De-Banking Report

February 2024

appg Fair Business Banking

Produced with the support of Humphries Kerstetter LLP

Disclaimer

This is not an official publication of the House of Commons or the House of Lords. It has not been approved by either House or its committees. All-Party Parliamentary Groups are informal groups of Members of both Houses with a common interest in particular issues. The views expressed in this report are those of the group.

Table Of Contents

About the APPG for Fair Business Banking

The APPG is a cross-party group with members from the House of Commons and the House of Lords which puts forward policy recommendations to Government that encourage a finance system which allows enterprise to flourish and business to thrive. The Group acts as a forum and focal point for the SME community and financial services industry to deliver reforms in their long-term interest.

About Humphries Kerstetter LLP

Humphries Kerstetter LLP is a high calibre, longstanding City litigation boutique, specialising in the resolution of complex commercial disputes by litigation and arbitration. The firm's clients are UK and internationally based corporates, banks, funds and high net worth individuals. The practice is truly international, handling a considerable amount of cross border work which consists mostly of international arbitrations or English Commercial Court matters involving international parties or coordination with proceedings in other countries.

The firm has wide civil, regulatory and judicial experience. The partnership is comprised of lawyers previously at top City and International law firms who have vast experience of court litigation in all levels of the English higher courts and domestic and international arbitration. A number of the firm's lawyers are experienced solicitor-advocates. The firm is regularly instructed against Magic and Silver Circle and leading US firms and the current value of the matters on which the firm is acting is in the billions. The firm is known amongst such firms as a heavy weight City litigation boutique engaged in the largest and most complex commercial disputes. It has worked with, for and against the very best practices in the City.

The firm has consistently been recognised for the quality of its work and client service, for example, by being shortlisted 3 times by The Lawyer for Boutique Law Firm of the Year, and by Legal Business for Litigation Team of the Year.

About the author

Jonathan Russell, Director, Lacing Limited
jr@lacinguk.com

Jonathan is a former journalist who now works in research and media relations. Jonathan advises on a variety of different situations including litigation, investment and regulatory matters. He has worked with the APPG, informally, for a number of years.

Foreword

When the All Party Parliamentary Group on Fair Business Banking commissioned a report into debanking its goal was twofold, firstly to explore the extent of the problem and then, if problems were identified, to suggest remedies. The work was prompted by a growing number of individuals, companies and trade organisations approaching the APPG with complaints about how banking facilities were being withdrawn, or refused, for reasons they considered at best unreasonable, at worst, unlawful.

Given the APPG's interest in creating a balanced financial system that supports enterprise and tackles financial crime, debanking was of clear interest to us. We kicked off our work in June last year. In July, the Coutts-Nigel Farage scandal erupted. Within weeks the chief executives of both Coutts and NatWest Group had resigned and the subject of debanking had taken hold as a major issue . Questions were being asked about the role of banks in society, whether they should be considered as more akin to a utility or a private sector service provider, and what rights an individual, or company, should have when accessing the financial system.

To an extent Mr Farage's treatment by NatWest provided a neat answer to our first question; clearly there was a problem. The scandal was an extraordinary case study into how banks operate, the role of Reputational Risk Committees, and how decisions to debank customers are made and then communicated to the customer and the wider world - the two things being by no means the same.

But while the Coutts-Farage scandal provides a useful perspective on the issue of debanking, it is far from comprehensive. As we explore in our report, thousands of customers are being debanked, or having facilities refused, every month. Many of these decisions will have been taken without the detailed, and troubling, analysis exhibited in Mr Farage's case. In fact it is this lighter, often automated, approach that is more relevant to our report. The case studies provided to us and many more reported in the press expose an awkward truth - that the financial, regulatory and reputational pressures facing banks are prompting more and more firms to decide that many clients, and some whole industry sectors, are simply not worth the candle.

As our report concludes, the conflation of banks' obligations to society and to shareholders, to fight financial crime and to turn a profit, has led to blanket de-risking of customer portfolios. This process is most clearly seen in knee-jerk responses to geopolitical events. As states turn rogue or enter into conflict with the West, think Somalia, Iran or Russia, the perceived risk profile of their diaspora community living in the UK rises, prompting a wave of letters to flow out from banks informing previously blameless clients that their accounts are to be closed. Of course, some of these individuals and businesses may be engaged in wrongdoing, but for the bulk of them, many of whom we have spoken to for this report, it is impossible to see why events thousands of miles away should justify such a change in attitude by their bank.

The problem is complex. To achieve a resolution it will need collaboration from banks, the Government and regulators. This was acknowledged by the Financial Conduct Authority with its review of the situation published in September last year and by the Treasury with its proposed change to the rules around Payment Service Contract terminations. However, neither initiative goes far enough. To properly address this problem will require a radical reassessment of what it means to be frozen out of the financial system and whether we need to start considering access to banking facilities to be a fundamental right, akin to a utility, rather than a discretionary service provision.

Banks have an obligation to assist in the fight against financial crime, for the simple reason that if they aren't fighting it then they will almost certainly be assisting it. However, debanking is a blunt tool that is often neither effective nor fair. Particularly when it emerges that it is being used for the wrong reasons.

Introduction

It is now almost impossible to consider the problem of debanking without reference to the former MEP and leader of UKIP, Nigel Farage. His case study may be heightened by the media scrutiny it has attracted but it still contains many of the key issues we need to consider if we want to understand debanking, particularly the reasons banks exit their customers.

Depending on who you choose to listen to, the reasons offered for Mr Farage's debanking by Coutts ranged from his supposed links to Russia and financial crime; to his political views and the reputational risk they carried; or to the financial burden that comes with banking someone with his public profile. All three of these reasons are explored in detail in the extraordinary documents Mr Farage extracted from NatWest Group via a Freedom of Information request[1]. These documents comprise of a briefing memo and minutes flowing from the meeting of the Coutts Reputational Risk Committee (RRC), where it was decided that Mr Farage should be debanked.

