

Financial Conduct Authority
By email to: FCASuper-Complaints@fca.org.uk

8 December 2023

Dear Sir/Madam,

Super-complaint on the approach taken by lenders to requiring personal guarantees for business loans

FSB is a designated consumer body for the purposes of s.234C of the Financial Services and Markets Act 2000 (FSMA).

FSB is a non-profit making, grassroots and non-party political business organisation that represents members in every community across the UK. Set up in 1974, we are the authoritative voice on policy issues affecting the UK's 5.5 million small businesses, micro businesses and the self-employed.

Small businesses face several challenges in the current economic environment, not least of which are the cost and availability of credit: our Small Business Index (SBI) report in Q2 2023 found that 30% of small businesses who applied for finance were offered an interest rate of 11% or greater¹. We do not expect the FCA to directly intervene on these fundamental issues, but we do believe there is one aspect of the small business lending market where regulatory intervention is needed to improve the situation for small businesses. This is the growing demand by lenders for personal guarantees on business loans, and in some cases on loans of relatively small amounts.

In summary, we believe this approach by lenders causes, or may cause, the following harms:

- Businesses are put off proceeding with loan applications, thereby forgoing the capital necessary to grow or being forced to seek out more expensive forms of capital. In some cases, individuals may give personal guarantees which they then take out insurance to cover – an unnecessary additional expense in cases where the guarantee relates to a loan which is easily affordable for the borrower
- Businesses may proceed with the loan having given a personal guarantee but then adopt an overly risk-averse approach to running their business to avoid the possibility of the personal guarantee being called upon
- Depending on the approach taken by individual lenders, there may be distortions in the market for small business lending (and in the wider economy) if some sectors are treated less favourably than others in terms of demands for personal guarantees
- In the event that a small loan backed by a personal guarantee is declared in default, individuals and their families may experience significant distress which is disproportionate to the loss or potential loss which the lender faces
- There is at least the potential for lenders to use the presence of the personal guarantee to gain influence over the decision-making processes of distressed businesses to their own advantage

¹ <https://www.fsb.org.uk/resources-page/sbi-q2-2023.html>

We recognise that any regulatory intervention in this market (which to be effective would necessitate expanding the FCA's regulatory perimeter) may have consequences for the cost and availability of credit which the FCA will need to consider carefully before making any decisions.

We set out the nature of our super-complaint in more detail below, in line with the FCA's *Guidance for designated Consumer Bodies on making a Super-Complaint under s234C*.

Details of the market (including details about the nature of the financial product or service concerned) to which the complaint relates

We believe that the relevant market can be defined as 'lending to SMEs by financial institutions', given that other forms of SME finance (e.g. venture capital, peer-to-peer lending) and lending to large corporates do not typically involve personal guarantees of any kind. According to the Bank of England, the size of this market is around £5bn of gross monthly lending (excluding overdrafts), though this increased significantly in the pandemic period to a peak of £25bn in May 2020.²

We recognise that the regulatory perimeter in this area is complicated, as set out in Chapter 14A of the Regulated Activities Order (RAO). The regulated part of this market as we understand it is business loans of less than £25,000 to individuals (including small partnerships) which are not otherwise excluded because, for example, they are Bounce Bank Loans. We would note that borrowers of this type constitute the majority of all SMEs. According to official statistics, of the 5.5m SMEs in the UK, 3.1m (56%) are sole proprietorships and 353,000 (6%) are partnerships³.

It may be that some loans to businesses which are structured as sole traders or partnerships do involve a personal guarantee given by a person who is not running the business, such as a spouse or parent. In this case, the loan and any issues relating to the personal guarantee would be within the regulatory perimeter, as long as the other criteria around size and type of loan (as referred to above) applied.

However, in relation to our super-complaint, we believe that the unregulated part of this market is the most relevant, given that in the context of business lending personal guarantees most often apply to loans taken out by companies which are guaranteed by their directors. We assume that this kind of lending was not included in the regulatory perimeter on the basis that limited companies exist to limit the liability of their directors if the business fails, so the risk of detriment to individuals from corporate lending activity should be low. Unfortunately, we believe that the logic of this argument against the need for regulation is significantly undermined by the use of personal guarantees by lenders on relatively small loans to companies: in doing this, lenders are piercing the corporate veil and discouraging the kind of risk-taking by business owners that the concept of limited liability was originally developed to encourage.

² <https://www.bankofengland.co.uk/statistics/details/further-details-about-monetary-financial-institutions-loans-to-non-financial-businesses-data> The relevant series is RPMZM8B.

