CMA Consultation on the Review of SME Banking Undertakings 2002 (Removing Bundling Limitation)
Innovate Finance response

About Innovate Finance

Innovate Finance is the independent industry body that represents and advances the global FinTech community in the UK. Innovate Finance's mission is to accelerate the UK's leading role in the financial services sector by directly supporting the next generation of technology-led innovators.

The UK FinTech sector covers businesses from seed-stage start-ups to global financial institutions that embrace digital solutions, playing a critical role in technological change across the financial services industry. FinTech has grown enormously since the Global Financial Crisis of 2007/8, which led to mistrust in traditional banks and coincided with an explosion in the use of smartphones, widespread adoption of the use of apps, the advent of blockchain technology, and significant investment in FinTech start-ups.

FinTech is synonymous with delivering transparency, innovation and inclusivity to financial services. In addition to creating new businesses and new jobs, it has fundamentally improved the ways in which consumers and businesses, especially small and medium-sized enterprises (SMEs), access financial services.

We represent most of the UK's digital-first and digital-only challenger banks, all of whom hold a UK banking licence.

1. INTRODUCTION

1.1 Innovate Finance welcomes the opportunity to respond to the Competition and Markets Authority (CMA) consultation on reviewing the "Limitation on Bundling Provisions" under its *Review of SME Banking Undertakings 2002*. In preparing this submission, we have sought to represent the views of a cross-section of our membership, including start-up and scale-up challenger banks and non-bank FinTech lenders.

1.2 Nearly 40 new banks have been authorised by the PRA since 2013[1], with their entry and ability to scale supported by the pro-competition interventions of the Competition Commission in the SME Banking Undertakings 2002; the CMA's 2016 Retail banking market investigation report, including open banking; the CMA's Retail Banking Alternative Remedies Package; and the Prudential Regulation Authority's (PRA) New Banks Start-Up Unit. The Limitation on Bundling Provisions has therefore been one element of a cumulative approach to promoting competition.

1.3 The UK economy is at a critical juncture for productivity and growth, and we are in general supportive of the government's desire to reduce regulatory burden.

1.4 However, we do not support the removal of the Limitation on Bundling Provisions. This is because:

[1] Bank of England, *New banks authorised since 2013*. See here: https://www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit/new-banks-authorised-since-2013

(a) Doing so would confer an unfair advantage on the CMA9 banks, given the strong product linkages between Business Current Accounts (BCA) and lending. This would favour the long-established banks.

(b) There also appears to be minimal benefit in its removal (the only potential benefit being reduced operational cost at the designated banks, but we understand this cost to be minimal given how long the Bundling Limitation has been established). Removing the restriction presents a meaningful risk of detriment in both the SME Lending and BCA markets.

1.5 We cannot therefore see how a cost benefit analysis would support its removal.

2. The current position

2.1 The prevalent view is that the requirement to not bundle is very well embedded into the major banks' way of operating and indeed the psyche of their SME staff, because this aspect of the SME Banking (Behavioural) Undertakings 2002 has been in place for over 20 years.

2.2 We also note that the current bundling limitation does allow major banks to bundle in some situations. This includes for example:

(a) **where it is required for shared security (e.g. current account with an authorised overdraft limit that uses the same debenture mortgage security that is used for a business loan); or**

(b) **if there is a price incentive (i.e. the customer gets better fees/interest by taking the integrated product than not, subject to the customer being allowed to take the products separately if they wish).**

2.3 Essentially, applications of bundling that are necessary for the loan or giving the customer a benefit are already allowed. It is notable that when challengers, who are not under the Limitation on Bundling Provisions, act in line with (a) or (b), they do not simply seek to insist a BCA is in place with a loan. This reinforces the view that removal of the Limitation would only create the risk of detriment to customers in the SME lending and BCA markets – i.e. designated banks could seek to use the removal of the Limitation as a way of taking back greater control of both SME lending and BCA markets.

