Rebuilding trust and confidence: **the role of voluntary standards**

We do not have to look very far to realise the importance of small businesses and the contribution they make to the UK economy. Accounting for 60% of all private sector employment at the start of 2017, the benefits associated with small business are well established, epitomised by productivity, innovation and growth in spite of the economic uncertainties surrounding the UK. There is no doubt, as we take the first tentative steps towards Brexit and a post-Brexit world that we need small businesses to succeed in order for the UK economy to thrive, and that they should be given the opportunity to prosper and grow, safe in the knowledge that they will be treated fairly and transparently by their lenders - equal treatment and mutual respect are key. At the same time research from bodies such as the British Business Bank confirms that lenders are willing to lend but borrowers are reticent about borrowing, largely driven by a lack of trust in the banking industry. As we know in all walks of life, trust is hard won but easily lost and, once lost, is incredibly difficult to rebuild.

It was against this backdrop that the Lending Standards Board (LSB) set about designing the Standards of Lending Practice for business customers (the Standards). The LSB, a self-regulatory body that drafts and independently oversees voluntary standards, primarily but not exclusively in the consumer credit sector, had previously monitored adherence to the Lending Code, which covered businesses up to micro-enterprise level (up to €2m and <10 employees). The Standards, however, represent a major step forward for the industry and the commitments they make to small business customers, extending the breadth of protections from the micro enterprise limit to businesses with a turnover of up to £6.5 million. They mark a significant shift away from the prescriptive rules of the Lending Code, focusing on customer outcomes and high level principles, and, by creating a set of bespoke Standards to cover business lending, they set out much more clearly the expectations on the lender and the protections offered to the borrower.

Mirroring the business customer journey, the Standards set out clear expectations on firms, which are underpinned by a robust set of commitments to ensure the fair treatment of customers at every step of the journey. Crucially, the Standards provide a clear focus for lenders on how they should treat their customers, enabling borrowers to understand what protections they have to create a level playing field irrespective of their level of borrowing or the decision to incorporate. We also wanted to learn from past mistakes. With that in mind we have introduced individual standards covering areas such as transparency of product sale terms and conditions, the treatment of customers whose businesses have hit financial difficulty and debt sale. In saying this, we recognise that the Standards can never be a panacea for the past; they do, however, represent a move to a framework which aspires to higher standards of conduct, with a focus on good customer outcomes. When it comes to supporting businesses in times of need, we only need to look to recent events to highlight the catastrophic impact that a liquidation of a large company can have on other businesses. To this end, we have set expectations on firms to ensure that all business customers are supported by measures designed to identify signs of financial stress, and pro-actively engaging with the customer to agree an appropriate solution.

So why move away from prescriptive rules, which are far easier to monitor and provide a clear process for firms to follow? When we reflected on what we were trying to achieve with self-regulation, we wanted to ensure that the markets work well for small businesses, that lenders could stimulate growth and that the end consumer receives a fair deal from a trusted source; we felt it important that firms could compete and innovate. By following an outcomes focused approach, the Standards encourage flexibility to account for the differences in lender business models.

Bridging the trust gap for lenders is a significant hurdle and self-regulation offers real advantages over statutory rules in helping to build that trust and enable the customer to benefit from this. The Standards are about the industry taking ownership of the conduct agenda by setting higher standards, and voluntarily holding themselves to account. At the same time, self-regulation at a principles level ensures that unintended consequences caused by a ‘one size fits all’ set of rules can be avoided, while the nature of self-regulation and the network that the LSB has can ensure that the Standards are agile – i.e. they can be developed quickly and respond to emerging risks, thus enhancing consumer protection.

Self-regulation is fine but how do we know if it is working in practice? We would agree that self-regulation, which is not independently monitored and enforced, falls short, and that the success of the Standards hinges on evidence that they are being followed. Following the launch of the Standards in March 2017, firms initially have worked to identify and remediate gaps against the Standards - this was the first step in the process, which was completed last summer. This exercise identified those areas where firms were already meeting the Standards and those where further work was necessary. Over half of the Standards went live from 1st October 2017 and by the end of 2017 the vast majority became effective; the few remaining Standards will go live from 1st June 2018. We have been very encouraged by lenders’ response to implementation as clear evidence of their commitment to setting higher standards of conduct.

The LSB will introduce a programme of oversight work combining risk assessments at firms to evidence that the Standards are embedded, supported by thematic review work, focusing on those areas where there is the highest impact on customer outcomes. Whilst this will follow a risk based and informed approach, key areas such as transparency at point of sale, and the way in which businesses are treated when they get into a turnaround situation will remain at the top of our agenda. Where firms do not meet the Standards, we will agree remedial action to address any issues identified. Where firms fall significantly below what is required, we will hold those firms to account, which could result in public censure.

But our work does not end there – in recognition of the evolving nature of the Standards, our research and development work will focus on areas of emerging risk, using this to identify and develop key insights, through extensive engagement with our stakeholders and registered firms. One such area, is vulnerability, and the impact this can have on a small business, in particular where the vulnerability relates to a key decision maker in that business, and where other employees are or may be affected. We have recently embarked on a joint research project with the Money Advice Trust, which runs Business Debtline, offering debt advice to small business owners whose businesses have run into difficulty, to explore the issue in more detail; this will undoubtedly continue to be an important topic as the thinking around it evolves. Due for publication in the spring, we hope that the research will shed light on this area and encourage debate and action to ensure businesses are offered the support when they most need it.

So where do we go from here? The Standards represent a landmark event and a key milestone in what will be an evolving project. With Brexit around the corner, and the growth in alternative lending products, it is essential that the Standards continue to offer the right level of protection, consistently, beyond core debt products to reflect the growing diversity in a business’ ongoing financing needs. Work will continue throughout 2018 on extending the product scope, beginning with asset finance as we seek to enhance protections and increase our market coverage. Whilst this process will inevitably take time, we believe that this will ensure that a business receives the protection of the Standards irrespective of the product they choose to finance their business with, or the lender they decide to approach. On this latter point, we are actively encouraging lenders who are not registered with us to join those that have already made their commitment.

We see a collective will from our registered firms and other stakeholders to ensure small businesses receive a consistent level of protection, and that the fair treatment of businesses is integral to the way in which lenders conduct themselves. We are also fully supportive of the Treasury’s inquiry into SME finance, and believe that the Standards have a definitive role to play in the protection of small business customers.

We are excited with what has been developed so far, and that in spite of the challenges that the future landscape might hold, the Standards will continue to mark a significant step in the right direction, and help to rebuild trust, which will be good news for lenders, but more importantly for small businesses and the economy.

For more details on the Standards and how to become a registered firm, visit our website at lendingstandardsboard.org.uk.

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