Firstly, the memo explored Mr Farage's reputation and how the bank considered it to be at odds with its world view:

> *The Committee did not think continuing to bank NF was compatible with Coutts given his publicly-stated views that were at odds with our position as an inclusive organisation.*

It then considered the unproven allegations that he was linked to Russian money:

> *Throughout 2022 we have seen negative/adverse press reports on NF, but alleged Russian Ties/Connections allegations increased post the invasion of Ukraine.*

And finally there was mention of the costs associated with banking customers considered to be higher risk:

> *…there is an extra cost attached to managing the accounts of high profile individuals such as NF.*

The thinking behind a decision to debank a customer has rarely, if ever, been exposed as starkly as in this memo. Across 40 pages, the report sets out how the bank was struggling with all three of the issues set out above, reputation, cost and the potential exposure to financial crime.

What is also fascinating is that while these issues are explored at length in the memo, there is no clarity as to exactly why he was instructed to leave the bank. The risk of financial crime is mentioned throughout the report - but with absolutely no proof of the same. The extra cost associated with banking a customer such as Farage, a Politically Exposed Person (PEP), is also repeatedly referenced, but there is no consensus that this is the reason he should be asked to move his accounts elsewhere. The best explanation offered by the memo was that the RRC had concluded that Mr Farage's public profile was not one that they wanted to be associated with. The Coutts briefing note states:

> *The values NF [Nigel Farage] actively and publicly promotes/champions, do not align with the bank's. Particularly given the manner in which he states (and monetises) those views - deliberately using extreme, hatful [sic] and emotive language (often with a dose of misinformation) - at best he is seen as xenophobic and pandering to racists, and at worst, he is seen as xenophobic and racist. He is considered by many to be a disingenuous grifter*.

This focus on reputation is as extraordinary as it is troubling. It is also, on a practical level, highly problematic. If you are basing business decisions on something as amorphous and ephemeral as reputation the pitfalls are everywhere and bring into play politics, changing public opinion or just poor decision making. The approach is also very likely to backfire. To continue with the Coutts example - concerned for protecting its own reputation, the bank exited Mr Farage, creating a scandal that led to a regulatory investigation, the resignation of two of the bank's most senior executives, changes to national legislation and, at one point, wiped £1 billion off the bank's value on the stock market. The real irony here is that the bank was warned. The infamous Coutts memo cautioned that should the bank withdraw Mr Farage's facilities there would be a 'significant reputational risk to the bank'.

While Coutts' thinking in debanking Mr Farage is far from clear, what the episode does allow us to do is look behind the cloak of silence that usually accompanies a decision to debank a customer and identify the three main factors that go into a bank's decision making. As we allude to above these are: 1) cost 2) reputation and 3) potential exposure to financial crime. While these factors can be linked and are often confused, they are worth considering individually if we are to really understand what is going on when a bank decides to exit a customer.

Costs

An Iranian, a Russian, a bookie and a yacht-broker all walk into a bank - and are promptly asked to leave. The line may be glib, the subject it introduces is anything but. For some years now various ethnic, industry and political groups have been making representations to the APPG about the problems they have obtaining or retaining banking facilities. The groups may be disparate, but their treatment is markedly similar. They have all seen existing banking facilities closed down, applications for new accounts rejected and their livelihoods put in jeopardy. In all but a tiny minority of cases, little or no explanation has been offered as to why they find themselves frozen out of mainstream banking.

While the groups are very different there is one characteristic that connects them all, their perceived risk profile being outside the norm. For different reasons groups such as cryptocurrency businesses, jewellers, bookies, politicians, sex workers, yacht brokers and others are seen as problematic for banks. The issues range from dealing with regular cash deposits, the remittance of funds overseas and the responsibility of safeguarding customers in high-risk situations (think victims of human trafficking or sex workers). These risk profiles all carry with them extra costs for the banks. Anti-money laundering checks, ongoing due diligence and background checks can quickly add up and, set against a profit margin that is minimal at best, push the relationship into the red for the bank.

These are serious issues for banks, but before exploring them further it is worth drawing a line between debanking due to costs and debanking due to financial crime. Debanking an individual member of a group named above - an oncourse bookmaker or cryptocurrency business - might legitimately be because a bank had identified activity that it considered to be linked to financial crime. Refusing banking facilities simply due to membership of the group is quite different – and should be seen purely as a question of costs. The experience of oncourse bookmakers, small businesses that often survive on net revenue of £50,000 a year or so, is that it is now all but impossible to get mainstream banking services for their businesses. The reason is that the business model is still largely cash-based, something that automatically raises red flags, and costs, with banks.

Cryptocurrency businesses have a similar experience. Pretty much the entire banking industry has turned its back on the crypto industry. Even the industry trade body, CryptoUK, has found itself being refused banking facilities, not because it trades in cryptocurrencies in any way (the organisation only accepts membership fees in fiat currency) but because it has the word 'crypto' in its name.

We spoke to representatives from both groups, who argued not only that their treatment by the banking industry was unfair but that it was also unjustified. The bookies argued that the sums their members are paid are so small they pose little or no risk and that anyway the racecourses where they operate have supervisors in place whose job is to oversee standards and compliance with the law.

Similarly, representatives of the crypto industry argue that while their industry is unregulated, they are obliged to register with the Financial Conduct Authority (FCA) as their Anti-Money Laundering supervisor as well as passing the fit and proper tests.

The concern then, one that has been raised previously with the banking industry, is that instead of considering each customer on their merits, a broadbrush approach is being taken, with groups of customers being debanked in response to national or international events. This is not a new worry. The Treasury Committee raised the issue of 'blanket de-banking' in 2019 and in 2021. Its report[2] - *Economic Crime: Consumer View* - said banks needed to be more transparent in explaining why they were taking action such as closing accounts and warned that the FCA was failing to take appropriate action. This was followed up by a letter to the FCA chief executive Nikhil Rathi asking what progress the regulator had made in tackling the issue of blanket de-risking. In his response Mr Rathi accepted banks should not treat industry groups as one, stating that firms needed to recognise "… the risk associated with different business relationships in a single broad category varies, and to manage that risk appropriately."

