Supporting UK business

The report of the Business Finance Taskforce

October 2010

Contents

Foreword

The chief executives of the six largest UK banks (“the Taskforce banks”) and the British Bankers’ Association (BBA) decided in July to take a close look at how we could do more to help the UK return to sustainable growth. We acknowledge the special responsibilities we carry in this regard, both in the wake of the economic crisis and in view of the role banks play as engines of the economy.

Over the last two years, the subject of bank finance has become a topic of national importance. On the one hand, since the UK economy slowed in the wake of the financial crisis in 2008 there has been much comment that banks are not lending enough; that lending is conducted at rates that are too high; and that banks are turning down loan requests for viable businesses. On the other hand, over this same period, the banks have seen a steady decline in demand for loans and a steep increase in the cost of wholesale funding, upon which much of their lending depends. Securitisation markets remain subdued, with knock-on consequences for the flow of bank credit into the real economy.

The Taskforce was set up to analyse the facts and look at what more could be done. The focus of the Taskforce banks is to balance the sensible extension of credit (we must only lend to those who can repay) with the support of appropriate borrowing by households and businesses which will be necessary to underpin a predominantly private sector-led economic recovery. In our work, we have been encouraged and supported by regular dialogue with the Government and its officials for which we are grateful.

We have focused our work on lending to businesses, especially smaller businesses. As the Government’s recent consultation paper recognised, small and growing businesses are vital contributors to economic recovery and it is through them that many new jobs will be created. We recognise the critical role banks have to ensure such businesses are given proper access to secure and sustainable sources of finance.

Our work has looked at the position today and what we can do to improve it. We have also looked at the particular challenges over the next few years, as the authorities withdraw special interventions made during the crisis and demand for consumer and business loans picks up.

Trust between banks and their customers has suffered during this period. We are determined to change that. Banks have a duty to their owners to generate sustainable returns, but we are also corporate citizens: we have a role in society that must be carried out responsibly and usefully. We hope the measures in this report will help rebuild trust between banks and business stakeholders. We look forward to a new process of active engagement, so we can work constructively together to help get the UK economy growing again.

So what has our work focused on? This report contains commitments relating to the creation of a £1.5 billion Business Growth Fund, which will deliver equity support to British businesses. We commit to enhancing the cross-industry dataset to ensure transparency of the demand for credit by UK businesses and its supply by banks and other providers, so that decisions are based on the best possible information. We will enable all companies seeking to renew credit facilities to participate in a dialogue with their bank 12 months ahead of the date of refinancing, so a good mutual understanding can be developed in terms of what will secure credit renewal.

We will put in place a new, transparent and independently monitored appeals process for customers who believe a bank’s decisions are in breach of its lending principles. We will facilitate an army of mentors to local businesses, with the aim of increasing the probability of success for business credit applications. And we commit to the creation and maintenance of a dialogue between banks and business groups that will support lending appropriate for local needs. A new Business Finance Round Table will be established with business group partners as a result of this work, which will facilitate the progression of the initiatives set out here.

To that end, we will ensure our staff receive appropriate training and resources to offer customers a full range of products in an efficient manner; and that staff are trained to work more collaboratively within each bank so customers are offered a coordinated and complete service. We will work hard to improve our customers' experiences and ensure the treatment they receive is smoother, more predictable and more transparent.

In the critical area of funding and wholesale markets, our report makes several practical suggestions. These are designed to have a materially beneficial impact on the availability of funding and liquidity to support lending to business as the economy recovers.

Together, the initiatives set out in this report represent a far-reaching set of activities, which are intended to be helpful to British businesses. Our report signifies a commitment by the Taskforce banks to make a positive difference to the prospects of the UK economy over the coming years. We will immediately start implementation.

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1 Executive summary

1.1 Purpose of the Business Finance Taskforce

The chief executives of the major UK banks with the BBA agreed in July 2010 to set up a Taskforce to review what more banks could do to support the UK economy, through financial and practical means, as it moves into recovery.

The Taskforce was designed to address concerns about the supply and price of credit from banks and perceptions that banks are not adequately supporting viable businesses. A particular focus has been small businesses. Our work also looked ahead to the macroeconomic challenges of the next two to three years and reviewed measures to ease pressures on the availability and cost of wholesale funding, so that the banks could provide as much support as possible to economic recovery.

Senior personnel from Barclays, HSBC, Lloyds, RBS, Santander and Standard Chartered have worked together in a series of workstreams coordinated by the BBA. We invited officials from the Treasury, Department for Business, Innovation and Skills (BIS) and the Bank of England (BoE) to attend our meetings. As the work progressed, we also engaged with business representative groups and with a range of other organisations to ensure we understood and factored in their concerns.

We have looked hard at how we can improve access to affordable finance for viable businesses, and how we can improve the quality of customer service in response to the challenging environment for businesses. We have agreed a number of commitments across these areas which, we believe, should make a tangible difference to the support that UK businesses will receive going forwards. We have also developed a number of proposals on how to ease pressure on wholesale funding markets, which should help improve the flow and cost of credit to households and businesses. We look forward to discussing these ideas with the relevant authorities and are committed to implementing them as soon as we can.

Before outlining those commitments and recommendations, this report first reviews factual evidence about the supply of, and demand for, finance to UK businesses.

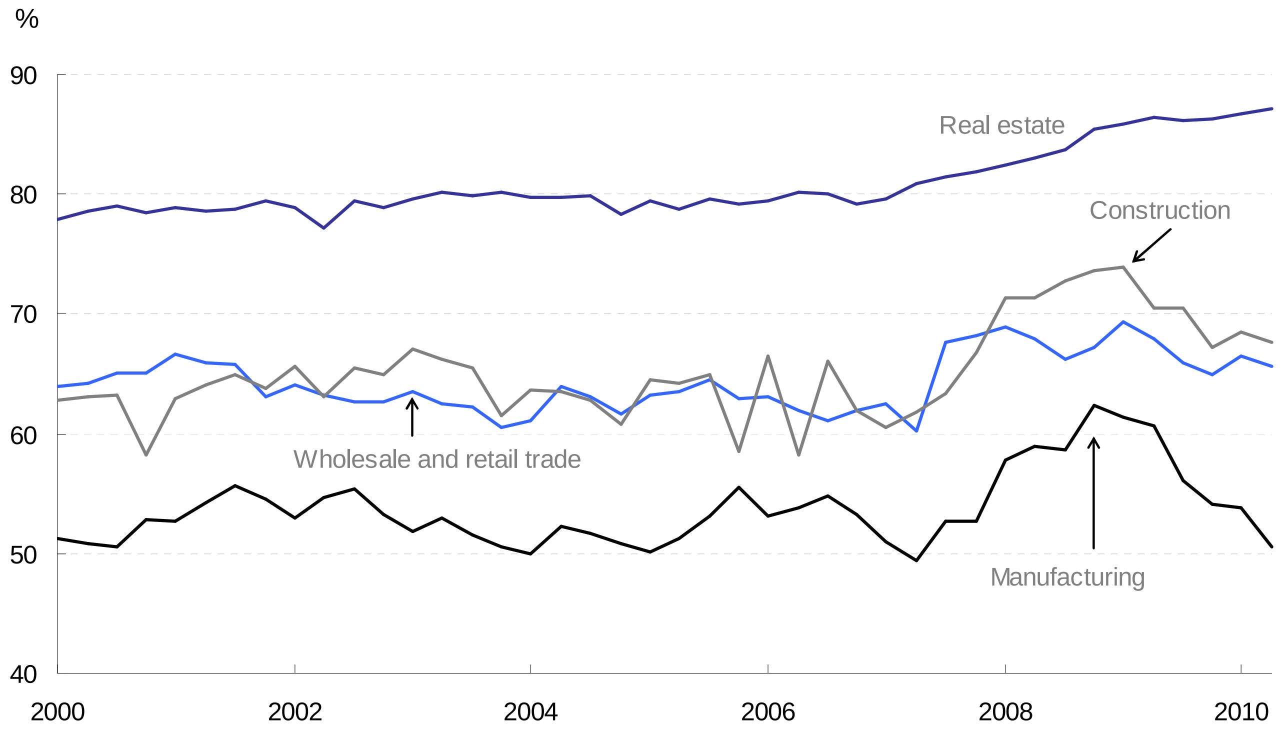
1.2 Bank lending: what's going on?

Starting in the mid 1990s, bank lending to UK businesses grew at a rapid rate. The most buoyant period was in the five years immediately before the financial crisis. The main drivers of this were growth in the commercial real estate market; the preference among many businesses for debt over equity; a ready supply of credit from foreign banks and non-bank financial institutions; the provision of credit to borrowers who had previously struggled to get loans; and the accommodating monetary policy adopted by many central banks over this period.

As the crisis accelerated in 2008, lending growth was maintained as companies continued to draw down on existing loan facilities. By early 2009, net lending started to decline when businesses began to de-stock, cut investment and repay existing borrowings. This trend started with medium-sized companies and then moved to small businesses. It is worth noting that the fall in business investment over this period was sharper than in either of the previous two recessions. Since that decline started two years ago, net borrowing by UK businesses has now contracted by around 6%, but still stands at over £500 billion, with £8 billion of new loans still made every month.

For the segment of small UK businesses, BBA data (which covers £1m turnover and less) indicates that overdraft and term loan lending continued to rise until August 2009. Since then, it has contracted by 3.5%. Most data (whether obtained via survey or directly from businesses or banks) point to a weakness in demand as the main driver of this reduction. Two particular facts support this view. The first is that across the range of British businesses the utilisation of agreed but unused lending facilities – which currently total £150 billion– has returned to levels seen pre-crisis (Chart 1.1 below). The second is that application levels are down as much as 50% in some segments.

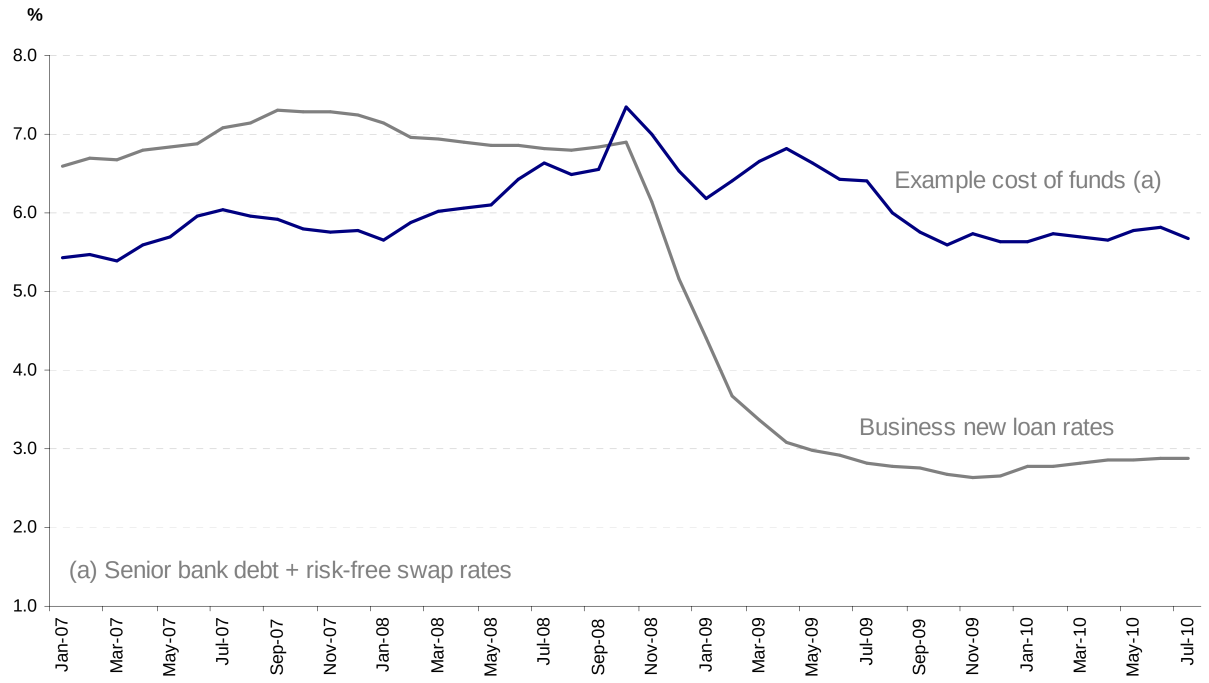
Chart 1.1 Utilisation of agreed financing commitments



Source: Bank of England

The price of credit has changed since the crisis began. Bank lending margins (which refer to the difference between the price of a loan and a typical reference rate, such as the Bank of England base rate) have reverted to levels that are more consistent with historical norms. Those margins in place just prior to the crisis look to be atypical when put in a historical context. We believe the change in margins indicates a more prudent reflection of underlying risk; and reflects increases in banks' capital and funding costs which, due to the introduction of understandably more stringent regulatory requirements are up sharply. The Chart below shows the relative movement of bank wholesale funding costs compared to new loan pricing.

Chart 1.2: Bank funding costs and new loan pricing to private non-financial companies



Source: Bank of England and Datastream

History tells us that a pick-up in lending demand will lag behind the pace of economic recovery. The normal pattern would be for the pick-up to start with larger businesses and work through to the smaller end of the market. This time, however, the pace of that change might be dampened by the overhang of heavily borrowed sectors such as commercial real estate and the strong financial position in which many SMEs find themselves (with lower overdraft utilisation compared to the last recession). We believe that new lending demand may pick up soon but, apart from investment related to inventory re-stocking, net lending could remain weak for some time. Over the long term, we expect lending growth to return to its trend rate of around 4% to 5% per annum (excluding real estate).

We are confident the banks can meet this recovery in demand, even if it grows more quickly than anticipated. Nonetheless, a number of important challenges need to be resolved – the most important of which is overall industry re-financing needs through 2012 – to ensure the industry has the headroom to support a stronger recovery.

1.3 What more can the banks do?

Evidence (from our customers, from Ministers and politicians, and business representative bodies) suggests there are a number of steps we should take to improve the environment for business success. We have listened carefully to the ideas put to us and carried out a full review of our collective current practices in order to identify those areas where we need to do more to help support UK business recovery. We have looked at how we lend and provide finance; how we manage relationships with our business customers; how we deal with complaints; and what help and support we provide to businesses when loan requests are not successful.

Customer feedback suggests that many smaller businesses are unaware of what type of finance options might be available to them; which option best meets their needs; and how to go about getting access to that finance. The banks can do more (through, for example, customer support, advice and signposting) to help businesses access the finance and help they need. We have agreed a range of actions to do that, which are outlined on pages 33 to 35.

Smaller businesses in the UK are heavily dependent on bank loans. The UK market is unusual in this respect as it lacks a ready means of supplying capital to smaller businesses to fund their investment for growth. We have studied how we could work together to improve supply in this area through the provision of equity via a new independent Business Growth Fund and have agreed to work with the appropriate Government departments, business representative bodies and other financial institutions to put such a fund in place. We have also looked at how we can better support trade finance for small and medium-sized businesses and have agreed a number of actions, which are outlined on pages 35 to 42.

We recognise that we can do more to improve our relationships with business customers. We need to be able to signpost sources of further help clearly and explicitly, and deal fairly and equitably with customers who want a second opinion should the decision, or the way it is communicated, on a request for borrowing not meet their expectations. We have agreed to formalise improved customer service standards in a new Lending Code of Practice and will proactively subject each bank’s appeal process to robust and transparent external scrutiny. We also need to ensure that our staff are properly trained and equipped to provide the help and support our customers’ need, particularly smaller business customers who often rely on us for financial advice. We have agreed a number of actions; those actions are outlined on pages 42 to 45.

Banks need to meet the expected demand for loans which will be needed as the pace of economic recovery picks up. This will be a challenge that increases as special market interventions are withdrawn. We can only be confident of meeting the demand when wholesale funding markets demonstrate higher levels of activity (recognising, as we do, that those markets may never return to the levels witnessed prior to the crisis). We have studied this issue closely and make a number of recommendations (which are outlined on pages 46 to 53 that we believe will improve the availability and cost of wholesale funding which banks can draw upon lend to UK businesses. We look forward to discussing these recommendations with the authorities: they are complex, but highly supportive of banks’ lending activities.

1.4 Conclusions and recommendations

We are committed to playing our full part in helping to restore the UK economy to sustainable growth. We recognise how important this is to the Government, businesses, consumers and citizens. We acknowledge the special responsibility we carry in view of the role banks play at the heart of the economic system and our part in restoring confidence in the overall financial sector. We want to ensure that viable businesses get the support and finance they need to thrive and grow, especially because of the important role that the private sector must play in generating economic recovery in the UK.

To demonstrate that commitment clearly we have agreed 17 initiatives, which we intend to implement quickly. We want to be open and transparent about our progress in resolving the issues identified in this report. An important part of that will be building and maintaining a more constructive dialogue with UK businesses and business representative bodies. Such a dialogue will also provide an outlet through which new areas of concern and opportunity can be surfaced and promptly addressed. We believe the most productive way to achieve this dialogue is to establish a high-level Business Finance Round Table, comprised of senior representatives of the banks and business groups, which will meet regularly. We will form this in the coming weeks so that it is fully operational by the beginning of 2011.

Bank commitments

The Taskforce banks have committed to 17 actions across three broad areas.

To improve customer relationships we will:

1. **Support a network of business mentors** by working with the business groups to deliver this free service to small businesses across the UK
2. **Improve service levels to micro enterprises** (businesses with fewer than 10 employees and turnover or a balance sheet under €2m) by setting out in a new Lending Code the levels of service banks will provide and outlining additional sources of help and advice
3. **Publish lending principles** which clearly set out the minimum standards medium-sized and larger businesses can expect when asking banks for loans and other services
4. **Establish transparent appeals processes** for when loan applications are declined, with processes independently monitored by a senior independent reviewer, who will publish the results of their review, to ensure each bank has a fair and equitable appeals process
5. **Initiate a pre re-financing dialogue 12 months' ahead of any term loan coming to an end**, which will include a timely review of business and re-financing needs and an assessment of what needs to be in place ahead of loan expiry to maximise the prospect of successful re-financing.

