below, has a number of merits, including ease and speed of decision. Some customers welcome the advances in technology which have provided the means for instant or near instant answers. However, in cases where the answer is to reject the application, the reasons for the decline will be more closely linked to the results of scorecard assessment linked to the individual bank’s risk appetite. Such reasons will be conveyed in a more standardised and less detailed way, a reflection of the speed with which the application has been considered.

Reviewing actual appeals enabled the team to validate some of the views taken when assessing the process maps. During the summer, with the benefit of more than one visit to nearly all of the banks at this stage, the appeal team was able to finalise a check list (Annexe D) that had been developed at the outset. This ensured that a standard approach was being adopted even across different banks and different lending channels. In addition, the team was able to create a more formal list of requirements that would make the case files easier and more complete to review (attached as Annexe E).

Appeal cases were reviewed on site at each bank. This provided the key benefit of being able to speak directly to those dealing with the cases. Not only were the review team able to satisfy themselves as to the extent of basic compliance with the process for each case (for example, was the appeal dealt with in the prescribed timescale?); they were also able to discuss the cases with those who had dealt with them. This proved to be a very valuable source of information. It enabled the review team to understand the approach taken on different cases and the thought processes used by the case handler to reach a decision. The team probed the appeal case handlers at the banks, for example, on how they assessed whether they needed further information from the customers. Questions such as those produced a broader picture for the review team to satisfy themselves as to the thoroughness of the review of each individual appeal case. The discussions with the appeal case handlers also brought out how any learning or process improvements were being fed back to the original decisions makers and relationship managers, where appropriate. The review team provided feedback to each bank at the end of each site visit which was then followed up with more detail in writing using a standard form (attached as Annexe F). The feedback highlighted examples of good practice as well as giving comments on any process breaches and suggestions for process improvements. The content of the feedback was always shared with the banks for factual accuracy but the comments and views expressed remained those of the review team and not subject to alteration.

Throughout the year, the feedback interaction with the banks has been very productive. On the positive side, the feedback has documented what had been previously highlighted for suggested improvements and which had subsequently been addressed by the banks. In some instances, the monthly feedback has enabled patterns to be identified on even more substantive issues. Where we had concerns that the issues highlighted might be of a more significant nature, for example, where it was likely technology changes might be needed or more extensive communication of relevant front-line staff, these were also raised with the more senior management at the banks overseeing the work of their appeal teams.

Sampling

The review team devised an appropriate approach to the numbers of specific appeals reviewed. As numbers initially were very low, I made it clear to the banks from the outset my intention to review 100% of cases. First, to do otherwise would not have provided sufficiently meaningful data against which to draw conclusions and make suggestions for improvements. As importantly, the comprehensive review of all cases ensured that the process maximised its credibility and the opportunity to give banks feedback, both shared and individual. Secondly, reviewing all cases enabled the review team to establish more quickly with the banks an agreed standardised methodology for the reviews. As the number of appeals increased at the banks, I agreed with the banks that the review teams would visit each site where banks were dealing with appeals on a monthly basis. As noted above, the banks quickly established the potential benefits of handling appeals in a centralised way and this approach also assisted the review team.

In the six months ending March 2012, just over 50% of all appeal cases have been independently reviewed. Where cases are handled judgmentally by the banks, we have continued to review between 75% and 100% of cases. Volumes of these cases remain much lower and there is more variance in this type of case, as you would expect where more information has been provided by the customer in support of their lending application. For the higher volume, lower value, appeals, we have reviewed between 30% and 40% of cases over the year as a whole depending on the bank. As is to be expected, banks require less information to process such cases and the decisions often centre on the outcome of the credit scoring process. The information gained from reviewing such appeals cases, therefore, tends to be more similar with less variance. Where we moved away from reviewing 100% of appeal cases, I decided that the focus of the review team's efforts should be skewed towards those appeals where the outcome was to overturn the original decline decision. In broad terms, the split of those cases reviewed at each site visit was 80% focused on cases overturned and 20% focused on cases where the original decision was upheld. In concentrating our efforts in this way, this will have helped build a more complete picture on the reasons why decisions have been overturned on appeal. It should also be noted that there is a time lag (usually around a month) between the banks receiving appeal cases and my review team sampling them. Cases that arose towards the end of 2011/12 will be reviewed as part of the sample for our work during the second year.

Current State of Compliance with the agreed Principles and Definitions

The diagram below summarises the main areas where the review team has verified compliance with the agreed standards as set out in Annexe C.

Was the customer notified in writing of the decline?

Did the decline letter:
- give reasons for the decline which can be matched to the evidence on the case file
- highlight the existence of the Appeals Process and the timeframe in which to appeal
- explain the timeframe in which the appeal will be dealt with if received
- signpost to alternative sources of finance

When received is the appeal dealt with by an experience lender not involved in the original decision?

Is the appeal dealt with in a timely fashion and subject to proper review?

Does the Appeal Outcome letter give reasons which underly the decision and are these evidenced in the case files?

In terms of current compliance with standards, I would highlight the following areas of strength and development which summarise this year's progress;

Strengths	**Development areas**
Appeals are dealt with thoroughly and promptly. In most cases, appeal decisions are made well inside the 30 days and in cases where the banks have taken longer to reach decisions, there have been good reasons and customers have been kept informed.	The banks have recognised the importance of giving clear and full reasons for declining applications. Some improvements have already been made, but it is an area where more could have been done and more still needs to be done. The banks recognise this and are responding positively.
Experienced and confident appeal teams with no reluctance to overturn original declines when appropriate.	The banks have been aware of the need for further training of front line staff and have been working to reinforce the message to ensure customers are

Strengths	Development areas
	made aware of the Appeals Process and are given clear and accurate reasons for lending decisions. It is a substantial task and the banks know more needs to be done.
If appeals are made by the customer after the 30 day period, banks have been willing to consider the cases as appeals even though they are not counted as part of the formal Appeals Process.	Appeal outcome decisions sometimes refer back to the original decline letter reasons and this is not helpful if the original letter itself was not clear. Some of the banks are aware of the need to make more progress in this area.
Appeal teams add value both in conversations with customers and feedback to front line Relationship Managers. Both of these factors are helping to improve the overall relationship between the banks and their customers as well as raising awareness of how customers can make changes to improve their credibility as a lending proposition.	The provision of timely and accurate management information to underpin the Appeals Process is an area the banks have struggled with during the year. In many cases, system improvements are required to provide greater consistency and reliability.

<u>Communications</u>

I was asked several times at the outset of the scheme how many appeals did I think we would get; and my consistent answer was that I had no idea as the number would depend on many things. Part of that was the way the process was communicated to customers and, as well as the wider publicity to launch the process and the efforts that each bank was making, a key part of the process was to ensure that any customer who was declined lending was made aware of the Appeals Process and how they could make an appeal. It was also a requirement that such customers were given pointers towards alternative sources of finance.

Given this uncertainty in the number of appeals that would be received, all the banks put in place resources to cope with a reasonable flow of appeals from the outset and had contingency plans in the event that numbers grew quickly. Banks were also alert to the potential risk, as seen from the customer's perspective, that declined applicants would be discouraged from appealing because of concerns this would damage the longer-term interaction with their Relationship Manager. The banks took pains to stress to their Relationship Managers that there should be no barrier to customers appealing.

In the event, following the April 2011 launch, the numbers choosing to appeal began slowly at all the banks and took some months before a regular pattern, in terms of appeal levels, was established. Against the background of low appeal volumes, it was pleasing to see the banks thinking about possible causes on a proactive basis. All the banks saw the benefit of re-enforcing communications to their staff about the existence of the Appeals Process, including the need to ensure customers were aware of it. The evidence that emerged even early on from the appeal reviews conducted was that some bank staff and customers were not aware of the process. Even after a full year of operation, there is still some evidence not all bank staff who interact with SME customers are aware of the process, which is highlighted from the recent research evidence, referred to earlier in this section, from the SME Finance Monitor. In response to the issue of possible gaps in communications and awareness, banks have pursued a range of initiatives. In the main, this centred on further training and communications from the centre. In some cases, banks raised the awareness by writing to all their SME customers, not just those who had requested or been declined lending. However, this is an area at the end of year 1 where more work needs to be done, as research evidence now available would appear to substantiate my own belief that not all customers are aware of the Appeals Process and they should be. The banks are open for business and knowing that you can appeal could make more businesses try for credit in the first place so the banks need to focus on communications with their customers in this area. This again is substantiated by recent research where SMEs believe that appealing would not change anything which is clearly not the case from the number of overturns achieved.

<u>Summary</u>

The review team has continued with its schedule of monthly visits to each bank throughout the year. This has enabled the team to keep up to date with changes to processes being introduced by the banks and to raise any emerging issues with them on a timely basis.

As had always been expected, the first year of operation of this new Appeals Process has been a journey for both the banks and those undertaking the independent review work. Not everything went smoothly from the outset and all the banks found there was a need to do further work to improve the communications and awareness to staff and customers. Likewise, the processes developed by the banks prior to launch did not always work in practice as originally envisaged once real cases emerged. The review team also adapted its approach as it became more familiar both with the different processes at each bank and the way in which actual appeals cases were handled across the banks.

Overall, therefore, I believe the evidence gathered by the review team from the appeal cases is sufficiently robust to provide a sound basis for conclusions, suggestions and areas for improvements. Indeed one bank has changed the way it operates its decision making process to give the Relationship Manager more opportunity to decide on the case themselves.

I have also gone beyond just visiting those who do the appeals and I am spending more and more of my time with Relationship Managers themselves and with customers. Each bank stratifies the way it deals with customers differently so each Relationship Manager will be in a group that deals with a certain turnover of businesses. Being able to meet with them, which I will continue to do, will add greatly to my and each bank's knowledge of how the processes they use impact on decision making.

5. The Results

This section of the report sets out the actual results from the first years Appeals Process in terms of numbers and percentages and aims, as far as is statistically sensible, to break down the data to provide wider knowledge.

As is stated in Section 4 above the total appeals for the years were 2177 and the overturn rate was 39.5%.

The numbers below though are not calculated on all 2177 as we do not have all the detail on all the cases that have appealed. We do have all the data on all the cases we have seen and audited which is almost 50% of the above and a much higher proportion of those cases overturned. Therefore the total overturn percentage in the tables below is slightly higher than the 39.5% on all appeals but we are content that in terms of statistical significance all the numbers and comments in the tables below are reliable.