However, the view expressed to us by various industry bodies was that they are all being treated as the same. A broad-brush approach is being taken to all members of the same industry, rather than each company, or individual, being assessed on a case-by-case basis. This view, that industry groups are being frozen out of the mainstream banking industry, is reinforced by the response certain groups get when they attempt to discuss their concerns with the banking industry. We were told that meetings between industry groups and banks were being turned down, and even when accepted some banks would then fail to turn up. Su Carpenter, Director of Operations at CyptoUK, said:

It's an impossible situation. On the one hand you have the Government actively supporting and promoting the crypto industry. On the other hand there is the banking industry refusing to offer us banking facilities. When we try to speak to them they are not interested. This is despite studies finding that crypto assets were less suspectable to financial crime than traditional currencies.

One of the starkest case studies about how banks are dealing with the problem of costs was presented to us by the owner of a social enterprise that manufactured solar powered water pumps to support small-scale farmers, largely in Africa.

Case Study

In 2020 a UK based SME with international operations building solar-powered water pumps in India and selling them on to sub-Saharan Africa, received a letter from their bank putting them on notice that their accounts were to be closed. The letter, in standard format, gave the company two months to find new banking arrangement before their accounts would be closed. It offered no explanation for why the decision had been made to close the accounts and gave the company no obvious route to challenge the decision.

The letter arrived despite the company having held accounts with the same bank for nearly 10 years. The company had no borrowing or overdrafts. It had never had to resort to borrowing as having set up a Social Enterprise with the core aim of supporting subsistence farmers in the developing world the company had attracted investment from USAID, UK DfID and similar organisations.

Notwithstanding the company's impeccable financial history its finances were complex. It owned its factory in India and worked with third party distributors across markets in 30 countries spanning East, West and Southern Africa, and South East Asia. This cross-border trading required reciprocal banking relationships across multiple jurisdictions, something the company had carefully built up over a number of years. The company knew that trying to reconstruct this network in just two months would be near impossible. The closure of their bank accounts would lead to the closure of the business.

What the company was looking for, but failed to get, was a reasonable approach from its bank. The company had a good idea why its business was being rejected. It was receiving funds from jurisdictions classified as high risk, such as Nigeria, and remitting them to a third country, India. But all this could be easily explained. If only the bank would listen. The chief executive of the company described the situation:

> *"There was no way of getting hold of anyone. It was like dealing with a black hole. The bank didn't want to listen and, seemingly, didn't care. A decision had been taken to push my company out of the bank and that was that. I don't know if any human beings were involved in the process but it felt very automated. Computer says no. It was a very scary time."*

Approaches to new banks were positive, up to a point. That point generally being when the question was asked about why the company was moving away from its existing provider. Unwilling to be untruthful, the company told the new provider that they were being 'exited' by their current bank for unspecified reasons. At this point the door was gently closed in their face.

Reassuringly for the company at the heart of this dispute this was a rare case where the bank reversed its decision. But this only happened after the company bypassed the usual customer complaints channels and, with the help of their local MP, wrote directly to the chief executive of the bank. The letter explained in blunt terms how the bank's decision was putting at risk a company whose purpose was to support subsistence farmers in Africa. Just as with the decision to close the close the accounts, no explanation was offered as to why the bank felt able to reverse its position.

The key to understanding this case study and why it is so pertinent to the issue of costs, doesn't lie within the bank's decision to exit the customer, but rather its decision to perform an abrupt u-turn. When the customer in question received the letter from his bank informing him he was being debanked it was in the usual format. No reason was given, no explanation offered. As is almost always the case, the bank gave its customer two months to move their account elsewhere, at which point the accounts would be closed down. The obvious, if unspoken, inference in the lack of any explanation was that the bank had discovered something suspicious, that there was at least some suggestion that the customer was engaged in wrongdoing and had become unbankable as a result. This is the position that the vast majority of customers find themselves in, subject to a silent accusation that is impossible to respond to. In this case, of course, the decision by the bank to reverse its position gives the lie to this suggestion. Clearly the customer wasn't involved in any type of financial crime. The only reasonable conclusion then, was that this was about costs.

The recent decision by Barclays and other high street banks to close the bank accounts of 'expat' customers is another example of how firms react in the face of rising costs. While Barclays did not set out the reasons for withdrawing from the 'expat' market, there can be little argument that it was a commercial decision driven by the cost of servicing overseas customers. Once again, this could be presented as a question of financial crime. It may be that customers living overseas are more likely to be engaged in financial crime. However, if there is any truth to this, it is likely to be marginal at best, a statistical quirk created by a handful of bad apples, and not representative of the whole. To tarnish the entire community of 'expat' customers with the actions of a few individuals feels, and is, wrong. It is also something that banks have been repeatedly warned about, by Parliament and their regulator, both of whom have cautioned against 'blanket de-risking'. The commercial reality though is that costs and risk go hand in hand, which would explain why Barclays told its customers it would be prepared to retain them if they switched to an account requiring a minimum balance of £100,000 or a monthly charge of £40.

The simple fact is that the regulatory and legal obligations on banks mean it is more expensive to bank a bookie than a baker. More AML checks are required, more ongoing monitoring, more due diligence at the point of onboarding. The banking industry spends billions of pounds each year on compliance costs. With no way of avoiding these costs, the obvious commercial solution is to simply avoid the customer. Banks make little or no profit serving the bulk of SMEs and private individuals. Where those relationships are mainstream the costs are low and manageable. However, as soon as the relationship slips out of the mainstream and into more unusual waters, the costs start to rise and the relationship can drift outside of the bank's risk appetite.