To ensure better access to finance we will:

6. **Establish and invest in a new £1.5 billion Business Growth Fund** (built over a number of years) to fill a crucial gap in the market and provide capital for viable businesses which want to invest and grow

7. **Support the Enterprise Finance Guarantee Scheme**, seeking continued Government backing through to 2012, and accommodating any changes made by Government
8. **Help mid-sized businesses access syndicated debt markets** by raising customer awareness, training customer-facing staff and engaging more actively with business groups and customers
9. **Improve access to trade finance** through targeted SME awareness-raising campaigns and exploring possible regulatory adjustments with the FSA. Seek to open with Government access to trade finance products for businesses that qualify for the Enterprise Finance Guarantee Scheme
10. **Signpost alternative sources of finance**, giving customers helpful information and advice if a loan is declined and raising awareness about the financial solutions they should consider
11. **Help improve the supply of credit to the wider economy**, working with the authorities to ensure that wholesale markets can support the necessary lending capacity as the economy recovers.

To provide better information and promote understanding we will:

12. **Fund and publish a regular independent survey**, commencing in early 2011, to a methodology agreed with Government and business groups, so there is an agreed and authoritative set of data on business finance demand and lending supply
13. **Enhance the cross-industry lending dataset** by broadening the statistics on lending available for wider bands of business activity; on lending to deprived areas; and on national and regional data on the provision of bank support to business start-ups
14. **Hold regional outreach events** throughout 2011 with business groups to enable business customers and business groups to meet with key staff from the banks to answer questions and explain what services are available
15. **Improve customer information** including a review of literature and other materials, so customers can more easily understand what products will best meet their needs
16. **Host a dedicated website** through the BBA to draw together and link useful sources of information to help customers access the most appropriate information. This will also connect mentoring networks
17. **Establish a Business Finance Round Table** where senior representatives from the banks and business groups meet regularly to discuss and review trends, identify emerging areas of concern, ensure problems are addressed and facilitate the implementation of the Taskforce initiatives.

1.5 Improving wholesale markets

Alongside deposits, the wholesale markets remain a vitally important source of funding for UK banks. The principal wholesale markets – the asset-backed security and covered bond markets – suffered significant declines in volumes during the crisis and have not recovered materially from those depressed conditions. The UK banking system has greater reliance on wholesale money markets than many other countries. Ensuring that wholesale funding markets operate efficiently is of particular importance in the UK as a facilitator of bank lending.

For a number of reasons, those markets are unlikely to return to the volumes they achieved at their peak prior to the crisis. But if they do not recover sufficiently from their current levels, this could restrict the ability of UK banks to supply enough credit at an affordable price to match a sustained and significant uplift in customer demand. This challenge will be compounded by the large volume of bank debt that needs to be refinanced through 2012.

The Taskforce banks can influence the restoration of these markets, and we commit to doing what we can to accelerate their recovery. However, the crisis has had such a severe impact on the markets that other steps will be necessary too. The Taskforce has identified a number of possible actions that we believe could be particularly helpful, and which do not require any state aid. We look forward to exploring these ideas further with the authorities. Full details are outlined in Chapter 4, but the measures include:

- **Levelling the playing field** to ensure the UK liquidity regime is equivalent to its international counterparts. Ensuring that the timing of the introduction of measures, the quantum of requirements, and the definitions of eligibility for different instruments to meet regulatory liquidity measures are consistent with other countries will help banks direct more cash resources to lending to viable businesses. These steps could materially support the further development of a UK covered bond market which in turn can provide funding necessary for banks to provide additional, affordable business lending
- **Rebuilding international investor confidence** in ABS. Alongside the steps to be taken by banks, in conjunction with European initiatives (potentially including implementation of a kite-marking scheme), promote inclusion of high quality European ABS within applicable definitions of eligible liquid assets with Basel Committee of Banking Supervision (BCBS) and Committee of European Banking Supervisors (CEBS)
- **Regulatory engagement** by working with Government to ensure that UK economic interests are fully represented in the complex and changing international regulatory environment affecting the secured wholesale market. For the UK covered bond market, the UK Regulated Covered Bond Council will also play a key role in this process
- **Greater disclosure and transparency** by providing more information to investors, expanding access to and visibility of loan-level data and promoting

simplified disclosure standards to help build investor confidence. The banks are committed to taking action to implement these improvements.

1.6 Next steps

A steering group of the Taskforce will continue to meet to oversee implementation of these initiatives. We will intensify our dialogue, via the Business Finance Round Table, with business representative bodies. Our intention is to ensure that all bank commitments are fully up and running quickly and the majority are fully implemented by the summer of 2011 (see the implementation timetable in Chapter 5).

We look forward to further discussing our proposals to ease wholesale funding markets with the authorities at the earliest opportunity.

2 Current state of business lending markets

2.1 Introduction

Banks have traditionally been the cornerstone of business finance in the UK. And we will remain the source - for the vast majority of small businesses seeking funding - of investment capital and cashflow finance.

Around two-thirds of UK businesses no longer need traditional bank lending at all. These companies often access the financial markets directly – and in increasingly sophisticated ways – to secure financing which is tailored to their needs. In aggregate, as well, even the smallest businesses are now holding more cash in hand; are experiencing fewer problems with late payments and are more stable than at the same point in the last recession. This is because many learned from their experiences in previous recessions, and benefit from an established workforce and customer base.

But many businesses are finding it challenging to raise affordable finance. And the UK still faces the important issue of how best to match demand for loans with the supply of affordable finance.

In this section we review the market for business lending and trade finance, setting out the use of business finance products and services across a range of business types. We then provide a review of:

- **Where we were**, examining trends in lending over the last 20 years, the relationship between lending and GDP, and some of the reasons for the high growth in business lending between 2003 and 2007;
- **Where we are now**, setting out why lending has fallen and repayments are strong, explaining the supply side 'squeeze' and setting out the current range of industry statistics, survey evidence and empirical evidence on current demand and cost for SME business lending;
- **Where we are heading**, detailing why a slow, but steady recovery in demand for borrowing is expected; and
- **The future challenges**, detailing how banks propose to address funding and regulatory challenges while underpinning an economic recovery through financing small businesses.

We have brought together evidence drawn from publicly available sources, including the Bank of England and Office for National Statistics, and have been supported by the BIS, who collect regular survey information about SMEs. We also commissioned pH Experian (part of Experian) to analyse borrowing trends extracted from balance sheet and profit-and-loss data from a cross-section of businesses with a turnover from £1m to £100m. pH Experian's work is published alongside this report and represents a continuation of work carried out for BIS in 2009.

2.2 The use of business finance

Providing businesses with access to appropriate funding is an essential element of any modern economy. Bank borrowing is one element of this funding. Other sources of funding such as retained earnings and equity investment are also important. The banking industry recognises that its role of providing lending is vital to the economy and it also recognises its role in working with other providers of business finance including private equity companies, venture capital, business angel investors and Government (e.g. through provision of the Enterprise Finance Guarantee).

The banking industry provides a wide range of financing products and services to all types of businesses in the UK, from sole traders and community-based businesses to large multi-national corporations. The majority of businesses utilise overdrafts and term loans – the former to fund working capital and the latter for capital expenditure on equipment and property. However, the number of businesses using more creative funding packages has been increasing. These businesses have taken advantage of less well-known financing options, such as invoice finance, asset finance, trade finance and supply chain finance.

The most appropriate financing package for a business will depend on the objectives of the business and often its ownership. As companies grow and develop, their appetite for a wider variety of alternative funding increases. Examples of alternative funding include syndicated facilities, trade finance solutions, private placement and private equity. This is not only a factor of size, but also of how professionally the business is managed, the sophistication of its needs and the visibility of cash flow to investors (e.g., management accounts/reporting). Many larger businesses have been able to access equity and debt capital markets directly over the last few years, thereby reducing the total level of bank borrowing in the UK economy. However, access to these markets has been restricted to larger businesses. Table 2.1 summarises the spectrum of finance products utilised across a range of business sizes.

Table 2.1 Use of business finance across different sized firms

	Turnover	Broad characteristics	Use of regular finance	Use of specialist finance	Typical providers
Smallest Micro businesses	Below £50k	Cash-based firms, often part-time business; few tangible assets; local operations	Limited mainly to overdraft, loans, and credit cards or personal finance products	Limited. Some asset-backed lending (ABL) – mainly vendor finance	Banks, credit card providers and point of sale (vendor finance)
Micro businesses	£50k to £1m	Increasingly full-time firms with staff, premises and assets; local activity normally limited to a single region; occasional exporting	Overdraft, loans, and credit cards	Increased use of structured ABL. Occasional use of trade finance products	Banks, credit card providers, specialised providers for ABL and trade products
SMEs	£1m to £25m	Full-time, larger multi-regional and national firms; increasing export/import activity	Overdraft, loans	Still some use of ABL, factoring and invoice discounting, export finance, some equity finance	Banks, credit card providers, specialised providers, business angels, private equity
Mid-size companies	£25m up to £500m	Larger national and international firms, often multinational operations	Overdraft (or a revolving credit facility), some loans	Export finance, invoice finance, asset finance and equity funding	Banks, venture funds, equity funds and stock market listing

Note: Definitions have been developed for the purpose of the Taskforce and may not reconcile with other definitions of SMEs.

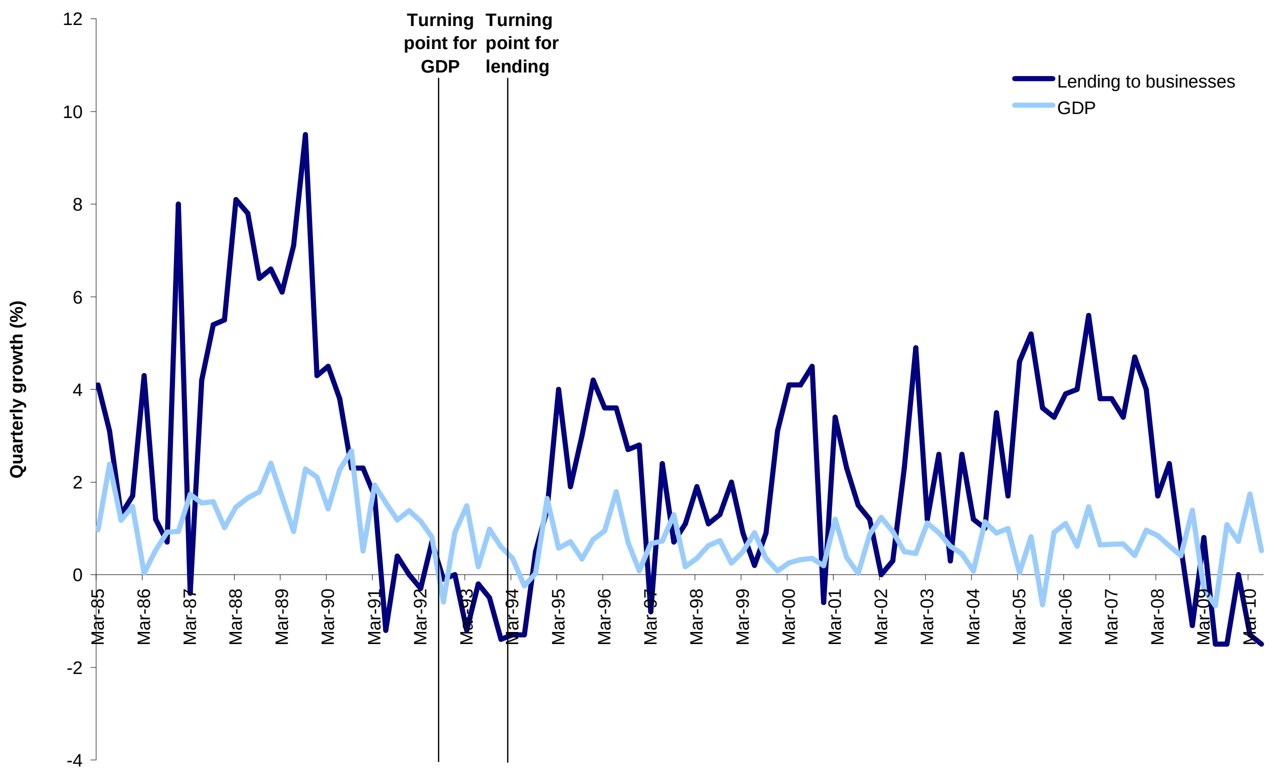
2.3 Where we were

Lending growth over the past 20 years

Bank lending to UK businesses has grown considerably over the past 15 years. The most buoyant period was in the five years preceding the onset of the financial crisis, when the three month annualised growth rate peaked above 30% in late 2007 (see Appendix B, Chart 1. Separate data indicates that lending to SMEs with a turnover of less than £1 million experienced a similar growth rate over the period 2003 to 2007 but the same segments of the business community experienced a more pronounced reduction in lending – in relation to larger firms – following the early 1990s recession (see Appendix B, Chart 2)

During the past three decades, bank lending and GDP have both broadly followed each other – a clear exception being 1992-4, when the recovery in lending lagged GDP by around 18 months. There are good reasons for this post-recession lag in lending. Firms have spare capacity at lower levels of economic activity, and therefore have less need to invest; and in such times both firms and individuals typically remain cautious over their spending and investment decisions and are more inclined to increase 'precautionary' savings above normal levels.

Chart 2.2: Relationship between the economy and lending



Source: Bank of England and ONS

Explaining the surge in borrowing from 2003 to 2007

The surge in borrowing from 2003 to 2007 was driven more by financial than economic conditions. These included:

- The boom in commercial property. Speculation about capital values and an increase in sale and leaseback activity saw real estate's share of total outstanding lending rise from 18% in 1997 to 44% in 2010. The real estate 'bubble' was fuelled by the view that prices would continue to rise and favourable capital weighting drove significant bank appetite[1] (see Appendix B, Chart 3)
- The swapping of debt for equity. The fall in interest rates and continued preferential tax treatment of debt saw bank lending increasingly favoured over equity finance for businesses during the 2003-2007 period. There has since been a partial reversal, particularly among larger firms which have more recently accessed equity markets to pay off debt
- The increased use of bank finance by previously 'occasional borrowers'. These borrowers were often higher risk companies that took advantage of easier credit availability in 2006-7. Ordinarily, these firms would not have had as much access to credit. These borrowers have since reduced their credit appetite
- Increased competition from foreign banks and other financial companies. The SME/mid-corporate market in the UK was attractive to many foreign banks; it is estimated that they accounted for approximately £175 billion of lending to private non-financial companies (PNFCs) in 2008 (32% of total, up from 26% in 2004). Many mutuals diversified into commercial property lending and SME banking, with a further £51 billion of capacity – at its peak – flowing from these sources as well as other independent lenders. Much of this capacity was refinanced in the securitisation market. Both the securitisation market and many of these providers of finance are now unavailable (see Appendix B, Chart 2)
- A relaxation in credit standards and increase in risk appetite, particularly seen in private equity transactions. Banks were willing to lend more to private equity to finance acquisitions. Whereas banks used to lend around four times a company's potential earnings, this had increased to a pre-crisis peak of as much as eight times, particularly where there was perceived asset backing.

The unwinding of certain markets; the deleveraging of previously highly leveraged businesses; and the closure to finance for certain businesses that were previously able to access finance; these are factors that stem directly from the 2003-2007 borrowing surge and are currently working their way back through the system. The marked rise in bank lending to the real-estate sector before 2008 also points to the potential for overall lending growth to remain subdued during the next few years, as portfolios are rebalanced, even if non real-estate lending is growing.

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[1] As a result, loan-to-value thresholds for Senior Debt, traditionally in the 60-70% range drifted upwards to the 75%-85% range with mezzanine and other structures bridging most of the remaining equity gap.

2.4 Where we are now

In this section we set out the key factors affecting the business financing landscape, noting that: lending to business has fallen; businesses are increasing repayments, and that there is a supply-side squeeze due largely to foreign banks and non-bank financial institutions exiting the market. Our assessments are drawn from survey, bank and company data.

Lending to businesses

Lending to businesses has fallen as the UK economy experienced a sharper decline in GDP and trade during the recent recession than in either the early 1980s or early 1990s. In the early part of the downturn net lending continued to grow as firms continued to draw down existing facilities, but around Q1 2009 net lending started to decline as businesses responded to the downturn by destocking[2] and by cutting investment[3] more rapidly than in either of the two previous recessions and clearing debts where possible. This trend started with medium sized businesses and then broadened to all SMEs.

The stock of lending to private non-financial corporations has contracted by 6% over the past two years, which is broadly equivalent to the reduction seen in the early 1990s recession. Notwithstanding that contraction, lending to UK businesses stands at over £500 billion and, apart from the commercial real estate sector, banks have committed a further £150 billion of facilities available to businesses.

Demand for short-term working capital has not been as strong as in the 1990s recession (this is consistent with the insolvency rate, which has also been lower). Two factors that have contributed to this are low interest rates, which have reduced the cost of servicing existing borrowing for many smaller businesses and SME liquidity, which is in a much stronger position than in the early 1990s. This additional liquidity is in part due to a much more mature age profile of SMEs at the beginning of this recession compared with the last, with firms typically being more stable and having greater access to reserves with less reliance on borrowing.

Trade finance activity has slowed globally, caused primarily by lower demand and deteriorating credit risk of OECD buyers. The global economy is now returning to normal with increasing trade activity, improving credit insurance availability, various targeted Government initiatives[4] and some regulatory changes[5]; but there is still a perceived lack of supply in some areas of trade finance to exporters and importers.

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[2] The level of inventories held by businesses fell from £188bn at the end of 2008 to £173bn at the end of 2009.

[3] Business investment was 16% lower in 2009 than 2007 and by H1 2010 had stabilised.

[4] Such as the Letters of Credit Scheme provided by ECGD and the Credit Insurance Top-Up Scheme.

[5] The FSA's approval of lower minimum maturities for selected Trade Finance products in December 2008 has greatly assisted trade capacity.

Repayments

While gross/new lending flows have declined, a further contribution to decreased net lending has been the increase in repayments as businesses have repaid more debt than contractually required, principally those with strong cash flow helped by low interest rates. This shows that businesses may be concentrating on paying back debt rather than spending or investing (see Appendix B, Chart 5).