³ <https://www.gov.uk/government/statistics/business-population-estimates-2022/business-population-estimates-for-the-uk-and-regions-2022-statistical-release-html#legal-form>

For completeness, where a business loan is secured on an individual's property, then it may be a regulated mortgage contract, where it is not a second charge business loan (as set out in s.61A of the RAO). We note that this is the case where second-charge loan amounts are less than £25,000 (so the same threshold as above). First-charge mortgages taken out by individuals for business purposes are regulated regardless of the amount.

Whether the complaint relates to the market as a whole or only to certain firms or parts of the market and whether any particular class or classes of consumers may be particularly vulnerable to harm

The complaint applies to the market as a whole, though as noted above we think the issue is most egregious when personal guarantees are applied to relatively small loans. We do not have data on loan size by type of lender (nor by individual lender) or borrower: it may be that particular lenders are more likely to lend small amounts and/or that certain kinds of borrower are more likely to borrow small amounts. The approach taken to personal guarantees may also vary between lenders, but we have not been able to obtain any data on this point.

Details of any relevant FCA principles, rules and guidance or other relevant legislation (for instance, EU rules), guidance, or policies that the relevant authorised person may be failing to comply with or that may otherwise be relevant to protecting the interests of consumers

As noted above, the issues set out in this super-complaint will largely fall outside of the FCA's current regulatory perimeter. However, we still believe it is useful to set out how firms might be in breach of FCA requirements if this activity was regulated.

We believe that Principles 6, 8 and 12 are relevant to this issue.

Principle 6 because in requiring a personal guarantee (especially for a small amount) lending firms may not be paying due regard to the interests of their SME customers and treating them fairly. It would not seem fair to require a customer who can afford a loan to provide a personal guarantee.

Principle 8 because there is potential for a conflict of interests where a personal guarantee is in place, in that lenders may seek to put a borrower in default without considering the wider interests and circumstances of the customer or may seek to inappropriately influence the decision-making process of a borrower in distress to the lender's advantage by using the personal guarantee as leverage.

Principle 12 (the consumer duty) because firms may not be acting in good faith in requiring personal guarantees from customers because they have not assessed whether the borrowing is affordable for those customers (see below for more analysis on this point) and may not be acting to avoid foreseeable harm for those customers for the same reason (either because those customers end up defaulting on an unaffordable loan or because they do not obtain an affordable loan because they are put off by the requirement for a personal guarantee).

Unsurprisingly, there do not appear to be any specific rules in the FCA Handbook that relate to personal guarantees on consumer credit. However, we note that there is guidance at CONC 5.2A.29G which sets out how affordability should be assessed for business borrowers: the absence of

any reference to the assessment of any assets that might be called on in the event of default might imply that a requirement for a relatively small loan to be backed by a personal guarantee is inappropriate.

By way of comparison, we note that there are specific rules for business mortgage borrowers set out at MCOB 11.6.25-32R and that these clearly state that affordability is to be assessed based on the income and expenditure of the borrower and a firm 'must not base its assessment of affordability on the equity in the property which is used as security under the *regulated mortgage contract*, or take account of an expected increase in property prices' (MCOB 11.6.26R). The same overall principle would presumably apply to personal guarantees on loans which are not mortgages (if the regulatory perimeter were to include lending to companies), but we would be interested in the FCA's views on this point.

It may be that lenders are not carrying out a meaningful assessment of affordability for business borrowers at all and are instead relying on personal guarantees to reduce their own risk while avoiding the expense of carrying out a proper assessment. We believe this is worthy of further investigation by the FCA, given the detriment that may be caused by such an approach. Clearly, there will be some borrowers who would benefit from this approach in the short term because they would get loans which would otherwise be assessed as unaffordable – in the long term though, such an approach may be to the customer's detriment. For those borrowers who can clearly afford their loans, demanding a personal guarantee can also lead to detriment because some will not proceed with the borrowing because of the possible personal consequences (however unlikely default may be in reality). Alternatively, they may take out an insurance policy which covers some proportion of their personal guarantee (up to 80%), but this would still be an unnecessary cost for businesses in these circumstances. In other cases, they may offer a personal guarantee but then proceed to run their business in a risk-averse way to avoid any possibility of a default, to the detriment of not only the business itself but also (aggregated across a number of businesses) the wider economy.

Any costs incurred or practical difficulties experienced by consumers as a direct result of switching to alternative suppliers

Anecdotally, we have heard that the use of pawnbrokers to finance small businesses has increased recently⁴. This would be in line with experience in previous economic downturns, such as the global financial crisis⁵. In some cases, this will be because businesses cannot obtain credit from their usual lender, either because general credit conditions have tightened⁶ or because lenders do not consider the borrower to be creditworthy in the circumstances. In such cases, turning to higher cost credit providers such as pawnbrokers may not be inappropriate.

