UK FINANCE

UK Finance Submission to TSC Inquiry into SME Finance March 2018

1. UK Finance was formed on 1 July 2017 to represent the finance and banking industry. It represents around 300 of the leading firms providing finance, banking, markets and payments-related services in or from the UK. UK Finance has been created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

2. Our objective is to work with our members to build a more customer-focused and innovative finance and banking sector, cementing the UK's role as a global leader in financial services for the benefit of the wider economy. The interests of our members' customers – whether they are individuals or businesses - are at the heart of our work.

Headline Summary

3. **Small and medium-sized enterprises are the backbone of the British economy** and we are determined to rebuild business trust in the financial services sector, support the economy and serve customers better.

4. Since 2010, the **banking and wider financial services industry has taken significant steps to better support SMEs with access to finance**. These steps have included:

    a. A Lending Appeals Process with independent oversight to enable businesses whose lending requests are declined or who are unhappy with the conditions offered to have their requests reviewed;
    b. A national mentoring network providing access to 27,000 enterprise mentors; and
    c. A Business Growth Fund, bank-funded with £2.5bn to act as an equity investor in SMEs, with local offices across the country.

5. Leading banks confirmed support in 2014 for the IFT Statement of Principles for the UK Business Support Units of Banks. This sets out best practice in banking business support, including how **businesses should be treated fairly, sympathetically and positively, in a professional way with transparent processes and procedures**. We are committed to refreshing this to ensure that it is remains fit for purpose.

6. In July 2017, **20 banks signed up to the new Standards of Lending Practice**, overseen by the Lending Standards Board, that define the treatment and outcomes SME customers should expect, including if find themselves in financial difficulty.

7. **UK Finance has also agreed to act as 'Strategic Partner' in taking forward the recommendations contained within the Banking Futures Real Economy Report**.[1] UK Finance is committed to working with our members to ensure that these important initiatives are taken forward, that trust is rebuilt amongst the industry's SME customer base and that access to finance continues to be diverse and available.

1 *Forging Closer Ties Between Banks & the Real Economy*, Banking Futures Report, 2017

8. More recently, **UK Finance has commissioned an independent, evidence-based, comprehensive review, looking at the scale and complexity of SME banking complaints**, particularly those that cannot be solved to the businesses satisfaction internally. Simon Walker CBE, former Director General of the Institute of Directors, has been appointed as the independent chair of this review.

9. UK Finance sees this as a critical piece of work to help **rebuild trust in the industry**. The review will also examine different dispute resolution processes, including those operating in different sectors and countries. It is intended to produce evidence-based conclusions to support recommendations for the industry and government as appropriate. The Chair will publish his findings in a report with full editorial control. We look forward to keeping the Committee sighted on its work and conclusions.

10. In terms of access to finance, this has improved significantly since contractions seen during and immediately after the financial crisis, with more finance options and greater competition amongst lenders. Only 4% of SMEs see access to external finance as a major obstacle to their future development.[2] However, demand remains weak and there is more to do to rebuild confidence around applying for finance, understanding different options and serving customers better.

11. We have provided detailed comments on the three areas the Committee has asked for evidence on below. We would of course be happy to discuss anything contained within the response with the Committee.

[2] SME Finance Monitor, Q4 2017

Section 1: Funding options for SMEs

12. Funding options for SMEs have never been more diverse. While bank lending is lower than before the financial crisis, it has shown a significant recovery since the contractions witnessed during it.

13. The market analysis provided by the British Business Bank (BBB) in its annual SME Finance Markets report demonstrates the diversity of finance options now available.[3] Table 1 shows the main sources of new supply of SME funding over recent years.