Table 3: Appeal Cases Reviewed - Overturns in Favour of the Customer (Based on Size of Lending Request)

Size of Lending Requested	All Banks	
	Total Appeals	Overturn Rate
x ≤ £5k	47%	61%
£5k < x ≤ £10k	14%	45%
£10k < x ≤ £20k	12%	33%
£20k < x ≤ £30k	6%	31%
£30k < x ≤ £50k	3%	22%
£50k < x ≤ £100k	6%	19%
£100k < x ≤ £250k	7%	22%
£250k < x ≤ £1m	4%	20%
x > £1m	1%	10%
All Lending	100%	45%

Table 3 shows that the number of appeals reflects approximately what I would expect the split by size of lending to be. The larger percentage overturn rate as lending gets smaller also reflects both the effect of partial automation at the small lending size levels and also the time that banks have to decide on lending at the smaller end of lending. Relationship Managers, dealing with small lending amounts and micro buisnesses, will have many more customers to handle there (can be up to 1000 per Relationship Manager) than those dealing with larger lending and companies, where judgement plays the greatest role (varies between 150 and 250 per Relationship Manager in this sector).

Table 4: Appeal Cases Reviewed - Overturns in Favour of the Customer (Based on Customer Turnover)

Customer Turnover	All Banks	
	Total Appeals	Overturn Rate
x ≤ £50k	33%	48%
£50k < x ≤ £100k	17%	51%
£100k < x ≤ £150k	10%	41%
£150k < x ≤ £250k	13%	46%
£250k < x ≤ £500k	14%	47%
£500k < x ≤ £1m	7%	45%
£1m < x ≤ £5m	5%	51%
x > £5m	1%	0%
All Lending	100%	45%

Table 4 shows that approx 33% of the Appeal cases were originated by SMEs with turnover of up to £50K. This partially mirrors the picture in Table 3 and highlights the challenges small businesses face and the issues banks have in dealing with them. Lending is like any other business in that you can only spend the amount of time on a transaction that the margin you receive from it warrants. As long as banks remain profit - making organisations with shareholders then they, like any other business, must find a way of producing what it needs in a profitable way for all customers.

Table 5: Appeal Cases Reviewed - By Government Office Region

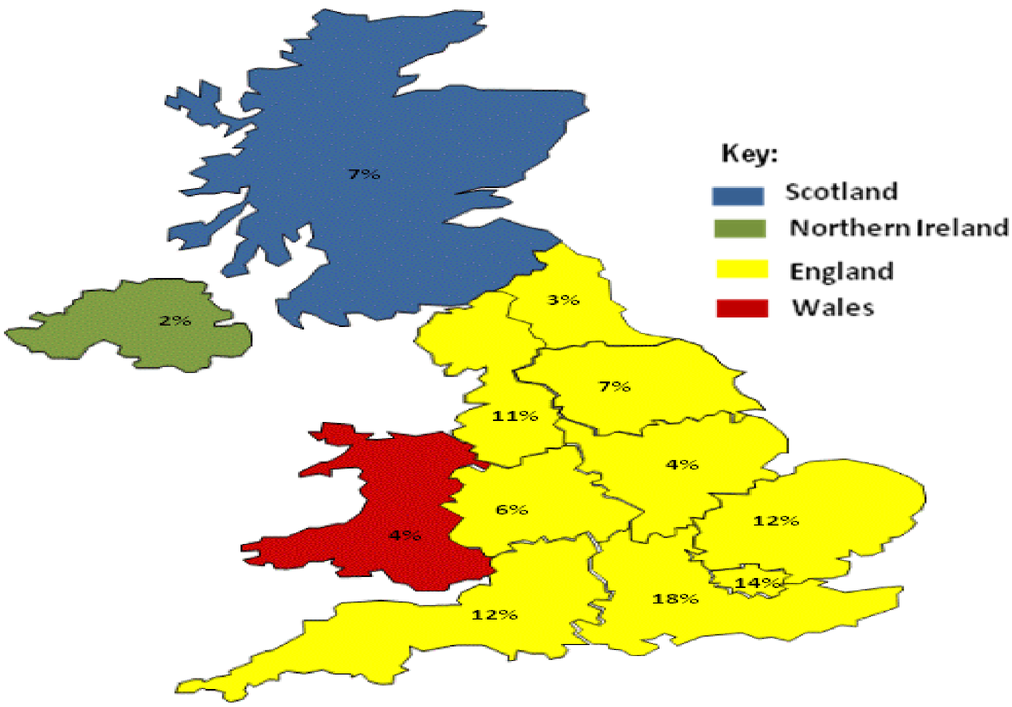


Table 5 shows the regional split of appeals across the UK. It may not show real demand across the UK as not all banks in the Appeals Process operate the same or at the same level across the UK.

Table 6: Appeal Cases Reviewed - By Industry Sector and Country

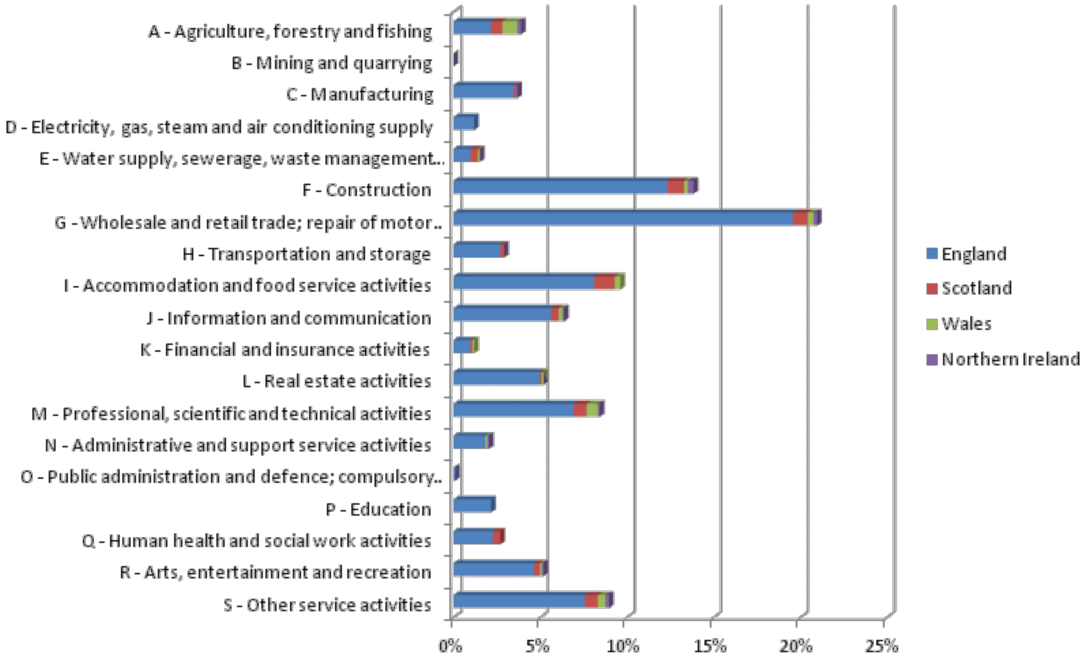


Table 6 shows appeals by SIC Industrial Code and shows that the most appeals came from the sectors of retail, construction, and hospitality which are all sectors which have both suffered from the recession and also have many small businesses in them.

Table 7: Appeal Cases Reviewed - By Industry Sector

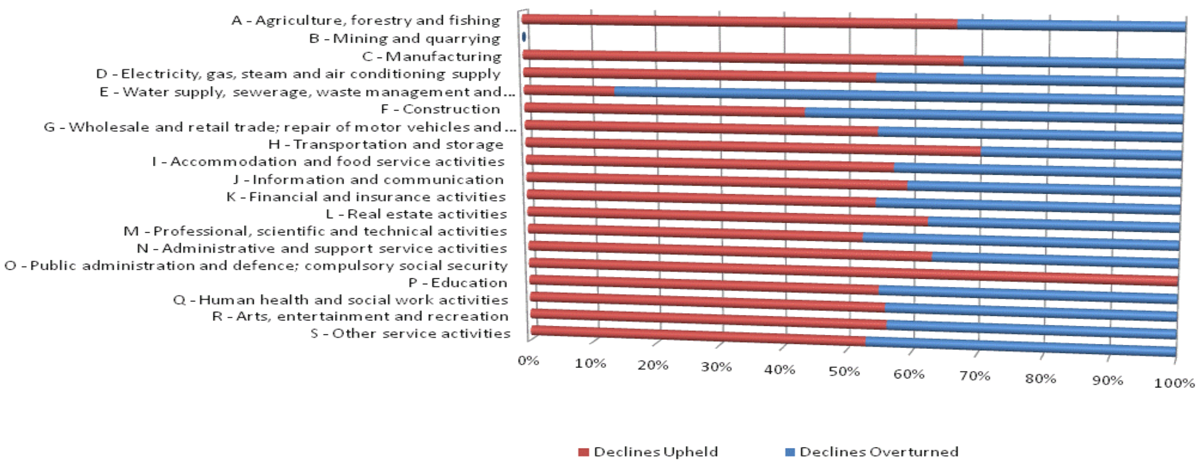


Table 7 shows that the majority of Industrial sectors , while they were not the highest in terms of overtrun rates, that had a high rate of appeal still had significant overturn rates which show the banks when looking behind the sector at individial companies do change their view.