However, if businesses are doing this because they cannot obtain credit from mainstream lenders without offering a personal guarantee, and they would rather pawn their personal valuables than

⁴ For example: <https://www.bristolpost.co.uk/whats-on/whats-on-news/bristol-pawnbroker-keeping-businesses-afloat-8161661>

⁵ For example: <https://www.theguardian.com/business/2008/dec/21/small-business-banks-pawnbrokers-recession>

⁶ In our SBI for Q2 2023 the share of respondents expressing negative views on credit availability and affordability increased to 52%, up from 51% in the previous quarter. <https://www.fsb.org.uk/resources-page/sbi-q2-2023.html>

offer that guarantee, then we believe this is possibly causing detriment given the significant difference in the cost of credit between mainstream lenders and pawnbrokers. Again, this is most obviously the case where lenders are requiring a guarantee even from those borrowers whose risk of default is low but who are nevertheless put off borrowing because they do not want to offer that guarantee.

The general level of profitability of firms in the relevant sector for the financial product or service and/or the price and pricing structures of the relevant financial product or service

This is not a complaint about the price of credit, but we note that every quarter we ask small businesses about their experience of obtaining credit through our Small Business Index⁷. Our most recent data found that there was a large jump in the share of successful credit applicants being offered a rate in excess of 11%. 30% of credit applicants were quoted a rate above this value in Q2 of 2023, up from 25% in Q1.

We are not raising the profitability of lenders as businesses or of small business lending as an activity as part of our complaint, so would make no comment on this.

Practices by firms in the relevant sector that may be restricting or distorting competition

We do not have detailed evidence on how a requirement for personal guarantees may vary depending on the sector of the economy the borrower operates in. We recommend that the FCA obtains this information from lenders in carrying out its assessment of our complaint: if there is significant variation then clearly this could have a distortive effect on economic activity.

There is also the possibility of distortion between kinds of business in terms of legal structure, given that personal guarantees are more likely to have an effect on the behaviour of companies than on sole traders and partnerships.

We also note that personal guarantees, when called, can also involve the payment of significant fees to the lender which the guarantor may not have expected, such as legal fees. This has an impact on competition in the sense that the full cost of taking out the loan may not be clear at the point of sale, and if this activity was regulated then full transparency around fees would presumably be a regulatory requirement.

Whether claims relating to the financial product or service, or elements of the financial product or service, are covered by the Ombudsman Service and the FSCS

The Compulsory Jurisdiction of the Ombudsman Service covers business lending in general, so goes wider than FCA-regulated activity. Eligible complainants are restricted by business size: micro-enterprises and small businesses as defined in DISP 2.7. A guarantor is also an eligible complainant, so in principle an individual who provided a guarantee for the borrowing of a company could also make a complaint (provided that company was an eligible complainant itself at the time when the loan was taken out).

⁷ <https://www.fsb.org.uk/resources-page/sbi-q2-2023.html>

We corresponded with the Ombudsman Service on 29 September 2023 to ask if they had seen any increase in complaints about personal guarantees on business loans recently and to ask for their views on this issue in general. They responded that this was something that they have been hearing about increasingly, though complaint volumes relating to guarantees of business lending currently remain very low. In the last financial year, they resolved only 42 cases from complainants who had guaranteed a loan relating to their business. The number of complaints from such complainants has increased year on year, but in part this is because this type of complainant only came into the FOS jurisdiction in April 2019, and the complaint must relate to a guarantee given after this date.

The FSCS does not cover lending activity.

Details of any industry codes of practice or guidance that apply to the good or service

The Lending Standards Board (LSB) has Standards of Lending Practice⁸ for business customers covering lending to businesses of up to £25m in turnover. These standards have been formally recognised by the FCA.

They state the following in relation to guarantees and indemnities:

“If an individual or a business agrees to be a guarantor or to provide an indemnity, the Firm should make the individual/business aware of their obligations under the agreement and that they have the option to seek legal advice, should they wish to do so.”

“Firms should not accept unlimited guarantees from an individual/business unless it is to support a customer’s liabilities under a merchant agreement[2]; however other forms of unlimited third party security may be taken, if available.

[2] A contract between a business and a credit card service provider.”

“Firms should ensure that where an individual provides a guarantee/indemnity or other security, they are able to request information regarding their current level of liability, as long as the customer gives their permission and confidentiality is not breached.”

None of these standards relate specifically to the issue at hand, which is that personal guarantees may be inappropriate in certain circumstances and may lead to harm.