This situation was spelled out very clearly to the APPG in an interview with UK Finance, the main industry group representing banks and building societies. We were told in blunt terms that economic factors are hugely important in how accounts are handled, and the amount of work firms are prepared to put in before pulling the plug on their customers. A senior executive from UK Finance explained how the enormous operational costs of compliance with money laundering checks, set against the financial jeopardy of getting it wrong meant it was sometimes easier, and cheaper, to simply move people on.

> *"One of the drivers is cost, coupled with the potential for significant financial penalties for getting things wrong. Each bank will have to make its own assessment of risk based on the specific circumstances of the case. But, in deciding whether continuing with or entering into a customer relationship meets the risk appetite of a bank or goes beyond it, it will be impossible to completely separate financial crime considerations from commercial ones."*

This cost of compliance was also addressed directly in the FCA's recent report into debanking - UK Payment Accounts: access and closures - put the issue in the following neutral terms:

> *"For business accounts, the commercial cost of serving or complying with financial crime requirements was also mentioned [as a reason for exiting customers]."*

These costs should not be underestimated. A study by LexisNexis found that compliance costs for the UK financial services sector hit £34.2 billion in 2022, up by nearly a fifth in just two years. Looked at from a more granular perspective the costs equate to an average of £265m per retail bank in the UK. Break down these numbers further and you can start to understand the pressures at work within the industry. By far the largest cost for banks was customer due diligence (CDD), making up 67% of their total annual spend. While some of this is front loaded, relating to onboarding costs, nearly a quarter of the total relates to ongoing CDD, a recurring cost that banks have to stump up year on year. On the most simplistic analysis these sorts of sums mean that banks are spending something like £5 per customer each year on due diligence. At this kind of price point it may still be commercially viable to bank low value customers, but as soon as those customers drift into any kind of higher risk category and the compliance costs rise they will very quickly become loss making and, commercially, unattractive.

But there are serious if unintended consequences to banks shying away from banking more problematic customers. Certain industry groups are already having to set up complicated systems whereby commercial operations are being banked through personal accounts or trusts. Others are seeking out alternative financial providers, relying on overseas banks or the shadow banking sector. None of this is welcome. Costs increase and regulatory oversight diminishes. The mainstream banking sector may have offloaded unwelcome customers, but by doing so they are simply pushing them into areas that are unregulated and likely to foster risk rather than contain it. Ultimately the economy is likely to be the loser.

Recommendations

No simple, one size-fits-all solution exists for tackling the issue of customers being debanked due to the cost of servicing their business. The regulator needs to talk to banks about the costs of compliance, proportionality and efficacy. The industry needs to consider introducing a 'Basic Bank Account' for small businesses. A similar device already exists for consumers, whereby customers who struggle to get standard accounts are offered a simple current account which doesn't come with any form of credit, cheque book or overdraft. The account does, however, ensure that everyone can have access to the financial system, deposit money and pay their bills. A similar facility for business customers could include limits on balances or turnover on the accounts which would, in turn, limit the compliance costs banks would have to spend managing such business. Such a move would need the backing of the regulator. If the banking sector and the regulator were not prepared to introduce such a service, the Government will need to intervene to legislate for the change.

For existing customers there should be some protections introduced to stop banks withdrawing facilities simply due to cost. Such protections would require at least two fundamental changes to be introduced. First banks need to be transparent about their actions. If the cost burden of maintaining a customer relationship becomes onerous this should be explained to the customer and alternatives provided. Such alternatives could include, where reasonable, increasing bank charges or offering a more basic banking facility. If these alternatives prove to be unattractive to the customer they could at least go back to the market to look for alternative provision without any cloud of suspicion hanging over them. To an extent this approach is being supported by the Government. The rule changes[3] proposed by the Treasury on Payment Service Contract termination state that banks should give customers a clear explanation for any account termination, unless it would be unlawful to do so. The paper also recommends a minimum of 90 days' notice of termination, rather than the industry norm of 60 days. While the Treasury work is principally focused on 'freedom of expression' any change in legislation must make clear that these protections should extend to all accounts.

Reputation

Create a word cloud of everything that's been written about the subject of debanking and it is quite possible the dominant word would be reputation. In report after report, the word appears more frequently than 'financial crime', 'regulation' or even 'compliance'. The FSA's 2011 report, *Banks' management of high money laundering risk situations*, has 26 mentions of the word, the memo Coutts produced about Nigel Farage leans even more heavily on the term.

The relevant section of the FCA Handbook, the Financial Crime Thematic Review, encourages firms to consider their own reputation, the reputation of their customers, their staff and their industry as a whole, when assessing risk. Confusingly this focus on reputation cuts both ways in edicts handed down by the regulator. The report, *Banks' management of high money-laundering risk situations*, notes that good practice in assessing money laundering risk includes an assessment of 'reputation' alongside more tangible factors such as source of wealth and corporate structures. But then the same report also cautions against "considering the reputational risk rather than the AML risk presented by customers."

The FCA Handbook takes this matter further, extrapolating out from the reputation of a bank's customers to the reputation of the bank and the wider reputation of the UK financial services industry. Rather than simply stating that banks should have zero tolerance of fraud the Handbook states:

> *We expect a firm to consider the full implications of the fraud risks it faces, which may have wider effects on its reputation, its customers and the markets in which it operates.*

This focus on reputation led the regulator to actively encourage firms to set up Reputational Risk Committees. In interviews conducted for this report we were told by former FCA officials that the regulator was actively encouraging firms to set up RRCs as long ago as 2013. A former FCA executive confirmed the position explaining:

> *It was in around 2013/14 that the FCA issued guidance that institutions should consider setting up reputational risk committees to look into these matters. This would have been done through guidance and through meetings with supervisors, rather than any overt or public diktat.*

The justification for this action was, we were told, that reputation had become such a live issue that in an extreme case it could pose a prudential risk to the bank. Whether there is any justification for such a view feels dubious at best. Is it really possible a bank's customer base could cause a run on a bank if they discovered it was servicing a politically or socially unpalatable customer? This seems unlikely. Major high street banks have been involved in the fraudulent manipulation of interest rates, terrorist financing and money laundering on behalf of major drug cartels with little or no noticeable impact on customer loyalty.