2.4 Regarding the CMA's current change of circumstances discussion, we refer to the factors discussed in the CMA's 2016 review of the undertakings.[2] The CMA stated that:

> *"We have decided to retain the bundling undertakings. We have not identified a relevant change of circumstances for the bundling undertakings. Both the CMA's initial assessment of the undertakings and the findings of our retail banking market*

[2] Competition and Markets Authority, *Review of 2002 SME banking undertakings: Final decision, 9 August 2016*. See here: https://assets.publishing.service.gov.uk/media/57a8c29940f0b608ab000000/sme-undertakings-final-decision.pdf

investigation suggest that there remain strong product linkages between BCAs and SME lending, and that this particularly favours the longer-established banks."[3]

2.5 In particular, the CMA's 2016 review stated that the growth of the competitive landscape and market share are not substantial enough to overcome the inherent advantage of large, multi-product incumbent firms:

> *"We do not think that recent entry and expansion into the SME banking market nor the implementation of our retail banking market investigation remedies represent a valid change of circumstances, such that the bundling undertakings can be released."*[4]

> *"The findings of our retail banking market investigation confirm that there are strong product linkages between BCAs and SME lending, and together with the information asymmetries between an SME's BCA provider and other lending providers, this favours longer-established banks. As such, these undertakings, which mitigate the adverse effects of these linkages, should be retained."*[5]

2.6 Building on the above, we emphasise that the growth of challenger banks and non-bank FinTech lenders has been enabled by a well-established regulatory framework and proactive oversight by regulatory bodies that have introduced initiatives to encourage innovation in financial services. We explored this in greater detail in our Innovate Finance report on *Better Banking* which includes the CMA's work on banking competition that helped ensure a more competitive market following the consolidations of the global financial crisis.[6] Most importantly, some regulatory measures not explicitly designed to promote competition have nevertheless contributed indirectly to a more dynamic market.

2.7 Against this backdrop, there is concern that the CMA's proposal to remove the Bundling Limitation could inadvertently weaken or gradually erode aspects of the regulatory environment that has cumulatively enabled challenger banks and non-bank FinTech lenders to grow, compete and lend. This concern is compounded by proposals from other regulators such as the PRA and the Bank of England (BoE), on matters like Basel 3.1 and MREL ("minimum requirement for own funds and eligible liabilities"), which either gold-plate international standards or are not being adequately revised. While prudential regulation is outside the CMA's remit, the removal of the Bundling Limitation by the CMA, in addition to wider regulatory issues, could contribute to the weakening of the overall regulatory environment from a competitiveness, growth and good outcomes perspective.

3. SME Lending

3.1 With regard to lending, data in the latest British Business Bank annual review shows that c.55% of SMEs only consider one lending provider, and SME Monitor data shows that nearly half of SMEs (49%) go straight to their main bank for lending.

3.2 Allowing a return to tied loan with BCA will likely enable the major banks to increase that percentage further and seek to reduce broker share. The use of brokers for SME finance

---

[3] Paragraph 4.2 in Competition and Markets Authority, *Review of 2002 SME banking undertakings: Final decision, 9 August 2016*. See here: https://assets.publishing.service.gov.uk/media/57a8c29940f0b608ab000000/sme-undertakings-final-decision.pdf

[4] Ibid. Paragraph 4.20.

[5] Ibid. Paragraph 4.21.

[6] Innovate Finance, *Better Banking*. See here: https://www.innovatefinance.com/policy-blogs/better-banking/

has grown very significantly since the 2002 order was introduced, and also significantly since the last CMA review in 2015/2016. Brokers are the main channel by which challenger and FinTech SME lenders have grown their share of SME lending over the last decade.

3.3 It is the general understanding of our members that some of the major banks would strategically like to reduce broker usage and have SME customers directly. However, brokers are crucial to fixing the problem of SME discovery and access to finance because there is now a diverse range of SME lenders out there (an estimated c.200 lenders across all main product types). Brokers are particularly important for SMEs of up to 50 full-time equivalent employees (FTE) where often there is no full-time finance director (FD)/Chief Financial Officer (CFO). In fact, the National Association of Commercial Finance Brokers (NACFB) data shows the average broker SME loan was for a company with 16 FTE).

3.4 SME business owners are rarely financial experts and are time pressed, so brokers are a vital aid to SMEs in navigating the now diverse SME finance market.

3.5 To further improve access to finance in the SME segment and thereby productivity and growth, it is important that broker usage continues to grow from an estimated 25-50% of SME lending (varying by product) towards the residential mortgage market position of >80%.

