

REGULATORY INTELLIGENCE

Give SMEs the regulatory protection they deserve

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It has long caused consternation that commercial lending to small and medium-sized enterprises (SMEs) is unregulated. Small and medium-sized enterprises are the lifeblood of the UK economy, comprising the overwhelming majority of businesses by number. For such enterprises, liquidity is essential.

That is especially so in the post-pandemic economy. As the Confederation of British Industry said when publishing its April 2022 trade survey figures, poor retail sales reflect how rising prices are affecting households' spending power, which means that the cost-of-living crisis is unlikely to abate for some time. This squeeze is already affecting SMEs in retail, services and manufacturing.

The Insolvency Service's announcement that business insolvencies had reached a 60-year high in Q1 2022 was unsurprising. This makes it vital, not only for SMEs but also for the entire economy, that businesses have access to finance. They should also be treated fairly and sensitively when loans are refinanced or if they struggle to make repayments.

Small and medium-sized enterprises can take scant comfort from banks' past conduct, however, as they have borne the brunt of bank misconduct in previous recessions. As the multiple reviews into banking scandals have shown — notably, the investigation into the [Global Restructuring Group](#) and the fraud at [HBoS Reading](#) — that misconduct has been most egregious in recovery units such as RBS' Global Restructuring Group and Lloyds' Business Support Unit. These bank recovery units are the divisions of banks likely to be particularly active in 2022.

The case for regulation is particularly compelling because SMEs will rarely have the practical ability to enforce legal rights against banks. It would be exceptional for an SME to have the financial resource to take a bank to court. Even if an SME is brave enough to do so, they face a judicial environment which, more often than not, favours the bank.

A judge trying a claim arising out of the 2008 financial crisis ruled that a bank executive threatening to have a borrower's "head on a spike", in the context of forcing a sale of the borrower's assets to the bank's own connected company, was merely part of the "rough and tumble" of normal commercial negotiations.

The counterweight to all of this should be the UK's financial services regulator, the Financial Conduct Authority (FCA). As the FCA acknowledged in its latest regulatory [perimeter report](#), however, almost all lending to businesses is unregulated. The FCA also highlighted the unprecedented nature and take-up of the Bounce Back Loan Scheme, and said these loans are now being collected. The regulator's only actual extensions of the perimeter, however, were to funeral plans and crypto-assets.

Meaningful protection

This is tinkering at the edges, leaving SMEs just as vulnerable as before. The authors believe that legislation can and should be passed which requires the FCA to provide meaningful protection to SMEs as the country faces stagflation or recession.

The authors propose new legislation which will enact two changes. First, it will ensure that commercial lending to SMEs — generally and in respect of property — is regulated. That will be achieved by amending the [FSMA \(Regulated Activities\) Order 2001](#) to remove the exemptions for credit agreements exceeding £25,000 and those relating to the purchase of land for non-residential purposes where the borrower is an SME. This will bring a large segment of lending to SMEs within the scope of the FCA's protection.

Secondly, it will enable SMEs to sue lenders for breaches of their regulatory protections by amending the [FSMA \(Rights of Action\) Regulations 2001](#) to enable SMEs, as well as individuals, to bring actions for breach of the FCA and Prudential Regulation Authority rules as "private persons".

Many legal claims by bank customers, for example, in relation to interest rate swap mis-selling, foundered because banks are not currently liable for breaches of the [Financial Services and Markets Act 2000](#). This change will therefore help business help themselves, via court action.

In each case, the EU's definition of SME should be adopted, being a business which employs fewer than 250 persons and has either an annual turnover not exceeding £40 million or an annual balance sheet total not exceeding £36 million.

The authors believe that this legislation will help the entire economy. It will enhance protection and also simplify it, by aligning SME protection with that already enjoyed by individual consumers, as well as with that often promised to business customers by banks' own policies. Meanwhile, avoiding the scandals that have plagued the banking sector since the 2008 financial crisis, and which are still costing banks significant sums in litigation, reviews and compensation, will help every part of the economy.



A bill to this effect, proposed by Lord Sharkey, is entered in the May 2022 House of Lords ballot and will hopefully receive a second reading before or after the summer break, depending on the results of the upcoming draw.

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