The supply-side squeeze

There has been a significant reduction in the market supply. It is estimated that foreign bank lending has already been cut back by approximately £34 billion since its peak with the clear possibility of further reductions as facilities become due for refinancing. The near closure of securitisation markets has also removed up to £150 billion of annual funding which the banks need to find from other sources to maintain and increase lending supply, putting significant pressure as well on the cost of funds.

Broader evidence on explaining lending trends

Credit demand has fallen – as demonstrated by survey evidence, bank data and company data – but there are some areas of specific weakness where businesses are not obtaining the finance they seek. These three areas are set out below.

Survey evidence

Recent survey evidence shows both weak demand and that some firms have difficulty accessing finance. Throughout 2008 and into 2009 the available survey data – especially on the SME market – were often hard to interpret because the high loan rejection rates reported by representative groups[6] did not tally with data collected by the banks (and the Bank of England on behalf of BIS[7]) which continued to show a fall in demand for new facilities as the main trend along with fairly stable acceptance rates.

The evidence collected from the UK SME Finance (UKSMEF) surveys in 2008[8] and 2009[9] has provided a more definitive analysis.

- Credit demand has indeed fallen, partly because of falling working capital needs, but also because of curtailment of growth and development plans
- However, the risk profile of the UK business population shifted with an increased number of ‘weaker’ firms still able to secure funding, but at higher

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[6] For example, the Federation of Small Businesses Credit Crunch Poll www.fsb.org.uk or the Forum of Private Business Economic Downturn Panel www.fpb.co.uk

[7] A summary of the data is published on a regular basis in the BoE Trends in Lending report which also includes material from the Credit Conditions Survey (of bank loan officers)

[8] www.esrc.ac.uk – see under Outputs, 2010 Stuart Fraser

[9] http://www.berr.gov.uk/assets/biscore/enterprise/docs/10-636-2009-finance-survey-smes-results.pdf

rates, and rising numbers of firms with an increasing risk profile unable to access new credit facilities

- Until 2008, bank credit systems appeared to work effectively, still ensuring average/good quality applicants were offered a loan or overdraft (albeit they were less common in 2008 than in previous years)
- However, as 2008 progressed it became more difficult for SMEs to obtain loans or overdrafts which in part reflected weaker cashflows and security values (and in due course this provided the basis of the market failure intervention that led to the announcement of the Enterprise Finance Guarantee and its launch in February 2009)

Further UKSMEF Survey evidence shows that the vast majority of SMEs do not use bank lending. Only 20 out of every 100 SMEs sought bank finance in 2009; of these 6 did not receive finance or rejected the terms or conditions offered.

In 2010, trends in the SME sector so far point to a continuation of the trends observed last year. Although comprehensive data from a UKSMEF survey are now 12 months old, independent surveys still point to low demand for finance. Representative groups also highlight that since the start of EFG access to debt finance has at least stabilised and may have improved slightly[10]. The continuing discrepancy between bank-sourced acceptance rate data and comments by representative groups suggests that many businesses are reluctant to approach their bank to apply for borrowing.

A key development in recent months has been the shift in attention from access to debt finance towards concerns about its cost (or at least the customer's margin over typical reference rates, such as the Bank of England base rate) and associated terms and conditions[11]. Further BIS surveys show:

- While there has not been much of an increase in the overall number of firms required to provide collateral (e.g., where a loan is secured on a property), there has been an increase in the incidence of banks taking collateral for smaller lower risk firms (see Appendix B, Chart 14, 18)[12]

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[10] http://www.berr.gov.uk/assets/biscore/enterprise/docs/s/10-p75b-sme-business-barometer-feb-2010.pdf or more recently the ICAEW BCM Poll A3 2010

[11] http://www.bankofengland.co.uk/publications/other/monetary/TrendsSeptember10.pdf

[12] As the business cycle turned down and the credit risk profile of the business population changed some customer groups were asked by banks to provide more collateral. In most cases the reason was the same. The very smallest firms had been able to secure small loans often without security in earlier years as banks traded off the high fixed cost of taking collateral against the relatively small size of the loan. In many cases, these were ‘point of sale’ type products, often at fixed rate, and from secondary banking suppliers. Also, the lower risk firms had often been asked for minimal security, often waived, as the likelihood of the loan going wrong was low. However, when the recession took full effect, both these concessions to normal practice by banks were withdrawn (and in the case of the smaller firms some shifted product away from ‘point of sale’ to main bank structured products to retain access to finance). Nevertheless, the number of borrowers in both categories as a share of the total borrowing population is small so the average collateral requirements asked for by banks did not change very much.

- Term loan arrangement fees have risen since 2004. This increase is particularly concentrated for smaller companies (1-10 employees) and for higher risk companies. This is, in part, a reflection of charges for arranging credit facilities being re-introduced, after a period when they were typically waived (see Appendix B, Charts 13, 17).

Banks' data

Data supplied by Taskforce banks supports a view of weak demand and echoes many of the survey findings. In particular, overall business credit facilities are currently 75% utilised, leaving headroom for additional borrowing. Utilisation ranges from around 50% in manufacturing to around 85% in real estate; across the industry, undrawn, committed facilities from banks exceed £85 billion. There is a further £70 billion of committed, undrawn facilities available from other lenders (see Appendix B: Chart 6).

In the SME markets, loan application numbers across the main high street banks are currently 20% lower than at the start of 2008. Overdraft application numbers for micro enterprises (<£1 million turnover) are almost 50% down. At the same time, application approval rates for SMEs in the £1 million to £25 million turnover band have held up in the past two years (approval rates for overdrafts and loans are 97% and 90% respectively). Approval rates for small firms have recovered to 2008 levels (overdraft approval rates are currently 80%, having fallen to around 67% in late 2009; loan approval rates are currently 70%, having fallen to around 63% in mid-2009) (see Appendix B, Chart 9).

We recognise that a small, but significant proportion of SMEs are not receiving the credit they seek and that some customers are deterred from applying for credit.

Company data

Company data reveals weak demand for credit, but certain types of companies have experienced bigger falls than others. pH Experian have prepared a segmented analysis of lending drawing upon data from Companies House and 15 other sources for businesses in the £1 million to £100 million size bracket. Their findings are detailed in a separate report. In summary they found that:

- Over the period 2000-2009, the incidence of bank borrowing (number of firms who showed increased bank borrowing on their balance sheets) has gradually declined in the population they analysed, although this is mostly a function of a the number of borrowers remaining stable, while the number of companies overall grew;
- The decline in incidence over the past two years is more pronounced than the long-term trend, particularly for regular borrowers using overdrafts for working capital purposes (whereas long- and short-term loans hold up well across all types of borrowers);
- This decline in incidence among regular borrowers is true across all types (e.g., by sector, credit rating, region), although there are some variations in timing (e.g., construction dropping off quicker than other sectors; agriculture and property later);

- The incidence of borrowing among poorly rated occasional borrowers appears to have dropped over the past two years, but this was from a high point in 2006/7, and the current rate is similar to that seen in the earlier years of 2004/5;
- Some of the drop in the incidence of borrowing over the past two years appears to be due to intrinsic demand falling (although only some of this is quantifiable); the balance is driven by supply.

Pricing and the cost of borrowing

The overall cost of borrowing has fallen sharply over the past two years. For example, the average interest rate on new, floating-rate loans to UK Private Non-Financial Companies (PNFCs) has fallen from around 6.5% in late-2008 to around 3.5% at present, according to Bank of England data (see Appendix B, Chart 8).

There is a sense, however, that borrowing costs could be even lower. This is because there is a common misperception that the Bank of England base rate is, or should be, a proxy for the cost of bank finance for companies.

In reality, the Bank of England base rate is only part of the cost of the funds that banks must obtain to lend to businesses. The decline in the Bank of England base rate has been partially offset by increases in other determinants of loan costs, such as: the amount banks must put aside to absorb unexpected losses; the higher amount of equity capital used to support loans given regulatory changes since the start of the crisis; and the increased cost to banks of raising longer-term funding. This means that margins expressed by reference to the Bank of England base rate have increased, and when businesses renew financing arrangements, they are often experiencing an increase in the margin over such reference rates (even though the actual price is lower than it otherwise would have been two years ago).

Given the cost of borrowing has declined as much as it has, we do not consider that the cost of borrowing has had a constraining impact on demand for the vast majority of borrowers (Note: this can be contrasted to the 1990s recession when base rates peaked at 15%). However, the larger margin on loans now present in the market could, when base rates begin to rise in the medium-term, act as a dampener on demand.

Where we are now: conclusion

- Credit demand fell sharply in 2008 and 2009 with falls continuing into 2010
- There is evidence of a squeeze on the supply side, which may not be constraining demand at the current time, but could become a constraint at some point in the future if the economic recovery continues to accelerate
- Few signs are evident yet that the underlying level of demand for external finance for expansion has risen, albeit with economic growth underway (see action 11, Chapter 3)
- A number of SMEs are being deterred from applying for loans, because they think they will be rejected

- Some suitable businesses may be misinterpreting signals from the media and the banks themselves about the likelihood of obtaining credit
- Not all SMEs obtain the finance they apply for, although loan approval rates are returning to pre-crisis levels (see Appendix B, Chart 9)
- The banking industry should not be aiming to approve every loan application, but this trend signals that banks need to clarify loan requirements and explain to those businesses which have not obtained the finance they require how they might be able to in the future (or the alternatives available) (see actions 4 and 10, Chapter 3)
- Finally, some SMEs are not applying for finance because they do not want to take on new debt and may well be seeking to deleverage, or they do not currently have investment opportunities. This may be the correct business management decision to take. From the stance of bank-customer relationships, trying to get these firms to borrow when they do not want to is clearly inappropriate and damaging. They will borrow when they are ready to and when they see the economy recovering and banks need to be ready for this moment (see action 11, Chapter 3)

This Taskforce wants to make it clear that Taskforce banks are willing and able to supply credit to viable businesses and encourage all businesses to discuss their needs with any one of us (see actions 14, 15 and 16, Chapter 3).

2.5 Where we are heading

Economic outlook

Trade

So far, the UK's trade performance has proven disappointing, as trade has continued to dampen headline GDP growth despite sterling's 25% fall from its 2007 peak. This may, in part, reflect the uneven nature of the global recovery, where growth has been stronger in Asia than in Europe, our main trading partner. As the effects of global recovery spread, and as UK companies gradually move resources towards the production of more competitive tradeable goods, net trade should provide a positive boost to overall GDP growth over the next few years.

Business spending

Similarly, business spending, which fell more sharply during this recession than those in the early 1980s or 1990s, is expected to make a stronger contribution to the economy during the next few years. Indeed, firms' spending has rebounded so far this year as investment has increased and the pace of destocking has eased.

Households

As for households, their spending fell by 5% in real terms during the recession as consumers sharply increased savings levels in response to rising unemployment, high levels of indebtedness and sharp falls in nominal house prices. Low interest rates, a stabilising housing market and a smaller-than-expected pick-up in unemployment have all helped underpin consumer confidence and spending during 2010. However, with household debt remaining close to 150% of household income – among the highest for comparable developed economies – and amid concerns over the impact of the coming substantial fiscal consolidation on jobs, consumer spending is likely to remain on a fairly anaemic recovery path over the next few years as households continue to focus on paying off debt.

Economic outlook: conclusion

The UK economy has been on a steady recovery path this year, following its deepest recession in the post-war period. Against the backdrop of a slowdown in the pace of firms' destocking and a steady rise in consumer spending, activity has expanded at close to its historical average pace – though it remains well below its pre-crisis peak – during 2010. Underpinned by the effects of considerable monetary stimulus, further growth in global demand and the impact of sterling's past depreciation, the economy is expected to remain on a steady, if subdued, recovery trend during the next two years.

The expansion of the economy is likely to be limited to below, but close to long-term trend rate of 2.5% over the coming years. This is broadly in line with the consensus view and that of the OBR. However, there are considerable uncertainties around private sector debt overhang and fiscal consolidation.

However, there are considerable uncertainties around this outlook. If firms and households were to respond to the effects of the fiscal consolidation by reining in investment or spending further than anticipated, headline GDP growth (and the demand for credit) could be weaker than expected. Conversely, if the interest rate and confidence effects of restoring fiscal credibility were stronger than anticipated, private sector spending could contribute to stronger growth. While the Taskforce considers this accelerated growth scenario unlikely, it needs to be in the position to enable and support such a scenario (see action 11, Chapter 3).

The outlook for lending demand

Earlier we noted that there are good reasons for a post-recession lag in the pick-up in lending (see Section 2.3), especially if the recovery is slow.

As a further guide, a recent study of crisis episodes by Reinhart and Reinhart[13] indicates that these large negative effects also tend to be persistent, with a strong link between trends in lending and GDP, both before and after the event. The authors find that in the decade leading up to a given crisis, the ratio of domestic credit to GDP rises by around 38% on average, helping to fuel the economy's expansion. After the crisis, this ratio declines by an amount comparable to the surge (38%), though the deleveraging is often a lengthy process, lasting around seven years overall. If a crisis occurs across many countries at the same time – as the recent one did – and is

[13] Reinhart, C and Reinhart, V, After the Fall, Federal Reserve Bank of Kansas City Jackson Hole Symposium, August 26-28th 2010.

coupled with a high public-debt burden, the authors suggest that the dampening effects on both employment and GDP growth can be substantial and long-lasting. A similar finding was obtained by the US Federal Reserve in a study of credit cycles[14].

While the Reinhart and Reinhart research is unable to distinguish the extent to which the lengthy post-crisis deleveraging is due to restricted credit supply, weak demand and/or tighter post-crisis regulation, it is likely that all three factors have a role – but that banks themselves can directly influence only the first of them.

Overall, past experience – both within the UK and across countries – suggests that a lag between economic recovery and a pick-up in bank lending is very likely. Given the global nature of the recent crisis, its roots in financial markets and the fact that it has been accompanied by a substantial build-up in public debt, the current lag could potentially be longer and more persistent than would be the case what be considered a more typical recession.

Demand for different types of borrowing

In this section we have broken lending demand into its key components and assessed its outlook on the basis of an expected weak economic recovery. While not an exact science because borrowing will depend on the speed of the recovery (need for external finance over internally generated resources) and because businesses prefer bank debt compared to alternative sources, it is a reasonable basis for establishing a qualitative approach to current and future needs (particularly over the period 2010 to 2014). The table below summarises the key components:

Table 2.4 Evolution of demand components

Demand component	Outlook
Capital expenditure	We expect capital expenditure to increase, but only slowly. It is still more than 15% below its pre-recession peak. It is common for firms to 'sweat' their assets during a recovery, driving productivity gains. We also believe that there is a considerable output gap (the difference between actual production and potential production in the economy). If this gap is large firms will be able to expand without increasing investment. If this expansion is slow (as the weak GDP forecasts suggest) it will take a long time for actual output to take up this spare capacity. The BCC Quarterly Economic Survey showed that in Q1 2010 small firms' confidence in making investments was still in negative territory (-6.7) compared with positive confidence on turnover in general (+25.5) (see action 5 in Chapter 3)
Working capital	We expect the inventory cycle to turn in the near future. Businesses destocked very quickly in this recession so any rebound could be sizable. Some businesses may have seen other elements of working capital increase, for example slower payments from their customers (see action 7 in Chapter 3)
Distress	Distress financing often involves utilising short-term overdraft facilities to fund short-term shortfalls. Distress levels are indicated by insolvency levels which have fallen substantially since they peaked in early 2009 and we expect them to drift slowly back to historic norms. There may remain many firms that are not in good financial condition but with interest rates expected to remain low for a prolonged period we are unlikely to see a substantial increase unless there is a double-dip recession, or interest rates are forced to rise rapidly to ward off inflation pressures (see action 10 in Chapter 3)
Trade finance	Expectations are for world trade to continue to grow, in particular to Asia. The UK faces a relatively weak domestic recovery so demand in external markets will be increasingly important for UK businesses (see action 9 in Chapter 3)
Acquisitions	Most transactions (by value) are currently from foreign firms buying UK companies. UK company acquisition of other UK companies is very low. Appetite for transactions still appears to be subdued albeit many businesses have identified potential acquisition candidates and many private equity funds are looking at

[14] http://www.financialstability.gov/docs/CPP/Report/Fed%20US%20Credit%20Cycles%20072409.pdf

	solutions to unlock investments as fund maturities arise.
Commercial real estate	Commercial real estate behaves in a similar manner to financial assets. Transaction volume is driven by expectations of rising prices. Derivatives markets are currently pricing in falls in capital values of 6% and 3% in 2011 and 2012 respectively after a significant peak to trough decline of 35/40% since 2007. The Construction Products Association September forecast suggested that construction will be the first major industry sector to fall back into recession following a temporary recovery in the first six months of this year. Their forecasts show construction output will continue to fall into the first part of 2011 with full recovery taking many years. This is driven by both weak real estate demand and public infrastructure building.

Ratings for different types of borrowing

The RAG ratings for these components is presented below, where Red (R) represents weak demand; Amber (A) represents moderate demand and Green (G) represents strong demand. At present many of the components of demand are located in the Red zone, reflecting both current uncertainty and low economic activity – the one exception being 'distress' which acts on a counter-cyclical basis.

Over time, however, given the trajectory of the economic forecasts, these drivers should evolve to Green signalling uplift in borrowing demand from 2012 to 2014.

Table 2.5 RAG ratings for borrowing demand

Demand component	2010	2011	2012	2013	2014
Capital expenditure	R	R	A	G	G
Working capital	R	A	A	G	G
Distress (overdrafts)	G	G	A	A	R
Trade finance	R	A	A	G	G
Acquisitions	R	A	A	G	G
Commercial real estate	R	R	R	R	A

Source: Assessment of Taskforce banks

Where we are heading: conclusion

By 2012 we envisage loan demand growth returning to more normal levels. It is therefore important to determine what an appropriate 'steady-state' lending growth rate is to assess the ability of the banks to meet that demand. This should not capture the excessive growth of the period 2003-7, which contributed – in part – to the cause and impact of the crisis.