Table 8: Appeal Cases Reviewed - By Lending Product and Type of Facility

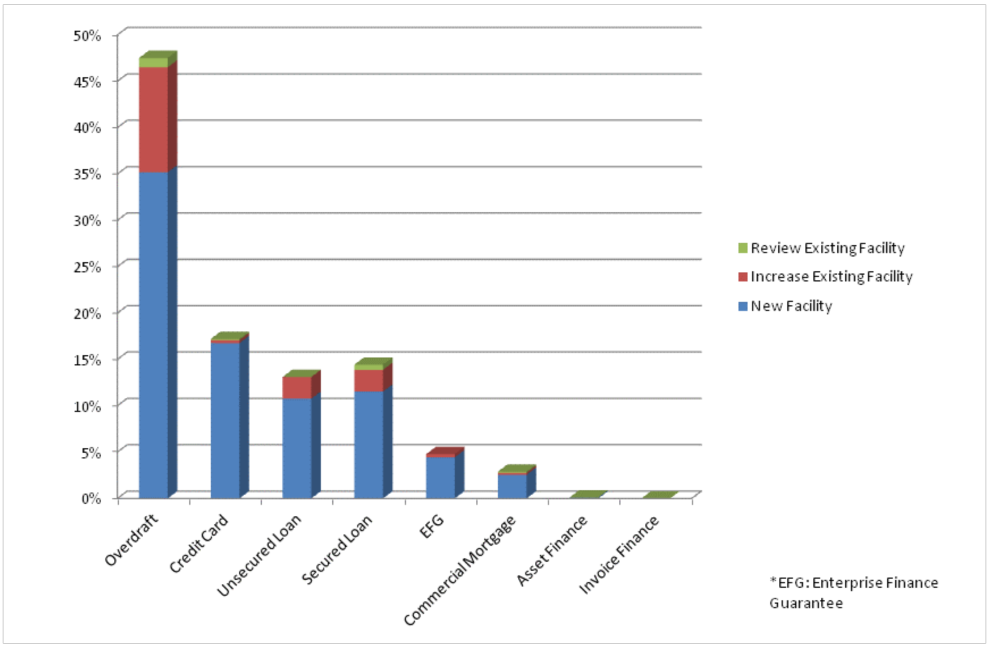


Table 8 shows that since the majority of appeals come from small business looking for a relatively small amount of credit then traditional methods are being used rather than asset and invoice finance which are now seen much more normally in the credit marketplace. Also the above, nor the Appeals Process itself, includes any reference to personal credit cards, which other research has shown can play a significant role in funding micro businesses.

Table 9: Appeal Cases Reviewed - By Product Type

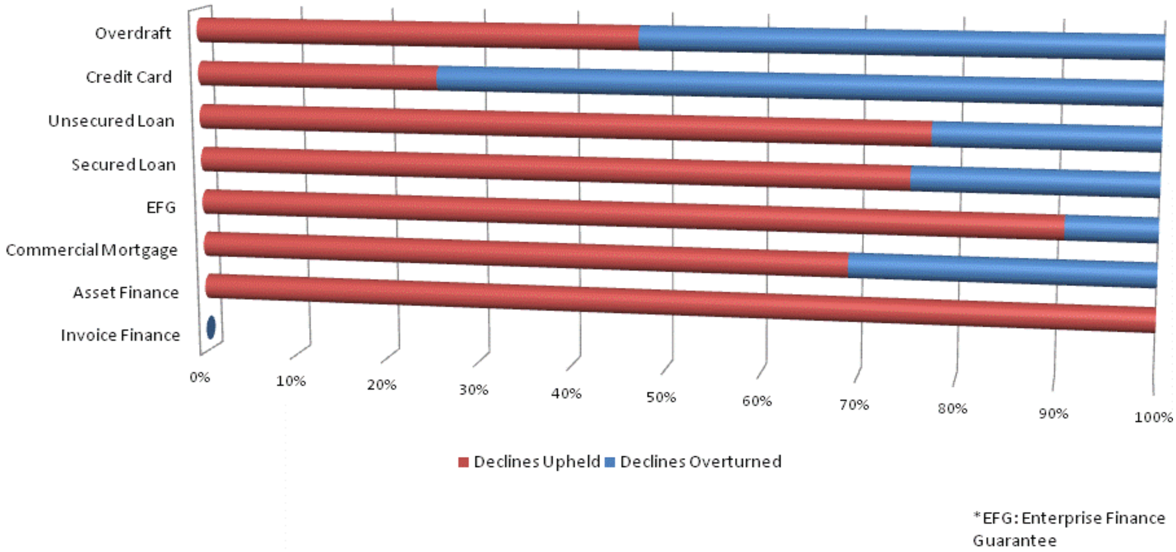


Table 9 highlights what was stated at the start of Section 5 of this report; that overdraft and credit cards were the highest areas of overturns and the vast majority were to do with the size of the limit rather than the credit vehicle itself.

Table 10: Appeal Cases Reviewed - By Customer Type

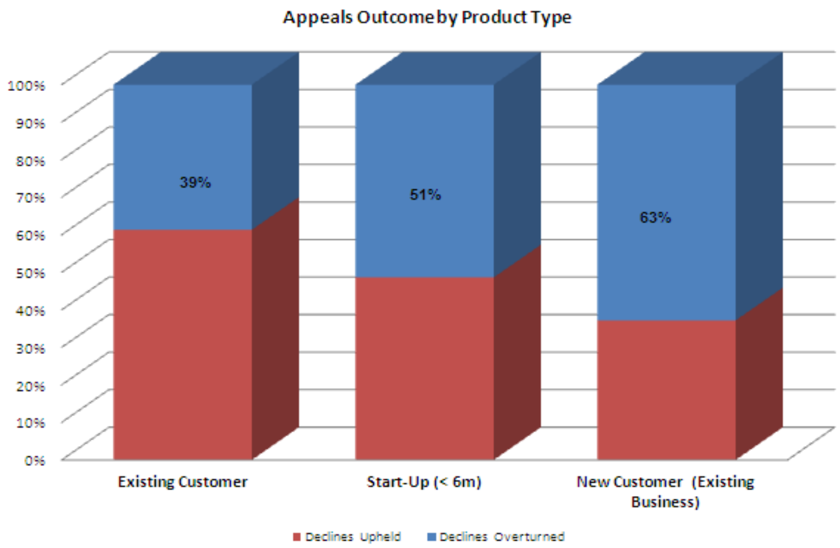


Table 11: Appeal Cases Reviewed - By Customer Type

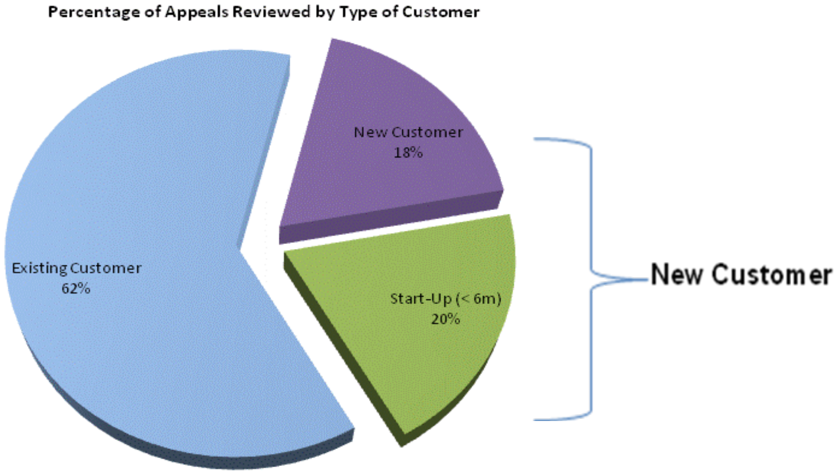
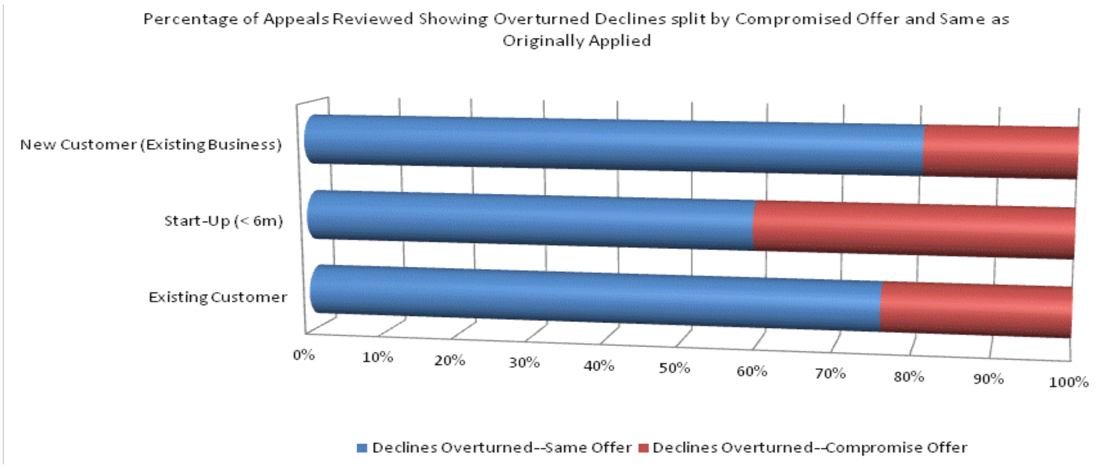
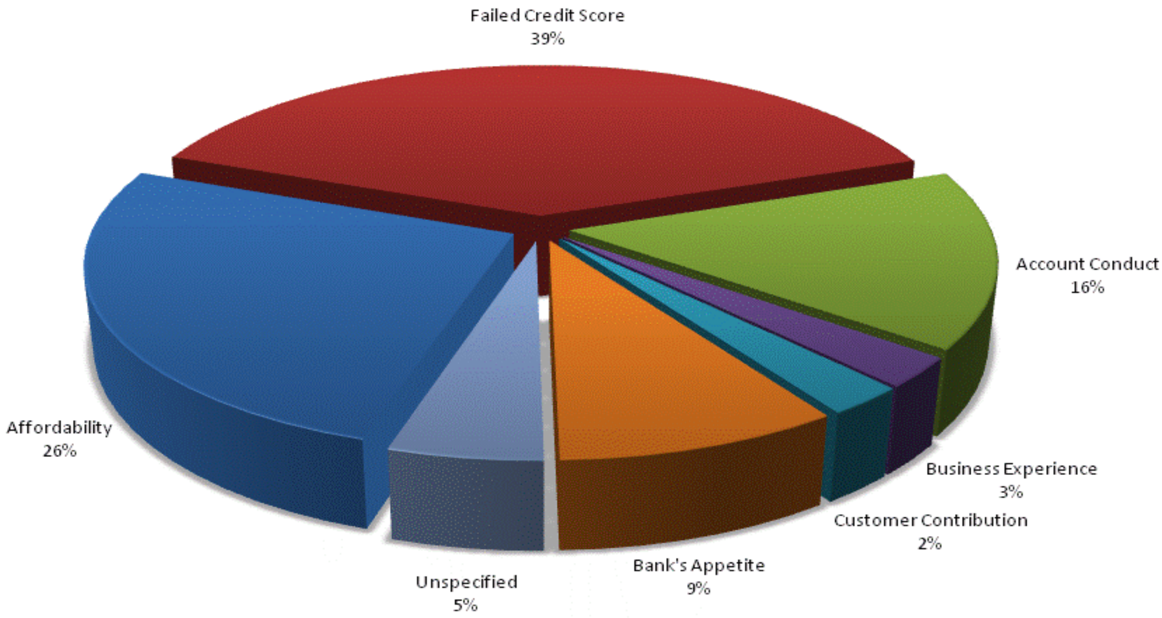


Table 12: Appeal Cases Reviewed - By Customer Type



Tables 10, 11 and 12 show that the majority of overturns are for start-ups or for customers moving from another bank. This is partially due to the fact that personal credit information on the owner of the business is used far more for these than for existing businesses. This also reflects on the type of overturn where start-ups tend to get less than they asked for.