Gross New Funding for UK SMEs, 2008-2016 and 2017 estimates (£ billion)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 (est)	Growth since 2011 (%)	Growth since 2011 £bn Baseline
Bank Loans	44.5	41.2	40.4	38.9	38	42.9	53.4	57.8	59	57	47%	74.9
Private Equity	1	0.5	0.5	1	1.5	1.5	2.3	3.6	3.4	5	400%	11.3
Asset Finance	14.3	9.95	10.2	10.6	12.2	12.9	14.4	15.9	16.7	18.6	75%	27.1
P2P Business Lending	0.001	0.001	0.001	0.02	0.06	0.25	0.59	0.8	1.2	1.8	8900%	4.6
P2P Invoice Funding	0.001	0.001	0.001	0.003	0.04	0.1	0.27	0.3	0.35	0.5	16567%	1.5
CDFIs	0.03	0.03	0.02	0.03	0.05	0.07	0.09	0.1	0.08	0.06	112%	0.3
Total	59.8	51.7	51.1	50.6	51.9	57.7	71.1	78.5	80.7	83.0	64%	119.7

Figure 1 Sources: UK Finance, BoE, BBB, RF. Note growth since baseline is the cumulative funding achieved from each source above the 2011 baseline number. UK Finance estimates for 2017 as required.

14. The gross supply of debt and equity funding to SMEs has improved substantially since the low point in the financial crisis. Gross new supply has increased from an annual rate of just over £50 billion a year in 2010 and 2011 to just over £80 billion a year in 2016 and 2017.

15. The increase in gross supply since the financial crisis is the consequence of several developments, including the Bank of England's monetary policy and related capital funding initiatives, structural reform, the market investments made by the BBB and private companies, technological innovation, as well as the broader cyclical recovery in the economy.

16. The diversity of supply has increased as well with invoice finance and asset-based lending, peer-to-peer lending, leasing and private equity all reporting significant growth. This is a very welcome development and a number of UK Finance members contribute to funding SMEs. Consequently, the share of new bank debt in total supply fell from about 75% in 2008 to under 65% last year.[4] Although valid international comparisons are difficult because of definitional challenges, SME financing conditions in the UK are generally on a par with our main competitors internationally.[5] In the European Union SAFE survey, the UK continues to perform comparatively well.

3 *SME Finance Markets Report 2017/18*, British Business Bank, February 2018

[4] See Table 1

[5] OECD Financing SMEs and Entrepreneurs, An OECD Scoreboard, 2018

EU Safe Survey: Rating of access to finance as the most important issue faced by business in 2017

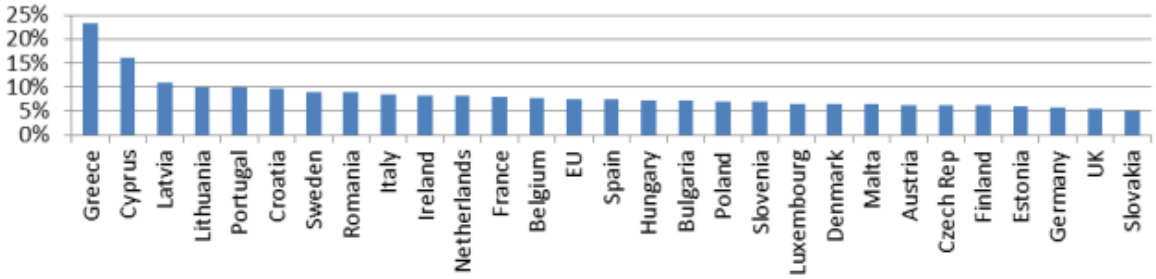

Figure 2: European Commission SME access to finance conditions 2017 SAFE results

17. Looking specifically at debt funding for SMEs, the UK banking sector has still provided the biggest share of the increase in gross new supply over the last decade (around £75 billion out of £120 billion).[6] Both larger and smaller bank players are very much 'open for business' with an appetite to grow lending books responsibly.

18. Peer-to-peer business lending and newer and specialist banks are making a real competitive challenge to the high street banks particularly for secured lending, partly due to interventions such as streamlining the processes around Deeds of Priority and Letters of Waivers. Newer firms are often able to take maximum advantage of new technology and can sometimes be more flexible and nimble compared to existing players.

19. Leasing (asset finance) and invoice finance and asset-based lending sectors are also growing rapidly (at faster rates than for bank lending). As well as the market investments made by the BBB, since the financial crisis, high street banks in particular have led calls for greater use of appropriate finance where the 'right' funding is sought for each applicant rather than 'any' funding, underscoring the banking industry's commitment to meeting the challenge of restoring trust by meeting customer needs.[7] We welcome the adoption of this as a key priority of the BBB, something which the industry has championed. This advocacy has also included supporting mentoring and forms of support (online support, entrepreneur hubs, sector specific engagement) to which the industry remains committed.[8]

20. UK Finance would draw this Committee's attention to one area, namely 'Bans on Assignment', where we believe action should be taken to remove an unnecessary barrier to finance options for SMEs. The Small Business, Enterprise and Employment Act 2015 included provision for Regulations to nullify the effect of restrictive terms in business-to-business contracts. These 'ban on assignment' clauses seek to prevent the assignment of debts for the purposes of accessing funding.

