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Nicky Morgan MP
Chair
Treasury Select Committee
House of Commons
London
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Sent via email

Dear Ms Morgan

Thank you again for the opportunity for CYBG to give evidence to the Committee, which I hope was useful for you and your colleagues.

We were pleased to receive your request for further information following the session and have provided additional answers and information in relation to your questions below.

In previous evidence sessions, the Committee has heard that many SMEs are not fully aware of the range of financing options available to them. In your experience, is understanding and awareness an issue for SMEs seeking finance? If so, what can be done to improve it?

Often the focus of debate is on the availability of finance for SMEs, although in our view SMEs' understanding of the options open to them is equally important - in particular, their understanding of what finance is appropriate at each stage of their development and for different funding needs.

The British Business Bank's Small Business Finance Market report for 2017/18 highlighted not just the lack of understanding amongst many SMEs regarding the finance options which are available to them, but also how to access different forms of finance. The report showed that SMEs are most aware of traditional bank finance but less aware of alternative forms of finance, including peer to peer lending, as well as equity and angel investment. In addition we believe that smaller firms are often unaware of the costs and benefits of the finance options available.

Given this, there is certainly more that could be done to improve SME's awareness of the funding options which are open to them. Intermediaries already play a critical role because selecting a bank, especially if there is significant financing required, is a relatively uncommon event for an SME. Experienced intermediaries are familiar with the market rates, product suitability and terms. Brokers are also able to inform their customers on what are credible, and what are likely to be non-deliverable, demands of finance providers, and therefore helping to find more effective and sustainable solutions for them.

However, advice from intermediaries is only likely to be an option for a relatively small group of SMEs. Advice for smaller SMEs is available but there is more scope for the financial services sector to work more closely with government and other bodies to help improve SME understanding of financing options and ensure they can access the advice and support they need. Initiatives such as British Business Bank's Business Finance Guide are to be welcomed. Equally, there should be scope for the industry to work with government and other public bodies, such as enterprise agencies (e.g. Local Enterprise Partnerships in England and Scottish Enterprise/Highlands and Islands Enterprise in Scotland) to help improve SME's understanding of funding options.

Do you view alternative finance providers – such as peer-to-peer lenders- as providing a credible competitive threat to the banks in the SME lending market? Would SMEs benefit from greater levels of collaboration between alternative finance providers and banks?

As highlighted by UK Finance, the diversity of funding sources has improved since 2008 with the share of new bank debt in total supply falling from c75% in 2008 to under 65% last year. Invoice finance and asset-based lending, peer-to-peer lending, leasing and private equity all reported significant growth.

A healthy funding 'eco-system' for SMEs includes alternative forms of finance such as Peer to Peer lending and Crowdfunding. However, these alternative forms of finance still only represent a very small proportion of the overall market for SME finance and the more limited scope of their offering means that they cannot meet the often varying needs of a significant number of SMEs. We believe that a material increase in competition in SME financing will mainly come from established full service banks that are able to offer the great majority of SMEs a full range of products to meet their diverse and often complex requirements.

What is your assessment of SME's willingness to switch banks?

For SMEs, banks are often sole suppliers of business-critical finance and cash management services and, consequently, switching banks has a degree of risk for all but the smallest and simplest of SMEs who can reasonably assume all their specific requirements will be met by most banks. Therefore, we tend to see a higher willingness to switch among micro businesses and smaller SMEs.

For more complex SMEs, switching bank is often linked to some type of corporate "event" – such as a new requirement for finance or a change in how they do business (for example increased trading overseas that requires trade or FX products) – or linked to a difference of opinion with their existing provider. It's rare to see a customer who is content with the service provided by their bank simply shopping for slightly different or cheaper services from another provider. The perceived risks along with the time requirement associated with change of supplier outweigh the perceived benefits.

To what extent will Open Banking improve SMEs' access to finance, and what is your assessment of the level of trust SME customers have in the initiative?

We consider that Open Banking will help to address the inertia described above, help improve the service offered to SMEs and deliver greater competition in SME banking. Enabling, at their discretion, the sharing of banking data in a secure environment will enable customers to more easily access products from other banking providers. However we would caution that all-assets security may limit the ability of Open Banking alone to deliver increased competition in lending to SMEs.

