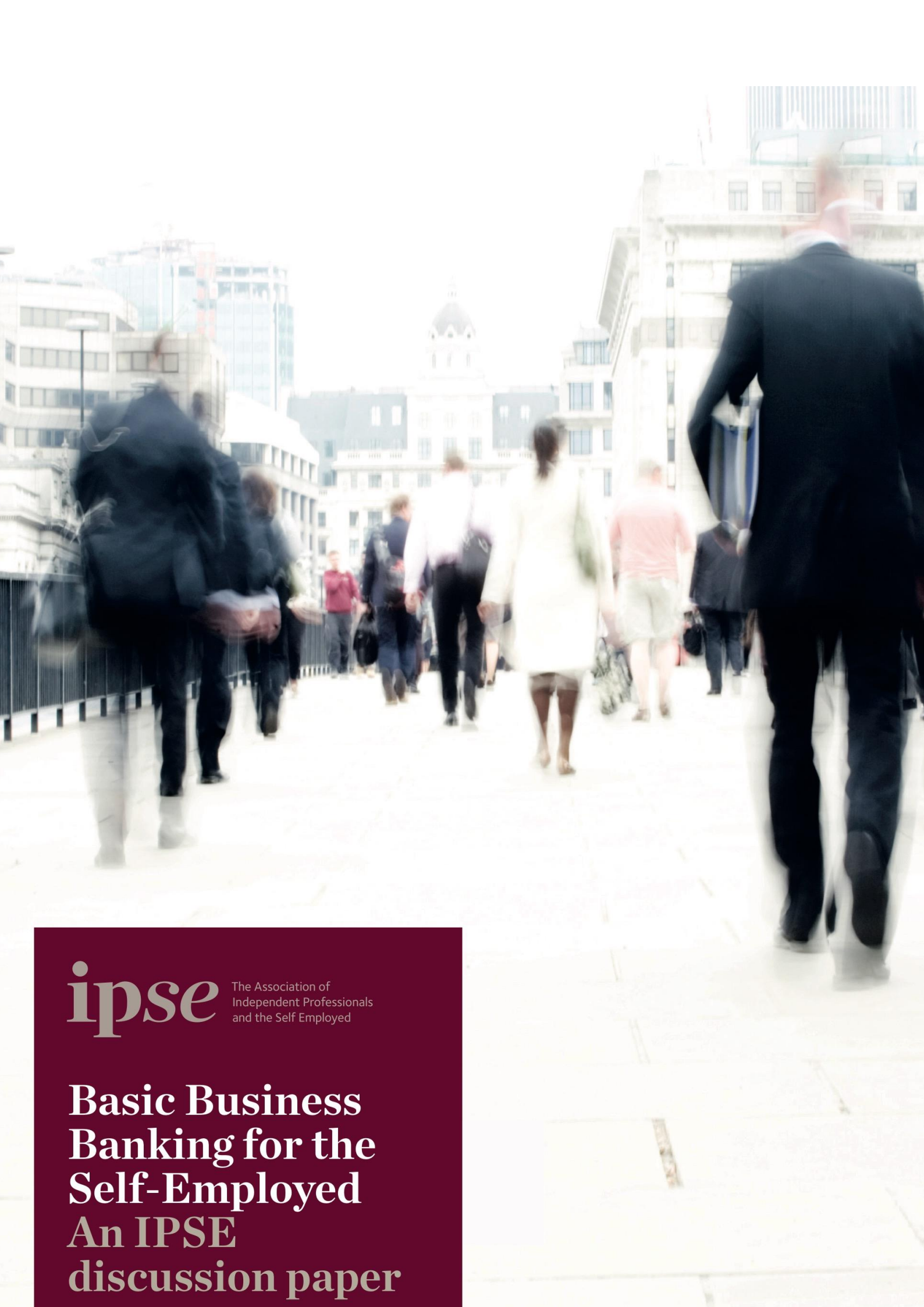


IPSE response to the CMA's retail banking market investigation

June 2016

Please note the following report is a draft version of a discussion paper on basic business banking for the self-employed.