How the relevant feature of the market is or may be causing damage to the interests of the relevant class of consumer, including the impact and extent of the damage or potential damage and an explanation of how this has been assessed or estimated

We have not been able to obtain definitive information on the proportion of SME lending covered by personal guarantees and how this has changed over time. We requested data from UK Finance on this and they responded on 9 October 2023. They said that they are aware that there are concerns

⁸ <https://www.lendingstandardsboard.org.uk/business-customers/>

about an increasing requirement for personal guarantees, although there is no hard evidence for this. They will be collecting survey data using the SME Finance Monitor going forward which will give better insight into personal guarantee usage (but will not provide data on past usage). They note that it is common industry practice to take personal guarantees to secure business borrowing when the business is a limited company with no or limited business assets, although some lenders don't take personal guarantees at all. They also note that lenders providing Covid loan schemes were not allowed to take personal guarantees for loans under £250,000.

There is some information in the public domain from Purbeck, a personal guarantee insurer which publishes regular blogs on its website. We recognise that this information relates to applications for insurance policies rather than directly relating to personal guarantees, and we recognise that Purbeck has a commercial interest. However, we believe that it possibly illustrates that personal guarantees have become more common over the last year or two.

Purbeck's blog of July 21 2023⁹ states that they have recorded a fall in applications for personal guarantee insurance between Q1 and Q2 2023 (the fall was 13%, and is the first such fall in their data series), which they assume reflects a fall in overall lending to small businesses (rather than a decline in the number of personal guarantees requested by lenders). Their data collection goes back to Q1 2021. Importantly, year-on-year they say that applications have increased 55%.

We included the following example of security being requested for a business loan involving a small amount in our *Credit Where Credit's Due*¹⁰ report, published in December 2022:

"I started a business and needed a leg up via external finance at the start, so I sought external finance to grow the business. I approached my bank and the BBB but was told I would need to put my home up as collateral. At the time I was single parent with a disabled child. I've owned my home since 19 and I was not prepared to take that risk for £5,000. This had an impact on my business for nine months and my business was dormant. Since then, I have chosen not to seek external finance but to self-fund through my own earning or community partnerships." - FSB member, Business trainer, Northampton

We believe that the FCA is easily able to obtain the necessary data from lenders to assess the scale of the problem, in a way that no other party (including FSB) can. We note that FCA guidance states that 'it is not necessary for a super-complaint to demonstrate that the interests of consumers have actually been damaged. Where a complaint does not demonstrate that consumers are actually suffering harm, complainants should provide us with clear information about why they think consumer interests are at risk of being damaged'. We believe that we have satisfied the latter requirement, but we would be happy to discuss this further with the FCA as necessary.

The steps the super-complainant has already taken or attempted to take in relation to the issue

As noted above, we have requested information from UK Finance on this issue.

⁹ <https://www.purbeckinsurance.co.uk/blog/fall-in-personal-guarantee-backed-sme-finance-in-q2-2023>

¹⁰ <https://www.fsb.org.uk/resource-report/credit-where-credit-s-due.html>

An indication of what outcome(s) the complainant is seeking to address the damage to consumers that has been identified

The FCA should investigate this issue further by requesting detailed data from lenders as to their use of personal guarantees, considering such issues as loan amount, type of borrower (including business structure, sector and other demographic information), type of lender, interaction with affordability assessments, and outcomes in terms of the level of defaults and the impact of any defaults on borrowers (considering such issues as how the personal guarantee is met and the wider financial consequences for the individuals concerned). We suggest that this data should go back at least five years so that a reasonable assessment can be made of how the prevalence of personal guarantees has changed over time, and what effect the increase in business borrowing during the pandemic period had on this issue (if any).

The FCA should also look specifically at whether there is evidence that lenders are using personal guarantees to gain influence over the operation of a business before it goes into default and whether this may lead to conflicts of interest and inappropriate behaviour on the part of the lender.

Depending on the outcome of this analysis, FCA should consider:

- Asking government to extend the regulatory perimeter so that all business lending below a certain amount is clearly subject to FCA regulation, including lending to companies. This threshold could be £25,000 as per current legislation, but the FCA and government could consider whether a different threshold is appropriate given recent inflation. The size of the borrower could also be a relevant consideration, as per the jurisdiction of the Ombudsman Service.
- (Assuming that the perimeter is extended.) Making specific rules in its Handbook relating to the use of personal guarantees in lending to companies, which balance the interests of borrowers and lenders appropriately. In doing so, the FCA will of course be subject to requirements under FSMA to carry out a cost benefit analysis, and this would consider the impact of such rules on the availability and cost of credit for businesses.
- Making rules relating to the use of personal guarantees on currently regulated lending (to sole traders and partnerships), again subject to cost benefit analysis.

Yours faithfully,

Martin McTague
National Chair
Federation of Small Businesses



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