Table 13: Appeal Cases Reviewed - Reasons for Original Decline Decision



The lists below give examples for each category of the type of activity or non-activity that can cause a bank to decline a lending request. The lists are not exhaustive but designed to give a flavour of some of the detail which may be behind a no decision

Failed Credit Score
Bankruptcy;
Defaults;
CCJs;
Adverse credit agency data;
Bad address data;
Account inactivity.

Account Conduct
Operating business through personal account;
Inefficient collections;
Dishonoured items;
Exceeding overdrafts.

Business Experience
Inexperienced management;
High competition;
Poor business plan;
Unachievable targets;
Risky start-ups.

Affordability
Low credit turnover;
Insufficient cash flow;
Projection based forecasts;
Insufficient security;
Unproven trading figures;
Existing debt commitments.

Bank's Appetite
High risk ventures/industry;
High level of prior lending;
Inappropriate product;
Contravening bank policy;
Less presence in sector.

Customer Contribution
Lack of capital;
Imbalance in risk exposure;
Start-up policy.

Table 13 highlights the impact that credit scoring has which is discussed in much more detail in Section 6 below. Together with account behaviour then over half of all declines are made for what the customer would see as non - business reasons. The 26% on affordability also highlights what we state elsewhere in this report that this is the key business driver now for banks making lending decisions.

6. Key Issues to Resolve

While the numerical results set out in section 5 are important to me, the most important part of the year has been looking behind the data to see what they mean and what are the issues we need to work on to make the credit process better. In no special order below is the list of what I feel is the key issues after the first year. I am pleased to say that in partnership with the appropriate organisations we have started a process of resolution on each which is described below.

Appendix G details 12 case studies which highlight the issues set out below and the impact they can have on the ability of a SME to borrow and the bank being able to assess their application correctly.

<u>Retraining of bank staff</u>

Much has been written over the last few years about the importance of Small and Medium size businesses to our economy. As someone who has and still works in and with SMEs, that reliance for our economy is absolutely true. Real employment growth comes from the 6% of SME businesses that grow beyond the norm so it is in all our interests to make sure that these and other businesses obtain the resource and assistance they need. The main reason I agreed to take on this role was to make sure that this could happen in a sensible and sustainable way for us all.

SMEs, probably more than any other parts of the economy, have felt the shock of the crisis and its aftermath and are still coming to terms with this new environment in which we find ourselves.

However, it is also clear that bank staff have been equally as shocked by the changes in their institutions post 2008 as were their customers. In many cases going from a confident (and often over-confident) selling environment to a cautious (even risk averse) one has been challenging. This was compounded by some banks employing some staff more suited to the selling environment who have had to adapt to the new situation.

Therefore it is important to stress equally to SMEs, and others, the importance to our economy of the role Relationship Managers in banks play as the other half of the lending equation with SMEs. Without them working effectively SMEs will not be able to access finance sensibly. To compare, and treat them the same as the high paid and high bonus investment bankers is wrong and the public, politicians, and the media do them, and therefore all of us, a disservice by doing so. We need the good Relationship Managers, now operating to more traditional risk-based principles of lending, as much as we need the businesses they fund and work with so we need to understand that and treat them accordingly.

It is clear immediately post 2008 that the circumspection being observed by lenders moved sharply to the most cautious end of the scale for a while. Also, as that changed, it filtered down to the Relationship and other Managers within banks who lend; then there probably was an over compensation in terms of lending decisions. If you had been employed to 'sell' products and credit to customers then suddenly moving to an environment that told you to be cautious, and in many circumstances, not to lend made saying 'no' was easier than 'yes' for a time.

In rebalancing that environment a number of things have and will have to take place

- Where appropriate, banks will have to retrain staff to become better lenders and know how to lend. That will involve retraining or new training for many staff and all banks are embarked on that process and have been for a while now. All the banks have now installed or reinvigorated their own internal credit lending processes. Staff will only be allowed to lend at a certain level if they have been trained to do so.
- New processes and ways of decision making need to be put in place to make sure that lending and credit decisions are made in the right place, at the right time, and by the right people. Again all the banks are already in the process of doing that; and I am pleased to say that I think that the Appeals Process has added positively to that process in having someone else look at how and why decisions are made.
- Agreement is needed on how much and what kind of information is required from a customer in terms of their specific credit application. A number of banks have put information on their web sites about how they make decisions and what they need which is a good start; but that needs also to be a key part of the dialogue between the customer and Relationship Manager.
- Understanding of what a holistic approach to lending means by all in the bank and an understanding that products e.g. commercial mortgages, which could have been sold separately will now be part of a lending package; so the place where the holistic rather than the specific lending decision is made could be different.

Many of the banks had already embarked on this process prior to the Appeals Process starting but the pace and breadth of change has accelerated since last April. The learning I had hoped would come from the Appeals Process is already delivering some positive results, in terms of a better dialogue between bank and SME.

However, while this is very positive, the retraining and change of culture within banks will take time so we should not expect this to be resolved finally for at least a further year and perhaps beyond.

Both bank staff and customers that I have spoken to believe is that this return to 'old fashioned banking' is where we need to be and no one I have spoken to wants to return to the pre 2008 scenario. Pre 2008 we all got ourselves into an unsustainable place in terms of how we ‘did’ credit for SMEs and individuals so where we are now is where we need to be and we just need to progress to getting that right. It is harder for all to get credit than before but that is perhaps just returning to where it was pre the immediate pre crisis years.

Customer Awareness

Lending between a bank and a customer is like any other transaction in business in that it takes two for it to happen (a bank wanting to provide credit and a customer needing it). It has never been the case that this equation has always been perfect and customers have always complained about banks who will not lend to them. This has gone on for decades, if not centuries, and while it may have gained more press headlines since 2008 than it once did, we will never reach a position where every customer is happy with a lending decision from a bank.

However, since 2008, as is stated many times above, the world of lending and credit (not just in banks but in all other types of supply of finance to business) has changed materially. As is also stated, this requires a different relationship between the customer and lender, and also more or better information on which decisions will be made.

Evidence, from talking to a number of businesses across the UK, suggests some businesses have realised that both the economic and credit environment have changed. However, some are finding that a difficult challenge, either from the point of view that their business is in a difficult financial position or they have never operated in a cautious credit market.

Even if none of the above economic conditions had changed, banks now have to operate in a different regulated environment. The FSA and others do not allow them anymore to do things the way they did pre 2008.

Given all that, there is evidence some businesses do need retraining in how to approach banks and other credit providers, and also what information they will need.

While the banks, as they have, can set out on their web sites and elsewhere what they require from businesses requiring credit some businesses will need help to become finance ready.

Whether the intermediary community or Government provides that help is for debate but the help will need to come from somewhere to assist them in being ready. It will also vary across the UK depending on the way that each of the devolved administrations and the various devolved intermediary bodies need to handle it so there may not be a one size fits all answer to this issue.

Pricing also remains an issue; and businesses that were used to having everything done through overdraft and pricing based on base rate need to realign. I was taught in business many years ago that there are two forms of capital for business, one for day to day working capital, and another for growing the business and they are different, could come from different sources, and are priced differently with the latter tending to be more expensive than the former. Base rate was never a good bench mark to judge what you are charged as a business for credit as different banks find their money to lend from different places and at different costs. Requirements for banks to hold much more liquidity and capital to make sure the crisis cannot happen again, has increased the costs for the banks from that alone, if nothing else.

However what can be stated for all – those that need help and those who do not – is that engaging with your bank as early as possible is key. The phrase ‘It’s good to talk’ has been much vaunted in many circles; but in this area it is key so both banks and businesses need to engage in on-going and positive discussion about what the future will bring and who and how banks and other lenders may be able to help, or not if that is the case. If a positive dialogue is not encouraged and increased then much of the change needed will not happen

Issues around Credit Scoring

As can be seen from Table 13, issues around credit scoring account for 40% of declines and the majority of overturns come from that category.

Credit scoring can be used by any bank in any circumstance should it want to do so; but primarily it is used in the areas of small lending and low turnover companies. While it varies probably in businesses turning over less than £250K.

I need to be clear on what I mean by credit scoring in this section so as not to confuse or mislead how banks and other lenders use credit scoring.

Lenders use credit scoring to help them make lending decisions using data that over time they have assessed to give indications of whether an individual or a business is a suitable case to lend. Each of the lenders will have their own processes and algorithms which they use, and which are reviewed from time to time, again depending on the lenders own internal processes. Lenders over time have conducted their own research on whether those processes and algorithms provide them with better lending decisions in terms of default and, in general, their research will confirm that the overall process does.

However some the components of the data used in that process will come from the lenders own records and some it will source from elsewhere, and specifically from Credit Rating Agencies who provide a service to all lenders, and indeed others.

It is the latter part of that process i.e. the data that is sourced by lenders from an external source (Credit Rating Agencies) that we believe that we need to examine and understand more.

Also, there are two types of credit scoring provided externally, one that covers the business, and one that refers to individuals within that business which relies mainly on their personal credit score and rating. It is the latter we believe that may be part of the reason for the majority of credit score related declines, so therefore requires further investigation.