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The Association of
Independent Professionals
and the Self Employed

**Basic Business
Banking for the
Self-Employed
An IPSE
discussion paper**

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Executive Summary

- An IPSE survey found that a third of freelancers (32.9%) do not solely use a business bank account, that is they use either a personal account or combination of personal and business accounts, to run their business. This hinders their ability to be commercially effective.
- The current EU definition of ‘micro-enterprise’ used by the Financial Conduct Authority (FCA) is a step in the right direction but does not recognise freelancers and the self-employed as a distinct category with specific business needs.
- Many freelancers feel banks do not cater for their specific needs. They may be deterred from conducting independent research into changing bank accounts and, due to the pressures of running one’s own business, they may not have the time to do so. There is a lack of awareness regarding the Current Account Switch Service (CASS) and its features.
- Regulatory bodies should categorise the self-employed as ‘nano-businesses’, reflecting the fact they are often businesses with consumer capabilities, and so face unique challenges regarding time, resource and bargaining power, as well as in accessing appropriate financial services and products. This would help pave the way for a basic business bank account for the self-employed.
- Banks should consider developing basic business bank accounts that reflect the specific needs of nano-businesses. This is an untapped market and could help challenger banks differentiate from market leaders. IPSE would welcome conversations with the retail banking industry around supporting and marketing such products to the self-employed. It would be beneficial for these products to include:
 - Innovative internet and mobile banking facilities able to streamline business activities, embracing regulatory changes and technological advances
 - Access to a trained adviser, with the possibility of webcam meetings, who understands the way the self-employed work and can offer tailored advice on a range of other products and services including mortgages and loans
 - A link to a flexible savings accounts, to help the self-employed better plan for paying taxes
 - No charges for every day banking services and fee-free overdrafts, giving greater flexibility around financial planning
 - Readily available, clear and simple terms and conditions, giving the self-employed a fairer deal and greater confidence in providers
- Government should better signpost CASS to improve awareness of switching bank accounts and understanding of its features. The successor the Money Advice Service should ensure information about CASS is simple, clear and readily available. Organisations like IPSE also have a role to play in helping members understand the options open to them as consumers.
- Banks, government, regulators, and organisations like IPSE all have a role to play in shaping a new financial services environment to support the economy of the future. The number of freelancers and self-employed is growing, and they are here to stay. Now is the time to ensure they are properly supported, so that they can be unleashed in the new economy.

Introduction

Our research found that **a third of freelancers surveyed¹ (32.9%) do not solely use a business bank account to run their business**. This hinders their ability to be commercially effective.

Freelancers and the self-employed provide the UK economy with flexibility and expertise. They allow firms to explore growth opportunities by utilising the skills of experts, fostering innovation while minimising the costs associated with hiring permanent employees. This has allowed the UK economy to navigate economic headwinds and remain competitive in a global market.

It is vital, therefore, with the UK economy still fragile, that this growing sector of the UK labour market is supported by a regulatory and retail banking environment understanding of the way it works and receptive to its unique needs. This paper explores some of the regulatory barriers and retail banking issues regarding business bank accounts for independent professionals and the self-employed. Using data gathered from an IPSE survey of its members and interviews, it makes recommendations to banks, regulators and Government. IPSE hopes to work with stakeholders to create a financial environment in which this growing, integral sector of the UK labour market can continue to thrive.

Regulatory barriers

The current EU definition of SMEs, used by the Financial Conduct Authority (FCA), does not recognise the self-employed as a distinct category, but rather as 'micro-businesses', and so does not fully recognise this group has specific business needs. The main factors determining whether an enterprise is an SME are²:

1. staff headcount and
2. either turnover or balance sheet total

Company category	Staff headcount	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ € 50 m		≤ € 43 m
Small	< 50	≤ € 10 m		≤ € 10 m
Micro	< 10	≤ € 2 m		≤ € 2 m

This is a step in the right direction, but does not go far enough in recognising that the self-employed face unique challenges. The vast majority of self-employed people work independently, i.e. without employees. According to the latest Business Population Estimates, published in October 2015, 76% of the 5.4m businesses in the UK only employ their owner³.

There are a number of ways people do this:

¹ The data was collected via an online questionnaire between 7th and 20th March 2016. A total of 614 IPSE members responded to the survey. It was optional for participants to provide a response to each question, therefore the number of individual responses for each question varies.

² European Commission. (2016) 'What is an SME?'. Available online here:http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index_en.htm.

³ Department for Business, Innovation and Skills. (2015) 'Business Population Estimates for the UK and regions 2015'. Available online: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/467443/bpe_2015_statistical_release.pdf.