But egged on by their regulator, banks have created a whole industry around reputation management. Senior committees have been set up with all the requisite support and backup to assess customer reputations and consider whether they match up to the image the bank would like to project. It is not difficult to draw a straight line from this focus on reputation to the Farage saga and the decision by Coutts to exit Mr Farage, based as it was on an assessment of his reputation and how that might impact on how the bank was viewed.

One of the obvious problems about this approach is its subjectivity. A challenger bank will view its reputation and the reputation of its customers very differently to an established bank. Equally an international bank with experience working in different cultures and geographies will have very different tolerances than that of a more parochial, national organisation. The regulator should not be encouraging banks to dive into such politically charged and stormy waters. As we explore below it should be acting as a buffer against such views, offering protection to the industry by requiring it to ignore political or social pressures.

What happens when geopolitical events suddenly alter our political mores as the case study below illustrates? Should banking customers be punished for crimes committed thousands of miles away for which they bear no responsibility?

Case Study

Sergey Grachev, a British citizen of Russian background and with strong links to Ukraine, had been resident in the UK for over 15 years in February 2022 when President Putin's tanks rolled over the border into Ukraine. At the time he was involved in 11 businesses in the UK, both as a shareholder and director. The businesses included a much-lauded fully-electric sustainable aviation business with connections to the Royal Air Force and the Department for Transport, a rescued animal sanctuary farm and his core business, a law firm that specialised in helping international businesses, including major Hollywood studios, set up in Russia in 2001.

Mr Grachev was quick to recognise the impact the war in Ukraine was going to have on him and others. Shortly after the Russian invasion he started the process of winding up any business relationship with his office in Russia, he donated funds from his charitable foundation to support humanitarian efforts in Ukraine and, in March 2022, he was one of the first people in his region, East Anglia, to take in refugees from Ukraine[4].

As a British citizen, albeit one with Russian heritage, he might have felt he was immune to what was going on in Eastern Europe. However, on 12 July 2022 he received 11 letters from Barclays informing him they were going to close down 30 accounts connected to each of his businesses, including his charitable trust. They gave him two months to find new facilities.

While a flurry of complaints failed to reverse their decision it did prompt the bank to reveal that they were closing the banking facilities across all his businesses because of him personally. Perplexed by this decision and keen to understand more about how the bank operated, Mr Grachev walked into his local branch of Barclays and applied to open an account in his own name. The account was opened - and remains open - with no objections or questions.

While the bank refused to disclose the reason it was closing his accounts, Mr Grachev established the most likely cause was that his law firm had previously worked for Alfa Bank, Russia's largest private bank and an institution that was sanctioned in response to the Russian invasion of Ukraine. However, as Mr Grachev points out, if that is the reason behind Barclay's decision it would carry with it no small amount of irony; Barclays itself previously worked with Alfa.

In his conversation with the APPG, Mr Grachev remained pragmatic. He accepted that his legal business with its ties to Russia, while operating entirely legitimately, may have been seen as too risky for Barclays. If all the bank had done was close down that business account while allowing him to continue trading his rescued animals sanctuary farm, sustainable aviation business and charitable trust, he would have been phlegmatic about the matter. However, to close down the accounts across all 11 businesses seemed to him to be not only deeply destructive but discriminatory.

Of course the case study above could be viewed in different ways. On Mr Grachev's account, Barclays closed down his accounts for purely reputational reasons; the bank didn't want any association with Alfa Bank, however historical. It may be that Barclays has a different view. If so Mr Grachev remains unaware of what it might be and, therefore, unable to answer to it. When we approached the bank all it would say was it had 'acted in compliance with its legal and regulatory obligations'. Quite what those obligations may be remain unknown. We do know that a competitor bank took a different view. After four weeks of intense due diligence, and the opportunity to speak to someone within the new bank about his background and financial history, Mr Grachev has recently opened up new accounts to replace those closed by Barclays.

What is clear is that reputation has taken on a position of outsized importance both from the perspective of the banking industry and its regulator. The position is now so exaggerated that reputation has, in some cases, leapfrogged the real risk of financial crime as the issue of paramount importance to banks. This was clearly set out in the regulator's 2011 report into risk, *Banks' management of high money-laundering risk situations*, which provided this warning:

> *We were concerned that senior management at a quarter of banks visited (mostly private banks or the private banking arms of major banks) appeared to treat money-laundering risk as a reputational risk issue only. In these banks, senior management attached greater importance to the risk that a customer might be involved in a public scandal, than to the risk that the customer might be corrupt or otherwise engaged in financial crime, and using the bank to launder criminal proceeds.*

In other words banks were more concerned about getting caught than they were about the crime; reputation very much as cause rather than effect. Of course, the reputation of both a bank and its customers stretches much wider than any involvement in financial crime. Banks have withdrawn banking facilities for any number of organisations, companies and people because their reputations did not chime with what the banks considered to be its values. Christian groups with controversial views about homosexuality and right-wing bloggers, as well as organisations involved in the shooting industry, have all had accounts closed. Companies have suffered a similar fate when they have found themselves seemingly on the wrong side of a political debate. An extreme example is the chemicals firm, Huntingdon Life Sciences, which was viewed with such hostility by animal rights campaigners it had to be given safe harbour by the Bank of England when the banking industry refused to be associated with the company.

Recommendations

What is clear about the cases set out above is that in any legal sense there is no allegation that the parties losing their banking facilities have done anything illegal. Their views or actions may be unpopular, even extreme by some estimation, but they are not in breach of law or regulation. It is here that it would seem self-evident that both the industry and the regulator need to be taking a far more principled stance.

The issue of reputation was touched on in the Treasury paper on the termination of payment service contracts. It stated that Ministers had met with the leaders of the UK's largest banks and received assurances that the banking industry would abide by the 'principle of non-discrimination based on lawful freedom of expression'. But this paper was published in October last year. Three months later, in January this year, further stories emerged about the shooting industry being cold shouldered by banks. This is perhaps not surprising given the Treasury paper on terminations specifically accepts that firms may choose "to terminate [a] contract for primarily commercial reasons, such as due to a policy decision by the provider not to take on the cost or reputational risk of certain categories of customer…".

