Banking Taskforce

Appeals Process

Independent External Reviewer

Quarterly Report

October - December 2013

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1. Introduction

This is the second of my quarterly reports and covers the period from 1st October until the end of December 2013. While I believe that moving to these shorter quarterly reports as well as my full annual report is the right thing to do, it is likely that it will be changes in process rather than the numbers themselves that will be highlighted in them.

In this quarter's report, the impact of Christmas where there are effectively only 2½ months of data, highlights differences in numbers and also historic trends show that businesses desire to borrow is not high at this time of the year.

However, in terms of process and other changes there has been a lot of movement and it is that primarily I will focus on, and specifically in terms of:

a) Those who were declined but did not appeal.
b) The benefits of customers knowing as much as possible about why they were declined.
c) The ways and channels through which lending operates.
d) Raising the awareness of the Appeals Process amongst SMEs.

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Independent External Reviewer
SME Banking Appeals Process

2. Comments on Numbers

Year 3 of the Appeals Process has been a year of consolidation and further learning for all those involved in the process including myself. As I state in the introduction this quarter really only encompasses 2½ months at best as the quiet period before Christmas appears to stretch further generally each year.

However, I would expect that by the end of January we will have passed the 8,000 mark in terms of number of appeals and by the time of my annual report be well passed the £40 million in terms of lending that the Appeals Process has provided for SMEs. Also we are beginning to see now more appeals in the high value lending space as well as the small which is good as it shows that the process is being viewed positively across all types and size of lending.

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

Appeals - April 2011 to December 2013	Year One Apr 11-Mar 12	Year Two Apr 12-Mar 13	Year Three Apr 13-Dec 13	Total
Total No. of Appeals Received (ALL BANKS)	2177	3311	2386	7874
Total No. of Appeals Overturned (ALL BANKS)	860	1298	793	2951
Overturn rate *(based on Appeals Received - ALL BANKS)*	39.5%	39.2%	33.2%	37.5%
Total Value of Appeals Overturned = £ *millions*	£10.0	£18.5	£10.3	£38.8
Total No. of Appeals Received (Excluding Credit Cards)	1587	2146	1970	5703
Total No. of Appeals Overturned (Excluding Credit Cards)	518	634	593	1745
Overturn rate *(based on Appeals Received - Excluding Credit Cards)*	32.6%	29.5%	30.1%	30.6%
Total Value of Appeals Overturned (Excl. Credit Cards) - £ *millions*	£9.7	£17.7	£9.9	£37.3
Total No. of Cases Reviewed	946	1777	1329	4052
Total No. of Cases Reviewed/Total No. of Appeals (as %)	43.5%	53.7%	55.7%	51.5%
Total No. of Overturn Cases Reviewed/Total No. of Overturn Cases (as %)	49.5%	62.9%	73.9%	61.9%

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

Chart 1 above though does show some positive movement in some of the key numbers that I focus on changing, namely:

i) A fall in both the overall and without credit card overturn rates which shows that some of the process changes that we have been working on with individual banks are starting to work.

ii) The number of cases myself and my team of auditors are sampling is also continuing to increase which allows us to grow our understanding of how and why decisions are made.

Appeals numbers themselves have not really increased which is why I am pleased about the campaign the banks have launched which I will discuss later in this report. However, on the other hand I am pleased to see a continuing fall in credit cards and other specific banks where we felt that declines, appeals and then overturns were generally too high and we have seen a reduction in all through process changes we have worked on with them. This does not mean that in the future these numbers could not increase as more banks become active in this growing sector but shows the positive impact that the Appeals Process is having.