Personal credit scoring also plays an enhanced role on new start up business and also those looking to switch from one bank to the other. Where the bank has no previous history on the business, the applicant's own personal track record as a person is a key part of what drives much of the decision.

None of the banks run purely automated systems in terms of deciding credit and there is always a human being involved in some form. However the degree to which that human being can influence the initial decision varies greatly across and within banks so the credit score does count for a lot.

Also where a human being within a bank does, at the appeals stage, look behind the personal credit scoring information and perhaps ask for more information then the decision has changed in many of the cases we have seen and the red light becomes green.

Our understanding is that Personal Credit scores are made up of many things including

- Information on individuals which are factual – age, where they live, prosecutions against them etc.
- How they operate parts of their life – do they pay their bills on time, do they seek credit a lot etc.
- Outcomes of what the information in the above two bullets mean in terms of characteristics, makes you credit worthy or not.

Some of those outcomes are factual but some are interpretations of behaviour that the Credit Rating Agencies, and others, interpret as 'bad' or 'good'.

From having spent now a lot of time looking into this, there are a number of issues that become apparent namely:

a) Do individuals and businesses really understand what goes into their personal credit score and if not should they?
b) Do individuals and businesses really understand that by doing certain things, or even not doing certain things, they can affect their credit score?
c) In some cases there appears to be no quantum of default so a mild or isolated default is treated the same as a large or persistent one.
d) How the scores are assessed, especially in terms of behavioural aspects and whether they fit with changing economic or social environments. Again specifically to personal credit scores.
e) From some basic testing we have done not all the data used appears to be accurate and does not appear to be updated quickly when found to be inaccurate.

f) The credit rating agencies believe that merging personal and business data can cause issues.

As always when you start to investigate any particular issue, I have come across many people in many walks and levels of all parts of life who have been caught innocently by personal credit scoring and suffered the negative impact it had on them in one way or another.

Therefore I believe:

i) We need to examine how personal credit scoring data is used in bank credit decisions to see that it is effective.
ii) Credit Rating Agencies and others need to be much more transparent on how they let people know what they do can affect their score. While some companies are good in letting you know this, not all are and, with the part that the internet plays in all our lives, it is easier than ever to breach a rule without knowing it.
iii) We need to re-examine some of the behavioural aspects used in the score to see if they are now relevant in this new economic world we find ourselves.

To me this is one of the key things I need to focus on over the coming year as, if we could make credit scoring better, logic would dictate, from the evidence to date, that we may reduce the number of declines. My role is to facilitate this discussion amongst a variety of organisations that will need to take place to resolve these issues. Without that happening then nothing may change and I will not have fulfilled the educational task I set myself and the process at the outset.

Given also that we know, from other research, that micro businesses especially use personal credit cards, which do not fall into the Appeals Process in any form, to fund their business then the situation described above may be compounded elsewhere.

I am pleased to say that from the initial discussions I have had, all parties involved appear to be willing to do so. We are all at least pointing in the same direction.

<u>Communications</u>

a) Of the Appeals Process to customers

   Earlier in my annual report I highlighted that I am still not convinced that all businesses know about the Appeals Process, and this has now been substantiated by research in the most recent SME Finance Monitor. Most, but not all of the banks, have only made customers aware of the Appeals Process when they have been declined for credit and I do think that there needs to be wider communication to all businesses that there is an Appeals Process in place that is working and overturns are being made.

Also many businesses do not get further than the first paragraph of the decline letter so may never get to the part of the letter that highlights that they can appeal, let alone what the reasons for the decline were and what possible other avenues of finance may be available. Indeed, again from the most recent SME Finance Monitor, results substantiate this view in that only a third said they had received a written response which we know is not the case, and 20% said they had been given no reason at all which again highlights the fact that SMEs do not read all that they receive.

There is an odd fact in anything we as human beings do that, if we know there is a safety net, then we might take more risk. The Appeals Process is a safety net of sorts and I do think more knowledge of it would encourage more businesses to apply for credit in the first place.

Therefore I will continue to work with the banks and others to see how we can get the message out to more customers.

b) Communicating decisions on lending within the banks

The other issue around communications is that, with more people now involved in general with credit decisions within all the banks, the ability to pass the blame or just not understand the reason between one part of the bank and another becomes greater.

The option now to blame the credit committee or the computer (neither of which really exist in the way they are thought to within banks) has become greater and since we also highlight the need for retraining of Relationship Managers and other bank personnel then this could compound that for a while.

Banks, in general, are large corporates where, because of their size, individuals involved in a single decision for a business may not work in the same geographic space, work under different rules, and may not even know each other as individuals.

Therefore banks need to work harder on ensuring the decisions they make are better understood by their own staff first and then make the decision clearer and more understood with their customer. In simple terms all involved in the decision process need to take ownership for the outcome and express that in the same way to the customer. While the decline letter can help in that process, as is stated above, we know that not all customers read those in full so the conversation between the Relationship Manager and the customer is critical. This needs to be done in a way that fulfils all the commitments that the banks have made to customers on this issue. If we do that, then we will also help the dialogue which needs to take place between customers and lenders.

Demand

Much has been written over the last year about whether there is a demand issue around lending. Much of that comment in my opinion has been uninformed, or badly, informed, or relied on specific anecdotes which can always prove anything if you can find a suitable one to match your case.

The fact is that demand for lending has dropped and that is due to changing economic conditions and the shock of the crisis changing many businesses' view on the extent and the size of what they wish to borrow.

There has been criticism about banks not wanting to take risk. This also applies to businesses in many cases. Many businesses have paid off, or greatly reduced their borrowings, and now have strong balance sheets but are wary, like the banks, in weakening them at the moment with new borrowing.

There has been a lot of comment from businesses who cannot get credit. There is real evidence that the banks are working with customers who have non - lendable balance sheets to put them back into a position where they can apply for lending. As that in general will be about reshaping the current debt they have, then that will take time – another year or two yet – to get them back to being credit worthy.

The new economic environment will also not support some of the highly leveraged models that existed before 2008.

Demand is therefore a real issue and we all have to remember that banks can only make the money they need to make their businesses profitable if they do lend so they have as much need to lend as businesses may have to borrow; but it is getting that balance right that is the key.

From what I have seen the banks are open for business but it is a different type of business than that which was done pre 2008. This is good, as that took us to a place to which we never wish to return.

The need for other forms of finance

Aligned to the Appeals Process, and as part of the decline process, banks are to try and help SMEs looking for credit, which the bank cannot provide, to other possible sources. This mainly applies to overdraft, loan etc. and not to credit cards. Indeed the most recent SME Finance Monitor does highlight positively that 19% of those initially declined for credit were referred to other sources of finance. While some may think this number is low, given the varying routes that SMEs can apply for credit, and the different types of credit as well I do think this is a positive result overall to date.

While it is not part of my remit to oversee this, I think it is useful to say that the whole debate around credit for SMEs and who should be funding them has encouraged a debate that we need to have.

Banks have been seen by many as the basic source of funding for business which is not the case elsewhere in the world. In the US banks are unlikely to be involved, for example, in funding start-ups until they reach a state when they are up and running and need working capital. Indeed one eminent and successful entrepreneur stated last year that he did not believe that banks should be involved in seed funding for start-ups at all as it was too risky and therefore not what banks should be doing.

Whether that goes too far or overstates the case is in itself debatable, but it is interesting from the Appeals Process data that it is start-ups that find most difficulty in getting funding from banks which would tend to support the case in the paragraph above.

What I have seen though as part of the Appeals Process are good initiatives by banks to help their customers find funding elsewhere. It still needs to be enhanced and expanded but there are now examples where banks working with other funders can find solutions for businesses that avoids bank finance. Whether it is using existing regional funds left over from the Regional Development Agencies and others in England or working with for example the Prince's Trust and others there are examples that the banks are taking this part of what they have promised to do as seriously as they are the Appeals Process.

Again, though, businesses need to be educated about these different forms and types of capital; and they may have inbuilt views about them that in many cases may not be correct so need to understand each correctly.

While banks are part of that education process they need others to be part of it as well. Again Government, Trade Associations, and the intermediary community have a large part to play in this as well and need to demonstrate they are playing their role.

While I have separated the issues I believe needed comment and action the change cannot come from one of them alone and all the above need to be tackled in a cohesive way where appropriate to bring change. This means that others, not just the banks, need to play their part as well.

Neither banks nor businesses can resolve on their own the situation we find ourselves in and the issues that brings. We all need to realise this. Banks have been easy to blame, as bits of them were a cause of the crisis that led to all of this, but we all now need to work together to make the changes which will put us back in a place where we have a system that works for us all, albeit different from the one that went before.

7. The Future

It is obvious from all the above that we have all learned a great deal from the first year of the Appeals Process. As we move into the second year we need to use that knowledge and focus on the stable processes we now have in place across all the banks. We need to ask what more we can do as a result of the information that will be gathered, with the aim of both reducing the number of declines that banks make and also reducing the need for businesses then to appeal the process for specific issues.

What is also clear is that through the Appeals Process we are building up one of the most robust evidence bases on which to examine both SME lending and the way it is handled.

Therefore for next year my focus is going to be on five things

1. Find ways to get the message out to more SMEs that there is an Appeals Process and also that it is worth appealing.

2. Make sure that the banks continue to operate an effective appeals system by continued auditing at a level which gives me the assurance I need.

3. Make sure that the things the banks and others said they would do and would build into their appeals and other processes from year 1 are completed. To ensure that we will put in place with each organisation involved a plan which sets out details and a timescale for delivery of each change.

4. Make sure we maintain and enhance the data source we have on the appeals. This will allow us to gain even greater understanding of the reasons and causes of decline.

5. Reveal any other issues that we have not discovered this year that will need to be resolved to get lending to the sensible place we all wish it to be.

That means that I will continue to spend time with banks at all levels and especially with Relationship Managers and customers to see how the interaction between them and SMEs continues to develop positively. I will also work as a facilitator between SMEs, banks, Government and others to try and address the issues that come from the Appeals Process which we believe can and need to be changed.

In terms of whether I think that the number of appeals and overturns will increase or go down I am not sure. Some of the things that the banks will do as a result of the work in year one will positively reduce the number of declines and appeals but, if we get the message out to more SMEs, then the number will increase through that.