Excluding real estate lending, the long-run growth rate in UK bank lending over the period 1997 to 2010 has been 4.4% per annum – close to the rate of nominal GDP growth. This suggests that the industry should aim to be in a position to be able to support lending growth reaching this level in the medium-term, with sufficient headroom should the economy grow faster. Commercial real estate loan demand is not expected to require this rate of loan growth for a considerable time, nor do we wish to encourage excessive loan growth in this (or in any other) area. Indeed the Financial Policy Committee is expected to focus on such areas of lending in order to prevent real estate asset bubbles occurring again.

2.6 The future challenges

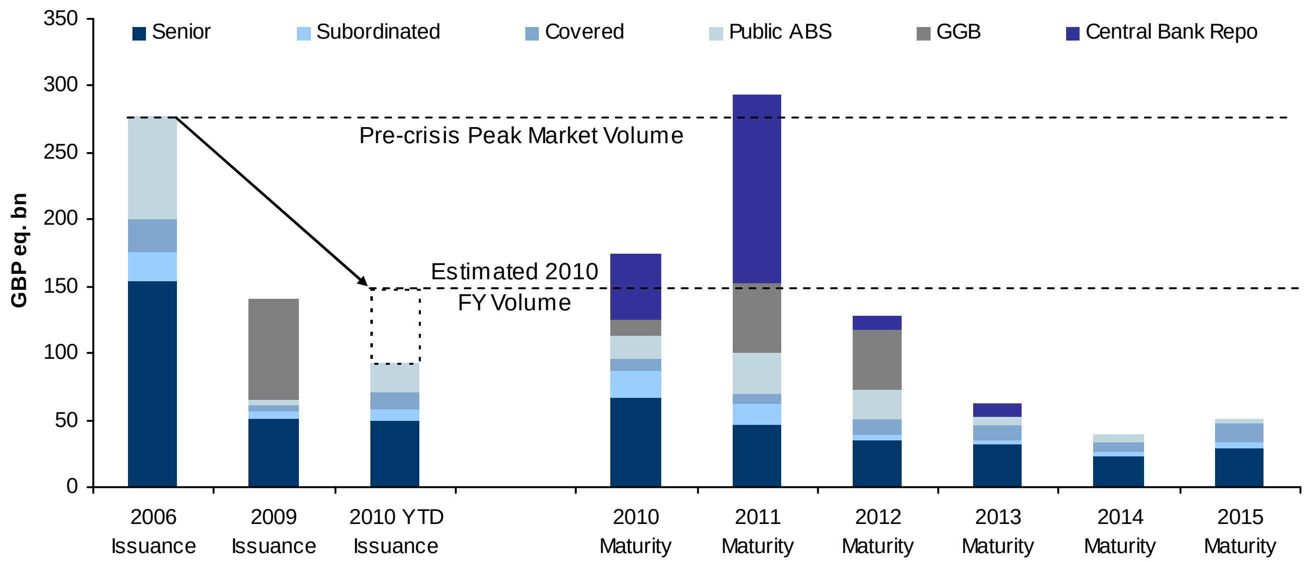
In light of the anticipated demand for lending set out above, the participant banks are confident they will be able to provide sufficient lending to support the economic recovery. There are, however, a number of challenges which need to be overcome.

Reducing the funding gap

Despite a significant improvement in the financing structure of the industry, funding pressures remain as a consequence of the requirement to refinance the Bank of England's Special Liquidity Scheme by 2012 and a large amount of other bank debt maturing at that time, in an environment where a number of wholesale sources of funding are only gradually reopening (particularly asset-backed securitisations – or ABS).

The chart below (see Chart 2.6) shows the amount of term debt refinancing the industry requires over the next five years, split by different types of financing. Notably, the amount of maturing term bank debt in 2011 exceeds the total amount of issuance completed by UK banks in the ABS, covered bond and unsecured bank debt market in 2006 when these markets were operating at respective peaks. Although the covered bond market is likely to be substantially larger in 2011 than it was in 2006, neither the unsecured nor the ABS market is likely to revert to historical form that quickly.

Chart 2.6: UK bank refinancing requirement



Source: Barclays Capital analysis

The Bank of England has carried out similar analysis in its June 2010 Financial Stability Report[15] and estimates there is a need for £750 billion to £800 billion of refinancing across the industry by 2012, equivalent to a run rate of £25 billion per

[15] http://www.bankofengland.co.uk/publications/fsr/2010/fsr27.htm

month. During the same time period we recognise that businesses will also need to refinance many facilities and the banks are committed to being able to meet this need.

Regulatory requirements for additional liquidity also place additional pressure on funding as banks are obliged to increase their liquid holdings by borrowing in the wholesale markets. While the FSA has not concluded its determination of the calibration and transition of liquidity reforms, its analysis in 2009[16] suggests that the industry may need to fund an additional £110 billion of liquid assets. If these reforms are brought in over the next few years, then the banks' funding challenges will be greater than those set out in Chart 2.6.

There are, however, a number of actions that banks are currently taking to reduce this funding gap. These include:

- asset sales to raise funds (either non-core assets or those disposals required by the European Commission) – this has the potential to reduce funding needs and increase cash available for funding
- further developing ABS markets and covered bond markets as diversified sources of funding – there have been a number of successful issues[17] during September 2010
- drawing upon the range of other wholesale and bond markets to replace ABS and covered bonds
- optimising where possible funding repayment timings.

Collectively, these measures mean the banks are confident they can bridge a significant portion of the funding gap identified above, but not closing it fully risks reducing their ability to supply sufficient lending to businesses. Further recommendations to help close this gap are outlined in Chapter 4.

Filling the gap left by foreign banks and other providers of finance

Following the withdrawal of a number of foreign banks from the SME market, net lending from these sources is still declining at a rate of £1.5 billion per month and the number of active players has been significantly reduced. These active market participants have already absorbed much of the reduction in lending from participants who have exited the market. Foreign banks and other providers of finance tend to be 'late cycle' lenders – they bring additional lending capacity at the end of the cycle. This suggests Taskforce banks have, and will continue to have, a more important role in financing the recovery as a result of these continuing trends.

The number of financial providers offering SME banking services (particularly mortgage-related) has fallen since 2006, but stabilised in the past six months. This stabilisation suggests that further withdrawal risks are moderate.

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[16] http://www.fsa.gov.uk/pubs/policy/ps09_16.pdf

[17] http://www.ft.com/cms/s/0/f31f5e0e-bf6c-11df-965a-00144feab49a.html?ftcamp=rss

Table 2.7: Number of providers of SME banking services

Number of providers	2006		2007		2008		2009		2010	
	Half 1	Half 2	Half 1	Half 2	Half 1	Half 2	Half 1	Half 2	Half 1	Half 2
Commercial Mortgages	66	67	72	75	75	72	49	45	39	39
Bank Business Loans	20	19	20	20	20	20	18	17	18	18
Re-mortgages - for Business Purposes	44	40	39	38	36	28	18	16	15	14
Total	130	126	131	133	131	120	85	78	72	71

Source: Moneyfacts

Securing trade finance

The UK Government is keen to encourage economic recovery through export-led growth, both with existing trade partners and increasing trade with new export markets. This can be facilitated by trade finance, which is an essential, but often overlooked source of business finance. Current challenges include the impact of regulatory reform, where the implementation of Basel III as currently envisaged could lift trade finance prices by 20% to 40%, unless we continue to recognise the short-term nature of these facilities in their risk weighting and within the leverage ratio.

Credit limits for importation may also prove inadequate to support growth during the recovery as demand increases, especially from SMEs, due to recent reductions related to liquidity, capital constraints and perceived market risks. Additional import limits from banks and possibly non-traditional providers such as the UK's Export Credit Guarantees Department, credit insurers or multilateral agencies will be needed to restore capacity. Given the importance of the UK's export performance, this report contains a number of actions specifically targeted at improving trade finance availability and price (see action 9, Chapter 3).

Striking the right balance of regulatory reform

Fostering economic growth and underpinning the strength of the financial system is a difficult balancing act to achieve. Fostering economic growth requires providing finance in order to allow businesses to grow and prosper, and underpinning the strength of the financial system requires holding capital and liquidity back in reserve to guard against future instability.

The Basel Committee of Banking Supervisors (BCBS) has proposed a new minimum Core Tier 1 capital requirement of 4.5% (up from 2%), with a capital conservation buffer of a further 2.5% on top. Given a drop into the conservation buffer will prompt restrictions on banks' ability to pay dividends and buyback shares (for example), the market and bank shareholders will no doubt demand that banks hold an extra buffer even beyond this effective 7.0% minimum Core Tier 1 requirement.

In response to regulatory and market pressure, the Taskforce banks have been strengthening capital ratios since 2008 and currently have an average Core Tier 1 capital ratio of around 10%, providing a substantial buffer over these new minimum requirements. However, there is still uncertainty over a number of other buffers[18] as well as how definitions of capital and capital risk weights may move in the future.

The BCBS recognises the need to phase in the new regulations in a manner that is compatible with the ongoing economic recovery and has separately carried out a macroeconomic assessment of the proposed reforms (through its Macroeconomic Assessment Group). The BCBS has proposed a transition timescale which should mitigate the risk of reductions in credit availability, particularly in the 2010 to 2012 period.

The proposed FSA liquidity reforms outlined above will materially impact the amount of cash buffers held by banks and these buffers will require funding from wholesale markets putting further pressure on already stretched debt issuance levels. These measures will also impact the pricing of bank lending.

Clearly each bank will take its own approach to managing its liquidity profile in the context of its balance sheet and the broader industry regulation. However, for the purposes of this report, it is fair to assume that this will at best exert a cost on the industry which will be reflected in higher margins over reference rates, and at worst introduce constraints to the total level of market liquidity available to support lending. The UK regulatory authorities can support UK businesses by adopting an equivalent regime to that proposed by the Basel Committee both in terms of the substance of reforms and the timetable of implementation.

Implications on loan pricing

A number of these challenges suggest that lending margins will increase versus typical reference rates over the medium term [19]. There are a number of reasons for this.

- Bank funding costs have increased and are likely to remain elevated to refinance the bank debt maturing over the next few years. This is best illustrated by the movement in the effective yields on 5-year bank debt – the cost for banks of raising medium-term funds in the wholesale markets. Five-year Corporate Default Swap spreads are currently 140 basis points (1.4%) compared to a pre-crisis figure of 10 basis points (0.1%). Wholesale funding accounts for 19% of industry-wide funding[20].
- Higher capital requirements for banks will increase the cost of lending, as expensive equity will necessarily replace cheaper debt in the capital structure of each loan. The BCBS has prepared a long-term economic assessment which suggests that for every 1% increase in capital requirement, the price of credit

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[18] For example, additional buffers for systemically important banks and buffers for counter-cyclical capital creation

[19] A fact sheet setting out how the price of a typical loan can be found at http://www.bba.org.uk/media/article/bank-lending-to-businesses-explained-in-new-factsheet/press-releases/

[20] Bank of England, Financial Stability Report, June 2010

will rise by 13 basis points (0.13%)[21] across representative international banks. SME pricing is further under pressure because SME lending is typically more risky than the average corporate, and banks are required to hold more regulatory capital against an equivalently sized loan as a result. This magnifying effect means that SME loan pricing could increase by even more than credit pricing on average.

- The FSA has proposed new liquidity rules. This has an estimated annual cost of £2.2bn[22] and could add 10 basis points (0.1%) to margins, if spread across all forms of lending of the Taskforce banks. The BCBS estimate of liquidity reform impact on credit pricing was 0.08% across representative international banks.
- Banks will also look to re-price according to a revised through-the-cycle assessment of borrower default risk. Bank write-offs for business lending were as low as 0.3% in 2007 and were expected to remain low, but subsequently peaked at around 1.3% during 2010. This re-pricing will differ according to borrower size and type.

The bank lending outlook: conclusion

Past experience (particularly during the 1990s recession) suggests the pick-up in lending demand is likely to lag the weak economic recovery. This pick-up will vary by size of firm – with the largest first and smallest last. The 1990s recession suggests that an early re-stock rise will be followed by several more quarters of paying off debt, rather than taking more on. This could be particularly pronounced in this recovery due to the overhang of real estate lending and other sectors with high leverage. Furthermore, the stronger financial position of many SMEs, and lower overdraft utilisation compared to the last recession, suggests a more prolonged period of low borrowing requirements.

This means that gross new lending is likely to pick up soon, but, on balance, apart from restocking, net lending will stay weak for some time thereafter. The message is clear: we need to be careful in the interpretation of lending statistics, as one figure alone does not provide a wholly accurate picture.

Supply pressures are not currently constraining the industry, and the industry is confident it can meet a steady recovery in demand, with some headroom if demand does grow quicker than expected. With over £150 billion of unutilised limits compared to an economy-wide destocking of £15 billion, the industry is confident that it can provide the working capital required to rebuild stocks. Funding for increased capital expenditure is expected, some years off. There remain a number of challenges for the banks, the most important of which is the industry refinancing needs around 2011/12.

There will undoubtedly be some businesses which will continue to struggle to access finance, many because bank debt is not the right form of financing for their business.

[21] http://www.bis.org/publ/othp10.pdf

[22] http://www.fsa.gov.uk/pubs/policy/ps09_16.pdf

But some businesses are being deterred from seeking bank finance and some are not receiving the right outcomes from their bank.

The recommendations later in this report are intended to address these gaps and ensure banks are able to maintain strong lending support to the economy.

3 Restoring confidence – Taskforce commitments to business

3.1 Introduction

The Taskforce banks recognise that business and public trust has been eroded over the last few years. Rebuilding trust has been a central part of our discussions with business organisations because we realise it is vitally important that we rebuild our relationships with customers and wider stakeholders.

Banks will continue to form the cornerstone of business finance in the UK. And we are committed to supporting customers while the economy recovers. But, as well as cash and capital, businesses need confidence to grow and prosper.

In order to help rebuild trust and restore confidence we will take steps to improve the quality of the engagement between banks and their business customers. We will work to ensure businesses are more aware of the finance products on offer, what is right for them, and the terms on which they can reasonably expect to access those facilities. We will ensure our staff are appropriately trained and empowered to offer customers the services they need as efficiently as possible, in order to streamline services and reduce hassle. We want the customer service we provide our customers to be smoother, more predictable and more transparent.

We will reach out to businesses, through the creation of a UK-wide team of business mentors (many of whom we expect will be experienced former bank employees) and by holding regional business-focused events. We will work closely with business partners such as the Federation of Small Businesses, and accredited Chambers of Commerce in delivering these initiatives to ensure relevance to as many firms, sectors and geographies as possible.

We will also welcome the commitment of any UK banks from outside the Taskforce, if they wish to join us in implementing these initiatives.

The Taskforce banks, along with other members of the BBA, made a number of public commitments earlier this year to help support business customers[23]. We agreed to:

- provide more guidance to customers on the factors that determine loan pricing
- make our timescales for loan application decisions clearer
- welcome SMEs who want to bring professional advisers with them for discussions with banks about their finances
- provide customers with a fair, balanced and transparent appeals process if an application for a loan is declined;
- provide clear feedback to SMEs when loan requests are refused and set out what next steps they can take for further advice and support

[23] Available at http://www.bba.org.uk/media/article/Banks-are-open-for-business-and-will-play-their-full-part-in-financing/press-releases/

- work with SME representatives and the Lending Code Standards Board to promote both these initiatives and the Lending Code itself.

The Taskforce has now agreed further key actions that will develop and enhance our promise to UK business customers.

3.2 Better customer relationships

Fairness, promptness and transparency are at the heart of good customer service. Here we set out five further steps that we will take to ensure customers receive a fair, prompt and transparent service.

1. Creation of a small business mentor network

A small firm can find the assistance and advice of an independent business expert invaluable. We will, therefore, work with existing organisations in this field, including the Federation of Small Businesses (FSB) and the Small Firms Enterprise Development Initiative (SFEDI), to coordinate, promote and develop a network of small business mentors for roll out across the UK. This service will be free of charge.

Banks will assist in recruiting mentors by encouraging current or former bank employees to become business mentors. We will also work with accountants and other finance professionals to encourage their participation in the mentoring network.

Whether a small business is just starting up, looking to access finance for growth or simply seeking to improve their business acumen, it will be able to make contact with a local business mentor and get free advice and support.

To create an effective referral process, we will help link existing quality networks by establishing a portal connecting them together (including those run by charities such as the Prince’s Trust, Arts and Business and PRIME) that wish to work more closely together with others that can meet appropriate quality standards. The portal will link new and existing mentoring networks, support the recruitment of mentors, and facilitate access to the most appropriate network for businesses and individuals.

Banks will contribute to a series of master classes in finance, featuring not just bank lending, but also asset finance, equity/business angel finance and trade finance, for mentors who wish to enhance their skills and expertise.

Banks will raise awareness of the mentoring service by referring customers and briefing customer-facing staff.

The Taskforce banks will underwrite the cost of these initiatives, with the aim of developing the scheme during early 2011 and implementing fully during 2011.

2. Better service standards for micro-enterprises

We will extend the promises we made earlier this year (see 3.1) to cover very small businesses or ‘micro-enterprises’. These commitments will be included in the Lending Code and regulated by the Lending Standards Board from 2011. Such businesses will be able to refer to the Code when making a complaint to a bank that they believe is not complying with the standards, or when making a complaint to the Financial Ombudsman Service.

The Code will apply to ‘micro-enterprise’ firms, defined by EU regulation as having fewer than 10 employees and a turnover of less than €2 million a year. Details will be available in bank branches and promoted by banks and the BBA. Customers will also be able to download the Code from bank websites.

3. Lending principles for larger businesses

The larger business lending principles will set out minimum standards of service that businesses can expect when applying for loans, including turnaround times and what customers can do if they want to appeal a decision. We will set out the banks’ lending principles in a plain-language leaflet. This will be available in bank branches and will be promoted by banks and available directly from the BBA. It will also be available to download.

Combined with existing commitments, these actions will create a comprehensive set of standards of and principles for the service that all businesses can expect when applying for loans.

4. Monitoring and appeals

The banks want to be more helpful to customers, including those customers who have loan requests declined. We have agreed to provide a fair and effective review process when a loan application is turned down. Business customers will be able to make a formal appeal of a declined loan application decision – either appealing the lending decision, or appealing because the lending decision process was not dealt with according to the Lending Standards.