Chart 2: Total Appeals - 3 Month Rolling Average

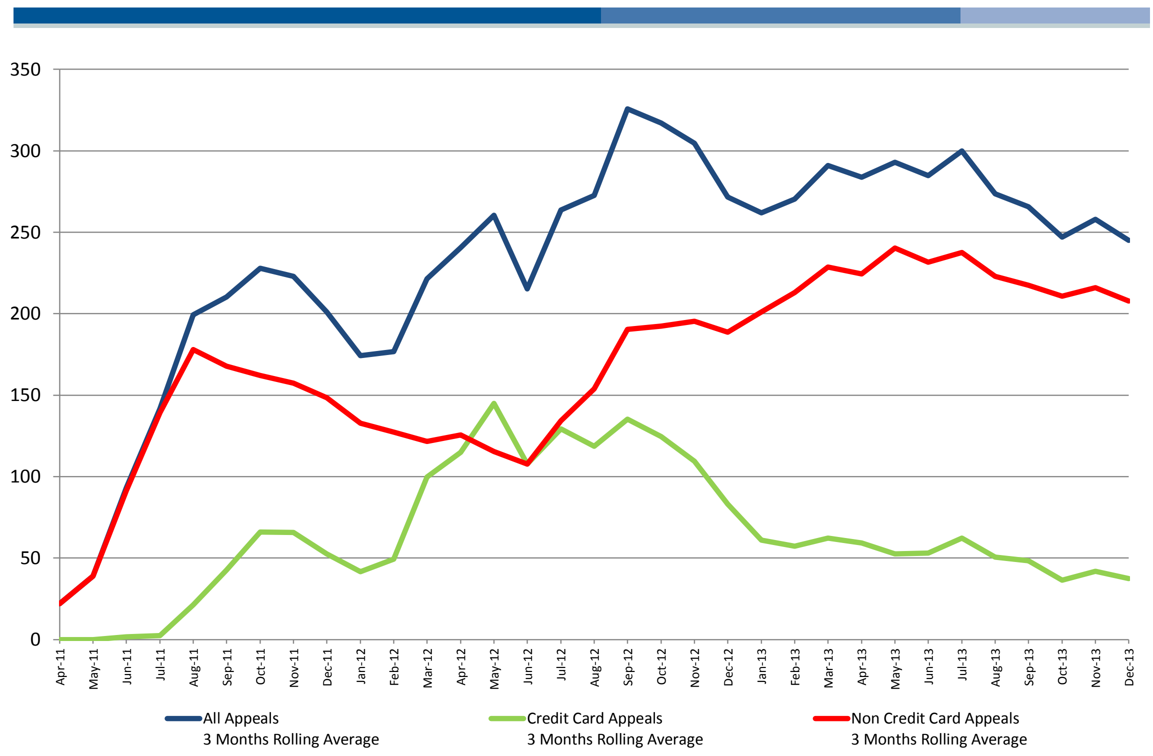


Chart 2 above illustrates the continuing positive decline in credit card appeals as more decisions are referred before final decisions are made.

Chart 3: Overturned % - 3 Month Rolling Average

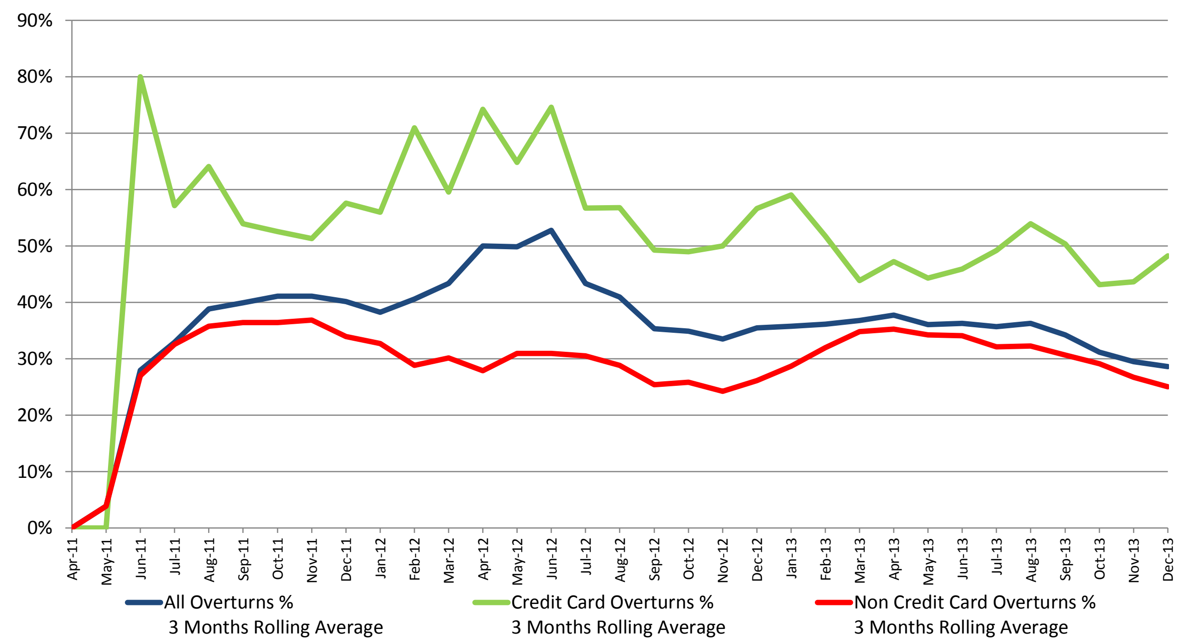
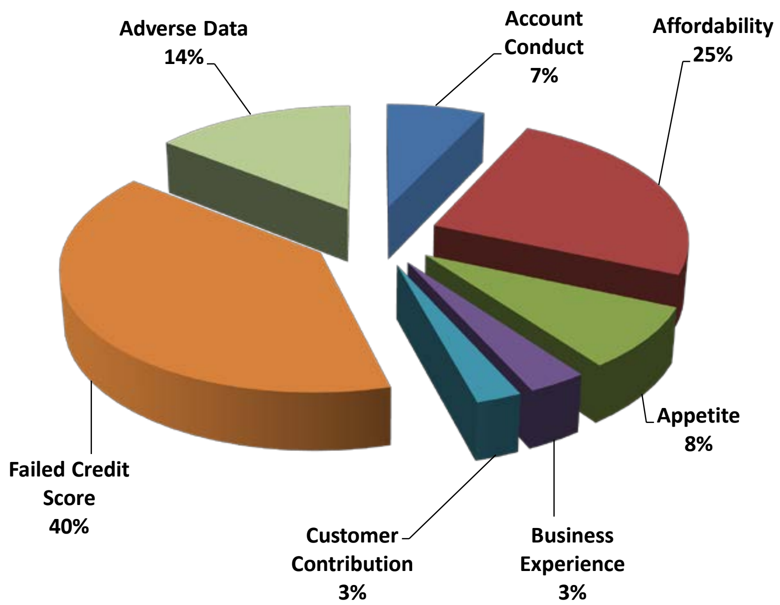