Annexe A

Bank commitments

The Taskforce banks have committed to 17 actions across three broad areas. To improve customer relationships we will:

1. **Support a network of business mentors** by working with the business groups to deliver this free service to small businesses across the UK
2. **Improve service levels to micro enterprises** (businesses with fewer than 10 employees and turnover or a balance sheet under €2m) by setting out in a new Lending Code the levels of service banks will provide and outlining additional sources of help and advice
3. **Publish lending principles** which clearly set out the minimum standards medium-sized and larger businesses can expect when asking banks for loans and other services
4. **Establish transparent Appeals Processes** for when loan applications are declined, with processes independently monitored by a senior Independent Reviewer, who will publish the results of their review, to ensure each bank has a fair and equitable Appeals Process
5. **Initiate a pre re-financing dialogue 12 months' ahead of any term loan coming to an end**, which will include a timely review of business and re-financing needs and an assessment of what needs to be in place ahead of loan expiry to maximize the prospect of successful re-financing.

To ensure better access to finance we will:

6. **Establish and invest in a new £1.5 billion Business Growth Fund** (built over a number of years) to fill a crucial gap in the market and provide capital for viable businesses which want to invest and grow
7. **Support the Enterprise Finance Guarantee Scheme**, seeking continued Government backing through to 2012, and accommodating any changes made by Government
8. **Help mid-sized businesses access syndicated debt markets** by raising customer awareness, training customer-facing staff and engaging more actively with business groups and customers
9. **Improve access to trade finance** through targeted SME awareness-raising campaigns and exploring possible regulatory adjustments with the FSA. Seek to open with Government access to trade finance products for businesses that qualify for the Enterprise Finance Guarantee Scheme
10. **Signpost alternative sources of finance**, giving customers helpful information and advice if a loan is declined and raising awareness about the financial solutions they should consider
11. **Help improve the supply of credit to the wider economy**, working with the authorities to ensure that wholesale markets can support the necessary lending capacity as the economy recovers.

To provide better information and promote understanding we will:

12. **Fund and publish a regular independent survey**, commencing in early 2011, to a methodology agreed with Government and business groups, so there is an agreed and authoritative set of data on business finance demand and lending supply

13. **Enhance the cross-industry lending dataset** by broadening the statistics on lending available for wider bands of business activity; on lending to deprived areas; and on national and regional data on the provision of bank support to business start-ups

14. **Hold regional outreach events** throughout 2011 with business groups to enable business customers and business groups to meet with key staff from the banks to answer questions and explain what services are available

15. **Improve customer information** including a review of literature and other materials, so customers can more easily understand what products will best meet their needs

16. **Host a dedicated website** through the BBA to draw together and link useful sources of information to help customers access the most appropriate information. This will also connect mentoring networks

17. **Establish a Business Finance Round Table** where senior representatives from the banks and business groups meet regularly to discuss and review trends, identify emerging areas of concern, ensure problems are addressed and facilitate the implementation of the Taskforce initiatives.

Annexe B

Monitoring & Appeals Process

Principles & Definitions

Background

In July 2010, HMT and SIS published a Green Paper- 'Financing a private sector recovery' which asked for proposals on how the UK can improve the banking sector environment to ensure businesses (in particular SMEs) are supported as the economy moves out of the recession.

The CEOs of "the Task Force banks" and the BBA took up the initiative, issuing a Business Finance
Task Force report on 13th October 2010.

As part of the range of initiatives, the Task Force has agreed to institute an Appeals Process for business customers. The process is to be created within a standard industry framework appropriate to each
Bank's structure and strategy. The objective of the initiative is to provide a credible Appeals Process that allows a Business customer to dispute a bank's actions if they believe them to be in breach of the Lending Code or Lending Principles. This can include having a finance application reviewed.

The Appeals Process is a voluntary code with external oversight rather than formal regulation – i.e. the role is not that of a formal statutory regulator.

The Process is to be implemented by the end of O1 2011. It will also be embedded in a revised Lending
Code and Lending Principles which are to be issued at the same time.

The Principles of the Appeals Process

At a high level, the Process will be:

- Transparent (i.e. promoted, communicated individually and disclosed as part of an annual report on total outcomes)
  - Available to all business customers with a Group Turnover below £25m
  - Carried out fairly and promptly
  - Subject to an external review of the process- i.e. the External Reviewer
  - All lending products to businesses are in scope

Customers will get the result of an appeal with an explanation of the findings, in writing.

The 5 UK Retail Banks of the Task Force- LBG, Barclays, HSBC, RBS and Santander- will be involved in the Appeals Process initially and it is likely that other Banks will then take up the Process over time. These standards will be published by the BBA through the BBA website, media briefings, etc. as part of the overall communications approach of the Task Force as well as by individual Banks.

The Appeals Process is to be launched at the end of O1 2011 and will be linked to the launch of Recommendation 2: Better Service Standards for Micro Enterprises and Recommendation 3: Lending Principles for Larger Businesses.

The Coverage of the Appeals Process

- **Customers in Scope:** Most banks operate separate support and recovery departments to provide intensive management support to help businesses who are struggling to avoid failure and to prevent recourse to the legal recovery process. These are structured in different ways at each bank and on that basis we propose that the Appeals Process is out of scope for businesses that are managed within a 'special support' or 'recoveries' unit.

  Any customer where the formal recovery process has commenced; i.e. formal demand for repayment has been made, will be out of scope for appeals because they will be ineligible for further lending and so the lending Appeals Process will not be value adding.. When things don't work out as planned, it can quickly result in the need to appoint administrators or, in extreme cases, liquidators. Speed is often of the essence here to protect the creditors and the employees of the company.

  Applications declined due to breach of regulations/Government/AML factors/Sanctions will not be a part of the Appeals process.

- **Products in Scope:** All lending products to businesses.

The Definitions of the Appeals Process

1) External Review

A review team independent of Banks and the BBA Task Force has been formed to meet the Principle of the Process being "Subject to review by a senior industry independent authority." The main elements are:

a) "Lead" Reviewer

The Lead Reviewer will ensure an annual review of the Appeals Process is undertaken. On production of the annual Review report (see below) the Lead Reviewer will act as the public face of the Review team in discussions with Trade and Government bodies supported by the Operational Review team and the BBA. The role will focus on the factual outcome of the report. It will not engage in discussion or speculation on any other aspect of banking services.

b) "Operational" Reviewer

The Operational Review team will undertake an annual review of the Appeals Process **within** each Bank to ensure Appeals are considered in line with that Bank's Appeals Process as defined in the Principles & Definitions of the Appeals Process and meet the designated Quality and Service standards. There will also be consideration of the Appeals Process **across** Banks to ensure consistency of approach.

c) The Annual Review

A detailed onsite operational review will be undertaken annually. (In the first year, there will be a half- yearly review to ensure that the Process is "bedded down" in each Bank. On completion of this initial review, Banks will take the lessons learned from the Operational and Lead Reviewers from the first 6 months and refine their Process as appropriate).

The review will assess the overall effectiveness of each Bank's Appeals Process by reviewing the handling of individual Appeals against their defined Process using a sample of Appeals cases. The Reviewer will also consider Management Information provided by the Bank and, should they wish, speak to individual customers. The Review will also evaluate the Appeals Process across Banks to ensure consistency of approach.

d) Annual Report

The Operational Reviewer will produce a report of their findings to be agreed with individual Banks, the BBA and the Lead Reviewer. The Lead Reviewer will present the Report findings to Trade and Government bodies with support from the Operational Reviewer and the BBA.

2) Communication of a Declinature to the Customer and Appeals Trigger

An application is "in scope" when all relevant information enabling a decision to be reached has been expressly provided and the Bank is satisfied that the application is complete in order to progress to credit scoring.

The Appeals Process is only for declined applications: where a Bank has made an offer but the customer outcome with the relevant relationship centre and if still not satisfied, the customer will be directed to the Banks' internal complaints process

Applications declined due to breach of regulations/Government/AML factors/Sanctions will not be a part of the Appeals process.

When a Bank declines an Application, they will communicate with the customer setting down:

- Reasons for declinature;
- Signposts to alternative sources of finance;
- That the customer has a right to appeal; and
- What the Appeals Process is.

3) How the Appeals Process will Operate:

If the customer takes up the right to Appeal, the following process will ensue:

a) Where **Automated Application Processing** involved and the Bank's lending criteria are not met, the process will operate as follows:
   i) The Bank will sense check the Application and also review to see whether any additional
   Information could be provided by the customer;
   ii) Where appropriate the Bank will work with the customer to achieve a favourable outcome.

b) Where **Manual Application Decisions** are made and the Bank's lending criteria are not met, the process will operate as follows:
   i) The bank will review the decision – including obtaining any additional information from the customer- using a "Four Eyes" principle;
   ii) The principle of a customer being able to appeal will similarly apply even where the original application has been declined by a credit panel consisting of a number of expert lenders;
   iii) **"Four Eyes" criteria:**
      (1) The original decision will be reviewed by another person (i.e.; original decision maker+ additional person = "4 Eyes")
      (2) That person will be internal to the Bank

(3) That person will NOT have been involved in the original decision
(4) That person will be an experienced lender.

4) Appeals Timescales

The Customer is required to appeal to the Bank within 30 calendar days of receiving the decline from the Bank. If the appeal is beyond this timeline, the Bank will treat the appeal as a new Application.

The Bank is required to respond to the customer within 30 calendar days of receiving the appeal from the customer.