On this point it is time that banks' role as a utility provider was explicitly accepted. The universal need for access to the financial system has already been recognised in the retail market where the nine largest credit institutions in the UK are required to offer a 'Basic Bank Account' to eligible customers who would not otherwise be able to get an account. It is now time that similar services are provided to SMEs. Reputation should not be a consideration when it comes to the most basic of banking services - a current account.

Of course, this kind of approach is problematic. There is every chance that a bank could face criticism for banking certain parties. To an extent this potential problem is answered by the confidential nature of a banking relationship. There is no need for anyone to know who is banked by whom. Nonetheless it is possible a banking relationship may become public and attempts could be made by pressure groups to financially isolate a company or individual by forcing the banking industry to cold shoulder them. This is where the regulator needs to step up, not just to police banks, but to protect them. An individual bank trying to explain how access to the financial system is more important than political or social debates is a near impossible task. The regulator, acting dispassionately and in the wider interest of society, is a legitimate voice that can act as a buffer against the public mood. In the same way that no-one would expect a water or electricity company to withdraw their services from any party due to their unpopular or unfashionable reputation, access to banking facilities should also be above such considerations. The regulator must reverse its position on reputation and issue guidance that requires banks to disregard the consideration – in all cases other than unlawful conduct – when providing access to the financial system. Presented correctly, such a move would provide banks with protection from criticism for doing no more than acting as a financial utility provider.

Financial Crime

Banks have an obligation to fight financial crime. They are the first line of defence against money launderers, terrorists and other national and international criminals. When this fails, criminals thrive. For this reason, when banks are found to have got it wrong the penalties are severe. In 2012, HSBC was hit with a $1.9 billion fine for laundering drug money in Mexico; in the UK, NatWest Group, was fined £265 million in 2021 for its involvement laundering millions of pounds deposited by a gold broking business. While these fines are large, perhaps the greater jeopardy is the risk of criminal enforcement by regulators such as the US Office of Foreign Assets Control, where an adverse finding can pose an existential risk to a firm found to have breached the rules.

It is against this backdrop that banks have to police their customer base, both existing and prospective. As we detail above, the industry spends huge sums meeting these obligations. But despite these sums it is still not clear whether the system works. Surveys of compliance officers about the effectiveness of their systems tend to return results that are evenly spread between effective and deficient. The LexisNexis report, True Cost of Compliance, found the response from the industry was equivocal at best when asked whether they thought the banking sector was effective in fighting financial crime. In the survey 66% said it was 'somewhat effective', 17% thought it was 'ineffective', with just 28% thinking the system was 'very effective' at detecting and preventing financial crime.

There are good reasons for this reticence to back their systems. Despite huge sums thrown at the problem, financial crime continues to rise in the UK. According to accountants PwC, the UK is second only to South Africa when it comes to financial crime incidences. The company's 2022 Global Economic Crime Survey found that 64% of businesses had experienced fraud, corruption or other financial crime in the two years leading up to the publication of their report. This was up from 56% in 2020, and 50% in 2018. It also compares very badly with the global rate of 46%.

Of course to blame banks for the incidence of financial crime in the UK would be to miss the point, but understanding the bigger picture does help to put the efforts made by banks into context. It is crucial the billions of pounds invested by banks in tackling financial crime are well spent. Banks need to get this process right, both to protect their customers but also to ensure that when they do debank customers it is justified.

As our table below demonstrates the numbers debanked 'for reasons of financial crime' are significant. Between 2018 and 2022, the FCA's figures show the volume of clients exited due to financial crime reasons surged 370%, hitting nearly 1,000 per day by the end of the period (see table).

Financial Year	Number of accounts closed	Notes
2016/17*	45,091	First year data was recorded. FCA cautioned it may not be as reliable as subsequent years.
2017/18	72,699	
2018/19	189,801	
2019/20	229,350	
2020/21	340,133	
2021/22	343,350	
2022/23**	185,654	Data incomplete as it was provided shortly after the year end

The headline increase in customers being debanked is eye catching, but the numbers themselves need some unpacking if we are going to understand what is going on here. Speaking to the banking industry, the reason given for the rise is that banks are getting better at identifying a potential crime. The introduction of automation and AI has improved banks' systems exponentially, which tracks through to the increases in customers being debanked.

This is unlikely to be the full story though. Systems and processes may have improved but, as we set out above, it is also the case that banks' sensitivity to costs and reputations have also been on the rise. Victims of debanking argue that financial crime is being used as a fig leaf to cover up debanking that is being done for other reasons: costs, risk appetite or reputational risk. They argue that the default position is to present every decision as one that is about financial crime. Customers who are debanked are usually presented with a fait accompli by their banks. They receive a letter from their bank informing them of the bank's decision. No explanation is offered, and if one is requested it is almost always refused, leaving the suspicion of financial crime hanging over the former customer.

The reason for the secrecy is due to provisions written into Section 333A of the Proceeds of Crime Act which makes it an offence for a regulated entity to disclose information that may prejudice an investigation - an offence known as 'tipping off'. Carrying a minimum two-year prison sentence, the offence is taken seriously by the banking industry. But what our research suggests is that the blanket refusal to offer any explanation for a decision to debank is just that, a blanket.

Looked at from the outside it would seem that parties who are subject to real suspicion are treated exactly the same as those whose reputation or profitability has fallen outside a bank's risk appetite. Almost all customers are given two months to move their business elsewhere - a process that allows criminals time to move their assets elsewhere while unfairly penalising those who are blameless. Looked at from the inside there may be more going on. Banks cooperating with each other by sharing details would appear to be ineffective when tackling financial crime, and unfair to those customers who are not involved in wrongdoing.

