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| **Title:** The Small and Medium Sized Business (Finance Platforms) Regulations 2015 | Post-implementation review |
| **PIR No:** N/A | **Date:** 14/10/2020 |
| **Original IA/RPC No:** RPC14-HMT2153(2**)** | **Type of regulation:** **Domestic** |
| **Lead department or agency:** HM Treasury | **Type of review:** Statutory |
| **Other departments or agencies:** N/A | **Date measure came into force:** 01/01/2016 |
| | **Recommendation: Keep** |
| Contact for enquiries: tukeer.hussain@hmtreasury.gov.uk | **RPC Opinion: Green** |

**1. What were the policy objectives of the measure?**

The Regulations seek to mitigate a market failure of information asymmetry that impeded small and medium enterprises' (SMEs) ability to access finance by referring customers of nine designated banks which are not accepted for finance by those banks to private sector platforms. In many cases, alternative credit providers were previously unable to offer finance to smaller businesses because they were not aware of their existence, whilst similarly SMEs were unaware of these alternative sources of finance. In 2014-15, the largest four banks accounted for over 80% of SMEs' main banking relationships.

These Regulations sought to help level the playing field for alternative credit providers, by facilitating them being matched up with SME customers seeking finance, and in this way improving SMEs' access to finance. The Regulations allow alternative finance providers to easily contact SMEs that are seeking finance after having been referred from other lenders at the point of decline. Specifically, designated banks are required to pass on details of SME applicants – with the SME's permission – which do not meet the lending requirements of said banks to private sector platforms. This improves competition in the SME lending market by highlighting potential lending opportunities to alternative lenders. The British Business Bank conducted a competitive designation process on behalf of the Treasury both for the banks mandated to refer customers, and for the finance platforms which match referred businesses to alternative credit providers.

The review clause contained within the Small and Medium sized business (Finance Platforms) Regulations 2015 requires this post-implementation review (PIR) by 1 January 2021 to review the original policy objectives, assess the extent to which they have been achieved, discuss the extent to which those objectives remain appropriate and assess whether a system that imposes less regulation could achieve the same result.

**2. What evidence has informed the PIR?**

HMT has engaged with a range of internal and external stakeholders to inform the evidences used in this PIR. HMT and UK Finance hosted a roundtable with both the designated banks and a representative sample of alternative credit providers to source qualitative feedback on the scheme. The PIR also uses feedback from the designated finance platforms, who introduce referred businesses to alternative credit providers. The evidence collected therefore represents the vast majority of key Bank Referral Scheme (BRS) stakeholders. Furthermore, primary data on scheme uptake is published annually on Gov.UK (most recent figures are from August 2019, with publication of 2020 figures having been delayed due to resource constraints due to the Covid pandemic).

**3. To what extent have the policy objectives been achieved?**

Up to Q2 2019, 1,695 deals worth a total of £32.9 million had been approved between alternative credit providers and SMEs, following just under 30,000 referrals through the scheme. This represents a cumulative conversion rate of referrals to loans of 5.66%. Although total supply of finance through the scheme is relatively small compared to SMEs' total finance needs, we note that the scheme can only add value insofar as SMEs make use of it, both by giving consent for their data to be shared with the finance platforms, and by applying for the loans with the alternative lenders thereafter. SMEs' relative inertia in seeking business finance is well known, for example with data from the Bank of England [Open data for SME finance] indicating that 50% of SMEs only want to go to their bank for finance, and 25% are put off by the bureaucracy around loan applications. Despite this, feedback from designated banks, alternative credit providers and finance platforms points to a marked change in behaviour by SMEs, crediting the scheme for making SMEs more aware of alternative credit providers generally, leading to more relationships being built directly with providers even without an initial rejection from a designated bank. Statistics on alternative lenders' asset, equity and marketplace business lending speaks to this point, having increased by 32%, 131% and 374% respectively from 2014 to 2019 (The British Business Bank, Feb 2020), although major banks remain the primary source of SME financing.