Chart 3 illustrates the other positive move in overturn rates which again highlights how the positive changes in process are having impact.

It is not just the process changes that are having a beneficial effect, from my own standpoint one of the key moments of recent months was at a series of meetings that I and one of the banks arranged for the Minister for Enterprise, Energy and Tourism for the Scottish Government who had expressed a key interest in the Appeals Process and how it was really working. The meeting not only included my own audit team and that of this specific bank but also a selection of Relationship Managers from across their business at all levels of lending. He asked them if the Appeals Process was really making an impact and the answer that was forthcoming was clear and positive.

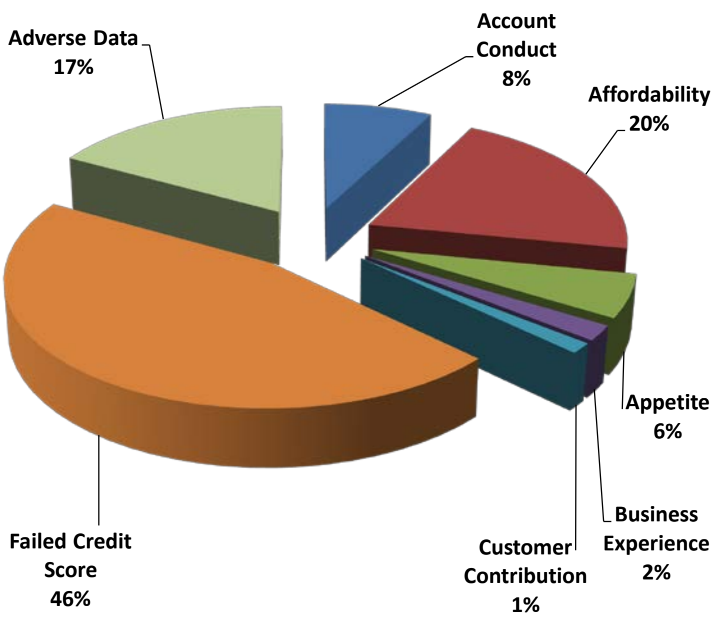
What they said in essence was that the whole process of the Appeals Process from making it clearer to customers why they were declined in the first place, through an Appeal being made and examined, elsewhere in the bank, through to the final conversation with the customer on the final outcome (whichever way it went) had really improved and enhanced the conversation and relationship they were having with customers and importantly allowing them to lend more. They were not concerned if customers appealed and do not see an overturned decision as something that would count against them, but that it was proving to be, what I had hoped it would, an education process between the bank and the customer which allowed them to have a better and more fulfilling conversation. This was not just in that specific request for lending perhaps being overturned but also in letting the customer know why they had been declined and how they could come back later with a stronger proposal so the bank might lend in the months or years ahead. They had already seen specific examples of that.

