EXPLANATORY MEMORANDUM TO

THE SMALL AND MEDIUM SIZED BUSINESS (FINANCE PLATFORMS) REGULATIONS 2015

2015 No. [XXXX]

1. This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The Small and Medium Sized Business (Finance Platforms) Regulations 2015 ("the regulations") place an obligation on designated banks to refer small and medium sized businesses ("SME") customers that they reject for finance, with the SMEs permission, to finance platforms that can match the SME with alternative finance providers. The regulations give HM Treasury the power to designate which banks and platforms to which the regulations apply.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 These regulations, for the first time, exercise powers provided in sections 5 to 7 of the Small Business, Enterprise and Employment Act 2015. These regulations are designed to complement the Small and Medium Sized Business (Credit Information) Regulations 2015.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Small and Medium Sized Business (Finance Platforms) Regulations 2015 are compatible with the Convention rights.

7. Policy background

7.1 These regulations seek to address a market failure of imperfect information that is impeding SMEs' ability to access the finance they need to grow and compete. Currently, the largest four banks account for over 80 per cent of UK SMEs' main banking relationships, and evidence suggests that the majority of SMEs only approach their main bank for finance, with around 40 per cent giving up their search if they are unsuccessful. A proportion of the SMEs that are rejected by the largest UK lenders are viable businesses, and are rejected simply because they do not meet the risk profiles of the largest banks.

7.2 In many cases challenger banks and other providers of finance are unable to offer finance to smaller businesses because they are not aware of their existence, and SMEs are similarly unaware of the existence of these alternative sources of finance. The Independent Lending Review of the Royal Bank of Scotland, led by Sir Andrew Large, found that a lack of awareness of the alternative sources of finance available to SMEs was a major structural problem with the UK lending market.

7.3 Although the largest banks will sometimes refer SMEs on to other providers or strategic partners on a bilateral basis; this is not happening systematically. Other voluntary commitments, such as a referral system to Community Development Finance Institutions, are limited in scope and have been slow in achieving results.

7.4 The Government has, therefore, taken the decision to legislate to require banks to refer SME customers that they reject for finance to finance platforms that can match the SME with alternative finance providers. The regulations give HM Treasury the power to designate which banks and platforms the regulations apply to.

7.5 The response to the consultation emphasised the need for SME's details to be properly protected when they are forwarded to a platform. The regulations create a new obligation on the Financial Conduct Authority ("FCA") to monitor and enforce compliance with the regulations.

7.6 These regulations also widen the pool of SMEs that can have recourse to the Financial Ombudsman Service ("FOS") in respect of referrals to include all those SMEs that generally have recourse to the FOS for other purposes (currently those which have an annual turnover of less than €2 million and fewer than ten employees). This will ensure that SMEs whose information is held by designated finance platforms have the same level of protection under the FOS as they do in relation to other financial services, and whether the finance platform is regulated by the FCA or not.

8. Consultation outcome

8.1 The Treasury ran a consultation between 28 March 2014 and 25 April 2014 on 'SME Finance: help to match SMEs rejected for finance with alternative lenders' which set out the proposal to require banks to refer SMEs rejected for finance to finance platforms and requested information on the scope and implementation of such a proposal.

8.2 The consultation received over 45 responses including major banks, challenger banks, alternative finance providers, business groups, trade associations and other interested parties.

8.3 Responses provided widespread support for the proposals and the Government's overarching goals as well as providing constructive and valuable contributions on areas such as the scope of regulation and SME protection.

8.4 All respondents also agreed that it was important to ensure that SMEs have confidence in how their data is being used and the importance of finance platforms adhering to good standards of practice in order to protect the SMEs that use them.

8.5 The Government published its Summary of Responses document[1] on 6 August 2014.

9. Guidance

9.1 The British Business Bank ("BBB") has published an "Expression of Interest" document that sets out the evaluation criteria for finance platforms that apply to be designated under these regulations.

9.2 An implementation guide will be produced, in partnership with industry, which will detail the required technical specifications to enable the secure and efficient transfer of data between finance providers and finance platforms.

10. Impact

10.1 The impact on business, charities or voluntary sector is an estimated total net present value cost of between £16.76m and £9.51m, with a best estimate of £13.26m. However, it has not been possible to monetise many of the benefits of this measure. This is a pro-competition measure and is therefore out of scope of the Government's 'one-in-two-out' regulatory framework.

10.2 There is no impact on the public sector, as the FCA is funded through levies on industry. FCA funding costs are included in the impact on business in 10.1 above.

10.3 An Impact Assessment is attached to this memorandum and is published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken will be to designate banks, to which this legislation will apply, based on SME lending market share. Therefore, only the largest banks will be affected by the legislation in order not to increase barriers to entry for smaller and challenger banks or alternative finance providers.

[1] www.gov.uk/government/uploads/system/uploads/attachment_data/file/341741/Summary_of_Responses_-_platforms_for_rejected_SME_finance.pdf

11.3 In some cases designated platforms will be firms that employ less than 20 people and these regulations will place obligations on these firms. However, platforms will not be designated unless they have requested to be designated and be within scope of this legislation, indicating that the benefits indicating that the benefits will outweigh any burdens on these businesses.

11.4 As a result of these regulations SMEs are expected to experience improved outcomes when applying for credit and therefore are expected to benefit from this legislation.

12. Monitoring & review

12.1 Part 6 of the regulations places a duty on HM Treasury to, from time to time, carry out a review of the regulations and publish the conclusions of the review in a report. The first report must be published on or before 1 January 2021 with subsequent reports being published at intervals not exceeding 5 years.

13. Contact

Rob Wareing at HM Treasury Tel: 020 7270 4504 or email: rob.wareing@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.