- Sole traders and ordinary partnerships: unincorporated businesses with personal liability, meaning personal assets are not protected.
- Limited Liability Partnerships (LLP): incorporated business partnerships where liabilities are usually limited to the value of investment into the company.
- Limited Liability Company (LLC): also incorporated businesses where liabilities are limited to the value of the investment into the company. These are sometimes referred to as 'Personal Service Companies' (PSCs).

According to the above categories, the self-employed, of which freelancers are a subset, are treated in the same way as a micro-enterprise with nine employees and a turnover and/or balance sheet of €2m. Unlike microbusinesses, freelancers and the self-employed, do not have any employees at all, let alone any responsible for managing company finances. These tasks are left to the freelancer themselves, along with any other business activity, from marketing to admin, without them necessarily having sufficient capacity, time or expertise.

This regulation, therefore, can in some circumstances compromise the proper functioning of the retail banking market, as it does not recognise that freelancers and the self-employed face unique challenges, and can hinder access to appropriate financial services and products.

To address this, IPSE recommends the creation of a new category of SME, a 'nano-business', which has no employees. With the self-employed specifically defined as nano-businesses, this group would be provided with more appropriate consumer protection and the retail banking market would be supported in developing more suitable financial products – including a basic business bank account. This would create an environment in which nano-businesses, a growing and increasingly important sector contributing to the competitiveness of the UK economy, are able to remain commercially effective.

We would welcome conversations with the European Commission and Department for Business, Innovation and Skills regarding this change, and also around applicable turnover and balance sheet totals.

Recommendation 1

Regulatory bodies should categorise the self-employed as 'nano-businesses', reflecting the fact they are often businesses with consumer capabilities, and so face unique challenges regarding time, resource and bargaining power, as well as in accessing appropriate financial services and products. This would help pave the way for a basic business bank account for the self-employed.

A basic business bank account for the self-employed

The survey of our members found that **a third (32.9%) do not solely use a business bank account to run their business**. Business bank accounts should be the main point of contact between businesses and their banks, through which they can deal with day to day activities. However, there is a barrier to uptake due to improper reflection of the unique business needs of the self-employed, existing products not being sufficiently targeted, and reluctance and lack of awareness to switching.

Account functionality

- **Nearly two thirds (64.7%)** said advanced internet and mobile banking facilities (e.g. mobile cheque imaging, webcam banking) would be very useful or somewhat useful for their business.
- **Nearly two thirds (64.4%)** said the ability to link a business bank account to other software that they use to run their business (e.g. bookkeeping, accounting and/or invoicing) would be very useful or somewhat useful for their business.

- **More than half** (56.4%) said having specialised business and finance advice for the self-employed from a trained adviser would be very useful or somewhat useful for their business.
- **Eight in ten** (80.3%) said a business savings bank account (e.g. for putting away money for tax) would be very useful or somewhat useful for their business.

Our research found that business bank accounts with features that assist with the management and administration of their business would be most beneficial to the self-employed.

What will the future of banking look like?

Three in five freelancers with no business bank account said advanced internet and mobile banking facilities would be useful for their business, including web chat. This is where technology can help to provide a more efficient banking service for people who have to shoulder the burden of running their entire business on their own. Payment Systems Directive II, European Union legislation coming into law by the end of 2017, means UK banks will have to open up their payments capabilities, enabling customers to receive their own data and share it with third parties⁴.

This can change the way freelancers run their business. Innovative cloud-based accounting, booking and invoicing solutions will play an increasingly important role, and could provide nano-businesses with a streamlined banking experience through a basic business bank account. All a freelancer would have to do is login to their accounting platform, select their business bank account and give their permission for data to be shared.

Given the government's ambition for paperless 'real-time' accounts by 2020 as part of their 'Making Tax Digital'⁵ agenda, there is potential for data sharing for tax purposes to be streamlined further. It is vital therefore that Government establish an independent authority responsible for ensuring data sharing standards are upheld. IPSE also has a role to play, alongside businesses, government and consumers, in helping freelancers and the self-employed to engage with technological developments, ensure they are aware of rights and responsibilities around data, and instil confidence that the financial information they are sharing is secure.

What role can 'challenger' banks play?