21. We believe that such contractual clauses are an onerous and unnecessary restriction on the ability of a business to use one of its most significant assets – the debts owed to it by its business customers – to unlock working capital. These Regulations render such terms ineffective and will allow businesses that suffer under their imposition greater access to wider finance options, whilst maintaining the rights of customer businesses. We encourage prompt progress on laying these Regulations before Parliament so that SMEs can gain the potential benefit of more diverse finance options. BEIS' assessment is that the Regulations will enable over £800 million additional funding to current invoice finance clients and between £100 and £150 million new funding to new invoice finance clients.

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[6] Gross new supply is the key financial indicator for the SME sector rather than the net stock of loans outstanding which is often influenced by the amortisation profile on long dated loan stock or, especially during the financial crisis, the decision of some UK banks to withdraw from new business but just collect and then not replace SME client loans.

[7] For example, the British Bankers Association written submission to the TSC 2014/15 Inquiry Conduct and Competition in SME Banking.

[8] Details can be accessed via www.betterbusinessfinance.co.uk and our dedicated site on www.mentorsme.co.uk.

22. As well as a diverse range of finance options for SMEs, it is important that businesses can access these options easily. Recently, a more formal referral system has been introduced by the Government for SMEs who cannot be funded by banks.[9] This goes beyond voluntary referral schemes already in place, including with Responsible Finance providers and the implementation of the process was independently reviewed in 2017. This review confirmed the successful embedding of the process across designated banks. The scheme means that eligible businesses turned down for finance are offered the opportunity to be referred to three different online Finance Platforms who can give a much wider selection of providers the opportunity to make funding offers to firms.

23. Despite all these favourable developments in the market, UK Finance members acknowledge that significant challenges remain. Two of the key ones we have identified are below.

Overall Application Rates: SME's appetite for borrowing

24. Despite the high and stable acceptance rates overall for SME customer loan requests from the banking sector, application rates in the business population are low.

25. In 2017, only about 7% of SMEs had a borrowing 'event' and – after excluding overdraft applications and events linked to closing loans at the end of full repayment - only around 2% of SMEs applied for a bank loan last year (including rollover and renewals). This was about 100,000 firms in 2016/17, of which around 70,000 were successful bank applications. As a result, while acceptance rates have picked up in recent year, the number of SMEs seeking funding is still falling as the initial application rate is depressed in the first place.[10]

26. Half of all SMEs remain currently classed as permanent non-borrowers.[11] This trend has been one of the most noticeable in recent years but has not been combined with a noticeable 'unmet demand.' For those who did wish to borrow, options (including non-bank options) have never been more extensive. This group reports no desire to borrow from any providers.

27. Indeed, the fall in the number of SMEs applying for a bank loan has been a much bigger influence on market trends in the last decade than any corresponding variations in overall acceptance rates over the same period. To put this in context, if the business stock *had not* grown sharply between 2004 and 2017, SME loan applications would have fallen even more sharply over recent years.[12]

28. Moreover, overdraft applications and usage have been declining since 1990 amongst SMEs in favour of alternative methods of finance, including cards, invoice finance and leasing. Where still used overdraft application success rates are also higher than for loans.

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9 Government Referral Scheme, Small Business Act 2015

10 See NIESR research for BBB Evaluation Study, Fraser (2008) and 'The effect of the credit crisis on UK SME finance', ESRC Report, (available at http://www.esrc.ac.uk/news-events-and-publications/evidence-briefings/the-effect-of-the-credit-crisis-on-uk-sme-finance).

11 Defined as "SMEs that seem firmly disinclined to borrow because they meet all of the following conditions: are not currently using external finance, have not used external finance in the past 5 years, have had no borrowing events in the past 12 months, have not applied for any other forms of finance in the last 12 months, said that they had had no desire to borrow in the past 12 months and reported no inclination to borrow in the next 3 months."