The solar pump case study detailed earlier would appear to be proof of this approach. The company in question was offered no explanation of why they were being debanked, bringing into play Section 333A of the Proceeds of Crime Act and raising the prospect that it was all down to suspicion of financial crime. However, when the company made the right representations the decision to debank them was reversed, suggesting there was no suspicion of financial crime and that this was really about the bank controlling its costs and derisking its customer base.

The Farage case is another good example of this trend. The decision by Coutts to exit Mr Farage initially went unexplained, allowing it to be linked to dark stories about Russian money and financial crime. Newspapers, bloggers, even parliamentarians, all repeated what turned out to be at best wildly exaggerated[5], at worst nonsensical, rumours that Mr Farage had been taking Putin's roubles. A senior Labour MP later apologised for repeating these claims in Parliament. But as these claims were gaining currency, Mr Farage was left with a problem that many people, without his platform and flair for campaigning, are facing on a daily basis. The suspicion of financial crime meant no other bank would touch him. Through formal or informal channels the stain of debanking spreads fast. A decision by one bank to turn a customer away can quickly translate into an industry-wide position that a person, or company, is unbankable. In a world where access to the financial system can be as important as access to water, electricity and fuel, this feels fundamentally unjust.

In Mr Farage's case it was his reputation that led to him being debanked. In the case of the solar pump company it was their risk profile. Neither had anything to do with financial crime. But the actions of the banks meant both parties were initially, and quite unjustly, tarnished with the stain of financial impropriety.

Trying to unpick the degree to which debanking is being done for one reason and then presented as another is not easy, to the extent that not even the banking industry knows the exact picture. The FCA report, *UK Payment Accounts: access and closures*, demonstrated that the data banks hold on debanking is completely unfit for purpose[6]. The data was so wildly erratic, with some firms reporting that they had terminated over 70% of business or personal accounts over a 12-month period, that the FCA was forced to discount outliers and caution against relying too much on the data.

And it wasn't just the numbers that were suspect. The categorisation of why customers were being debanked would also appear to be highly unreliable. Only four instances of customers being 'debanked' for political reasons were reported, all of which were later found to have been wrongly categorised. While this led to favourable headlines for the industry that the FCA report had found no instances of customers being debanked for political reasons - this is also likely to be misleading. Thousands of cases of debanking, in fact one of the largest single explanations of the reason for debanking, are simply described as 'other'. The FCA explained this finding in its report in the following manner:

> *We asked firms to tell us about the reasons for declining, suspending or terminating accounts. Some firms reported a high proportion of "Other" reasons and in the available time we have not been able to work with firms to disaggregate and better understand this category.*

Obviously, this failure to properly explain the reasons for declining, suspending or terminating an account is unacceptable and needs to be addressed. It also raises the possibility that the reasons customers are being debanked are being wrongly categorised. This idea is particularly concerning where financial crime is given as the reason. While it is impossible to say with certainty that banks are presenting financial crime as the reason for debanking when in reality other factors are at play, there are strong indicators this may the case. Take the data reported above, showing a four-fold increase in the number of customers debanked 'for reasons of financial crime'. This increase is normally put down to improvements in banks' compliance and due diligence processes. But if detections rates are improving so dramatically, would we not also see a similar jump in other data sets that track the detection of financial crime? Unfortunately, this is not the case. Over the period that saw a 370% rise in debanking, the number of reports about potential criminality, known as Suspicious Activity Reports (SARs), filed by banks rose just 77%. If the increase in the rate of debanking was entirely down to improved monitoring and detection, wouldn't the reporting of SARs show a similar, if not identical, rate of increase?

Suspicious Activity Report

The SARs regime was introduced in its current form as part of the Proceeds of Crime Act 2002. It requires regulated firms to submit reports to the National Crime Agency if the firm 'knows' or 'suspects' that a party may be engaged in money laundering or dealing in criminal property. In the last financial year over 900,000 Suspicious Activity Reports (SARs) were submitted to the National Crime Agency. Of these the vast majority, nearly 700,000, came from banks and building societies (see table).

Year	Total SARs	SARs Banks & Building Socs	% of SARs submitted by Banks and Building Docs	Notes
2014/15	381,882	334,251	87.5%	First full year in which data was presented
2015/16	419,451	363,766	86.7%	
2016/17*	634,113	547,684	86.2%	18 month period, to bring reporting in line with tax year
2017/18	463,938	391,162	84.5%	
2018/19	478,437	405,447	84.7%	
2019/20	573,085	462,895	80.6%	
2020/21	742,317	580,853	78.2%	
2021/22	901,255	694,707	77%	

While the rate of increase between debanking for reasons of financial crime and SARs are wildly out of kilter, it is also worth noting that the two data points fail to match up in absolute terms. In 2021/22 banks exited 343,350 customers while submitting 580,853 SARs. It doesn't have to be the case that one SAR should correspond to one customer exit, banks can submit SARs about parties that are not customers. However, it does feel more reasonable, under the current regulatory and legal regime, to expect one SAR to correspond to at least one customer exit. Unfortunately, this is not always the case.

One bank submitted evidence to us of how they had a strict one-to-one policy that meant a customer was automatically exited if they had a SAR submitted against them. At the same time, we were made aware of banks that would adopt a different approach depending on how valuable the customer was to them. In practical terms this meant the bank would be prepared to submit a SAR against a customer but allow the party to continue to use their accounts while they awaited a response from the NCA or other investigating authority. Only when, or if, the bank received an indication that an investigation had started, such as being hit by a Production Order or a request that the account should be frozen, would the bank move against their customer.