Chart 4: Decline Reasons all Banks for all Lending Year 3 only



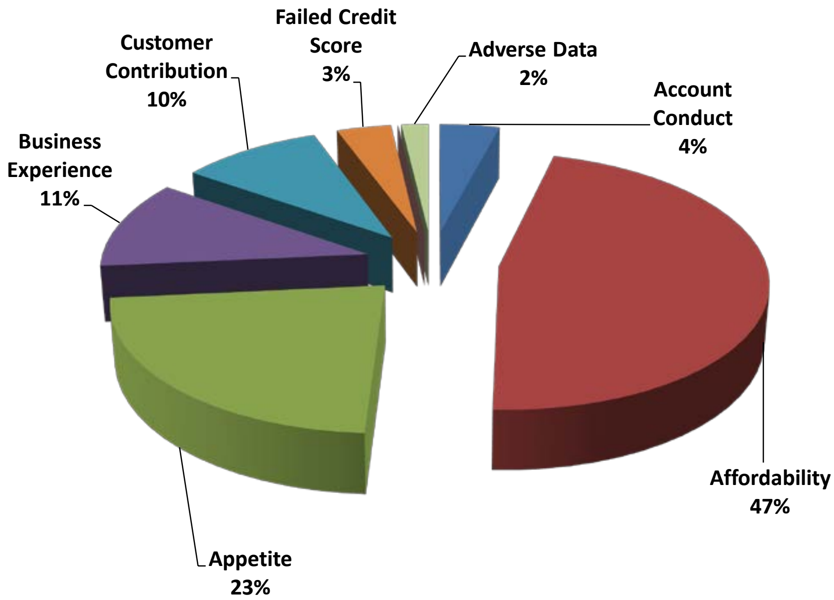
There have only been small movements in the reasons for decline in this quarter, none of which are significant from a statistical point of view. However, again as I gather more data as we accumulate more appeals we can look deeper at specific decline reasons. I mentioned in my last quarterly report that we could now split credit scoring data into two parts, namely adverse data and other credit scoring. What I see as adverse data are things like CCJs, full debt defaults, struck off from being a Director, IVAs, etc. which are issues which will make borrowing difficult, if not impossible in certain circumstances. However, there is no consistent and agreed definition of what individual banks classify as adverse data so there are differences across the banks. Given now that in the decline letters and reasons which go to customers we are beginning to see credit scoring and adverse data specified differently, it is confusing to the customer if one bank's definition of adverse data is different from another as it could mean that while one bank declines, another may not, even though this category usually defines a general difficulty in lending. This is why I plan to work with the banks through the BBA to come up with a more consistent approach. It should also be said that while adverse data usually does make lending problematic it is not always the case and it is good to see how some banks drill down further into what the causes of these might be and again in conversation with the customer come to a better understanding of the reasons which in some cases may allow the bank to lend. However, these tend to be the exception rather than the rule in cases where adverse data is a significant amount. I would not disagree with this as all the longitudinal studies on lending show that this category is a challenge to lend to and not result in subsequent default.

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



There again are no material changes in Chart 5 above and Chart 6 below that warrant any specific comment this quarter, that have not already been made elsewhere in this report.

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



3. Action Plans

I continue to meet quarterly with each of the banks in the Appeals Process and have nothing too specific to report at this time as all the banks are progressing well with the Action Plans we set them at the beginning of the year. We do add things to these plans throughout the year as issues arise which we have done this quarter and will progress those in line with the timescales we set for each. I will report more fully on the Action Plans in my Annual Report.

4. Continuing or New Issues

From all the above it is clear that the Appeals Process is working and having a positive impact in many ways. I am pleased with this progress, but it also highlights why it is important that everyone, both among bank staff and bank customers, needs to have an understanding of the Appeals Process.

This has been a key quarter in tackling that in two ways, namely:

i) Ensuring that those customers who are declined and who could have appealed but chose not to for whatever reason.
ii) Ensuring that those customers and staff within banks who should know about the Appeals Process know and are aware of it.

In terms of i) I stated in my previous review that I would work with each of the banks to look at whether those who had been declined but who had not appealed were what we expected in terms of their ability to appeal and whether they would be successful or not.

We have discussed this matter with all of the banks concerned and have now reviewed the outputs from 3 of those banks. With each of these banks, having looked at a significant sample of those who have been declined but did not appeal, I am pleased to report that for each, the number who I think would have had a reason to appeal is under 5% of the total and in some cases as low as 2%. Given that there will, and have always been, requests for lending to banks that were not agreed but might have been, I think these numbers are within what would be expected from any system and at any time. We are about to conduct a similar review with one of the other two banks and will report on that subsequently. The other bank is in the middle of a major process change which was instigated as a result of the Appeals Process therefore it would be fruitless to sample at this time. I will check all the banks again in 6 months to see if the numbers remain the same to ensure that the samples taken at this time are not skewed in any way. However, from the evidence so far, I can now say that I do not think that there are a great number of people who did not appeal who could have and who might have been successful.