We will ensure the review process is transparent, available to all customers and designed to allow any business whose application has been declined to seek a second opinion from a person not involved in the original decision in the bank concerned.

Each bank will establish an appeals process, based on a transparent set of common standards, to give small business customers a means of appeal if they believe their loan application has been unfairly rejected. The appeal process will ensure that the appeal will be carried out fairly and promptly, usually within 30 days, by a suitably qualified member of staff not previously involved with the loan application. The customer will get the result of the appeal, and an explanation of the findings, in writing.

Relationship managers will receive appropriate training to ensure awareness of: the standards required under the Lending Code; best practice principles; and the appeals process. We will subject our appeals processes to scrutiny by an independent external reviewer on a regular basis. Results of the independent review will be published.

5. Finance reviews for business customers

Despite the fact that banks are fully able to refinance viable businesses at present, we recognise that some commentators are concerned about banks' ability to refinance business loans over the 2011-2012 period as this coincides with banks' own refinancing pressures. There is also concern about a change in pricing that may occur following refinancing; or a move to more expensive credit facilities. The Taskforce has therefore carried out an assessment of business refinance needs.

The Taskforce banks promise to work with customers 12 months before loans are due. This process will be targeted at credit facilities that do not have an agreed annual review process (e.g., an overdraft). There is ample evidence that entering into discussion early will help customers either to prepare to repay or roll over their loans.

Customers will be provided with a comprehensive checklist of the information lenders will need in order to undertake this review. The Taskforce banks will help customers in other ways too, such as providing helpful information on how to develop and review business plans, or how to do cashflow forecasts. We will make information and advice of this kind available from a variety of sources, including Business Link, banks' own websites and other SME advice services.

3.3 Better access to the right finance

Customers may sometimes need help in order to understand the range of products that could be available to them. Many businesses think of banks as mainly providers of products such as overdrafts or term loans. In reality, banks can provide access to a wide range of financial products ranging from traditional overdrafts and loans to more specialist products such as invoice finance, asset finance, trade finance and supply chain finance.

These specialist products provide alternative funding options and can also give customers significant non funding benefits. For example, invoice finance reduce the hassle of debtor management for businesses, improving cashflow through more effective and timely debtor collection. Asset finance can provide cost effective use of capital equipment.

The following set out our ideas for helping improve customers' access to the right financial solutions.

6. Establishing a new Business Growth Fund

Bridging the equity gap for businesses

A recurring theme in private sector and government commentary[24] is the gap in availability of long term equity growth capital for firms requiring between £2m and £10m. Conventional private equity and venture capital funds are very limited in this range, given the investment risks and the relative costs of making and managing small investments. Above this range deal sizes are generally served by existing commercial funds and below this range there are existing Government support schemes, such as the Enterprise Capital Funds.

The Taskforce therefore proposes to create a new Business Growth Fund targeting the needs of growing companies, typically with a turnover of between £10m to £100m, with equity funding requirements generally in the range of £2m to £10m. The investment provided would be in the form of equity capital, to be complemented by loans and trade finance offered by banks in order to deliver a complete capital solution to growing companies.

Aims of the fund

This Fund is proposed to achieve a lasting and substantial economic and market impact. It will strengthen the suite of financial options available to businesses and help re-establish the importance of equity investment for small to medium sized businesses. It underlines the need for responsible and appropriate lending to growing businesses and it will play an important role in the rebalancing of the UK economy. The fund will promote sound investments and support sustained growth; it will not simply leverage deals to generate returns.

The creation of new capability and capacity will also seed the future market with talented individuals and provide an important template for future funds.

How it would work

The Fund would work with companies with strong growth potential to put in place the right capital structure to support their growth. It would have the necessary equity directly at its disposal, so could move quickly and without hesitation once due diligence is completed. Where appropriate, it could offer innovative equity-like products such as redeemable preference shares. It would use a panel of lenders (including – but not restricted to – the shareholding banks) to provide additional debt facilities, for example, as working capital, as part of an overall capital package.

The minimum equity stake in any business would be 10 per cent and the average duration of the investment is expected to be five years.

The fund would operate through a dedicated distribution network of regional offices in addition to its head office.

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[24] "The Provision of Growth Capital to UK Small and Medium Sized Enterprises", 23 November 2009, which can be obtained at http://www.berr.gov.uk/files/file53698.pdf

Total funding available

The Taskforce banks intend to build a substantial investment portfolio over a number of years which is expected to reach a total of £1.5 billion; subject to rolling review as the initiative progresses.

The Taskforce banks, subject to agreement to terms, would welcome additional shareholders in the Fund and will work with others to seek to grow the investor base over time. The banks are committed for this to be a sustainable Fund

Governance

The Fund will be a new entity and operate through an independent Board:

- The main board will include representatives of the Banks and Government, other independent non-executive directors and directors representing executive management. It will focus on ensuring that the fund has effective infrastructure, strong internal governance and an appropriate investment strategy. It will not be involved in investment or operational decisions.
- The operating board would comprise executives and the independent non-executive directors and it would have overall accountability for investment and operational decisions.

A Chairman will be appointed with the appropriate stature and expertise to guide this enterprise, with a strong chief executive to build and maintain an organisation of the required scale and prominence. To foster partnering, and to ensure broad support, there would also be a wide role for non-executive directors and representatives of business organisations.

Annual shareholder reviews would be a key component of governance: monitoring fund performance against plans and funding requirements, assessing activities against mandate and objectives (the Fund would not be able to deviate from its target investment segment) and outlining management intentions for the next period.

Government engagement

In our ongoing discussions, the Government has acknowledged the need for such a Fund to fill the gap identified in the Rowlands review. The Government has also indicated its support for such a Fund and the banks welcome this partnership approach with Government as well as Government's advocacy. We also hope the Government will place a member of their team on the board of the Fund to be a full part in the creation, development and ongoing oversight of the Fund's performance and activity.

Next steps

The banks will take this proposal forward quickly. During the remainder of this year, we will:

- further refine analysis of target investments
- seek additional investors
- appoint a chairman

- develop a detailed business and operating plan, so that we are in the position to start assessing investments by April 2011

7. Increasing mid-sized businesses' access to syndicated debt markets

A bank will make its assessment of the creditworthiness of a borrower, taking into account all its existing and proposed borrowing (not just the bank's own exposure), so a business that is good for, say, £30 million of debt is likely to be able to raise this amount either from one bank or in smaller amounts from more than one. A business usually looks to borrow from multiple lenders either to diversify its supplier risk or – more commonly – because one bank has reached its exposure limit to that company, sector or asset class.

In the UK, most SMEs deal with a single bank to provide their debt finance. The simplicity of dealing with one lender appears to be the key reason for this. But some SMEs, and particularly mid-sized companies, opt for multi-bank funding scenarios (via one of the mechanisms listed below) for modest requirements that could be delivered by one bank. There is no evidence of any market restriction on them choosing this option if it is their preferred structure.

When companies reach a certain size, it may no longer be feasible or optimal to raise their finance from one lender. Where this occurs there are a number of different multiple-lender solutions including:

- **Club finance:** usually a single-facility agreement to which all the lenders and the borrower are parties. This is a cost-effective form of raising finance from multiple banks, but negotiations can be inefficient as all parties need to agree on terms.
- **Syndicated loan:** an underwritten loan provided by one or more banks, and subsequently 'sold down' to various other parties (usually banks or institutional investors). Banks taking the underwriting risk may charge a premium for this service. This is often the best solution where a significant amount of capital needs to be raised but negotiating with multiple parties would be not be feasible (e.g. BHP Biliton's £45billion loan for its proposed acquisition of Potash, where there would be hundreds of lenders).

The market for club and syndicated loans markets already exist for businesses which require multiple lenders. Any business either large enough to need to borrow from multiple lenders or with a preference to do so will have access to these products. The use of these types of facilities is less widespread in the UK than in other countries. Banks will continue to work to create the necessary conditions to help mid-sized businesses access those markets.

We therefore propose to raise awareness, and where appropriate facilitate access to syndicated bank funding options via an education process, appropriate staff training within the banks and greater engagement with industry bodies.

8. Supporting the Enterprise Finance Guarantee

The Enterprise Finance Guarantee Scheme (EFG) was introduced in January 2009, with support available to a considerably wider range of businesses than its predecessor product, the Small Firms Loan Guarantee Scheme. The EFG provides a 75% guarantee on individual loans made by participating banks to small companies with a turnover less than £25 million. The loan amount can be up to £1 million.

The key improvement has been the ability for lenders to take additional security (excluding a director's family home) which aligns EFG with other traditional forms of bank lending.

Under the scheme, £1.3 billion of lending was available to SMEs up to end March 2010 (projected to be around 1-2% of SME lending) with a further £700 million available in 2010/2011 following the emergency budget. Current capacity appears sufficient on existing run rates, but a sustained recovery period, with improved market confidence, could extend market demand and might create EFG supply constraints.

The Taskforce fully supports the EFG and would welcome the Government's confirmed commitment to the scheme through 2012. We believe this would help support the recovery, but we recognise the fiscal challenges facing the Government

The Taskforce has held constructive discussions with Government on whether the design of the EFG could be enhanced. Overall, the banks consider it a useful and well-structured scheme. We have identified some possible amendments to its scope which could have a positive impact on accessibility whilst still meeting state aid requirements. For instance, Government could lift the loan ceiling to £1.5 million and increase the eligible businesses turnover threshold from £25 million to £50 million, to allow larger SMEs to access EFG funds. We consider these changes to be of modest benefit (given the scheme's use is concentrated in smaller SMEs), but we would be pleased to support Government if it chose to amend the scheme in either of these ways.

In our view, one of the most beneficial enhancements to the EFG scheme would be to provide EFG-qualified SMEs with trade finance products. This is explored further below.

9. Enhancing trade finance facilities

More needs to be done to make SMEs aware of how trade finance solutions can help their business. Some of the actions we have already set out will help to increase the capacity to provide cost-effective trade finance, and through mentoring and providing advice we will increase the understanding of the support available to small businesses and the opportunities offered.

We also advocate targeted regulatory reforms to help to encourage trade finance, a new trade finance scheme which sits alongside the Enterprise Finance Guarantee Scheme, and modification of the Export Credit Guarantee Department's letters of credit scheme.

Extending Government support to trade products

There are differences in the way international trade and domestic trade are conducted, with specific trade financing products available and often required by trade counterparties. This includes the financing of transactions (documentary credits, transaction-specific bonds and guarantees) and trade loans (export loans, import loans, pre-export finance, stock finance). At present the EFG scheme is designed to help companies with general financing, but – for state aid reasons – it is not able to help qualifying businesses by financing exports.

Bank research shows this could be negatively impacting a significant number of SMEs, as 28% of SMEs in the £250k to £1m turnover bracket are involved in export activities. This proportion is greater for larger SMEs and lower for the smallest businesses. Exporting SMEs play a key role in the economy. In 2007, the University of Glasgow undertook research that suggested over the period 1996-2004 some 60% of UK productivity growth was attributable to exporting firms, including established and new exporters. The same research found that, over the period between 1997 and 2003, firms engaged in exporting were 11.4% more likely to survive.

When trade partners will not trade on an open account basis – i.e., when they require a letter of credit from a UK bank – this can be a barrier to businesses who wish to trade. Further bank research suggests that 42% of exporters say that they need more flexible credit limits that cover a broader range of trade financing products. The BCC Publication – *Exporting Britain*[25] – found that 13% of businesses interviewed reported problems with trade finance in the past 12 months and 47% reported lost business to exporters from other countries with state-backed schemes. The EEF, the Manufacturers' Organisation, also recently published a report - *Rethinking Growth, Building Blocks of An Export Led Recovery*[26], which emphasised 'the need for finance for working capital' and stressed 'it will be important ...to ensure that opportunities are not missed because of a lack of finance'. This issue is very relevant to the competitiveness of UK businesses.

The Taskforce therefore believes there is an important subset of SMEs who:

- fit the eligibility criteria of EFG, so are viable businesses, but at the margins of commercial lending because they have insufficient security or track record
- have a need for specific trade finance products.

We wish to continue our work with BIS and HMT to assess whether there is a mechanism for using existing Government support to provide more export trade finance products to help the relevant businesses. There are a number of issues to overcome, including eligibility, pricing, administration, and how to prioritise this support in relation to targeted domestic trade support. Some of these issues will be helped by the fact that trade transactions are typically lower risk than the existing EFG portfolio.

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[25] www.britishchambers.org.uk/6798219244343545990/Exporting_Britain.pdf

[26] http://www.eef.org.uk/publications/surveys/Rethinking-Growth---building-blocks-of-an-export-led-recovery.htm

The Taskforce recognises the weak UK fiscal position, but thinks such an initiative could provide welcome support to a trade-based economic recovery and we are committed to developing this initiative further.

Regulatory initiatives to support trade finance

Our work has determined that improving access to and pricing of trade finance products for customers will require some regulatory steps. The steps we have outlined below are targeted at either existing or expected Basel rules or the UK implementation of Basel rules. They intend to provide a customised treatment for trade finance products. They are:

- Extending the one-year maturity floor waiver to all trade finance products which pass the three principles (short-term, self-liquidiating and with recourse)
- Proposing a less penal risk-weighting for trade finance; less penal because it would take into account the lower correlation risks of trade finance exposures, given that they are small in size, very diverse in terms of geographic spread, self-liquidating in nature and have low historic default rates (businesses tend to repay working capital obligations first to keep their cashflow engines running)
- Establishing a single required stable funding value for trade-related off-balance sheet activities in order to recognise the security of trade transactions and avoid unintended consequences of imbalances created by a national jurisdictional approach
- Creating a database of credit conversion factors (CCF) data for trade contingents amongst UK banks, leveraging earlier research carried out by the International Chamber of Commerce (ICC); working with industry bodies such as the BBA, BAFT-IFSA, International Chamber of Commerce (ICC) and World Trade Organisation to suggest appropriate regulatory treatment of trade finance assets in the calculation of Leverage Ratio and Credit Risk RWA; in the interim, proposing that the CCF values from the Basel II Standardised Approach be used for such calculations; not only would this trade customised regulatory approach be more accurate, it would require banks to hold less capital for trade finance products and thereby help banks to reduce cost to end customers.

Improving the Export Credits Guarantee Department (ECGD) letters of credit scheme

The Taskforce has reviewed the way in which te letters of credit scheme works for small business customers and believes there could be benefits from considering a number of adaptations to the scheme.

The scheme (in modified form) has the potential to make a valuable contribution if the term covered could be extended to medium-term exposures. For SME exporters selling on extended terms, a letter of credit solution may prove more practical than traditional ECGD schemes, which have a low take-up in this segment. This would help address gaps in satisfying private sector appetite for credit.

- **Coverage** – It would be particularly helpful if the ECGD scheme were expanded to include more banks from emerging markets to which UK exporters are selling.
- **Undertakings** – The scheme could also review the undertakings it imposes on exporters and seek to reduce them where possible.
- **The exporter declaration** – for every transaction placed under the scheme, the exporter has to sign a detailed and binding declaration. This creates a barrier. For example, some beneficiaries approached have refused to sign the agreement given the additional work and potential (internal) legal opinions they would need. A practical way forward would be to have a single declaration from the exporter rather than one per transaction.
- **Disclosure** – for the majority of other bank risk-sharing schemes any 'sell-down' is done on an undisclosed basis. The ECGD scheme involves a declaration from the exporter which requires the bank to declare its participation. This is not always helpful to fulfilling the business contract and we are working with ECGD on whether there is an alternative to this approach.
- **Participation fees** – for some markets the ECGD's required pricing is above the origination pricing and therefore uneconomic.

The scheme (in modified form) has the potential to make a valuable contribution if the term covered could be extended to medium-term exposures. For SME exporters selling on extended terms, a letter of credit solution may prove more practical than traditional ECGD schemes, which have a low take-up in this segment. This would help address gaps in satisfying private sector appetite for credit.

10. Signposts

Customers need to know what to do, and where to go, if the bank declines a credit application or offers an alternative finance solution. The Taskforce banks have agreed to commit to providing proactive and clear information on what alternative sources of finance and other help might be available. Information is already available from a variety of sources, including Business Link and banks' own websites, but the key is to provide the most useful and relevant information to small businesses and their advisors.

Our signpost initiative sets out the minimum standard of service customers will get, either verbally or in writing. If their loan application is unsuccessful, they will be told why and they will then be guided to alternative sources of help and advice, including how to improve their creditworthiness. The network of experienced business mentors (see action 1) will also be available to firms which have been unable to obtain bank finance.

11. Working to improve the supply of credit to the wider economy

Banks require access to wholesale funding markets to supply credit to the wider economy. When these funding markets slowed significantly during the crisis, the normal flow of credit into the economy was impaired, and while wholesale market volumes are rising, concerns remain that weak wholesale markets for banks could restrict their ability to lend to the wider economy. The Taskforce has therefore dedicated a separate workstream to this topic and will shortly publish a detailed review of this recognising its importance and complexity. Meanwhile, Chapter 4 of this report provides a broad overview and a summary of our key recommendations.

3.4 Better information and understanding

To better understand and support our customers' ongoing needs the banks commit to the following new initiatives:

12. Establishing an independent business survey

The Taskforce recognises the crucial importance of establishing credible, authoritative and robust data regarding business lending, that all interested parties can rely on. We will therefore fund an independent business survey to provide information on business trends, demands and needs, as well as details of finance supply to UK businesses from the banks and other institutions.

The survey will be carried out regularly, highlighting the current position and providing a snapshot of the demand for and supply of finance. It will cover applications, approval rates, and how close businesses are to their agreed limits. It will also ask businesses if they are considering borrowing, and set this alongside what is going on in the wider economy by taking in GDP figures and information from trade surveys.

One key focus of the survey will be to assess the regional pattern of demand for business finance from SMEs with turnover up to £25 million, as this is the area where there is the least reliable survey information.

The survey will be independent of banks, other finance providers, government and business groups. It will extend the UK SME Finance Survey (UK SMEF) which was established in 2004 and is run by the banks, BIS and the representative/professional organisations. It will provide a continuous UK SMEF – modelled on the Labour Force Survey and be split into two parts covering: 1) quarterly headline survey data; and 2) a rolling four-period sample assessing detailed policy issues as they emerge.

