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Dear Sir

During the debate on 27 June 2019, regarding the *Report on the Financial Conduct Authority's further investigative steps in relation to RBS GRG*, you stated that you believe that commercial lending for SMEs should be regulated, and asked why mortgage lending is regulated, while charges taken on homes as part of a commercial lending arrangement are not.

The Government is committed to regulating only where there is a clear case for doing so, to avoid putting additional costs on lenders that could ultimately lead to higher costs for businesses. Loans of less than £25,000 to the smallest businesses (sole traders, partnerships consisting of 2 or 3 partners and unincorporated businesses) are already treated as regulated consumer credit agreements for the purposes of the Financial Services and Markets Act 2000 (FSMA). This protects consumers where there is the potential for detriment in their dealings with banks and alternative finance providers, even when operating in a business capacity. In terms of numbers, approximately two thirds of the 5.7 million UK SMEs are sole traders, partnerships consisting of 2 or 3 partners and unincorporated businesses.

Were SME lending to be brought into the scope of regulation, there would be a number of direct and indirect costs associated with such a move. Direct costs would include annual FCA fees, product reviews and increased compliance and monitoring costs; while indirect costs would include stifled product innovation, narrower product choice for SMEs, and higher barriers to entry leading to reduced competition in the SME lending market. These changes could in turn impact on the price and availability of credit for small businesses, which is not a desirable outcome.

This does not, however, mean that SMEs should not have the ability to access appropriate mechanisms to resolve a dispute with their lender, should such a need arise. For that reason, the Government welcomed the recent expansion of eligibility to take a complaint to the Financial Ombudsman Service (FOS) to 'small businesses' with a turnover of less than £6.5m, and either fewer than 50 employees or a balance sheet of less than £5m. As 'micro-enterprises' already had the ability to take a complaint to the FOS, this expansion gives an additional 210,00 SMEs access to the FOS, meaning that as of 1 April 2019 well over 99% of businesses now have access to fast, free and fair dispute resolution via the FOS.

The Government also welcomes the banking industry's proposal to establish a voluntary Dispute Resolution Service to address both complaints from businesses with a turnover of between £6.5m and £10m, and unresolved historic complaints from SMEs who would now be eligible to take their complaint to the FOS. Work is well underway to deliver this new body, and the Government looks forward to its implementation.

Furthermore, the Government believes that the financial services industry has changed significantly since the very challenging period following the financial crisis. For example – and as I mentioned during the debate – all the major SME lenders have signed up to the Standards of Lending Practice ('the Standards'), which contain clear guidance on best practice. As industry standards and codes of conduct are considered by the FOS, the Standards are part of how the FOS can determine what is 'fair and reasonable' when adjudicating. And with the introduction of the Senior Managers and Certification Regime, the FCA now can take enforcement action against individuals – including holding them to account for the way they treat their SME customers, even where such activity is unregulated.

Given these factors, and as I stated during the debate, the Government therefore does not believe that there is a clear case for bringing SME lending into regulation.

This also extends to the question you raised regarding the difference in regulatory treatment between mortgages and charges taken on residential property as security for commercial loans – a form of 'personal guarantee' secured against the guarantor's home. Were such guarantees to be subject to the same regulatory treatment as mortgage lending, this would essentially lead to the regulation of much SME lending via the back door. Given the likely impact that this would have on the price and availability of credit for SMEs, the Government does not believe that this would be a desirable course of action.

However, such guarantors of commercial loans are not without any protection. Alongside the expansion of eligibility for the FOS to small businesses, as of 1 April 2019 personal guarantors of loans to a business that they are involved in are now also able to take a complaint to the FOS – regardless of whether the loan is regulated or unregulated. While previously guarantors of business loans were only eligible if they were not directly involved in the business – for example, where a person provided a personal guarantee for their spouse's business – this recent change ensures that all guarantors of commercial loans can take a complaint to the FOS if they require.

I trust that this letter provides a further explanation of the Government's position as I outlined it during the debate and answers the questions that you raised.

I will also place a copy of this letter in the House library.

A handwritten signature in black ink, appearing to read 'Lord Young of Cookham', with a large, stylized initial 'L' to the left.

**LORD YOUNG OF COOKHAM**