HSBC UK

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Rt Hon Nicky Morgan MP
Chair, Treasury Select Committee
House of Commons
Westminster
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Dear Nicky,

Thank you for your letter dated 24 May 2018. I have sought to answer each of your enclosed questions in turn and hope the responses are informative.

1. Is understanding and awareness an issue for SMEs seeking finance? If so, what can be done to improve it?

The SME Finance Monitor research, to which I referred in my oral evidence, suggests that it is demand for, rather than awareness or access to finance which may be the issue.

I would draw your attention to a number of factors that might be contributing to muted demand and provide an explanation:

- A willingness of firms to use savings in a low interest environment rather than borrow money.
- 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 be done to encourage businesses to consider finance for growth.
- Any significant rise in SME loan application rates over the coming years is likely to be linked to wider economic activity and policy developments. The main barrier to applying in 2017 was a reluctance to borrow in the current climate (50% of Future Would Be Seekers).
- As the supply of finance has diversified and competition increased, many businesses who previously sought bank loans and overdrafts as the 'default' options have growing awareness, and access to, alternative options. It is true, however, that more could be done to educate SMEs on the alternative finance options.

More broadly, the industry must continue to work to support growth ambitions among UK SMEs. At HSBC, we are working hard to ensure SMEs know that we are open for business. We approve over 90% of lending applications for start-ups and switchers, and use our £10bn SME fund to engender confidence. The fund is broken down into ring-fenced, regional funds to facilitate applications across the country and has grown from £6bn since its launch in 2014.

We are also continually improving our processes to support frontline teams, deliver a better customer experience and ensure businesses are able to secure the services and products they need.
Our Business Lending Eligibility Checker, for example, lets customers know – within minutes and before a full credit check and application – whether an application is likely to be approved and provides an indicative price before making a full application. This helps to encourage customers to complete a full application with a high level of certainty in the decision; about 98% of successful applications get the same decision or better. Any SME application for funding that does fail can use our declined lending appeals process as well as the declined lending referrals process (subject to customer consent).

2. Do you perceive P2P/alternative lenders as a credible competitive threat to banks in the SME lending market? Would SMEs benefit from greater levels of collaboration?

We are seeing increasing competition from both traditional and alternative finance providers, driven by regulatory reform and developments in technology. This has been supported by the CMA's banking inquiry, which introduced a number of remedies aimed at improving competition in SME banking. We welcome this competition.

It is important to note that not all new entrants are trying to win significant market share by volume or achieve national reach. Many operate business models that target particular customer segments and products – they are focused on targeting the most valuable customer segments of established banks. This will be further facilitated by the implementation of Open Banking and the Credit Data Sharing Act. We also expect this to be accelerated by a successful outcome of the Nesta Competition as well as PSD2.

On the broader theme of collaboration, we understand that streamlined processes are crucial to this end. We have 45 standardised templates which allow execution of a Deed of Priority within four working days from the point we have all the required information. This ensures those wanting to secure finance can do so via any provider of their choice. This is well within the seven day period agreed under the Common Protocol for the Agreement of Deeds of Priority and Letters of Waiver.

3. What is your assessment of SMEs' willingness to switch bank?

Recent research from FIS PACE report suggests that approximately 25% of SMEs are looking to switch in the next year. HSBC itself regularly sees customers switch to and from the bank across all segments.
Whenever a customer leaves, we work hard to learn from their experience. This feedback is vitally important, enabling us to constantly keep our services under review in an effort to retain customers and attract new business. This has never been more important in an increasingly competitive environment.

It is important to note that SMEs may not formally switch using the Current Account Switching Service (CASS) but instead open a Business Current Account elsewhere and then slowly migrate transactions to the new provider, leaving the original account to fall into dormancy. While the SME is still technically a customer, in reality the primary relationship has switched to a competitor.

4. 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?

It is still too early to have a clear sense of impact of the CMA's Open Banking remedy, or to get a true gauge of the level of trust SME customers have in the initiative.

We are however taking the introduction of Open Banking extremely seriously. For example, we recently ran our first 'hackathon' to encourage internal innovation on the usage of data to help our customers and provide an even better service.

5. 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?

Our own experience suggests demand for finance is stable - our Business Banking loan balances have increased over the last two years.

Small businesses are increasingly seeking our support however in understanding the post-Brexit environment and its impact on issues such as their workforce, supply chains, and new trade opportunities. Many have not made concrete plans in preparation for Brexit yet, although those involved in the movement and storage of goods are more advanced in considering how their supply chains will be affected. We continue to work with customers to support them through any challenges.

6. 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?

We operate in a market that has never been more transparent or competitive, which is of great benefit to customers. Two areas for further improvement I would highlight to the committee include:

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i. Awareness raising

- SMEs in the UK are diverse and invest in a broad range of areas – expanding into new markets overseas, investing in new premises, new machinery or equipment, into research and the development of new products. It is important that businesses understand how best to grow and then crucially get the right type of finance to support their investment.

- As mentioned above, debt is only part of the financing solutions with limits to how much banks can lend prudently. Capital rules favour secured lending but many companies have few assets so we need to think of ways to inform SME of the benefits of other instruments such as equity investment and organisations like the Business Growth Fund.

- We would see benefit in a coordinated campaign by the wider finance industry, policymakers and business groups in explaining the finance options available to SMEs. Reinforcing the positive stories of successful British businesses and acknowledging the partnerships with banks that have helped them to grow and prosper would help improve SMEs' understanding of and confidence in the role played by the finance sector in supporting their growth ambitions.

ii. Dispute resolution

- Resolving disputes fairly is vital to building trust and confidence. We are supportive of increasing the remit of the Financial Ombudsman Service to cover SMEs with less than 50 employees and under £6.5m annual turnover with appropriate up-skilling of staff to ensure fair outcomes of cases they review.

- Beyond this, UK Finance has commissioned an independent review, led by Simon Walker, into the ADR landscape which will conclude with a series of evidence based recommendations. These will be presented later this year and should be considered once the FOS remit has been extended.

Thank you for the opportunity to discuss these issues with you and the committee, please do get in touch if I can be of assistance further.

Yours sincerely,

Amanda Murphy
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