13. Enhancing the cross-industry dataset

The Taskforce recognises that information about the SME sector needs to be improved. Currently the BBA publishes monthly information about lending to SMEs whose turnover is under £1 million. We believe it would be beneficial if the data available were expanded to include the volume and range of finance solutions for various SME size brackets in the £1 million to £100 million range.

We also intend to broaden the statistics on lending available for wider bands of business activity; on lending to deprived areas; and on national and regional data on the provision of bank support to business start-ups.

We also want to work with HMT, BIS and the Bank of England to develop a more coherent approach to data collection and provision.

14. Regional outreach events

Banks recognise it is not enough just to help those who find their way through our doors and that we need to do more to reach out to others. We commit to work with established business networks and trade bodies to provide SMEs with face-to-face information, advice and support by means of a series of regional outreach events. Representatives from the major UK banks will attend these events and be on hand to explain the support they can provide for small businesses and answer questions.

The regional events, commencing later this year, will be open to all small businesses, advisors and representative bodies. They will tap into the business support available regionally and will provide a valuable opportunity for businesses to make and maintain local support networks.

15. Leaflets and web-based information and advice

The banks are committed to making it easier for customers who are considering applying for credit and supporting them through the process, whether they have decided if they want a loan now or are just thinking about it.

We acknowledge that banks’ marketing and publicity can sometimes create unrealistic expectations when it comes to borrowing and may not match the experience on the ground for a number of customers. We want to cut out misunderstanding and aim to provide clearer, more frank and more transparent information which outlines what banks can and cannot offer.

We will also make the loan application process more straightforward. Commencing later this year, customers will be provided with a comprehensive checklist of the information the bank will need to see to consider their application properly. This could be sent out with the interview confirmation, accompanying literature or by a link to the bank’s website. Banks will also provide help to customers in matters such as developing and reviewing business plans or preparing cashflow forecasts. We will make such help available through a variety of sources including Business Link, our own websites and SME advice services.

16. Online information portal

A number of sources of support and information for businesses seeking finance already exist. But we know there is no ‘one stop shop’ and, as a result, it can sometimes be confusing and time-consuming for a small business to get the information it needs.

The BBA will create and maintain a dedicated website to draw together and link useful sources of information to help business customers access the most appropriate information. It will also connect mentoring networks and support the joining up of existing sources of advice and help that wish to work more closely together. We will inform our customers of this one stop shop source of helpful information.

In order to ensure the information available through this portal is accurate and of the right standards we, will work with charities such as the Prince's Trust, Arts & Business, PRIME, and with SFEDI and the National Federation of Enterprise Agencies.

3.5 Partnering for success

The Taskforce understands the importance of taking steps to rebuild trust between the banks and the business community. We recognise the importance of working more closely together and in partnership with business organisations so banks and business representatives can share any concerns, address emerging problems more effectively, and ensure the commitments in this report are properly implemented.

We have started a programme of work – *Doing Business Better* – to recommend good practice, working with the wider credit industry and business groups, including the Confederation of British Industry, the Forum of Private Business and accountancy bodies. The objective is to improve financial management capability and presentation and use of financial information. Working together, we aim to help businesses enhance their access to finance, their credit ratings and terms. We recommend that this work is extended and the Taskforce banks will engage – through the BBA – to launch a broader initiative in early 2011.

In researching and considering the recommendations within this report, the Taskforce banks have consulted widely with business organisations. Our intention is that we build on this through more structured and regular working sessions to further the work already carried out by individual banks.

17. Establish a Business Finance Round Table

During the course of the Taskforce, it has become apparent that a dedicated standing group of senior representatives from both banks and business groups would be helpful both in terms of facilitating closer dialogue and mutual understanding between banks and business and in order to address the issues in this report and new, emerging issues as the economy recovers.

Stakeholders have welcomed the idea of convening a high level bank / business group of this kind – a Business Finance Round Table – to meet regularly. The group would: facilitate progress on the commitments made in this report; discuss and review trends; identify emerging areas of concern; and ensure any new problems or opportunities are identified and addressed. We look forward to working closely with businesses representative groups through this new Business Finance Round Table as soon as possible.

4 Restoring confidence – how wholesale markets will help

4.1 Introduction – improving wholesale markets

Banks fund their loans to business from two main sources: their customers' deposits and the wholesale markets. Until the onset of the credit crunch in summer 2007, banks financed a material portion of their lending through securitisation – the process of transforming mortgages and corporate loans into investment products, such as asset-backed securities (ABS) and particularly residential mortgage-backed securities (RMBS), as well as covered bonds. At the onset of the credit crunch, the wholesale markets dried up, and first securitisation issuance, then senior unsecured issuance and ultimately covered bond issuance, stopped.

While all avenues of wholesale funding have reopened, the securitisation market is much smaller than its pre-crisis size, largely due to a lack of depth in the current investor base. The industry is working hard to revitalise the securitisation market and provide additional impetus to the UK covered bond market. The Taskforce was charged with finding ways to accelerate the recovery of the securitisation market and increase the size of the UK covered bond market and to identify other ways in which expansion of secured wholesale markets can be fostered as means of promoting expanded lending to individuals and businesses.

To do this, we need to work in partnership with the authorities – Government, its agencies, our regulators and international and other countries' regulators – to continue to develop covered bonds and ABS as attractive investment products. Not only to UK investors, but also to those overseas.

4.2 Recommendations

We recommend three specific actions which will provide significant impetus to the UK covered bond market and help overcome existing obstacles to reviving the securitisation market as a viable source of long-term funding. Our recommendations aim to level the international playing field by addressing existing competitive/regulatory disadvantages to the UK.

4.3 Recommendation 1 – levelling the playing field – ensuring the UK Liquidity Regime is equivalent to its international counterparts

Our first and overriding recommendation in respect of the wholesale funding markets is to level the playing field to ensure the UK liquidity regime is equivalent to its international counterparts. Ensuring the timing of the introduction of measures, the quantum of requirements, and the definitions of eligibility for different instruments to meet key liquidity standards are consistent with other European and international markets will be vital to ensuring the UK economy continues its recovery and maintains pace with international competitors. It will help banks use more cash resources to lend to viable businesses, rather than to build up super-equivalent liquidity buffers.

Placing the UK regime on an equivalence path is also critical to ensuring the UK banks continue to have the same access to finance as US and European banks and, thereby, are able to continue to refinance viable businesses and meet ongoing heightened demand for lending as the economy recovers and grows. This will also help to ensure the UK maintains a strong position in the financial services markets so vital to fuelling business activities.

This is particularly important given the refinancing challenges highlighted in Chapter 1; the gap left by the withdrawal of foreign banks from the UK market; and the concern in the marketplace about the extent to which the UK regulatory regime will remain at levels above international standards.

A key component of this is to ensure that UK covered bonds are part of eligible assets for the UK liquidity regime. The following detail in respect of covered bonds would place the UK on a similar footing to Europe and in alignment with Basel 3 requirements. These measures will help address the refinancing gap and create further capacity in the system for onward lending to business.

i) Aim: To increase the market for UK covered bonds by permitting them to be immediately eligible as liquidity assets in the FSA liquidity regime in common with other markets and Basel 3 rules.

The covered bond market is performing reasonably well, with some UK banks currently benefiting from good access to this expanding market. Enabling UK banks to invest a portion of the assets they must hold as liquidity buffers in UK covered bonds would increase demand and, therefore, overall market liquidity. In addition to abetting the development of a currently modest domestic investor base for UK covered bonds, the simple fact that UK banks would be buying UK covered bonds would attract additional investors from beyond the UK banking sector to this market in advance of the implementation of new Basel rules.

In the UK, the FSA has thus far not allowed covered bonds into liquidity buffers, preventing UK banks from investing any portion of their large, and growing buffers, in this high quality, higher yielding product. Given the recent Basel 3 proposals on eligible assets, the UK regime should immediately move into line with the Basel 3 rules (which are still more restrictive than current European practice) and therefore allow covered bonds into the UK liquidity regime with immediate effect. This should also include clarifying eligibility of covered bonds in Bank of England facilities.

For its part, the European Central Bank (ECB) treats covered bonds as “marketable assets”. Under the ECB approach, the national central bank is responsible for assessing their eligibility, which will then be included in the list of eligible marketable assets published on the ECB website. If the UK adopted the same approach, the UK covered bond market again be boosted by substantial additional international investor demand.

It is essential to level the playing field and ensure equivalence. If this disparity between the UK and other EU markets is not addressed, there is a risk that continental European banks will be prevented under the Capital Requirements Directive (CRD) from investing in UK covered bonds, a development that would have devastating consequences for the issuance of covered bonds by UK banks, thereby negating a growing source of wholesale funds.

Added to this is the multiplier effect witnessed when the ECB unveiled its Covered bond Purchase Programme in July 2009. The announcement of this programme led to increased market activity, and risk averse and liquidity conscious investors were drawn to the covered bond market in increasing numbers.

More basically, there is considerable value in demonstrating to covered bond investors that a market that UK banks will rely upon heavily to meet term financing needs is at the same time one they will invest in themselves. Similarly, the FSA's immediate acceptance of UK covered bonds as eligible assets for liquidity purposes would significantly reinforce investor confidence in this market.

ii) Aim: Establish provisions for cover-pool assets to be used as collateral for Bank of England Discount Window Facility (DWF) borrowings in the event of an issuing bank's insolvency and consider modifications to UK covered bond legislation, including allowance for "integrated" segregation of assets

The covered bond market is improving. For some investors the maturity mis-match between covered bonds (issued generally to scheduled maturity dates of 10 years or less) and underlying mortgage assets on which they are secured (which typically have maturity dates of much longer than 10 years) remains a deterrent to more active participation in the UK market. In the case of an issuer's insolvency, covered bonds would need to be repaid through asset sales or alternative sources of liquidity. In some European jurisdictions, provisions already exist, or are in the process of being established, which allow for underlying cover-pool assets to be converted into cash through liquidity arrangements provided by national central banks. But in the UK, no such alternative source of liquidity currently exists, although the Bank of England has recently amended the Discount Window Facility to enable banks to source liquidity through presentation of whole (i.e., stand-alone) residential mortgage loans, amongst other forms of collateral.

A secure source of emergency liquidity for the assets that make up individual covered bond securities (so-called "cover-pool assets") would materially increase the perceived strength of UK regulated covered bonds while demonstrating strong government support, thereby putting it on a more level playing field with its European counterparts.

Additionally, a secure means of monetising whole loans on a repurchase basis would reduce the need for assets to be sold at fire-sale prices under what would almost certainly be highly challenging market conditions. Avoidance of the inefficiency which the forced sale of assets inevitably involves, particularly where the seller is under duress and markets are heavily dislocated, is an important consideration for equity investors, unsecured creditors and depositors (and the guarantor of deposits). The ability to delay or complete the sale of cover-pool assets in a more orderly manner than might occur otherwise, could result in significant preservation of value while also protecting other unrelated covered bonds from contamination risk.

Integrated transfer techniques should be considered in the UK

Under existing UK practice, cover-pool assets are identified and actually transferred to the applicable guarantor Special Purpose Vehicle (SPV) via equitable assignment, an asset transfer technique devised to facilitate true-sale asset securitisation. This "structured" approach is more intricate and complex than "integrated" constructs used in some other jurisdictions, including Germany. Under integrated segregation, specific assets are identified and notionally ring-fenced but otherwise remain on the bank's balance sheet. In the event of the bank's insolvency, covered bond investors have unchallenged access to the assets in question as the necessary bankruptcy remoteness is enshrined in law, whichever approach is used. However, the "integrated" approach allows for more efficient and simple issuance structures which may be preferable to investors. An integrated issuance structure would also facilitate the issuance of small-ticket private placements (through increased operational ease of issuance and reduced legal cost/complexities).

At the time UK covered bond legislation was enacted, the industry did not favour the use of an integrated approach for a number of reasons, including (i) the related need to change UK insolvency laws would have delayed enactment of covered bond legislation; and (ii) concerns over the emergence of a two-tier market since legacy issuance through existing programmes had been (and continues to be) completed via a structured, off-balance sheet approach.

Regulatory Bond Council

It is now worthwhile revisiting the legislation to determine whether refinements to the legislation could make covered bond issuance more efficient for UK issuers and more attractive to investors. Review of covered bond legislation should occur in the first instance through the UK Regulated Covered Bond Committee (UKRCBC), which includes all of the issuers admitted to the register of regulated issuers by the FSA. The UKRCBC has been recently strengthened by the pending appointment of an independent Executive Director whose remit is to galvanise the UKRCBC, represent the interests of the Committee (including with UK and European authorities) and promote the UK Regulated Covered Bond product domestically and internationally.

4.4 Recommendation 2 – rebuilding international investor confidence in ABS

Aim: In conjunction with European initiatives (potentially including implementation of a kite-marking scheme), promote inclusion of high quality European ABS within applicable definitions of eligible liquid assets from the Basel Committee of Banking Supervision (BCBS) and the Committee of European Banking Supervisors (CEBS).

As noted earlier, the covered bond market rebounded quickly after the credit crisis, in no small part as a result of consistent and coordinated official support within the Euro zone. The advantage provided by official advocacy and supportive policy initiatives contrasts with sustained criticism of the ABS market for its real and perceived transgressions. Related to this, official criticism of the ABS market has generally not differentiated between those sectors (and jurisdictions) that performed as originally advertised from those where disastrous performance can justifiably be cited as a contributory cause of the credit crisis.

In addition, the dramatic spread widening experienced by ABS and the aforementioned severe lack of secondary market liquidity in this market during the credit crisis, would seem to make a case for excluding all forms of ABS from definitions of liquid assets. This argument, however, ignores the fact the lack of liquidity was specifically related to the rapid withdrawal of much of the leverage that underpinned the ABS market and that such leverage is unlikely to return to the markets going forward. Equally, this view has not been adjusted for the fact that the anticipated collapse in the credit performance of European ABS did not materialise. Indeed, the credit performance of triple-A rated, European RMBS has been at least as robust, and in many cases better, as the performance of covered bonds, over the last three years.

Covered bonds are included in the Basel III definition of Level 2 liquidity instruments in some significant part because the buy-and-hold nature of the investor base prevented a catastrophic sell-off when the crisis began. For this reason, spread widening in the covered bond market was more muted than witnessed in the ABS market.

In an environment in which banks maintain considerably larger liquidity buffers than has been the case historically, where spreads applicable to triple-A ABS are ten times higher than historical lows, where leverage has been largely withdrawn and where most importantly as a consequence the investor base has moved towards stable, real-money hands with similar keep and hold characteristics of covered bond holders, there is a case to be made for eventual inclusion of ABS in the definition of eligible liquid assets. This is also particularly so as many of the real economy assets – including, amongst others, corporate loans, mortgages, and credit card receivables – within ABS structures are of the same or better quality as those under traditional Eurozone covered bonds.

A kite-marking scheme may strengthen the case for inclusion of ABS

While there is currently no European support for allowing bank liquidity buffers to be invested in ABS, there are indications that this position may change in respect of ABS products that meet an agreed kite-mark standard. The Taskforce banks have a cautious view regarding kite-marking, although it recognises the utility of such schemes in the context of a broader package of measures, including elevation in the official/regulatory status of kite-marked ABS.

The industry appreciates the headline appeal of kite-marking initiatives that seek to accelerate recovery in the ABS market through the imposition of uniform asset-eligibility criteria, promotion of structural simplicity and expanded/improved disclosure standards allied with undertakings to improve secondary market liquidity. Careful assessment of the impact on investor demand needs to be conducted before such schemes are launched to prevent unintended consequences.

Prime Collateralised Securities Initiative

The Prime-Collateralised Securities Initiative, an outline, pan-European ABS kite-mark scheme which is currently going through a form of industry review is proposed as a stand-alone initiative, not currently directly linked to any specifically proposed adjustments in the official status of securities subject to the kite-mark.

The industry believes this scheme can only be beneficial if implementation occurs alongside corresponding elevation in the official treatment of kite-marked securities, reflecting the Authorities' view of their soundness and relative liquidity standing.

4.5 Recommendation 3 – greater disclosure and transparency

i) Aim: To work with government to ensure that UK economic interests are fully represented in the complex and changing international regulatory environment affecting the secured wholesale market

The rapid and ongoing evolution of the global regulatory landscape[27] represents a complex regulatory patchwork which UK issuers are uniquely exposed to, given reliance on transactions completed in multiple currencies and multiple markets. These initiatives will impact UK banks' ability to issue both securitisations and covered bonds.

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[27] Initiatives in process include: From the European Commission (CRD2 Article 122a; CRD3); from CEBS (CP40); from BoE (eligibility of whole loans for the DWF; revisions to disclosure standards in the Sterling monetary framework); from ECB (increased disclosure requirements including loan level disclosure; amendment to the Credit Rating Agency Regulation); and from the U.S. Securities and Exchange Commission (SEC) (updated requirements for ABS disclosure under Regulations AB and Rule 144a; Rule 17g-5).

It is critically important that the UK Government and regulatory authorities intercede with the ECB, European Commission, CEBS, and the U.S. SEC (amongst others) to ensure that the UK is not disadvantaged relative to other jurisdictions, and that the recovering securitisation market is not stifled by well intentioned but perhaps misguided and/or conflicting regulations. Similarly, coordinated engagement with international counterparts will help ensure that regulatory initiatives from different jurisdictions are implemented fairly and in ways that minimise adverse unintended practical consequences.

ii) Aim: To provide more information to investors, expanding access to loan-level data, dynamic transaction modelling tools and improving transparency and promoting simplified and uniform disclosure standards. Working with UK authorities to support the continued supply of funding from wholesale markets.

Greater disclosure and transparency, as well as the standardisation of prospectuses and investor reporting, are all important steps in rebuilding the securitisation market. The UK securitisation industry is collectively involved in multiple initiatives to build the foundations on which the diminished ABS investor base can be rebuilt.

Eleven UK securitisation issuers (including banks, building societies and specialist mortgage lenders) have signed up to the European Securitisation Forum (ESF) ‘RMBS Issuer Principles for Transparency and Disclosure’. The principles are an important component of the industry’s initiatives to increase transparency in the securitisation market as recommended by governments and regulators. The principles will establish a standard of consistency, transparency and data accessibility to be expected by investors, and will enhance comparability of reporting across Europe.