Being able to bank quickly and conveniently, combined with seamless data sharing, is an important demand of this market. This type of offering might be particularly attractive to challenger banks. According to the FCA, the market for business banking is concentrated with the big banks. The four largest providers of business current accounts serve 83% of business account holders in England and Wales, and a greater share in Scotland and Northern Ireland⁶. However, as our research shows, these providers' offerings do not always support nano-businesses as effectively as they could.

Warren Mead, Head of Challenger Banks and Global Co-Lead Fintech, at accountancy firm KPMG, believes that for challengers to be successful, "banks need to either develop a cost advantage or differentiate in order to compete effectively"⁷. Moreover, Julie Deane OBE, Founder of the Cambridge Satchel Company, highlighted the commercial opportunities for banks to offer more flexible financial products as part of her independent review for Government into self-employment:

⁴ Open Data Institute. (2016) 'Introducing the Open Data Standard'. Available online: <https://www.scribd.com/doc/298568600/Introducing-the-Open-Banking-Standard>.

⁵ HMRC. (2015) 'Making Tax Digital'. Available online: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/484668/making-tax-digital.pdf.

⁶ FCA. (2015) 'Our approach to SMEs as user of financial services'. Available online: <https://www.fca.org.uk/static/documents/discussion-papers/dp15-07.pdf>.

⁷ Financial Times (2015) 'UK challenger banks need to take account of hurdles ahead'. Available online: <http://www.ft.com/cms/s/0/09b68238-a95e-11e5-955c-1e1d6de94879.html#axzz45oksngSB>.

“As the number of self-employed continues to increase, the need for more flexible financial solutions, from mortgages and insurance to pensions, will become more imperative. The financial institutions that choose to address this need stand to benefit enormously. When such flexible financial instruments do begin to appear trade organisations will play a key role in signposting these so that their self-employed members can benefit from them.”

Not only could remote banking facilities, such as web chats, cost new market entrants less than branch overheads, it would also allow quick, flexible access to a trained adviser offering specialised business and finance advice to freelancers and the self-employed on products such as mortgages and pensions, a feature more than half of respondents said would be very useful or somewhat useful for their business.

How can basic business bank accounts make running a business easier?

Because of the fluctuating incomes inherent in contract based working, it can be difficult for nano-businesses to budget effectively throughout the year. Eight in ten respondents said a business savings account for putting away money for tax would be very useful or somewhat useful for their business. One IPSE member commented that they “tried variously to get products for storing corporation tax or saving” but they “generally [required regular payments for] too long a term and/or don’t allow you to ... remove at the relevant time”. Another said they thought they would “lose more money in fines for late payment.”⁸

Dr. Jonathan Sapsed, Principal Research Fellow at the Brighton Business School Centre for Research in Innovation Management (CENTRIM), also highlights this:

“The self-employed are a structurally growing part of the labour force. We have to get used to the idea that it is not going away, but also that people are not self-employed as a second-best choice after employment. The Brighton Fuse research has shown that aspiration to realise one’s own ideas and have control over work are the main motivations. Barriers against this include unfavourable banking arrangements. We propose a specific bank account for the self-employed, with advice on long-term personal finance like pensions and mortgages, as well as flexibility to manage the feast and famine of this workflow.”⁹

It would be beneficial, therefore, for a basic business bank account for the self-employed to be linked to a regular savings product, with low minimum payment requirements and/or allowing for missed payments to be made up in following months. This type of savings vehicle would take into account the project-based nature of self-employment, and allow nano-businesses to save conveniently and responsibly to, for example, pay their taxes or save a deposit for a mortgage.

Account costs and conditions

- Of those who do not have a business bank account, **more than one in five (22%)** said it is because fees and charges associated with them are higher than those of their personal bank account.
- **More than half (51.5%)** of all respondents said no charges for everyday banking services (e.g. bank transfers, monthly/annual fees) would be the single most important feature that would influence their decision when choosing a business bank account.
- **More than eight in ten (83.8%) of all respondents** said transparency around bank charges would be very useful or somewhat useful for their business.

Dr. Sapsed’s comments also make reference to a business bank account for the self-employed needing flexibility to manage fluctuations in income inherent in project-based work. All businesses

⁸ Interviews with IPSE members.

⁹ Sapsed, J. (2016) IPSE interview.

require a degree of certainty around funding in order to plan effectively. Nano-businesses typically lack the capital reserves of larger companies to account for cash flow changes caused, for example, by fluctuations in demand for services or late payments. Basic business bank accounts for freelancers and the self-employed could offer overdrafts, some of the facility of which would be free of charge, which are not repayable on demand, so nano-businesses are given greater certainty to plan for the future.