12 The comments in the above paragraph and the data in Table 2 exclude overdrafts to ensure consistency with the data in Table 1 on the gross flow of new loan facilities.

Table 2: Trends in Loan Application and Success Rates for SMEs

SME Monitor Waves	% apply loan	Number of SMEs applying
2001/4	14%	520,641
2005/8	11%	451,158
2007/8	14%	590,847
2008/9	11%	473,385
2010/11	10%	447,577
2011/12	7%	323,643
2012/13	4%	190,687
2013/14	3%	149,595
2014/15	3%	155,422
2015/16	2%	107,501

Figure 3 Source: NIESR Analysis and SME Finance Monitor (break in series); BEIS Business Population estimates

29. One of the key factors in determining SME lending application rates is underlying economic and business confidence. Hence despite the period of upswing in economic activity in the years after 2008/9, even though SME gross new loan supply increased year on year, the pace of this recovery in loan supply was muted by low application rates. In the years immediately after 2009/10, the banking sector was often cited as not being 'open for business' leading to fewer loan applications.[13] However, for many years now the high street banks in particular have supported a wide range of market building measures such as mentoring and customer engagement activities, and provision of better information about the full range of finance options that may be available and appropriate for a business. This has often been in partnership with the BBB and other key stakeholders.[14] As noted above, new challenger banks have set up to create an even more diverse banking sector.

30. Despite this, application rates have continued to fall, although more new loans have been agreed in value terms (as indicated in Table 1) this has been for larger loans to fewer firms.

31. In part, lower application rates in recent years could be due to a range of factors, such as:

    a. A willingness of firms to use savings in a low interest environment rather than borrow money (and SME deposits are at high levels as well).[15] According to the SME Finance Monitor, "Almost all SMEs held some credit balances and the average amount held in 2017 was £37,000. On average SMEs held the equivalent of a quarter of their turnover as credit balances. 25% of SMEs held £10,000 or more in credit balances and most of them said this reduced their need for external finance."[16] Overall, four-fifths of SMEs are currently classed in independent research as 'happy non-seekers of finance'[17];

    b. Also, in the decade prior to 2007, in a lighter touch regulatory environment application rates may well have been 'too high' by any reasonable current prudential benchmark, so a lower application rate might represent the norm in the market; and

    c. Some evidence of greater direct use of alternative, more appropriate, funding solutions as the supply of finance has diversified. Many businesses who previously

[13] For example, Oral Evidence by Dr Vince Cable, Secretary of State to the TSC Inquiry on Bank Lending and Business Growth May 2013 (https://publications.parliament.uk/pa/cm201213/cmselect/cmbis/533i/120717.htm)

[14] See footnote 5 and https://thebusinessfinanceguide.co.uk

[15] www.ukfinance.org.uk/q4-2017-sme-manufacturers-borrow-more-while-service-businesses-retrench

[16] SME Finance Monitor, Q4 2017

[17] SME Finance Monitor, Q4 2017

sought bank loans and overdrafts as the 'default' options have growing awareness of alternative options.

32. UK Finance would strongly endorse a view that any significant rise in SME loan application rates over the next few years remains inextricably linked to wider economic activity and policy developments, including certainty around key issues regarding the UK's exit from the European Union. However, as the SME Finance Monitor shows, those who apply for funding are far more likely to be successful than they believe. While this gap has narrowed in recent years, there is clearly more to do for the sector to show that it is very much 'open for business'.

Variations in loan acceptance rates

33. Although average SME bank loan acceptance rates in 2016-17 are higher than since the period immediately after the financial crisis, a range of variation between different types of applicant is evident and follows key credit risk criteria. For example, an established repeat SME loan applicant with a good credit profile experiences a loan acceptance rate which is significantly better than those reported for first time or higher risk borrowers.

Table 3: SME Bank Loan acceptance rates 2016/17 (%)

All SMEs	69.1
-Minimal risk	92.0
-Worse than avg risk	54.6
-First Time applicants	51.6
-Other new facilities	75.6
-Renewals	88.6

Figure 4 Source: SME Finance Monitor

34. This variation is closely linked to the risk profile of the applicants rather than any customer demographic, location or industry sector alone.[18]

35. As a result, for example, the growth in the business stock in the last decade has increased the share of first time borrowers in loan applicants since 2015 which impacts adversely on the long-term analysis of acceptance rates as the mix of applicants has changed over time.