3.6 Allowing the tying of a loan and BCA where there is no customer benefit, cannot improve the SME lending market and could cause material issues to the growth of the broker channel and ultimately the growth of SME lending. It also risks undoing progress in diversifying and enabling competition in the SME lending market between big banks and challenger banks as well as non-bank FinTech lenders.

SME Business Current Accounts (BCAs)

3.7 Turning to the BCA market, it is important here to segment SMEs.

3.8 The new start and microbusiness BCA market has changed a lot in the last ~8 years driven by innovation from many of our members, with total market share of neobanks in microbusiness estimated at c.25% (and materially higher for share of new starts). This has been an incredibly positive change from what was historically a very underserved market.

3.9 The Alternative Remedies Package included a £425m Capability and Innovation Fund (CIF) which provided grants from 2018 to help challenger banks and non-bank lenders improve their banking and related capabilities for SMEs, boosting their ability to compete with NatWest. Banking Competition Remedies Ltd, who administered the grants, stated that this resulted in increased competition (30% of SMEs holding bank relationships with CIF awardees), growth and innovation, including the introduction of over 250 new products focused on business tools and financial products designed to help SMEs.[7] Ultimately, these measures support the UK SME market and drive the government's priority of boosting economic growth. The government needs to continue to encourage these beneficial outcomes for the UK SME sector and the economy.

3.10 However, the established SME BCA / switcher market remains moribund in comparison. For example:

[7] Innovate Finance, *How Banking Competition Remedies Supported the Growth of UK FinTech*. See here: https://www.innovatefinance.com/policy-blogs/how-banking-competition-remedies-supported-the-growth-of-uk-fintech/

(a) **Pay.UK data shows there are only c.20-25k current account switch service (CASS) switches per annum for business/charities, which is less than c.1% of SMEs that could be switching (based on businesses >2 years old); and**

(b) **A recent survey by one of our members of the BCA market focused on SMEs with 10+ employees showed the five major banks holding 89% of BCA share, other traditional banks at 5% and digital banks at 6%.**

3.11 The established SME market is critical in terms of the CMA considering the linkage between Loans and BCAs, as almost all SME lending goes to firms established >2 years, and c.70% of SME lending goes to firms with 10+ employees.

3.12 Within the established SME BCA market, there has actually been a worsening of customer outcomes since the 2000s. One of our members, Allica Bank, with the support of the Federation of Small Businesses (FSB) and Institute of Directors (IOD), has research which shows that established SMEs keeping cash balances on non-interest bearing current accounts (NIBCAs) is costing them up to £5.5bn per annum versus top quartile rates they could receive placing money on instant access accounts. There is a further £3bn in interest per annum being missed by SMEs keeping money on low earning instant access accounts at designated major banks, where there is a nearly 3% difference in the average interest rate being paid to SME versus a Corporate by major banks.

3.13 The situation was very different in the 2000s, where only 10-20% of SME cash was held in NIBCAs and the rest in interest earning accounts paying a competitive yield - SMEs got conditioned over the 2010s decade of near-zero interest rates to not seek to look for yield on their cash. This SME inertia through NIBCAs is now providing a major funding cost advantage to the major banks for lending now interest rates have risen.

3.14 Given the still extremely concentrated nature of the established SME BCA market and worsened customer outcomes when the Bundling Limitation was not in place, we cannot see how its removal can be justified.

3.15 Finally, if the CMA9 are allowed to return to bundling practices, it could trigger other credit institutions and non-bank lenders to broadly adopt this practice as a defensive measure. Bundling as an industry practice would undermine the ease of switching account providers, reducing choice and competition. Furthermore, business bank account providers which do not provide SME lending may be omitted as an option by SMEs, further narrowing the market. Bundling could risk a substantial share of the SME payment account market reverting to the CMA9.

3.16 In summary, removing the bundling restriction will reduce choice and value for SMEs, jeopardise the government's substantial investment in creating a competitive SME banking market, and potentially the viability of the UK challenger bank sector. If the CMA would like to discuss further, we would be delighted to arrange a meeting with a group of challenger banks (and non-bank lenders) for them to provide more detail on their business models and directly share their concerns.

[ENDS]