IPSE research also found that one of the reasons members do not have a business bank account is because the fees and charges associated with business bank accounts are higher than their personal account. Generally speaking, terms and conditions around bank charges, are often lengthy, technically and legally complex, biased in favour of the provider, and lack transparency.

As part of interviews conducted with IPSE members, one noted that they, “like many people, don't read the small print to any great detail” as the bank “dress it up in long-winded legal language”. Another said terms and conditions were “very copious” and so “generally don't get read”. Yet another said that they didn't have a choice but to accept the terms and conditions if they wanted the product, and that all contracts had unfair terms, but “they are all the same anyway”¹⁰. This illustrates that the self-employed often feel unable to engage with, or powerless to negotiate, terms and conditions with regards to financial products.

A basic business bank account for freelancers and the self-employed with no charges for every day banking services, fee-free overdrafts (an overdraft repayable over a minimum period, e.g. six months, instead of on demand, would go a step further), would see nano-businesses able to handle their finances with greater certainty in light of fluctuating incomes. Readily available, clear and simple terms and conditions would also lead to freelancers and the self-employed feeling confident that they are securing a fair deal.

Recommendation 2

Banks should consider developing business bank accounts that reflect the specific needs of nano-businesses. This is an untapped market and could help challenger banks differentiate from market leaders. IPSE would welcome conversations with the retail banking industry around supporting and marketing such products to the self-employed. It would be beneficial for these products to include:

- Innovative internet and mobile banking facilities able to streamline business activities, embracing regulatory changes and technological advances.
- Access to a trained adviser, with the possibility of webcam meetings, who understands the way the self-employed work and can offer tailored advice on a range of other products and services including mortgages and loans.
- A link to a flexible savings account, to help the self-employed better plan for paying taxes.
- No charges for everyday banking services and fee-free overdrafts, giving greater flexibility around financial planning.
- Readily available, clear and simple terms and conditions, giving the self-employed a fairer deal and greater confidence in providers.

Account switching

- **More than eight in ten (84.8%)** had never switched the account they use for their business from one bank to another.

¹⁰ Interviews with IPSE members.

- **Nearly one in five (18.8%)** said that one of the reasons they have not switched the account they use for their business is because they do not have time to invest in researching alternative banking providers.
- Of those who have not switched the account they use for their business from one bank to another (excluding those who are satisfied with the account they currently use for their business) the top reasons for this are:
 - **19.4%** said they were concerned about the disruption to their banking transactions (e.g. incoming, outgoing payments failing).
 - **19%** said it is something they have never thought about.

The Competition and Markets Authority (CMA) has provisionally found that, with regards to business current accounts, a number of factors, including “low customer engagement” and “barriers to searching and switching”, were giving rise to “adverse effects on competition”¹¹. Moreover, a 2006 survey from the Office of Fair Trading (OFT) found that, relative to larger customers, smaller banking customers were more likely to be dissatisfied with their fees and charges, but less likely to tell the bank that they were considering switching and where they did, the bank was less likely to change its offering in response¹².

This is echoed by comments made in member interviews highlighting banks “showed no interest in my company, asked no questions & therefore have never offered me a product that would suit my needs”, expressing “worry that all banks are the same”, and having “no knowledge of what is out there and what options I have”. The self-employed do not feel engaged with by their account providers, nor do they feel they would be catered for by market competition. They often see no point in conducting independent research into alternative products and, due to the pressures of running one’s own business, may not have the time to do so.

The CMA has also set out provisional plans for banks to cap unarranged overdraft fees and issues warnings to customers before they go overdrawn. This is a welcome change, particularly as freelancers often experience fluctuating incomes and may receive payments late. Furthermore, the proposed development of new online comparisons tools, where the costs of other accounts would be tailored to reflect individual consumers’ specific usage through open APIs, could go a long way in raising awareness and increasing rates of switching. It is important however that the CMA also address barriers to market entry as this would allow more challengers to increase competition, which could lead to more tailored business bank accounts for the self-employed.