36. Overall average loan acceptance rates are still not back to pre-financial crisis levels as far as can be measured (they are on mix adjusted terms). However, even more noticeably it would appear to be the case that the introduction of a more complex risk adjusted credit process as part of the wider regulatory environment in the run up to the financial crisis has led to an even wider range of outcomes for loan applicants than commonplace a decade or so ago. Understandably, this has led to worries amongst customers, representative groups and policy makers about the credit risk appetite amongst lenders for SME applicants.

37. In the case of customers this is particularly to be expected as some firms only apply for a new facility every three or five years, so regulations and procedures have changed noticeably each time they apply. Banks are keen to ensure customers know how loans are assessed and now offer more information and literature giving guidance plus the appeals process for SME customers, but the tougher regulatory environment and the prudential lending checks are a factor for some types of customer.

[18] See footnote 8

38. As part of the Competition and Markets Authority (CMA) Retail Banking Order, the largest high street banks have introduced a loan price and eligibility tool which is open to SMEs that wish to check a banks appetite to lend to it as well as obtaining an indicative price at which it will do so. The business can then decide whether to apply with the additional comfort of data that shows how many SMEs secured the same decision and price as returned by the tool.

39. We encourage the Committee to recognise that risk appetite is a competitive differentiator between industry participants and the declined lending referrals process allows participants to meet customer demands within their own risk constraints to lend to SMEs that have been declined by traditional providers.

40. A similar issue has been evident in recent years for people looking to invest in an expanding business or set-up a new one. Prior to the financial crisis, periods of sustained economic growth and rising property values led to the use of equity release from housing wealth as a way of funding a cash injection into a business.[19] As the business owner had a significant personal stake in the venture, banks were often able to provide additional modest debt funding as well. However, tighter mortgage regulation and lower house price inflation has reduced the supply of such funding, creating more problems for newer higher risk ventures in obtaining debt funding.

41. In part, this has been addressed by developments in equity and venture funding, particularly through the work of the BBB, but the likelihood is that the current growth in debt aversion in reality includes business owners who are unwilling to borrow too much on a business loan rather than split the debt between personal mortgage (releasing a cash injection into a business) and a smaller business loan, partly on the expectation that a lender is less likely to foreclose on a mortgage security than a business loan.[20]

42. A tougher regulatory regime for established loan providers has, in part, provided a market opportunity for some new providers of SME debt, notably peer-to-peer business lending and some challenger banks (in the latter case, notably for secured loans). However, it has also increased the possibility that a funding gap is evident where viable business propositions are unable to obtain funding on normal commercial terms. This has been a focus for government policy intervention since the early 1980s starting with the Small Firms Loan Guarantee Scheme (SFLGS), where government guarantees a degree of the losses on private bank loans to SMEs. A major recent policy initiative is the Start-up Loans programme where the national government has directly funded the capital provision for loans to this part of the business population (and in effect underwritten all the losses).

43. UK Finance believes that these policy initiatives have played a crucial role in the financing landscape for those businesses who are unsuited to traditional bank lending. Indeed, UK Finance members support them all and are the primary intermediaries in many of the initiatives. However, the Start-up Loans Company programme is due to expire in its current form in 2020.

44. Furthermore, a number of European Investment Bank (EIB) guarantee schemes have an uncertain future post-Brexit. We encourage resolution of this uncertainty as soon as possible, or a clear commitment to preventing a funding gap emerging.

45. While equity investment is currently clustered rather than evenly distributed, UK Finance notes the BBB's findings that "Bank lending is largely distribution in the UK in line with the overall business population in most areas."[21] Those areas (London and the South East) that have proportionately lower shares also have the highest levels of use of alternative finance sources.

