KEVIN HOLLINRAKE MP

HOUSE OF COMMONS
LONDON SW1A 0AA

18th September 2021

The Rt Hon Rishi Sunak MP
Chancellor of the Exchequer
HM Treasury
Correspondence and Enquiry Unit
1 Horse Guards Road
London SW1A 2HQ

Dear Chancellor,

I attach a copy of the APPG on Fair Business Banking's latest report 'Scale up to level up', an in-depth, analytical report on the availability of SME finance. This report was written in conjunction with WPI Economics and followed a call for evidence, four inquiry sessions and a consultative roundtable with Minister for Small Business, Paul Scully, and Economic Secretary to the Treasury, John Glen. It highlights key areas of concern in the current financial system, the subsequent consequences for our economy and proposed recommendations to improve the flow of finance to SMEs and level up the British economy.

This inquiry raised many areas of concern, not least the issue of regional disparities for SME finance. Key findings include:

The provision of SME finance in the UK is hugely concentrated and largely shared amongst the Big 4 banks, all of whom are primarily responsible to their shareholders and at times of crisis can prioritise profits at the expense of their customers

- During the critical post-recession period of 2008 to 2013, total bank lending to non-financial businesses in the UK dropped by around 25%, during the same period in Germany, lending by the thousands of regional mutual banks (Sparkassen) and co-operatives increased by around 20%. Similar dynamics were in evidence in the US, Switzerland and Japan, all of whom have effective and established mutual and cooperative banking sectors
- Clear evidence that, in general, 'big banks lend to big businesses'
- A critical shortage of SME finance and a lack of trust between banks and businesses which has significantly reduced the borrowing appetite amongst SMEs. A significant proportion (73%) of SMEs would rather grow more slowly than borrow, which is clearly bad for the business itself, for the jobs that could be created and, when multiplied millions of times, for UK plc.
- This lack of finance is a particular barrier to the government's ambition to level up as availability is less of a problem in prosperous area such as London and the South-East.

The good news is that the solutions are within our gift, including:

- Removing regulatory and competition barriers for challenger banks, mutuals and Community Development Finance Institutions
- Providing pump-prime funding for mutuals and CDFIs via on-lending from big banks and dormant assets
- Giving non-bank lenders access to cheap money to lend from the Bank of England's Term Funding Scheme for SMEs
- Rolling out Legal Entity Identifiers to make it easier for big banks to lend to small businesses
- Improve signposting of finance options
- Develop a new approach to equity finance through a 3i 2.0 and regional angel programmes

I would also like to raise some key, immediate concerns raised by challenger banks:

Bank of England Term Funding for SMEs expires in October 2021 – the TFSME scheme has been vital in reducing funding costs for challenger SME banks and supporting more affordable lending for SMEs through the crisis. We believe the scheme should be extended beyond its current expiry date of October this year and well into 2022 or 2023, to underpin the period of forecast unprecedented economic growth by ensuring ongoing lower pricing to SMEs.

Basel VI/SME support factor – if EBA preliminary guidance is followed, the SME support factor will cease at end 2022 with the start of the so-called 'Basel IV' regime, leading to a potential 30% increase in the capital requirements for SME lending, and thereby a reduction in the supply of finance to SMEs by banks. This is likely to begin to bite during late 2021 and 2022 as banks prepare for its removal, just as the economy is meant to be growing at an unprecedented 7%. The PRA has complete flexibility post-Brexit to maintain the support factor, and we understand will be consulting on 'Basel IV' implementation later this year – we would urge at a minimum that they should be maintaining the support factor for SME challenger banks subject to the Standardised capital regime, which the EBA guidance paper from 2019 recommended.

I look forward to hearing from you regarding the above concerns and recommendations.

Kind regards

Kevin Hollinrake

Kevin Hollinrake MP
Member of Parliament, Thirsk & Malton Constituency
Co-Chair, APPG on Fair Business Banking