Open Banking should increase the ability to integrate information into non-banking products such as accountancy packages, expense management, HR services and allow businesses to pool and sweep their cash resources to maximise liquidity. This has the potential to deliver significant benefit to SMEs, helping them manage their finances more effectively and allowing them to focus management time on growing their business.

We believe that trust in Open Banking will build as SMEs see and feel the benefits to their business. We also recognise that Banks have a vital role to play in building this trust.

In our experience, small business owners are often early adopters of new technology and may well be ahead of retail customers when it comes to the adoption of services provided under Open Banking and PSD2. Under PSD2, banks and other payment service providers will be required to provide access to the payment account information of their customers to approved Payment Initiation Service Providers (PISPs) and Account Information Service Providers (AISPs) at the request of those customers. In a recent report by Pinsent Masons, fintech firm Fluidly highlighted that trust in AISPs is more advanced for SMEs as the functionality exists in many accounting packages that already offer bank feeds.

What are your views on the design and likely effectiveness of the Alternative Remedies Package?

We are very supportive of the RBS Alternative Remedies Package agreed by HM Treasury with the European Commission and have prepared assiduously to ensure we are able to contribute to its successful delivery, especially through the proposed Incentivised Switching Scheme.

We believe the design of the Alternative Remedies Package is an innovative solution that offers a very realistic prospect of introducing more competition and choice to the SME banking market.

If successful the Incentivised Switching Scheme will see 2% of the UK's SME business current account (BCA) market transfer from RBS to the challenger banks. We believe this primary focus on business current accounts (rather than lending) is correct as BCAs continue to be the "gateway" product that drives an SME's primary banking relationship. BCA provision is therefore critical to ensuring a shift in market share and increase in competition in the market.

We also believe the proposed incentivisation approach, with a tiered structure offering larger incentives for larger SMEs with more complex banking arrangements, offers a realistic route to encouraging current RBS / Williams & Glyn customers to transfer from RBS to an alternative bank.

We intend to play a full part in the switching scheme and will be applying to be an eligible participating bank when the new Banking Competition Remedies body opens applications. As we reported in our half year results, we have already invested £5m in preparing to handle the large numbers of customers that could potentially switch to CYBG from RBS as part of this scheme to ensure there is a robust, secure and smooth process in place for SME customers.

The Capability & Innovation Fund will, we believe, also play a key role in promoting greater competition in the SME banking market. It is widely acknowledged that mid-tier challenger banks and smaller players face greater investment constraints than the large incumbents . A scheme that provides greater investment capacity for those banks to develop SME services and propositions will play a critical role in expanding choice and service across the industry for the benefit of SME customers.

We agree with the scheme being designed in a way that a large proportion of potential funding is focussed on those banks with existing scale and we believe strongly that enabling a small number of banks to reach meanigful market share by developing new capabilities and services will deliver a much better competition outcome than spreading investment much more thinly across the whole sector.

It is also important to recognise that there will still be significant Capability & Innovation Fund awards available for smaller institutions, providing support to these banks, fintechs and other operators that would not otherwise be available to expand their current services.

How has the Brexit vote affected the SME finance market, and what impact do you expect to see when the UK leaves the European Union?

CYBG has pledged to lend £6bn across the UK by the end of 2019, exceeding this pledge in the first year lending £2.1bn. We continue to see good demand from SME's for lending. However, we recognise that the current economic and political uncertainty may impact demand. While the most recent results of the SME Finance Monitor have shown an increase in lending to SMEs, demand has been largely flat over the last year.

While it has not yet materially impacted on our lending to SMEs, we are hearing some concern from our customers regarding the impact on them from Brexit, particularly from a 'no deal' scenario.

Are there steps that you believe the Government and/or the financial regulators should be taking in order to make the SME finance market function more effectively?

The sharing of SME credit data is a step forward in terms of the portability of SME banking relationships. Implementing similar arrangements for KYC data could augment this, provided the solution is explicitly approved by the banking regulators and can be relied upon for decision-making purposes.

I trust these answers are helpful. Should you require any further information, please contact Jamie Maxton, CYBG's Government Relations Manager, who will be happy to organise further detail for you and your committee colleagues.

Kind Regards

Yours sincerely

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