Our research also found that freelancers express concern about the disruption to their banking transactions that switching could cause. However, this indicates a misunderstanding of the functionality of the Current Account Switch Service (CASS), which, for 36 months, guarantees payments accidentally made to an old account will be automatically directed to the new account, with any losses or charges refunded¹³.

With regards to switching, CASS must be better signposted by government and the successor to the Money Advice Service as well as organisations like IPSE. This will improve not only awareness of the service and its features. This, combined with more tailored products for freelancers, would improve competition and uptake of business bank accounts and help nano-businesses improve their commercial effectiveness.

¹¹ CMA. (2015) ‘Retail banking market investigation – Provisional findings report’. Available online: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/470032/Banking_summary_of_PFs.pdf.

¹² IFF Research Ltd (2007) “Survey of SME Banking: Research Report prepared for Office of Fair Trading”, http://oft.gov.uk/shared_oft/reports/financial_products/oft937b.pdf.

¹³ Simpler world (Date unknown). ‘The Current Account Switch Guarantee in full’. Available online: <https://www.simplerworld.co.uk/Downloads/AccountSwitchingGuarantee.pdf>.

Recommendation 3

Better signposting of CASS by government and membership organisations to improve awareness of switching bank accounts and understanding of its features. The successor to the Money Advice Service should ensure information about CASS is simple, clear and readily available. Organisations like IPSE also have a role to play in helping members understand the options open to them as consumers.

Conclusion

The way we work has now changed fundamentally throughout the last decade, with self-employment set to continue to rise. The current business bank account offering for freelancers and the self-employed is not sufficiently tailored to their business needs, which has contributed to low uptake. This vital group is not being sufficiently catered for.

This is underpinned by the fact that nano-businesses are not recognised as specific entities within current regulatory definitions, which hinders freelancers' ability to be commercially effective. The success of this growing sector of the UK labour market is vital to our economy's ability to remain globally competitive.

We all have a role to play in shaping a new financial services environment to support the economy of the future. Regulators should recognise this group; banks, and in particular challenger banks, can tailor products to the needs of freelancers, delivering technological solutions to streamline business activities and offering specialised advice from trained advisers with fairer charges, terms and conditions. Government and business organisations like IPSE should work to ensure facilities like CASS are well-known and understood. IPSE welcomes discussions with these stakeholders.

The UK is growing in numbers of entrepreneurs who want to go out and make it on their own. Now is the time to ensure they are properly supported.

About IPSE

The Association of Independent Professionals and the Self Employed (IPSE) represents the estimated 4.6¹⁴ million individuals working for themselves in the UK. Often referred to as freelancers, contractors, consultants and nano-businesses, independent professionals are highly skilled specialists supplying their expertise on a flexible basis to a variety of businesses - from large companies to SMEs.

Representing over 67,000 freelancers, we are the largest association of independent professionals in the EU. We exist to support, promote and advise independent professionals to ensure they can fulfil their true potential, delivering growth and innovation for the UK economy.

About the self-employed

The self-employed are workers without an employee. One in seven, around 4.7 million, of the UK workforce are now self-employed and the numbers are growing rapidly, by around 44% since 2000¹⁵. Self-employment growth remained resilient during the economic crisis, 85% of the jobs lost in the recession were replaced by self-employed jobs¹⁶.

About freelancers

Freelancers, also known as independent professionals or contractors, are a subset of the self-employed who are highly skilled and work in a range of managerial, professional and technical occupations. There are now an estimated 1.91 million freelancers in the UK¹⁷, an increase of 84% since 1992¹⁸.

A growing number of the UK's most talented graduates and young professionals are now freelancers and those aged under 29 make up the fastest growing segment¹⁹.

¹⁴ Office for National Statistics (2016) 'UK Labour Market, May 2016'. Available online: <https://www.ons.gov.uk/releases/uklabourmarketstatisticsmay2016>.

¹⁵ Ibid.

¹⁶ Office for National Statistics (2013) 'Self-employed up 367,000 in Four Years, Mostly Since 2011'. Available online: www.ons.gov.uk/ons/dcp171776_298533.pdf.

¹⁷ Kitching J. (2016) 'Exploring the UK Freelance Workforce in 2015'. Small Business Research Centre. pp. 4

¹⁸ Kitching J. (2015) 'Tracking UK Freelance Workforce Trends 1992-2015', in 'The Handbook of Research on Freelancing'. Senate Hall Academic Publishing. pp. 15-28

¹⁹ Ibid.