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[19] This was first discussed by Blanchflower and Oswald (1998); see also ECB Working paper 'House Prices, Home Equity and Entrepreneurship'

20 The more recent negative relationship between mortgage debt and entrepreneurship is discussed in Mortgage Debt and Entrepreneurship (2017) from the LSE Research Series (http://eprints.lse.ac.uk/84703/1/Bracke_Hilber_Silva_Mortgage%20Debt%20and%20Entrepreneurship_Final.pdf)

[21] BBB, Small Business Markets Report, 2017/18

Section 2: The ability of SMEs to resolve disputes and access fair and reasonable compensation when they borrow money

46. UK Finance members seek to operate all products and services – not just those linked to borrowing money - in a way to meet and hopefully exceed customers' expectations of operational standards as well as fair and equitable treatment. However, in any commercial relationship there will be issues and challenges. In some cases, these can lead to customer distress and a breakdown in relations between the business and the financial services supplier. UK Finance members recognise where this happens they have a duty to correct the errors and, where appropriate, compensate customers.

47. Following the recent publication of the FCA consultation paper on this issue (CP18/3), UK Finance members have been broadly supportive of the proposals to give even more businesses access to the Financial Ombudsman Service.

48. While we are still assessing the detailed proposals of reform to the existing Ombudsman regime, UK Finance can provide an outline of the initial views of member's on CP18/3 and some further initiatives in this area. In addition to the outline contained below, UK Finance will provide this Committee a copy of its detailed response to the FCA as soon as it is available.

49. At present, the summary views of UK Finance and our members on this issue are as follows:

    a. The vast majority of small business complaints are resolved to the satisfaction of the customer "in house" without reference to the FOS. Only about 1% of micro enterprise complaints end up being taken to the Ombudsman service for adjudication. This suggests the current broad dispute resolution arrangements (internal and external) are working well for customers currently in scope. Nonetheless, UK Finance members acknowledge definitions and coverage can be confusing for users, notably in view of differences with eligibility thresholds used by the Small Business Commissioner, Bank ring-fencing regulations; and other definitions;

    b. UK Finance and our members endorses the principle outlined in CP18/3 to extend the coverage of the existing Financial Ombudsman Service from microenterprises (typically under £1m turnover) to SMEs up to £6.5m (along with other appropriate, fair qualifying criteria). This will add about 200,000 further businesses into the scope of the FOS with only a small number of larger SMEs outside of scope from a business population of over 5.5 million;

    c. We do have some concerns over the detailed practicalities of the changes, notably around the qualifying criteria trying to ensure fair treatment for all. Further discussion is also underway regarding the tight schedule for implementation by December this year, as well as the requirement to increase fully-trained resources for the FOS. UK Finance are committed to working with the FCA and FOS to respond proactively to these challenges; and

    d. UK Finance members also endorse the principle of extending in certain respects the coverage of the FOS to allow loan guarantors to be included. Again, the exact detail needs detailed discussion and agreement;

50. Regarding the call for further institutional change to handle SME banking disputes, UK Finance does not believe a case has been established that any such action is required (beyond ongoing initiatives to reform the UK courts system to improve access for all). A number of historical cases of poor treatment are normally cited as justifying change. These show that trust must be rebuilt amongst SME customers and a core objective of UK Finance is to restore business confidence in the industry.

51. UK Finance members believe the incidence of cases justifying redress on a scale that cannot be addressed by the FOS is low. However, we recognise that this is difficult to quantify without reliable evidence and in-depth analysis of all the possible options. Therefore, UK Finance has commissioned independent research into Alternative Dispute Resolution for business

customers into this issue supported by a widely based stakeholder steering group – including the APPG on Fair Business Banking and Finance looking at this issue - and led by a specialist legal expert. Full details will be included in the UK Finance response to the FCA's current consultation on the issue.

Section 3: The regulation of SME lending

52. It is important to recognise that the vast majority of SME lending and similar types of credit contracts measured by volume are already regulated via consumer legislation (Consumer Credit Act) covering sole traders and small partnerships, including requirements on treating customers fairly requirements. These regulated products are straightforward credit arrangements and selling procedures with limited (or no) scope for customisation. They essentially treat small business purchasers the same as a retail consumer, so in effect, mirror the arrangements for the FOS which offers little distinction between personal and business complainants (apart from the later only being eligible up to a size limit). We think this is broadly appropriate and working for smaller businesses.

53. However, many UK Finance members go beyond formal regulation, including as signatories to the Standards of Lending Practice Business Customers which covers businesses up to an annual turnover of £6.5 million. These are independently overseen by the Lending Standards Board and importantly include commitments on how businesses in financial difficulty should be treated, as well as debt on-sale. The Institute for Turnaround's (IFT) *Principles on Business Support Units* is another prominent example of this.