In addition, the UK issuers are supporting these objectives by beginning to implement these initiatives into live transactions. Recent securitisations by Royal Bank of Scotland and Lloyds Banking Group both used prospectuses based on the new Bank of England standard template, as well as adopting the Bank’s new enhanced transparency standards.

In the covered bond arena, as highlighted above, the UKRCBC will add further impetus. Its promotion of the UK covered bond marked will include launch of a website, building of key regulatory relationships and will be the forum by which the legislative reviews recommended in 1 ii) above should be conducted.

But while these steps may contribute to an improvement in secondary market liquidity, unless combined with other more ambitious measures, they will not be enough to accelerate the recovery of the ABS markets and recognition of the quality of the UK covered bond market on their own.

Finally, key consideration must also be given to the fact that a substantial amount of aggregate investor demand for UK covered bonds and ABS emanates from EUR and USD investors. UK issuers access this demand typically through the creation of USD and EUR denominated instruments backed by GBP assets, in reliance upon securitisation derivatives to align asset and liability cash-flows.

The market for these derivatives has been severely curtailed by a range of factors, including newly adopted liquidity regulations and applicable rating agency mark-to-market collateralisation requirements and counterparty downgrade criteria. If not addressed, acute shortages in the availability of securitisation derivatives will curtail the ability of UK issuers to access recovering ABS and covered bond markets.

4.6 Next steps

We will be developing these recommendations further with authorities in the coming weeks which will include the publication of a supplementary report, which will provide further detail and context on the secured wholesale markets.

5 Delivery milestones

5.1 Introduction

Supporting UK Business is not empty rhetoric. We will stand by our promises to government and business and be judged by our results. We will start to work on these actions immediately following the publication of the Taskforce report, with stretching delivery/go live dates, as set out in the table below.

Actions	Required actions / key steps pre-launch	First delivery / go live
Better customer relationships		
1. Support a network of business mentors by working with business groups to deliver this free service to small businesses across the UK	• Recruitment of advisors • Obtaining agreement and collaboration with all existing mentor networks • Creation of an industry standard e.g. SFEDI • Creation of a portal to allow on-line access to the mentoring network	Q2 2011
2. Roll out a lending code for micro-enterprises setting out their rights and sources of help	• Agreement of text with Lending Standards Board and Independent Code reviewer • BBA resource • As the booklet will need to be available in both hard and soft copy options, IT resource will need to be factored in to enable the latter • Prior establishment of the appeals process to deal with declined borrowing requests • Printing, distribution and stocking of hard copies	Q1 2011
3. Create and implement a set of business lending principles for larger companies to align banks' commitments to them with the code that already exists for micro-enterprises	• Prior establishment of the appeals process to deal with declined borrowing requests • BBA resource • Production and distribution	Q2 2011
4. Establish a transparent appeals process for when loan applications are declined	• Communication of the appeals process to SMEs • Training of internal staff to deal with the new appeals process • Agreement of a methodology for reporting the banks' individual results re: the appeals process each year	Q1 2011
5. Initiate a dialogue with customers 12 months ahead of any term loan coming to an end	• Review systems to obtain relevant data • Individual banks to set out format of customer interaction and cascade to customer relationship teams	Q4 2010
Better access to the right finance		
6. Establish a new Business Growth Fund to fill a gap in the market and provide capital for viable businesses which want to invest and grow	• Requires detailed implementation plan to be prepared in Q4 2010	Q2 2011
7. Support the Enterprise Finance Guarantee Scheme	• Discussions with BIS/HMT	Q4 2010
8. Help mid-sized businesses access the syndicated debt markets	• Review current access arrangements • Disseminate best practice through customer relationship managers	Q1 2011
9. Improve access to trade finance	• Letters to European regulators	Q4 2010

10. Signpost alternative sources of finance	• Review existing procedures • Bring together refined advice • Disseminate through customer relationship managers	Q1 2011
11. Help improve the supply of credit to the wider economy	• Discussions with HMT, BoE, European regulators and and Basel Committee	Ongoing
Better information and understanding		
12. Fund and publish an independent survey to identify business demand and needs	• Creation of survey steering group • Process to issue tender and appoint an external agency to run the surveys • Process to appoint an external PR agency to promote the surveys	Q1 2011
13. Enhance the cross-industry lending dataset	• Creation of industry data steering group (incl. BBA, BIS, BoE) • Assessment of data options and systems work required • Agreement across industry on what and when to publish and the vehicle for publishing (e.g. BBA or BoE Trends in Lending)	Q2 2011
14. Hold regional outreach events with business organisations	• Agreement with business representative groups re: their participation in the scheme • Agreement re: the format and content of the events	Q4 2010
15. Improve literature to help customers find the right product for them	• Completion of existing print runs • Systems access dependent on prior commitments • Literature will need to signpost the replacement for RDAs • There is no Business Link in Scotland, Wales or Northern Ireland, alternative signposting (within the literature) will be required • New regulatory communications e.g. the CCD may impact on print runs	Q2 2011
16. Set up an online information portal providing advice and joining up support	• Take content from other recommendations – e.g. Mentors and literature • Confirm where to host online portal (BBA likely) • Resource team for ongoing support	Q1 2011
17. Establish a Business Finance Round Table	• Agree participants and terms of reference • First meeting	Q4 2010

5.2 Review in 2011

We intend to monitor our progress against these recommendations and this timescale. Some recommendations will require interim progress reviews, but we anticipate a full review one year from the publication of this report in – i.e. in Q4 2011.

Appendix A: Taskforce objectives

Overall objectives

(i) Explore the problems currently affecting securitisation markets

(ii) Discuss what could be done from a UK banking perspective to create a stronger and more sustainable market for business finance

(iii) Explore other issues that will influence the ability of UK businesses to obtain the finance they need to support private sector growth

Approach to the Taskforce

This work has been undertaken through a series of clearly defined workstreams to identify, analyse, review and recommend actions to help ensure that viable UK businesses of all sizes have access to appropriate finance and other support during the recovery and beyond.

Issues examined by the workstreams

1. Market Analysis and Understanding:

(i) Prepare a detailed assessment of the drivers of supply and demand for business finance

(ii) Determine the relationship between bank lending activity and key economic indicators over the last three years

(iii) Assess the likely future of lending demand drivers in the context of the current economic forecast

(iv) Assess the supply capacity/challenges including impact on regulatory changes (capital/liquidity), pricing trends and risk assessment

(v) Points (i)-(iv) will be considered in the context of liquidity and capital consumption and the impact of the new requirements as set out in the Basel III proposals

2. Securitisation and Funding:

(i) Propose specific industry and policy measures to restart the securitisation market as a significant means of addressing potential funding problems

(ii) Assess issues relating to mortgage funding constraints

(iii) Consider and propose other wholesale and capital market measures to improve the ability of banks to fund appropriate business

3i. Business Finance and Business Aid Schemes:

(i) Recommend the actions required to ensure that mid market companies (£10 million to £100 million turnover) have access to appropriate finance through the recovery

(ii) Assess the refinancing of heavily leveraged companies and the availability of syndicated debt finance

(iii) Examine possible options for the extension of the EFG scheme to cover larger enterprises and deal sizes

(iv) Propose amendments to any other public schemes to support business, so funds available can be used to best effect

3ii. Small and Medium-Sized Enterprises – to examine issues specifically relating to SMEs (up to £10 million):

(i) Share best practice on how banks can provide better information, advice and support to smaller and medium-sized businesses through the recovery phase of the cycle; to resolve any practical issues with the existing EFG scheme for SMEs

(ii) To determine how an industry-led, government-sponsored equity fund might provide small and medium-sized businesses with access to appropriate equity finance to support their growth

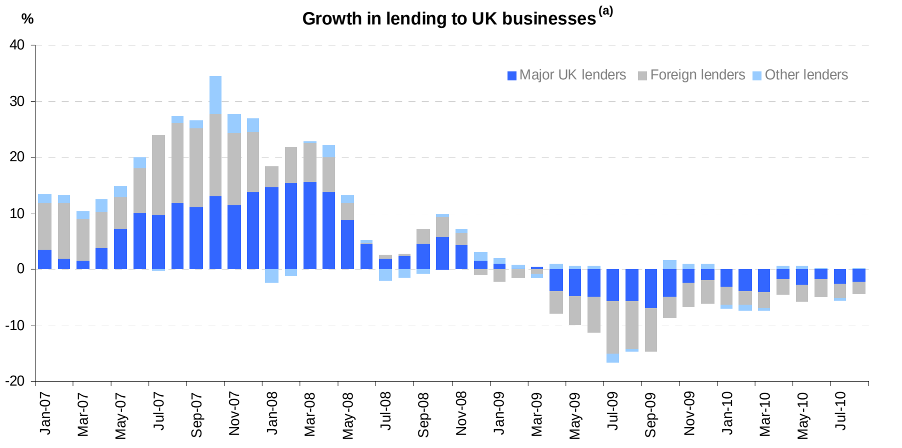
4. Trade Finance

(i) Examine trade finance issues and make recommendations to support the UK's position as a major trading hub by improving information transparency, risk management, financing availability and the regulatory environment. Areas of coverage could include credit insurance, export credit guarantee schemes and the potential impact of Basel III on trade flows.

Appendix B: Supporting market data

Chart 1

UK and foreign banks saw substantial lending growth in the period prior to the financial crisis. Repayments from business and slower new lending has seen stock levels stabilise for smaller businesses and contract for mid-cap and larger businesses, which have used alternative finance.

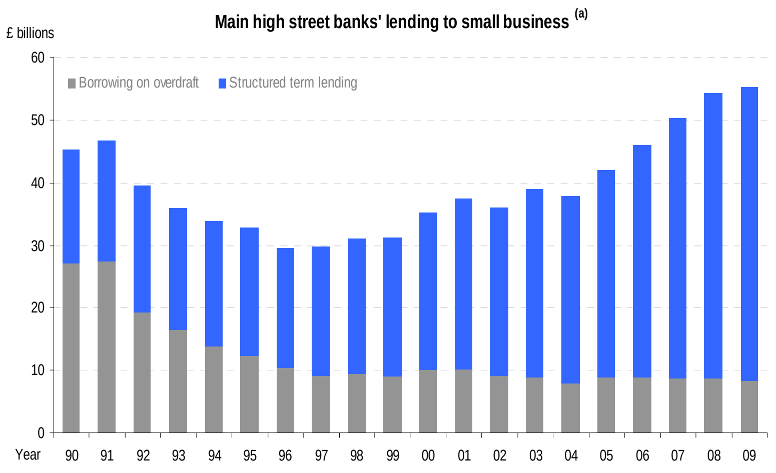


Source : Bank of England

(a) Three month annualised rate of growth in stocks of lending in both sterling and other currencies. Data for major UK lenders are seasonally adjusted; data for foreign lenders are not seasonally adjusted; data for other lenders are calculated by residual from seasonally adjusted totals.

Chart 2

After the early-1990's recession, lending to small businesses, with a high proportion of overdraft borrowing, contracted for several years. In this decade, lending to small businesses has expanded consistently, with greater demand for structured-term loans.

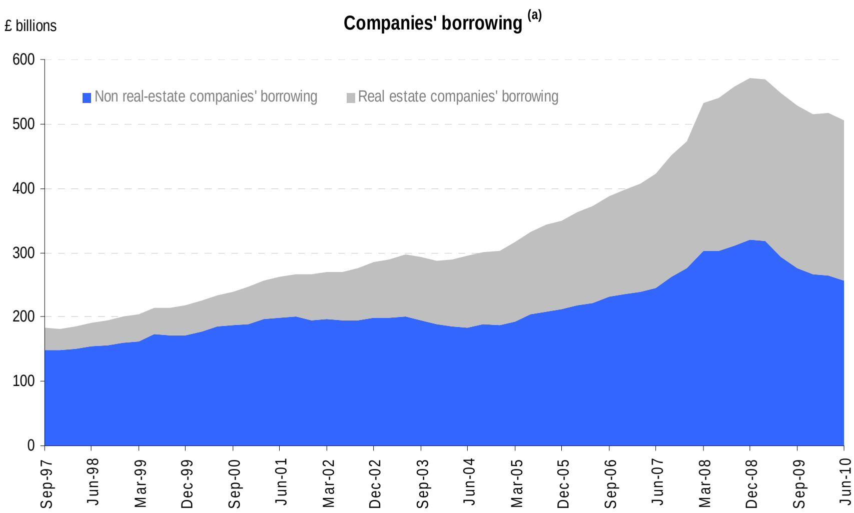


Source : BBA

(a) Businesses with under £1m debit turnover per annum through their banking accounts.

Chart 3

Lending to the UK private sector became polarised in the last decade. Commercial real estate borrowing grew to an extent that was disproportionate to borrowing by all industries in the rest of the private sector

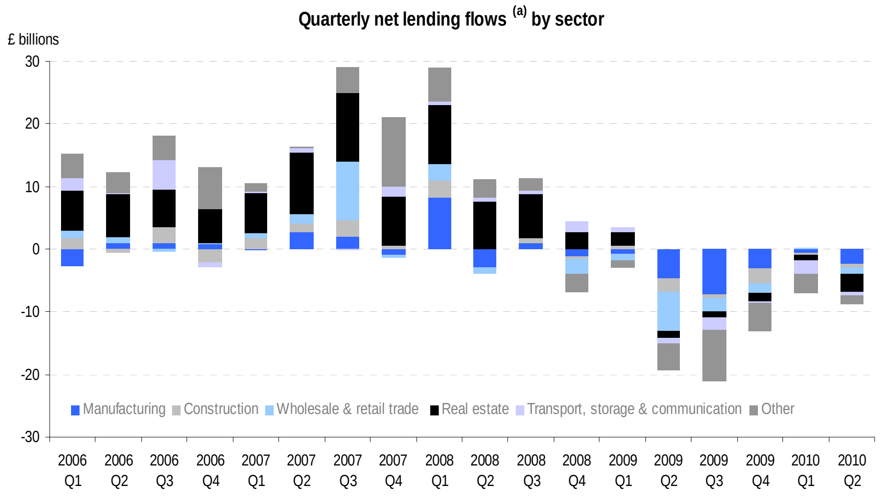


Source : Bank of England

(a) Companies' draw-down of firm lending commitments from their banking provider.

Chart 4

Primary industries have been most impacted by the recession. As business management decisions have been made to run down inventories, postpone capital expenditure and investment, reducing businesses' cost base has included repaying borrowing.

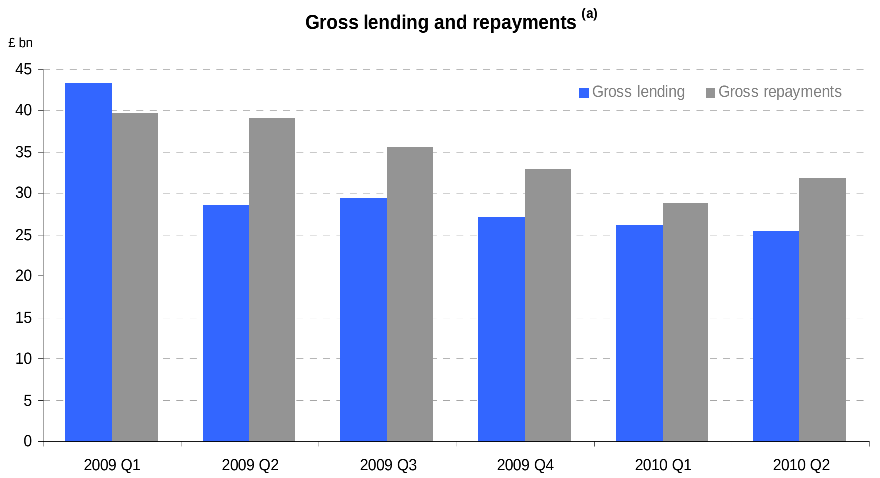


Source : Bank of England

(a) Lending to UK private non-financial corporations in both sterling and other currencies by UK monetary financial institutions. Data are partly estimated and not seasonally adjusted.

Chart 5

Since the second quarter of last year, the business sector has consistently repaid more of its borrowing than the £25 billion of new lending each quarter.

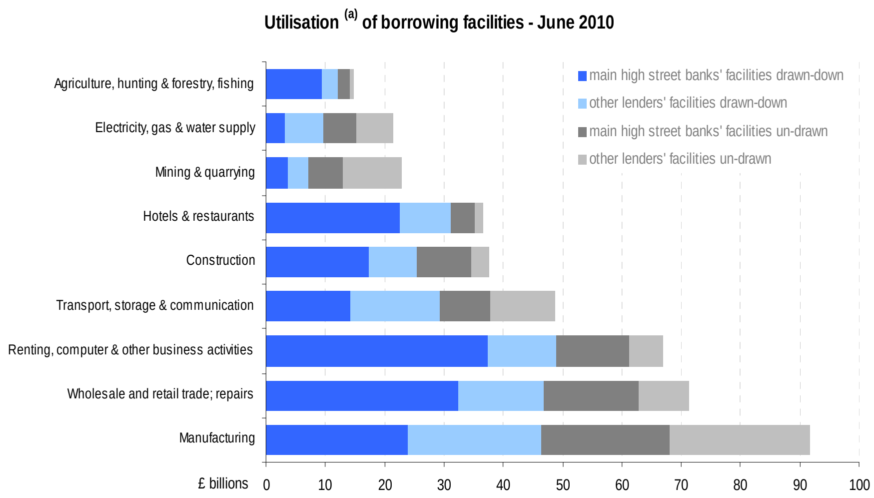


Source : Bank of England

(a) Major UK lenders data for gross lending and repayments to UK private non-financial corporations in both sterling and other currencies. Data are not seasonally adjusted.

Chart 6

For each industry sector, there is unused 'headroom' - the difference between lending commitments (borrowing facilities granted by lenders) and the amount drawn-down by business (outstanding borrowing).

