

Response to The Financial Stability Board’s inquiry into the effects of financial regulatory reforms on the provision of financing to small and medium-sized enterprises

Written evidence submitted by OakNorth Bank plc

Company overview

1. OakNorth is a global fintech company founded by Rishi Khosla and Joel Perlman - two seasoned entrepreneurs who in building Copal Amba (their previous venture), encountered issues securing growth finance from UK high street banks.

2. The problem exists because over the last three decades, banks around the world have increasingly focused their relationship managers on large companies, while centralising and automating underwriting processes for smaller loans. **SMEs seeking loans of £500k up to £30m have therefore been overlooked and underserved, and access to finance is now the largest issue holding back SMEs’ ability to scale.**

3. OakNorth was launched in September 2015 to help solve this issue and it does it using its artificial intelligence platform, *OakNorth Analytical Intelligence*. In the UK, it uses the platform to do its own balance sheet lending, offering loans of £0.5m up to £40m to fast-growth, profitable businesses and property developers. **To date, it has lent over £3bn without a single default and the its loans have directly helped with the creation of over 12,000 new homes and more than 13,000 new jobs in the UK.** SMEs remain critical to the UK economy – providing over 67% of the UK’s private-sector jobs and contributing over 50% of UK GDP – which is why OakNorth has focused its proposition on supporting this niche.

4. Outside of the UK, the platform is being licensed to banking partners across multiple countries and is enabling them to replicate OakNorth’s success with SME lending in the UK in their own markets. Thus, multiplying the multiplier effect outlined in paragraph three.

5. To help fund its lending, OakNorth offers a range of competitive savings products - fixed term accounts (ranging from six-months to five-years), easy-access accounts, notice-accounts and cash ISAs – to retail customers, as well as fixed term accounts for businesses. It currently has c.40,000 savings customers who are making the most of their money by depositing with it. As a result, it is benefiting its customers on both sides of the balance sheet.

6. The Board is chaired by Cyrus Ardalan, former vice-Chairman of Barclays, and other non-executive directors include Navtej Nandra, Ted Berk, and Robert Burgess. Lord (Francis) Maude, Lord (Adair) Turner, Martin Stewart and Nick Lee are advisers on OakNorth’s Advisory Board.

7. The bank is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Reason for submitting evidence

8. OakNorth is submitting evidence because it believes the market for business loans, particularly to SMEs, is uncompetitive to the detriment of OakNorth, other new banks and businesses that want to access growth finance.

What have been the main trends in SME financing (i.e. types of financing, volumes, prices and maturities) since the financial crisis? How do these trends differ across jurisdictions (e.g. advanced vs emerging market economies) and sectors (e.g. high-tech vs traditional firms), as well as by firm size (micro vs small vs medium-sized firms) and age (e.g. start-ups vs mature firms)?

9. While things are improving in the UK in terms of the options available to SMEs when it comes to current accounts, there is still a relative lack of choice when it comes to borrowing. This lack of choice has contributed to a) the apathy that exists among business customers in the UK, b) the lack of switching between banks and c) a likely reduction in the demand for debt finance.

10. This is evidenced by the fact that SMEs in the UK borrow about half as much as their counterparts in the US and Germany, where they are supported by competitive and diverse banking systems. In the US, there are around 7,000 banks; in Germany, there are about 2,000; but in the UK, there are c.350 (source: [Expatica](#)).

11. Furthermore, five banks account for 90 per cent of SME business loans in the UK, while in the US, the biggest four banks control only 39 per cent of the small business loans market and in Germany, the biggest four lenders control 20 per cent of the total banking market and OakNorth expects their share of the SME lending to be similar (source: [FCA](#)). This strongly suggests that SMEs in the UK are not used to approaching third parties for their lending requirements, often reconciling themselves to the fact that they cannot raise debt financing.

12. The revised bank license authorisation process, which involves initial authorisation with conditions before exiting mobilisation, has reduced the barriers to entry to become a new bank in the UK, by making it easier for prospective banks to raise funds to launch their business. This has been instrumental in encouraging new banks such as OakNorth to set up, thereby giving SMEs more choice of financing options. However, several barriers remain towards achieving the Government's ambition of a more competitive and diverse banking system.

Have financial regulatory reforms such as Basel III affected bank financing to SMEs (e.g. in terms of loan volumes, prices, maturities and collateralisation)? If so, how?

13. Yes. However, there is an opportunity to reform certain regulation and create more proportionality between challenger banks and incumbents, ultimately unlocking more capital for SME lending.

