UNLOCKING SME GROWTH

Modernising the regulatory regime

Finance & Leasing Association – 2020

Introduction

1. The Finance & Leasing Association (FLA) is the leading trade body for the asset, consumer and motor finance sectors in the UK. Members in our asset finance division provide hire purchase and leasing solutions to businesses.

2. Our members include banks, subsidiaries of banks and building societies, the finance arms of leading retailers and manufacturing companies, and a range of independent firms. In 2018, members of the Finance & Leasing Association (FLA) provided £33 billion of finance to businesses and the public sector to support investment in new equipment, representing over a third of UK investment in machinery, equipment and purchased software in the UK last year.

3. Our members play a particularly important role in delivering finance for small and medium-sized enterprises (SMEs). Asset finance offers an easy and lower risk method for SMEs to acquire the equipment they need compared to other forms of finance such as overdrafts and loans. This is because the asset is usually the security on the finance, the funding term is linked to the working life of the asset and the asset will typically be generating income or reducing cost for the business.

4. Asset finance also enables SMEs to manage their cashflow and access working capital. Consequently, they can deploy resources in other areas and increase their business' productivity.

5. However, our members ability to support small businesses is held back by a regulatory regime designed to cover consumer lending, and a business advice landscape that is disjointed and which prevents businesses from accessing the help they need.

6. This paper suggests changes to regulation (including the Consumer Credit Act) and the business advice landscape to create a simple, predictable regulatory landscape, improve productivity and ensure that asset finance can continue to play its important role in supporting the smallest businesses.

Summary of recommendations

7. **Small companies should have appropriate legal protection just as consumers do. But the current legal and regulatory framework does not serve their interests well. Action is required by the FCA, PRA and by Government, i**n particular, to modernise several provisions of the Consumer Credit Act.

8. **Funders should be able to provide a one or two-page summary of the agreement to regulated business customers** which set out the key terms of that agreement, instead of having to follow the same format as that for consumer agreements. The regulations require information to be repeated, often in a format that confuses rather than helps a customer. A busy SME customer should be able to review the key information once and be in a position to make an informed decision.

9. **Funders should have the freedom to provide flexible agreements for regulated business customers,** which would allow novation and payment holidays with minimal administrative burden to the funder or customer. This would allow funders to respond positively to requests from customers to amend agreements in response to changes to their business needs.

10. In light of coming changes to the rules on prudential regulation, **the PRA should review the risk weighting of asset finance products**, to ensure that the prudential regulation requirements that apply to these products are in line with the true risk faced by the funder.

Specific Proposals

The Consumer Credit Act (CCA)

11. Over 1.5 million of the UK's smallest businesses are covered by the CCA. Lending agreements with these businesses are subject to extensive regulation designed to protect individual consumers under the Act. Whilst the FCA has previously acknowledged that businesses are generally better equipped to understand the risks and conditions of commercial finance agreements, the regulations imposed by the act do not reflect this.

12. The Consumer Credit Act was originally passed in 1974, in an environment which does not reflect current customer behaviour, sophistication, or access to information. It also does not address the considerable innovation in credit markets that have taken place since that time including online banking and the emergence of non-bank funders.

13. The CCA imposes strict requirements on the information and documentation that must be provided to customers. Providing the appropriate documentation is costly for funders and time consuming. As a result, some asset finance funders have withdrawn from the market to provide asset finance to regulated consumer or have avoided entering it entirely. This reduces competition and customer choice, leading to higher costs for businesses.

14. For example, the Standard European Consumer Credit Information (SECCI) form, which prescribes the format of a credit agreement, is cumbersome, difficult to comply with and unclear. Customers therefore receive information duplicated in several different formats, creating confusion and limiting the way in which this information can

be provided in a modern environment. For businesses this can mean that regulated contracts can run to multiple pages and be double or triple the length of text as compared to a substantively similar unregulated agreement.

15. The regulations governing pre-contract information are complex and contradictory, leading to inconsistent application. The Consumer Credit (Disclosure of Information) Regulations 2010, governing pre-contractual disclosure for business customers do not have to be complied with if a funder is compliant with the Consumer Credit (Disclosure of Information) Regulations 2004. This means that the format for pre-contract information is not consistent across funders. A customer may receive Pre-Contract Information (PCI) from one funder and Pre-Contract Credit information (PCCI) from another for essentially the same product. The wording and the formats used for these documents have been designed with individual consumers in mind, and there is no derogation to allow for funders of business agreements to modify the format.

16. Where a customer has multiple agreements from the same funder, the information and documentation requirements will differ greatly from agreement to agreement if they have a mix of regulated and unregulated agreements. The format and wording of non-regulated agreements is controlled by the funder. This allows innovation and the provision only of the most necessary information. It also allows agreements to be arranged quickly – for business customers time may be of the essence and the administrative burden of providing compliant information in the appropriate format may prevent a funding agreement from being reached in a timely way. Regulated customers of business agreements are unable to complete deals quickly due to the requirements of the Consumer Credit Act limiting lenders' agility.

17. The Consumer Credit Act also limits flexibility for businesses. For example, some unregulated business agreements may allow customers to take a "payment holiday", and others may allow novation in certain circumstances at minimal cost to the customer. In regulated agreements this would not be possible.

18. Where a customer misses a payment or is delayed in making a payment on an agreement, the regulations prescribe the wording which must be used in the "notice of Sum in Arrears" (NOSIA) letter. This wording can be intimidating to the customer and cause unnecessary distress. In unregulated business agreements, the funder is free to make the customer aware of arrears in a manner appropriate to the customer's individual circumstances.

***Prudential Regulation*:**

19. Banks are subject to regulation by the Prudential Regulation Authority. The PRA apportions risk weighting to different types of finance, setting out the minimal capital a funder is required to hold. As part of the review of the future regulatory framework, the Government should consider reviewing the risk weighting of asset finance. Asset finance products present a lower risk of capital loss for funders than other forms of finance. This is because, in the event of non-payment by the customer the asset is recoverable and will typically retain a significant portion of its saleable value at the time it is recovered. However, funders are still required to hold capital equal to the value of the agreement. This does not protect the funder or the customer and has the

ultimate effect of reducing liquidity in the market and reducing access to finance for small businesses.

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