Annexe C

Minimum Standards

I. Completeness
1.1 Available to all business customers with a Group Turnover below £25m
1.2 Applicable to all business lending products
1.3 Businesses in support and recovery are ineligible to Appeal
1.4 Businesses in breach of regulations/Government/ AML factors/sanctions are ineligible to Appeal
1.5 Applicable to all formal complete credit applications
1.6 Only for declined applications where no offer has been made
1.7 Scheme launched on April 5, 2011
II. Transparent
2.1 Reasons for application decline to be communicated with customer
2.2 Signposting declined customers to alternative sources of finance
2.3 Eligible customers to be informed of Appeals process
2.4 Appeals decisions to be communicated in writing with an explanation of findings
III. Fair
3.1 Automated applications to be sense checked
3.2 Automated applications to be reviewed in case additional information is required
3.3 Manual applications to be reviewed using "four eyes" principle. Reviewer will not be involved in the original decision
3.4 Reviewer will be an experienced lender
IV. Prompt
4.1 Customer required to Appeal within 30 calendar days of original application being declined
4.2 Bank required to deliver Appeal decision within 30 calendar days of receiving Appeal
V. Consistent
5.1 Basic MI to be provided including: Number of applications received Number of Applications Declined Number of Appeals Received Number of Appeals Overturned (in favour of the customer) Number of Appeals where Decline is Upheld
5.2 Relationship Managers to receive training to ensure awareness of Lending Principles and the Appeals Process

Annexe D

Appeals Case Review Form

Promontory Ref		**Review Date**	
Bank Name		**Site/Location**	
Reviewed By		**Secondary Reviewer**	

Bank Staff Member Assisting Reviewer

1. CASE SNAPSHOT			
Bank Appeal Reference Number			
Company Name			
Business Type/Description			
Business Location			
Customer Type	☐ Existing	☐ New Customer	☐ Start-Up
Business Start Date			
Date Bank Account Opened			
Group Turnover			
Facility Requested	☐ New Facility	☐ Review Existing	☐ Increase Existing
Amount Requested			
Lending Product			
Purpose of Loan			
Details of any Existing Facilities			
Business in Support/Recovery? [1]			

2. APPEAL SNAPSHOT				
Access Channel	☐ Branch	☐ RM	☐ Online	☐ Phone
Type of Application [2]	☐ Formal Application		☐ Declined at Source	
Date Application Submitted	D D M M Y Y	Evidenced:		
Date Decline Letter Sent	D D M M Y Y	Evidenced:		
Date of Customer Appeal [3]	D D M M Y Y	Evidenced:		
Date Appeal Receipt Sent	D D M M Y Y	Evidenced:		
Date Appeal Outcome Letter Sent[4]	D D M M Y Y	Evidenced:		

. ORIGINAL DECLINE DETAIL			
Was customer declined all lending in this application? [5]	☐ Yes	☐ No	
How was customer informed of original decline?	☐ Verbally	☐ Letter	☐ Email
- By whom?			
Bank's reason(s) for declining the lending application			
Was customer given reasons for decline? [6]	☐ Yes	☐ No	
Do the reasons align with the reasons documented in the case file notes?			
Was the customer referred to the appeals process? [7]	☐ Yes	☐ No	
Was the customer informed of…	☐ 30 days for customer to appeal	☐ 30 days for appeal decision	
Was the customer signposted to alternative financing? [8]	☐ Yes	☐ No	
Other comments on the original decline detail (decline letter, signposting etc.)			

4. CUSTOMER APPEAL			
Method of customer appeal	☐ Verbally	☐ Letter	☐ Email/Online
Reason(s) for appeal			

5. BANK REVIEW OF APPEAL		
Who conducted the review?		
Is this person an experienced lender? [9]	☐ Yes	☐ No
Was this person involved in the original lending decision? [10]	☐ Yes	☐ No
Overview of review methodology[11]		
Was any additional information requested? [12]		

Customer Documents Evidenced:

- ☐ Personal Financial Statement
- ☐ Management/Audited Accounts
- ☐ Cash Flow Forecast
- ☐ Business Plan
- ☐ Business Profile
- ☐ Other Documents – i.e. Bank Statements

Appeal Outcome	☐ Original Decline Upheld	☐ Original Decline Overturned	
- Rationale			
How was the customer informed of the appeal outcome? [13]	☐ Verbally	☐ Letter	☐ Email
- By whom?			

Does the written communication include the reasoning behind the appeal outcome? [14]	☐ Yes	☐ No
- (If Decline Upheld), Do the reasons align with the reasons documented in the case file notes?		
Other comments on the bank review of appeal		

6. PROMONTORY OBSERVATIONS

Minimum Standards

1. Out of scope if formal recovery process has commenced
2. Enquiries that do not progress to credit scoring are out of scope
3. Customer required to appeal within 30 calendar days of receiving decline
4. Bank required to respond within 30 calendar days of receiving appeal
5. Appeals Process only for declined applications. Customer dissatisfaction with terms and conditions are directed to complaints process
6. Bank will communicate reasons for application declinature (any method is acceptable)
7. Bank will inform of customer's right to appeal and what the Appeals Process is
8. Following a declined application the Bank will signpost to alternative sources of finance
9. The appeal reviewer will be an experienced lender
10. The appeal will be reviewed by a person not involved in the original decision
11. Automated decisions will be sense checked and manual decisions reviewed using Four Eyes
12. All reviews should check whether any additional information could be provided by customer
13. Customers will get the result of an appeal in writing
14. Customers will be given an explanation of the findings of the appeal in writing

Annexe E

Promontory Site Visit Requirements for Appeals Files

Requirements

- Prior to the visit, we need to have a reasonable idea of the numbers of completed and in-scope appeals to be reviewed, and the number overturned by the appeals process. This is important for resource management purposes at Promontory, and reduces the need for repeat visits to the same site. Your help in communicating likely volumes for a visit is appreciated.
- For each visit, we need the files to be complete and in date order. Clearly labelled and organised files help us review files quickly and enable us to confirm compliance without undue additional work. Banks should also make sure, apart from the specifics listed below, that they include all other relevant documentation relating to the transaction.
- For individual files, the following information should be included where available:
    - Original application, including documentation that enabled the case to be decided, such as financial statements, account history, business plan, cash flow forecast, credit score outcome, accounts, etc. A summary containing the key data from these may be sufficient
    - Details (inc dates/amounts where relevant) of the customer, location, new business, new to bank, length of relationship, existence of other facilities, turnover/size of business
    - Clear details of what product(s) is being asked for and for how much. Details of existing facilities and terms where topping-up, and a clear purpose of what the credit is being asked for.
    - Details of any internal "4 eyes" process prior to the original decision being given to the customer including notes and dates
    - Names of original decision-maker, including those involved in any "4 eyes" process
    - Details of any referral to "Credit" and any views given by them, also to include dates
    - Copy of the decline letter and any notes of conversations with the customer as part of that process (it is known that more clarity around reasons is often provided in this way)
    - Appeal letter/email/note of call from customer including details of any reason for appeal including "don't agree/not fair"
    - Acknowledgement letter when sent and where part of the process
    - Details of any information submitted with the appeal
    - Name of person who dealt with the appeal
    - Details of the appeal reviewer's assessment/conclusions of the case, including whether any further information was sought from the customer and, if not, reasons why.
    - Details of information given to branch/local RM by the appeal reviewer where appeal outcomes are conveyed locally
    - Appeal outcome letter sent to customer
    - Details of any other conversations with the customer relating to the appeal outcome
    - Where Minimum Standards documentation is missing or the process was not adhered to, there should be an explanation of why it is not available and what is being done to ensure that it will be in future

Annexe F

Promontory Site Visit Feedback

Site:	TFB Name
Date:	xx xxx 2012
Attending:	xxx
	xxx

Appeals Reported To Date				Files Reviewed			
	To Dec 2011	Jan 2012	Total		Previous Visits	This Visit	Total
Appeals Received	xxx	xxx	xxx	In Scope Files Reviewed	xxx	xxx	xxx
Overturns	xxx	xxx	xxx	Overturns	xxx	xxx	xxx
				Out of Scope	xxx	xxx	xxx

Positive Themes

-
-

Observations / Next Steps / Matters for Consideration

-
-

Annexe G

Case Studies

Case Study No.1

The initial application

An existing Sole Proprietor in the retail sector, who had been the Bank's customer for four years, asked for an increase to an existing overdraft facility of £15k to help finance expansion. There were also existing EFG loans. The Bank declined the request, as it was concerned that the borrower could not afford to take on an extra loan. The request also fell outside the Bank's policy guidelines at that time for lending to the retail sector. The customer subsequently submitted a second request, for a reduced overdraft increase, which was declined by the Bank Relationship Manager (RM) without being submitted to the Bank's Credit Department.

The Appeal

On Appeal, the decision was overturned as the Bank established that its affordability criteria for the lower lending request could be met, in part because it was discovered that the Proprietor had a secondary income. The Company was also ahead on the capital repayment instalments for one of the existing EFG loans. By this time, the Bank had also increased its willingness to take further risk in the retail sector.

The lesson

The case highlights the importance of a bank frontline staff understanding the right questions to ask in assessing affordability and ability to repay, as in many cases SMEs may have capability to repay which are not shown in their business accounts but can come from elsewhere. However also SMEs need to ensure that in applications all pertinent information is known to the bank so they can make a decision based on all the information, and not just part.

Case Study No.2

The initial application

A potential customer, with business activities in the retail sector, who wished to switch from one bank to another requested an EFG loan (£600k) from the new bank. This money was to refinance existing facilities and to fund additional stock purchases. The request was declined because the Bank was concerned that the customer could not afford to take on the additional debt, coupled with the fact that the financial information provided by the customer raised questions over its ability to repay.

The Appeal

On Appeal, direct discussion between the Reviewer and the customer established that the latter had in fact applied for the same lending facility with at least two other banks. The only reason the customer had made the approaches was because its existing bankers could not provide EFG loans.

The Bank’s original decision to decline the application was upheld by the Appeal Review. The additional information did not alleviate the Bank’s concern that the company’s business plan assumed a very rapid rise in sales in what was a niche market and therefore would be difficult to achieve. The Bank also considered that the customer had underestimated the additional working capital it would need if the additional sales were in fact achieved. The other banks had taken a similar view when declining to lend.

The lesson

Banks now will demand more information to substantiate business plans especially if rapid growth is forecast. Pre 2008 the risks in an environment where everything was perceived to be growing are different now in an economic climate where everyone is cautious and the economic indicators are not encouraging. Also the bank will challenge business owners and managers more on their plans to test that they have the capability and capacity to achieve them. This will be especially true in a customer looking to switch banks where they may have had an existing long term relationship. Also for those switching banks the examination of the business owner as a person will also be more rigorous.

Case Study No.3

The initial application

A new Limited Company in the beauty industry requested a small overdraft facility of £1k for working capital purposes. The request was declined due to: a ‘low credit score as the Limited Company was newly established. In addition there was a lack of positive indications (such as the proprietor’s seeming ability to repay other debts, such as mortgage or credit cards); and the directors’ names not being found on the Voters’ Roll.