In terms of getting more SMEs aware of the Appeals Process so that they might apply for funding in the first place and also ensuring that those with the banks are aware and fully participating in the process:

A. The major banks have launched a new public awareness campaign to encourage businesses to explore and pursue their options when it comes to obtaining finance and to also significantly raise awareness of the appeals process.
   This 12 month campaign which has both central funding through the BBA, as well as individual banks undertaking their own marketing activity, aims to ensure SMEs have greater confidence to approach lenders for business

finance on the basis that they are a lot more likely to get the credit than they think as per the independent research under the SME Finance Monitor. Online advertising, social media and the re-launch of the Better Business Finance website – an invaluable resource for businesses looking to apply for finance – have been employed to spread the message that banks are open and money is available to viable businesses. Crucially, a core element of the new campaign is heavily focused on making sure businesses know about the Independent Appeals Process.

Initiatives like this show that the banks are working hard to make sure businesses know they have the right to appeal if their application is rejected. Entrepreneurs and SMEs should approach their bank knowing that they have the right to appeal any lending decision. I will be closely monitoring this awareness raising campaign to measure its impact and help ensure its effectiveness. This will include having regular discussions with the government and business groups on it.

B. I will examine with each of the banks how their internal communications and systems continue to improve awareness of the Appeals Process.

The Chancellor in his Autumn Statement asked that I monitor the outcome of this campaign and I am in the process of working with the banks so that outcome metrics can be put in place for the individual banks. Given that this campaign will run for some months I will report on progress in my Annual Report.

In my last quarterly report I also raised the issue of whether customers fully understand why their applications are declined, particularly those where credit scoring plays a large part in that outcome. Having examined it further it is clear to me now that the reasons behind a decline caused by a failed credit score are not always relayed to the customer which is concerning given that one of the reasons behind the Appeals Process was to establish more transparency between the bank and its customers. As I have said in previous reports, personal credit scoring is often a key influencer in the finance decision. In many cases, particularly for start-ups who may only require small amounts of credit, it is the individual rather than the business that is judged first.

Each bank operates both the way they gather the information for, calculate, and operate their credit scoring systems differently, which includes how they buy scores and data from Credit Reference Agencies. This will vary from the purchase of the raw data which the banks inputs into its own credit scoring model to just buying the score itself. This results, in some cases, to only the actual score and/ or the general existence of adverse data being made available to the Relationship Manager dealing directly with the customer, which means the customer can only be given a ‘declined scoring’ or ‘failed credit score’ answer. The customer is then told that they must approach the relevant Credit Reference Agency to get the details of their credit report and then bring that back to the bank so that they can review it with them.

I believe that telling the customer to go and get their own credit score so they can determine why they have failed does not fit with the way the Appeals Process was set up and I do believe will put some SMEs off from appealing. I also believe that the Relationship Manager not knowing what the reasons are is equally at odds with the Appeals Process which is to encourage and better conversation between customer and bank.

Therefore, where the Relationship Manager does not know what the reason is, or where that reason is not relayed properly by the bank concerned, it is important that they look to change their systems so that the customer gets the real reason for the decline from them. Where this is an issue with a bank, I will add it to their Action Plan for this year with a plan in place to resolve it timeously and sensibly. It is critical that all banks give their customers as much information as they can when declining and work with them so they understand the reasons why that has an impact on the bank's decision.

Credit scoring though with all its faults has proved that it is a good forecaster for lenders and there is a lot of longitudinal data and research to substantiate that. It is also inevitable given the volume of customers and transactions that the main banks handle. Without it I doubt many more people would be refused lending as at the level of borrowing that it applies it is the most economical way to make good decisions if operated properly. We have only seen one bank who does not really use it at all and that is one which operates only provincially with a small customer base.

Finally, I have seen in the media and elsewhere that there is concern over banks moving some customers from a face to face service to a telephony or internet only service. While I can understand the perception of this from those who do not understand how lending works fully, there is an opposite point of view which needs to be balanced against this. Over the last quarter I have talked to at least two banks who operate a face to face service for all customers and will continue to do so but have had to introduce a telephony or internet offering as they were losing customers without it. There are SMEs who only want to deal with someone by telephone or indeed only operate on-line and the banks have to provide that service to have a full service offering to all their customers. SMEs are probably the most diverse customer base of any in terms of type, size and need so not all want or need a face to face service so what we need to ensure is that there is an offering in all the channels they use rather than be prescriptive about which channels they should use.