54. However, the key point is that these standards need to have a robust independent monitoring and evaluation regime to underpin user confidence. This is starting to emerge and banks and other financial services providers are very supportive of such an approach. UK Finance would support practical proposals to strengthen and even extend voluntary codes and procedures where it was shown to be of real benefit to customer trust and business practice.

55. In this regard, UK Finance would particularly draw the Committee's attention to the independent *Standards Framework for Invoice Finance and Asset Based Lending*, established in 2013 by the ABFA and brought across into UK Finance when it was launched last year. The Standards Framework sets and enforces standards in the provision of invoice finance (factoring and invoice discounting) and asset-based lending to SMEs. It includes an independent ADR service provided by Ombudsman Services, as well as an independent Professional Standards Council that is responsible for safeguarding and promoting the reputation of this sector. We believe these Standards are a positive example of the financial services industry being responsible and proactive in establishing and promoting standards of best practice.

56. Proposals to further increase the regulation of SME lending relates primarily to larger loans to SMEs outside the scope of the FOS arrangements. These loans will often be bespoke in nature to meet customer needs and will predominantly be taken out by companies (usually of greater financial sophistication), rather than sole traders or small partnerships.

57. As mentioned above, UK Finance does not believe up to date, independent and representative evidence is available looking at this issue and as a result has commissioned an independent review in this area which will deliver clear recommendations later this year.

58. While the FCA proposals to amend the eligibility criteria for the FOS will add some additional protection to the lending process outside of the current regulated process for small loans – notably around guarantors – most of the loan contracts for larger businesses are bespoke. In each case they are negotiated with the directors of a company who have a responsibility to ensure they understand the nature of the products and services they are seeking to access and to take whatever independent advice may be required to do that. This is already regarded by many SME owners as a burdensome process, a perception which further regulation is unlikely to improve. Indeed, research on discouragement amongst SME owners has highlighted

perceptions of delay and complexity in the application process as a major contributory factor and this is normally a process outside of the control of the financial services provider.[22]

59. UK Finance would encourage the Committee to recognise the challenge around SME customers seeking to urgently agree a new loan facility or renegotiate existing contracts to avoid financial distress. While independent legal advice is particularly appropriate in such circumstances, it is always the case that speed is vital to avoid too much damage to a firm's reputation and ability to trade. Hence, it is already a fine balance to make between the responsibilities of directors in entering into commercial agreements, the need for a finance provider to make appropriate checks and take due diligence to deploy its depositors' funds at low risk, alongside the need for the company to continue to trade with sufficient cash flow.

60. Any regulatory changes however well-intentioned are unlikely to make this balancing act any easier. Hence, UK Finance takes a cautious stance on the desirability of any legislative changes in this area without consideration on the potential impacts on banks' and other finance providers' ability to lend, and SMEs' ability to obtain finance smoothly and on a bespoke basis where desired. The Companies Act and other commercial legislation on contract law provide a long established regulatory framework which is well established in the legal system, full consideration of which is essential before making significant changes.

61. Finally, we would also note UK Finance's participation in the APPG on Fair Business Banking and Finance's Contracts Working Group. This is working with a number of parties to review bank standard lending contracts (where those banks who are signatories to the Standards of Lending Practice) against these Standards. This will result in feedback to our members of how their standard contracts can be made clearer and to thus lower potential barriers to smaller businesses, in particular, accessing finance.

Conclusion

62. UK Finance believes the evidence shows that SMEs access to finance landscape has been transformed significantly in recent years. The financial services industry has taken significant steps forward, with UK Finance playing a central role in this. There is a central focus on SMEs in UK Finance's work and as well as on-going dialogue with business groups and other stakeholders, we are pleased that Teresa Graham OBE (Chair of UK Finance's independent SME Advisory Group) will hold us to account on this objective.

63. We recognise that there is no room for complacency and see rebuilding SME trust in the financial services industry as a key barometer of our success. We believe that the recommendations that will be made through the independently commissioned review into dispute resolution will be an important part of this, as well as other initiatives discussed above.

64. UK Finance would be pleased to discuss any of this response or the work the industry is doing to support business customers with this Committee or its members. We will ensure a copy of our response to the FCA's consultation paper is provided to the Committee.

[22] See Footnote 10