The individual who reported this approach to us was the head of financial crime at a UK bank. While the person stressed that this lax approach was not something they would countenance at their bank, they said they had direct knowledge that other banks were allowing commercial considerations to hold sway over their compliance obligations. For obvious reasons the person requested their name be withheld. They explained the concerns they had with such an approach:

> *To submit a SAR you need to have fairly robust grounds, so it would be surprising if the customer wasn't debanked. That said, I am aware that some banks are doing just that. The simple truth is that sometimes commercial reasons prevail and a customer would not be debanked as they were valuable to the bank.*

This lack of consistency in approach can equally work the other way around. A challenger bank, which submitted data to us on the condition of anonymity revealed that in 2022/23 they closed 40 accounts 'due to fraud concerns'. Over the same period, they submitted just five SARs. Why the huge discrepancy? We would expect the regulator to be far more proactive in monitoring this kind of data, to be questioning why different banks had such wildly different policies and approaches. This is particularly the case given the fact that such concerns are nothing new to the regulator. The failure of banks to treat their customers in a uniform manner was flagged by the regulator, in its June 2011 report, Banks' management of high money-laundering risk situations[7]:

> *Some banks appeared unwilling to turn away, or exit, very profitable business relationships when there appeared to be an unacceptable risk of handling the proceeds of crime. Around a third of banks, including the private banking arms of some major banking groups, appeared willing to accept very high levels of money-laundering risk if the immediate reputational and regulatory risk was acceptable….some banks are willing to enter into very high-risk business relationships without adequate controls when there are potentially large profits to be made, means that it is likely that some banks are handling the proceeds of corruption or other financial crime.*

Other data points relating to fraud are similarly out of kilter with debanking due to financial crime. Cifas is the not-for-profit group through which companies from all industries can share information on potential fraudsters. The organisation maintains a database of fraudulent conduct, comprising reports from all manner of organisations and groups, including the public, retailers, utility companies and, of course, the banking sector. As would be expected, a large proportion of these reports relate to the banking sector, involving crimes such as identity theft, misuse of facility and false documentation. While the numbers recorded by Cifas are concerning, the latest data[8] showing 264,799 reports over a nine-month period, they do not show anything like the same rate of increase as witnessed in the debanking numbers reported above. Between 2019 and 2022, reports to Cifas increased by just 11%. Debanking for reasons of financial crime soared 80% over the same period.

The evidence above suggests the regime is not working on multiple levels. Too many banks remain open to banking high value customers even when there is a suspicion of economic crime. At the same time there is growing evidence that banks may be wrongly using the label of economic crime to offload customers merely because they represent little or no profit for the bank.

Recommendations

What is abundantly clear from the information presented above is that debanking activity for reasons of financial crime is totally out of step with almost all other similar indicators. There needs to be a concerted effort to marry up the reports that are coming out of the banking sector with enforcement by agencies. The frequency of customers being debanked or SARs being submitted by banks, running to hundreds of thousands each year, is totally out of kilter with prosecutions or other enforcement action. To give just one metric, in 2021, the NCA reported 341 'disruptions' of fraud. This was in a year when 343,350 customers were exited by banks for reasons of financial crime and 580,853 SARs were submitted to the NCA. The need to address this discrepancy through proper funding for law enforcement is something the APPG and others have previously, and repeatedly, addressed. We would particularly point readers to our Economic Crime Manifesto[9], published with the APPG on Anti-Corruption and Responsible Tax in 2022. To leave banks to freeze companies or individuals out of the financial system with no commensurate action by law enforcement amounts to a failure of the state both to prosecute bona fide criminals and to protect those who are being wrongly tarnished with the taint of financial crime.

The proposals by the Treasury to mandate that banks must explain to their clients, where lawful, the reasons for any debanking are welcome. However, finding the correct balance that both protects the innocent from being unfairly treated while allowing the authorities to pursue those suspected of wrongdoing should not be impossible. We would encourage both the Treasury and the FCA to keep this area under review. One area we do not think will work in its current form is the Treasury's decision to leave it to the banks to decide what information should be provided to customers that are being exited. The overwhelming likelihood is that banks will find ways to once again leave customers in the dark, rather than offering them a proper explanation.

A final thought on the process by which banks act against suspected financial crime: too often the default position appears to be to take action against the customer rather than the transaction. We would urge consideration by the authorities of the adoption of a regime that is more focused on the movement of money rather than moving on clients. In the world of AI, and with vast resources available to banks, there must be a way of better policing transactions so that suspect monies can be frozen, and then action taken against parties, only when and if any suspicions are found to be well grounded.

Methodology

The APPG's work on de-banking has been going on, informally, for some years, largely through listening to representations from industry groups and business owners about their treatment by banks. As the evidence mounted we decided in early 2023 there was a wider problem that needed looking into. To better understand the extent and breadth of the problem we sent questionnaires to all the main banks and the regulator asking for data about the frequency of debanking. We supplemented this with proprietary research, including the use of Freedom of Information requests and obtaining source information from the industry, regulators and the Government. We also issued a press release calling for case studies from the wider public. It will perhaps come as little surprise that we received a significant wave of complaints from individuals, companies and industry bodies. Where appropriate and relevant we followed these up with interviews and included these case studies in this report. Even where case studies were not used in our report we are very grateful for all those who took the time to come forward with their own stories of how they found themselves frozen out of the UK's banking ecosystem.

Endnotes

1 https://www.documentcloud.org/documents/23881614-private-redacted

2 https://publications.parliament.uk/pa/cm201919/cmselect/cmtreasy/246/246.pdf

3 Payment service contract termination rule changes: implementation, timings, and next steps - GOV.UK (www.gov.uk)

4 https://www.thesun.co.uk/news/18084184/russian-rehouses-ukrainian-refugees-alpaca-farm/

5 The link between Mr Farage and Russian money appears to stem from purported payments received by Mr Farage for appearances on the Russian television network Russia Today for which he may have received some, possibly minimal, appearance fees.

6 The FCA is producing a follow up report which will hopefully fill in the some of the more obvious holes in the current work

7 https://www.fca.org.uk/publication/corporate/fsa-aml-final-report.pdf

8 www.fraudscape.co.uk

9 https://www.appgbanking.org.uk/wp-content/uploads/2022/05/Economic-Crime-Manifesto-1.pdf

appg Fair Business Banking

DESIGN BY WOND.CO.UK