The Appeal

On Appeal, the Relationship Manager in the Bank who was responsible for this client made clear to the Review that this was not in fact a new business but an existing customer of four years who was changing from a sole trader to a Limited Company. The sole proprietor’s business bank accounts had been well run, with no excesses or unpaid items. The Bank made a further check, to resolve the outstanding “Know Your Customer” issues caused by the “missing” Voter’s Roll data.

The Appeal Review reversed the original decision to decline as a result of that information.

The lesson

The case highlights the importance of a bank checking the full information through the scorecard process and not just accepting the red light as a stop which it does with some lenders. There are challenges for lenders in doing this given the large portfolio sizes of Relationship Managers working at the small lending end of the market. However it would allow more judgements to be made in this process which could be helpful. This case also highlights failings in lenders own systems of not being able to track customer movements from one type of business structure to another to make sure that all information is kept together. In some cases, this will require system improvements at banks and, potentially, better linking of data at the credit reference agencies as well.

Case Study No.4

The initial application

An existing Limited Company customer of six years, in the Accommodation and Food Services sector, requested an increase of from £5k to £10k to a working capital overdraft facility. The need for the extra money request was that the customer was now buying stock from a firm that would not give it credit rather than from a supplier that did. The request was declined by the Bank due to 'personal adverse credit information' about the main director.

The Appeal

On Appeal, the main director was asked to provide a copy of his personal Experian/Equifax credit report and, also, up to date company financial data. These checks established that the adverse personal data related to a relation registered at the same address and having the same forename, and the applicant had in fact a good credit record.

The Appeal Review overturned the Bank's original decision to decline.

The lesson

The case highlights the importance of the risk that if credit reference agency data is incorrect or incorrectly linked it can adversely affect an innocent person and business. There should perhaps be some standards for Credit Reference Agencies in terms of checking and changing data as this information does influence much that we do as individuals and businesses.

Case Study No.5

The initial application

An existing Limited Company customer of eight years, in the retail sector, requested a working capital overdraft facility of £28k.to help finance business expansion. The request was declined by the Bank, which was concerned that the borrower could not service the debt, something which seemed to be confirmed by the audited financial statements.

The Appeal

On Appeal, a further discussion with the customer ascertained that the company's business pattern had changed. The business no longer traded with a key customer and business turnover for the prior year, as reported in the accounts, had fallen considerably. However, the firm had in part mitigated this by obtaining a new and major customer who would more than double sales turnover. The customer provided details of his business and financial projections, plus evidence of a signed new sales contract.

The Appeal Review overturned the original decision to decline, but supported a smaller offer £20k, rather than £28k for an overdraft facility, which the customer found acceptable.

The lesson

The case highlights the importance of a continued and open dialogue between the customer and its bank as the bank was not aware of the changing circumstances of this business so assessed it only on the financial information – which tends to be historic – it had rather than on a full explanation of the changes within the business and the positive, rather than negative impact this would have. Keeping your bank informed ahead of changes whatever they are is always the best way to handle situations so on-going dialogue is key to keeping a positive relationship going between the two. This case also highlights that a good compromise can be reached often between bank and SME in terms of how much credit is required. While SMEs may ask for what they think would be a 'safe' amount for them that might not fit with the bank's own risk appetite but if there is good dialogue as there was in the end on this case then a good working compromise can be reached which satisfies both bank and SME.

Case Study No.6

The initial application

An existing sole proprietor customer of two years, in Real Estate, requested a combination of a short term loan and working capital overdraft facility totalling £900k to start new building projects. The lending request was declined due to lack of the customer's experience in "new build" projects and because of the Bank's limited risk appetite for further exposure in this sector.

The Appeal

On Appeal, although the customer had existing loan facilities with the Bank, the Reviewer concluded that the reasons cited for the decline were valid in that the customer did not have experience in managing new 'build projects' and Bank's appetite for this segment of the market was limited to the larger house building companies. The original decision to decline was upheld.

The lesson

The case highlights the need for a customer to enter into early dialogue with its bank if it wishes to seek finance for a new activity; an existing track record of repayments may not be sufficient if the business risk profile changes as it did in this case.

Case Study No.7

The initial application

A business ‘Start Up’ partnership that was acquiring a business in the education sector from an existing bank customer asked the Bank for a term loan of £174k**.** The Bank declined the request, due to its concerns that the customer could not afford to both service the debt, make drawings from the business in order to meet personal financial obligations, and also because it appeared that the customer was not venturing any of its own money.

The Appeal

On Appeal, the customer was asked to provide additional supporting information, including the financial statements for the existing business activities. It was established that the partner who would be directly involved in the day to day business activities was not reliant on drawings from the business and, indeed, that there would be an overall reduction in staff costs from the acquisition. Furthermore, the customer was now able to find additional resources of its own, reducing the size of the lending requested.

The Appeal was overturned in the customer’s favour, with the Bank offering a slightly smaller amount of £140k, an amount that would meet the customer’s revised needs.

The lesson

The case highlights once again the need for banks to ask for all the information they need at the outset and for customers to keep banks informed of changes in their circumstances which could impact on both their business and their ability to obtain credit.

Case Study No.8

The initial application

An existing Sole Proprietor customer of four years, with business activities in the retail sector, requested a temporary overdraft facility of £20k (on top of existing term loan facilities of £250k). The overdraft request was to bridge working capital needs and to cover personal drawings from the business during the quiet period of the firm’s year. A similar lending request had been made the previous year and declined by the Bank, which took the view that the customer should have made provision for these needs from operating income during the year.

The Appeal

On Appeal, the Bank confirmed that it had no appetite to lend new monies to this customer given relationship concerns due to a fall in business turnover and increased level of drawings from the business.

The original decision to decline was upheld by the Bank. However, a temporary capital repayment holiday on the existing term loan was offered, to help the customer.

The lesson

This case highlights the fact that a customer should not assume a seasonal overdraft facility will always be provided without full due diligence by the bank. Historically, (pre 2008) the company might have had access to a seasonal overdraft facility for precisely the reasons given in the lending application. However, the world has moved on and such facilities should not be assumed.

Case Study No.9

The initial application

An existing Limited Company customer of two years, with business in the retail sector, requested an EFG loan of £70k to finance expansion. This was a top up to an existing EFG loan £50k. The Bank declined the new request, due to its concerns regarding the customer's ability to afford the additional servicing costs and to repay the loan on maturity.

The Appeal

On Appeal, a full review of the company's financial data and available market research contained within the business highlighted that, while turnover had doubled, the company's cash needs had increased threefold. This proved to be the result of a move to larger business premises.

The Appeal Review upheld the original decision to decline the request.

The lesson

This case highlights the importance of both bank and customer fully understanding the business and the impact that changes in business patterns have on available cash-flow prior to credit application as in this case the Relationship Manager could have explained to the customer before the application why it was unlikely to be successful but perhaps also offer the customer alternatives or actions that they could take to help an application in future.

Case Study No.10

The initial application

An existing sole proprietor customer of two years, with business activities in the retail sector, requested a £5k loan as a top up a £6k loan granted previously to assist planned business expansion. The Bank declined the request because of concerns about the customer's ability to afford to take on additional debt and because the Bank felt that the customer should be using the funds which had been advanced for this purpose some 12 months previously.

The Appeal

On Appeal, it became clear the original loan of £6k taken out 12 months previously had been intended for a business opportunity that had in fact fallen through. The customer had sought to repay the loan but, at the suggestion of its Bank Relationship Manager, had instead placed the funds on deposit in case another suitable business opportunity arose. The new lending request was to top up the previous loan and this had been clearly explained in the application. Additional information provided by the customer at the Appeal stage showed that the customer was not intending to draw funds from the business until it had become established and also that he had a secondary income to meet his personal living costs.

The Appeal Review overturned the original decision to decline.

The lesson

The case highlights the importance of the Relationship Manager making others within the bank aware of what the full story is and not leaving it for others to surmise what that might be. Sometimes banks own internal systems do not allow sufficient information to be passed on so when we are now in a position where banks want to correctly make more holistic decisions around a SMEs lending decision then their internal systems should allow that to happen easily.

Case Study No. 11

The initial application

An existing Limited Company customer in the business services sector, and who had been this Bank's customer for ten years, asked for an increase of £30k to an existing overdraft of £50k to help finance a rapid expansion in the business. . The Bank declined the request, as it was concerned that the borrower could not afford to service the increase in the overdraft facility. The Bank noted that turnover for the prior year had reduced and that the company already had a payment arrangement in place with HMRC[2].

[2] HMRC, Her Majesty's Revenue & Customs.

The Appeal

On Appeal, a further discussion with the customer ascertained that recent events in the area had led to a significant increase in business and that the customer's need for additional working capital facilities was due to a lag in public sector payments that the firm could be sure to receive in due course. Evidence of the level of outstanding receivables was provided to the Appeal Reviewer.

The Appeal Review decided in favour of the customer but with a reduced offer of £20k for six months with which both parties were happy.

The lesson

The case highlights the value of the customer providing early information on all the factors behind its credit request and of the bank establishing the full background to the request.

Case Study No. 12

The initial application

An existing Sole Proprietor customer of twelve years, in Agriculture, was acquiring another business and asked for an increase of £60k to its existing £25k seasonal overdraft facility. The money was needed to meet an immediate demand, on completion of the deal, for debts to HMRC. The request was declined because banks will not generally provide facilities to fund tax payments outside normal day-to- day business working capital requirements. In addition, the bank had concerns that the customer would not be able to service the increase in facilities.

The Appeal

On Appeal, discussion between the Appeal Reviewer, the Relationship Manager and the customer established that some of the monies which would be paid to HMRC would be reclaimed, with payment expected within two months. The customer had already received funding by way of term loan facilities from another institution but this institution was unable to provide the additional short term funding now requested.

Further discussion with the customer indicated that he would accept a reduced amount and the Appeal Review was decided in favour of the customer, with a reduced offer of £30k for three months which both parties found acceptable.

The lesson

The case again highlights the importance of establishing the full facts behind the lending request and the expected source of repayment. A bank lender is unlikely to fund payments to HMRC that do not arise out of normal day to day working capital requirements, especially in the case of payment arrears. It also once again highlights that if all that information is in place then a satisfactory compromise may be found that satisfies both parties.