14. The PRA has taken several very significant steps to improve banking competition in the UK – for example with the creation of the New Bank Startup Unit which has seen tens of new banks granted licenses since 2010. OakNorth sees Brexit as a potential opportunity for the Government and the Bank of England to take this even further, determining which aspects of legislation from the EU they

wish to maintain and which they wish to reform. **OakNorth hopes that this will result in more proportionate regulation for new banks vs incumbents, particularly in respect to capital.**

15. Currently, the European Banking Authority mandates that national regulators in EU member states must impose the Basel standards in full on all banks, regardless of size or whether they pose a systemic risk or not. This means that new banks like OakNorth have to adhere to more onerous capital requirements and in some cases, hold up to 10 times more capital than larger banks to write the same loan. OakNorth has to use a Standardised Approach to its risk weighting, compared to the Internal Risk-Based model that larger banks get to use. **By being able to apply its own model regarding risk weighting instead of having to use the Standardised Approach, OakNorth would have a larger amount of capital at its disposal which would ultimately mean more money that it could lend to SMEs. This would be good news for SME lending competition and good news for borrowers.**

How does the impact (if any) of financial regulatory reforms vary across banks operating in different geographies and with different size and business models? What other G20 financial reforms or other domestic financial regulations (if any) may have impacted financing to SMEs and how? Have financial reforms prompted a shift in the provision of SME financing, e.g. between banks and other financial institutions (substitution effects)? If so, how?

16. The Bank Levy was created as a financial stability contribution after the 2008 Financial Crisis and applied to large banks who were required to make an appropriate contribution which reflects the risks that they generate to the economy.

17. In 2016, the then Chancellor of the Exchequer (George Osborne) announced that the Bank Levy would be replaced with a new eight percent Corporation Tax Surcharge on the profits of banks, in addition to the existing corporation tax at 18 percent. It applies to all banks with annual profits over £25m, so OakNorth, despite being less than four years' old, is now subject to it.

18. In OakNorth's view, the replacement of the Bank Levy with the Corporation Tax Surcharge is a retrograde step in terms of stimulating more competition for the benefit of bank customers.

Ramping up taxation on profits means that new banks such as OakNorth have less capital to reinvest in their businesses and less retained capital to lend to SMEs. It also sends a very negative signal to investors looking to put capital into the UK banking sector, as it is the only industry singled out for an additional surcharge, making it a less attractive sector to invest in.

19. As the European Banking Authority noted in its paper *Proportionality in Bank Regulation*, regulation should be judged by five measures to ascertain whether it is proportionate. These include whether sufficient differentiation is made between different types of banks without compromising the objectives of regulation. The Bank Corporation Tax surcharge fails on this measure.

20. The Bank Corporation Tax surcharge also fails on the measure that regulation should be proportionate in relation to the objective sought i.e. that banks “should continue to make a fair contribution in respect of the potential risks they pose to the UK financial system and wider economy (source: [HMRC](#)).” Large banks pose a systemic risk to the UK economy, small banks do not.

21. The Corporation Tax Surcharge should be withdrawn or reduced for banks below a certain size in the interests of creating a more competitive and diverse banking system that better supports British business and the economy.

Are there any other issues or relevant factors that should be considered as part of the evaluation?

22. Improving the growth and productivity of SMEs is central to improving the performance of the economy. **However, while the UK economy has a strong track record in supporting start-ups, it performs less well when it comes to supporting scale-up businesses, particularly those that are considered “fast-growing”.**

23. The British Business Bank has done some excellent work to help address this and support SMEs with high-growth potential through schemes such as Help to Grow and the ENABLE Guarantee programme – both of which OakNorth is part of. However, there is still a lack of awareness with only 37 percent of SMEs stating that they have a full understanding of bank loans. Furthermore,

confidence amongst SMEs planning to apply for bank finance has declined, falling from an abysmal 55 percent in Q4 2016 to 43 percent in Q4 2017 (source: [BBB](#)). This lack of confidence stems from the fact that many businesses which would like to borrow from a bank, don't end up applying as they either feel they would be turned down ('indirectly discouraged'), or feel the bank is reluctant to lend ('directly discouraged').

24. While scale up businesses tend to use a wide variety of finance, four in ten do not feel they have the right amount of bank or equity finance in place for their needs (source: [The ScaleUp Institute](#)).

25. SMEs need to be able to compare lenders against several factors (average transaction time, speed of response, flexibility in terms of lending structure, etc.), rather than just price.

26. Following its retail banking investigation which concluded in 2016, the Competition and Markets Authority recommended that a price comparison website be created to help SMEs compare different providers when it comes to loans of up to £50,000. While OakNorth agrees that a comparison website would be helpful for increasing SMEs' awareness of other providers and enabling them to find the best lender for their needs, it disagrees that it should focus on price, or that it should be limited to loans of up to £50,000.

27. The key issue with a comparison site that focuses on price is that it is trying to resolve adverse pricing in a market where the fundamental problem is lack of supply. If you push down prices in a supply-constrained market, you will have even less supply therefore worsening the situation. A simple price comparison website would therefore not work as lending needs to be tailored very closely to the characteristics of the business at hand. Price comparison websites tend to 'commoditise' the products they compare and encourage market participants to compete on price, ultimately leading to a computer-says-no approach.

28. A comparison website should enable SMEs to compare a multitude of factors including price, such as speed of response, customer service, average transaction times, whether the bank offers term and revolving credit facilities, and what collateral the lender is willing to consider as security (real estate, stock, debtors, plant and machinery, alternative assets, intellectual property, etc.)