Designated banks report that the BRS provides a well-functioning referral system that supports customers that they cannot offer finance to. They suggest that the scheme might result in larger referral numbers if steps are taken to 1) make the BRS more accessible for specialist finance (asset, plus invoice) and 2) understand, and seek to address, why SMEs do not take up the scheme in the first place, for example, lack of confidence in the ability to successfully apply for finance after a first rejection. Major lenders highlighted the second point as a key issue with the scheme, suggesting further SME education on the purpose and merits of the scheme might be helpful.

While BRS has been permanently integrated into the digital infrastructure of both the designated banks and platforms, feedback does suggest there is room for improvement in their implementation of the scheme. Notably, feedback suggests that more consistent communication to SMEs of the benefits of the scheme, as well as more accuracy in the data provided in the referrals to the platforms, could help better achieve the policy objectives.

**SCS of Banking and Credit**

Signed: ***David Raw*** Date: ***14/10/2020***

Sign-off for Post-implementation review: Minister

***I have read the PIR and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.***

Signed: ***John Glen*** Date: ***15/10/2020***

## Further information sheet

Please provide additional evidence in subsequent sheets, as required.

**4. What were the original assumptions?**

The Explanatory Memorandum assumed that a statutory scheme requiring designated lenders to refer SME customers they had rejected for finance, to finance platforms, would improve outcomes compared to the voluntary or bilateral schemes that previously existed. The outcomes listed in Section 3 justify this assumption, because stakeholder feedback was clear that previous bilateral or voluntary schemes had made little impact compared to BRS.

The costs of the BRS – calculated in 2015/16 – were estimated at – £13.26 million. The 9 designated banks bore most of the costs at central assumptions of £6.3 million on namely additional IT requirements. However, the platforms did also face transition costs of approximately £500,000 and a supplementary £200,000 for the sending/receiving of specified information. Moreover, the business assessment for this policy estimates a direct impact annual equivalent of £1.2 million, which is in scope of 'One in Two Out' (OITO) and qualifies as a zero-net cost. This was all founded on a 10-year time period with an assumed discounted rate of 3.5%, meaning costs were essentially initial infrastructure spending – with a relatively small maintenance cost.

**5. Were there any unintended consequences?**

Generally, the consequences of the BRS have been as identified in the original Regulatory Impact Assessment (RIA).

A known possibility was that some applicants who are rejected by a bank may also be rejected by an alternative finance provider, illustrating the problem of lower quality referrals. However, the intention of the scheme is to increase the likelihood of an SME securing financing by matching them up with alternative options, not to guarantee access to finance for all SMEs.

Another issue highlighted by alternative finance providers on the BRS is the actual difference in lending offer as the designated banks often tend to have lower interest rates than the alternative credit providers, and the terms and conditions for the finance can differ significantly. Again, this was a known possibility, reflecting that – particularly for less creditworthy businesses – the price of alternative finance may be higher.

**6. Has the evidence identified any opportunities for reducing the burden on business?**

Feedback has suggested that burdens on SMEs, in terms of how effectively the referrals are processed and how they are communicated to SMEs, could be reduced by providing guidance on how the scheme should be implemented across the designated lenders. This would not require an amendment to the Regulations.

A key point highlighted is the data quality used for referrals could be improved by ensuring that all referrals comply with minimum data requirements. Some feedback suggests that the data quality and user journey of SMEs being referred can be inefficient and slow. In some cases, received data is poor with incorrect fields such as phone numbers/amounts requested. Moreover, the time between a customer decline and a consideration of a referral is not standard and sometimes poor coordination between the referring banks and users results multiple brokers are contacting SMEs at the same time.

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| Also, several stakeholders have pointed out that there is little standardisation of communications for the BRS across the designated banks, with references to the scheme often only included in passing at the end of lengthy communications. This fact has meant some SMEs rejected from designated banks have either not known – or found out too late – about the BRS. |
| **7. For EU measures, how does the UK's implementation compare with that in other EU member states in terms of costs to business?**<br>N/A |

**Recommended Next Steps**

This review proposes to keep the legislation

The Bank Referral Scheme has made a small but significant contribution to competition in business lending, improving some SMEs' access to finance, since its launch. Stakeholder feedback has highlighted some opportunities to improve the operation of the BRS through guidance, but no need to revisit the Regulations themselves. We will undertake further work and to identify whether guidance could make a meaningful improvement.