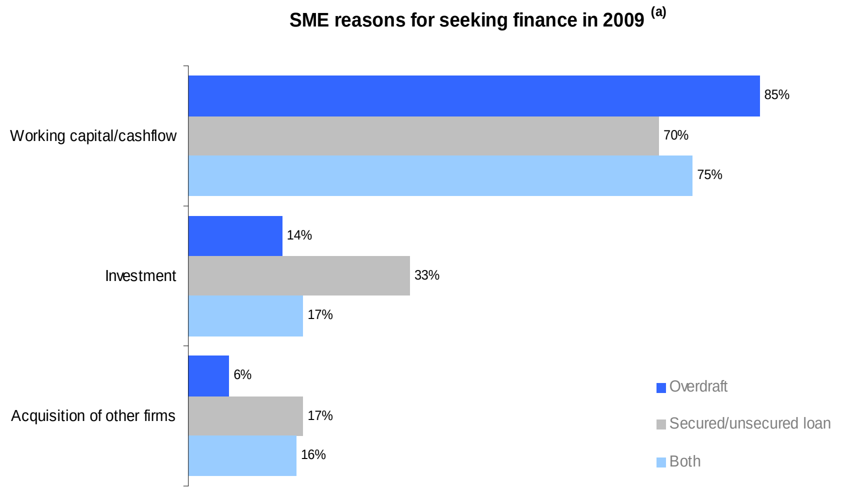


Source : Bank of England

(a) Draw-down of lending under a firm commitment by those sectors estimated to be UK private non-financial corporations.

Chart 7

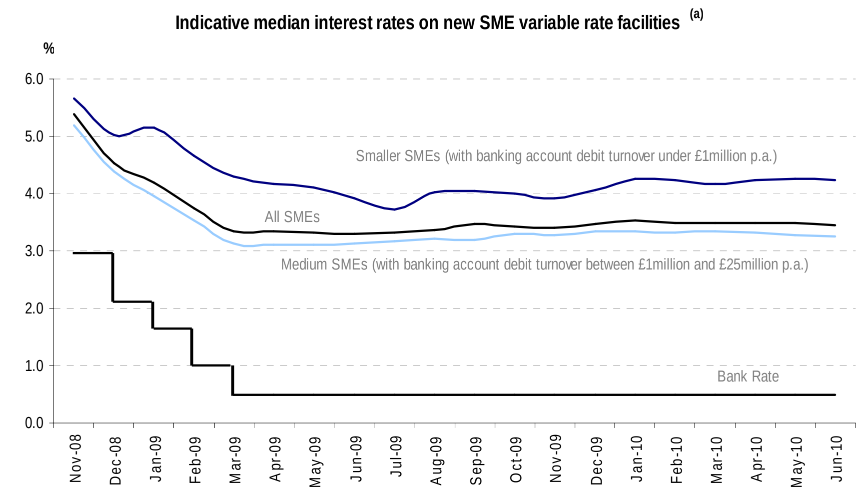
The subdued economy and adverse trading conditions in 2009 meant that working capital or cashflow was perceived to be the biggest reason for SMEs to be seeking finance.



Source : Department for Business, Innovation and Skills
(a) 2009 Finance survey of mid-cap businesses (those with £10m-£500m turnover)

Chart 8

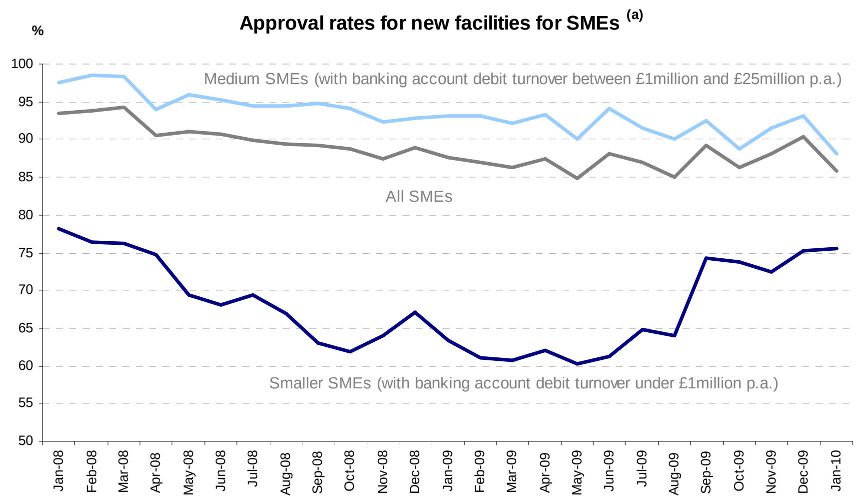
As Bank Rate fell to its current rate of 0.5%, median interest rates on variable facilities followed. The higher margin now between Bank Rate and lending rates reflects increased funding costs and greater counterparty risk, though nominal rates remain lower than they were before Bank Rate started falling.



Source : Bank of England and Department for Business, Innovation and Skills
(a) Median by value of new SME facilities in both sterling and other curecies, priced at margins over base rates by four major lenders.

Chart 9

Lending criteria tightened in response to the financial crisis and heightened risk assessment, particularly for small businesses, but loan approval rates have recovered this year.

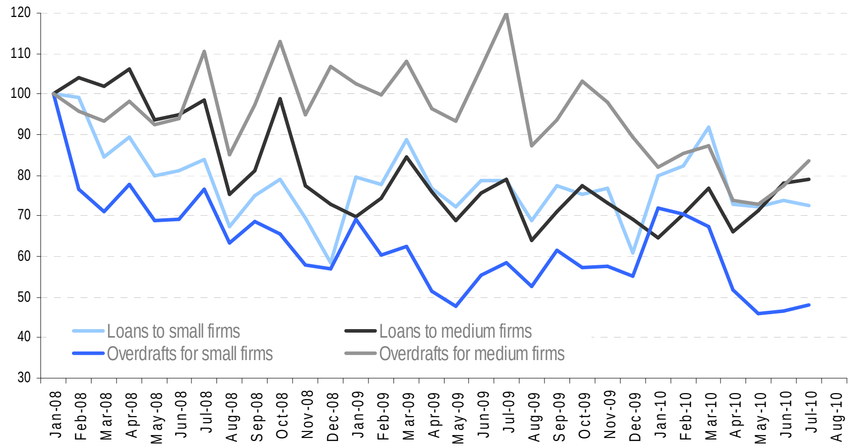


Source : Bank of England
(a) Approvals of new loans and new or renewed overdrafts in sterling and other currencies to SMEs by 4 major UK lenders, expressed as a percentage of the value of applications.

Chart 10

Compared to the start of 2008, the volume of finance applications is noticeably lower, by around 20% for medium-sized SMEs and loans to small firms, whilst overdraft applications are only half the numbers seen in early 2008.

Index of application numbers for loans or overdrafts [a]



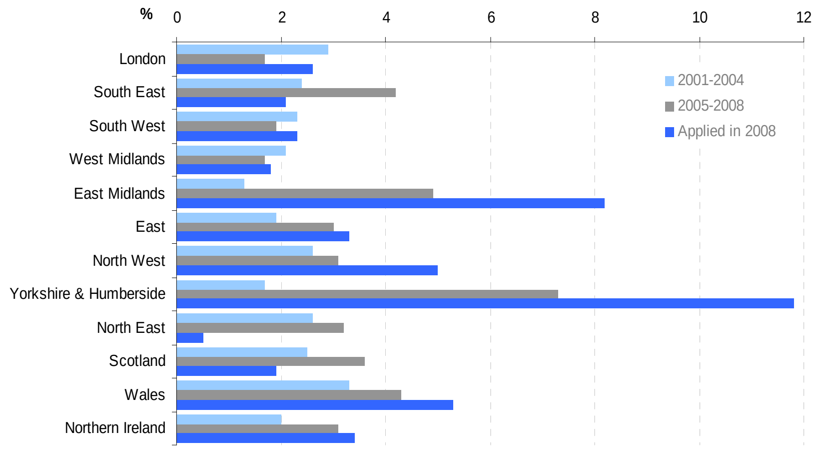
Source : Department for Business Innovation and Skills

(a) 2009 Finance Survey of SMEs.

Chart 11

The cost of SME overdraft borrowing is variable across the regions. Yorkshire & Humberside and East Midlands in particular saw significant growth in margins during 2005-2008 and again in those applied in 2008.

Overdraft margins over Base [a]



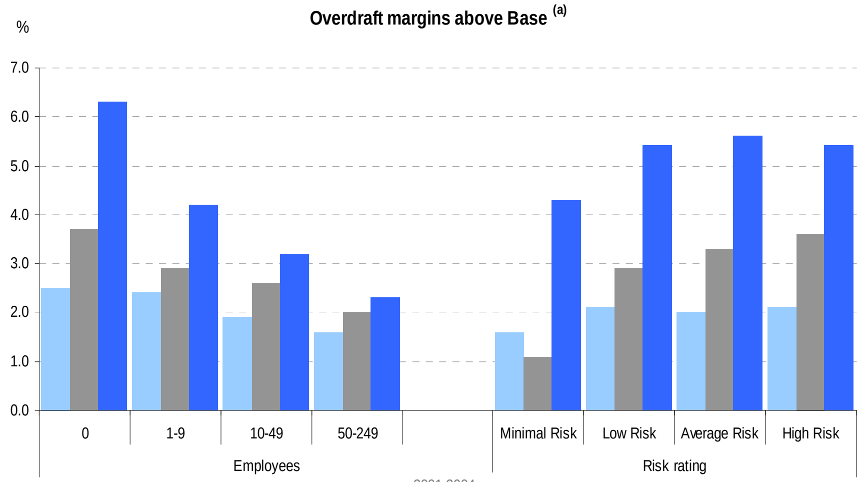
Source : Department for Business Innovation and Skills

(a) 2008 Survey of SME Finances.

Chart 12

When the SME sector is broken down by business employment size, it is clear that margins, though higher than in previous periods, decline with business size. When broken down by perceived default risk, higher margins are fairly uniform.

Overdraft margins above Base [a]

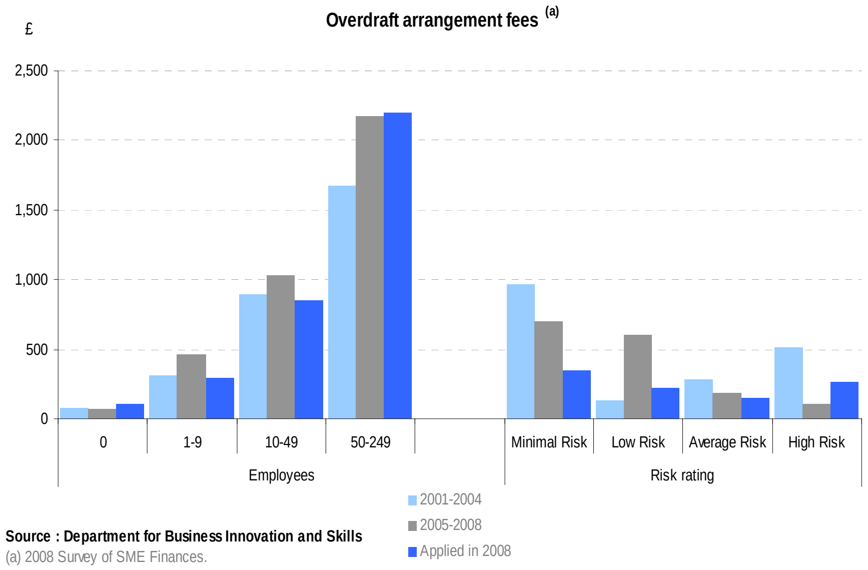


Source : Department for Business Innovation and Skills

(a) 2008 Survey of SME Finances.

Chart 13

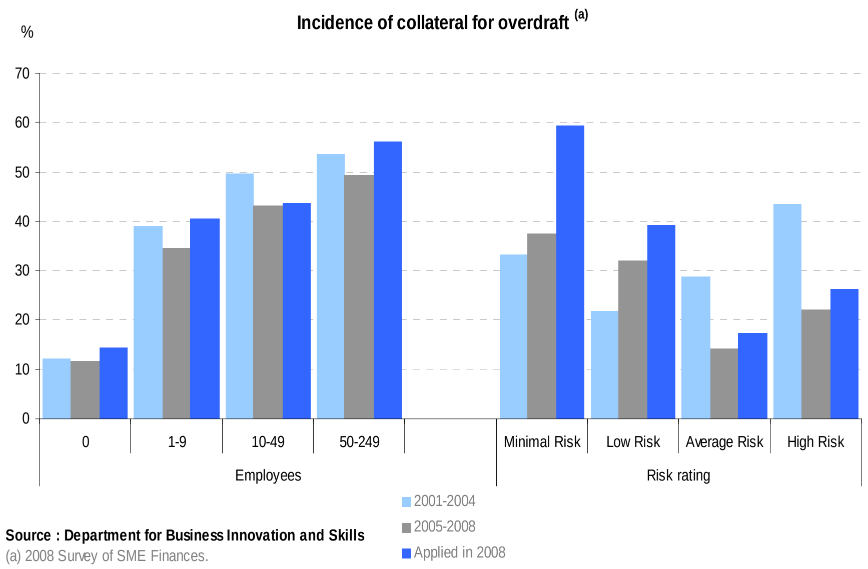
Arrangement fees for SME overdrafts are commensurate with business employment size. Across perceived default risk categories, business overdraft arrangement fees started to see some moderation in 2008.



Source : Department for Business Innovation and Skills
(a) 2008 Survey of SME Finances.

Chart 14

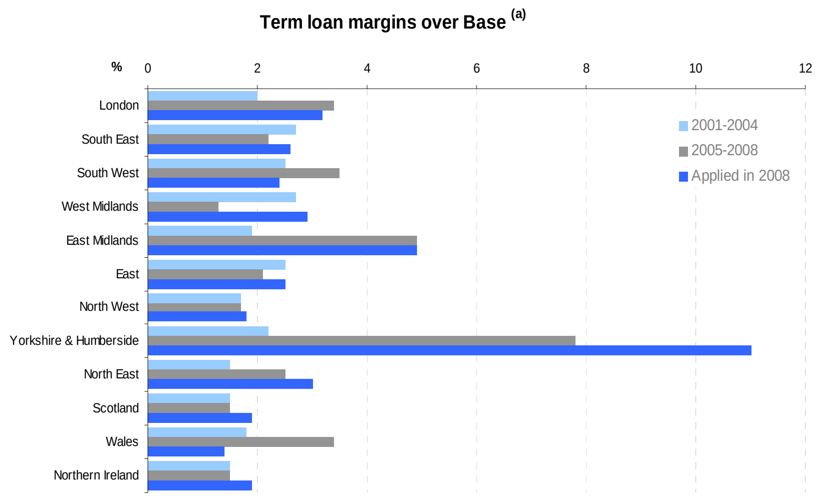
Greater risk perceptions have led to increased incidence of collateral being required for overdraft borrowing.



Source : Department for Business Innovation and Skills
(a) 2008 Survey of SME Finances.

Chart 15

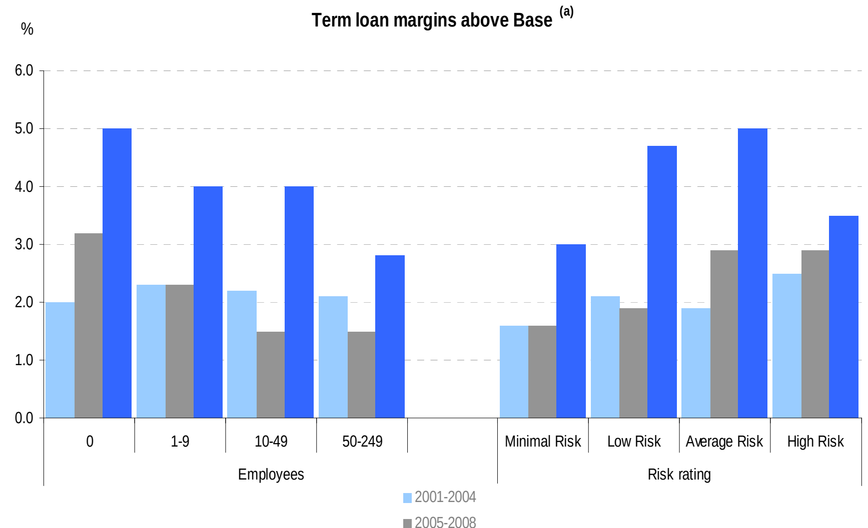
The cost of SME term lending is variable across the regions. Yorkshire & Humberside and East Midlands in particular saw significant growth in margins during 2005-2008 and again in those applied in 2008



Source : Department for Business Innovation and Skills
(a) 2008 Survey of SME Finances.

Chart 16

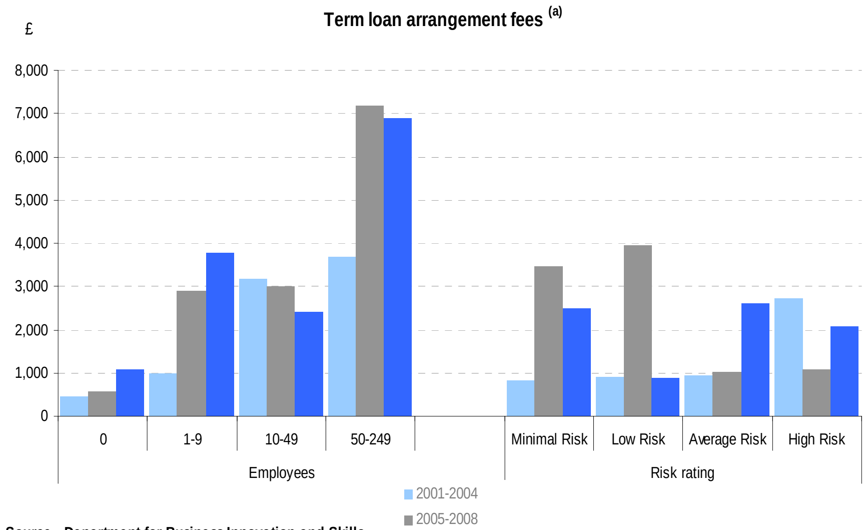
When the SME sector is broken down by business employment size, it is clear that margins, though higher than in previous periods, decline with business size.



Source : Department for Business Innovation and Skills
(a) 2008 Survey of SME Finances.

Chart 17

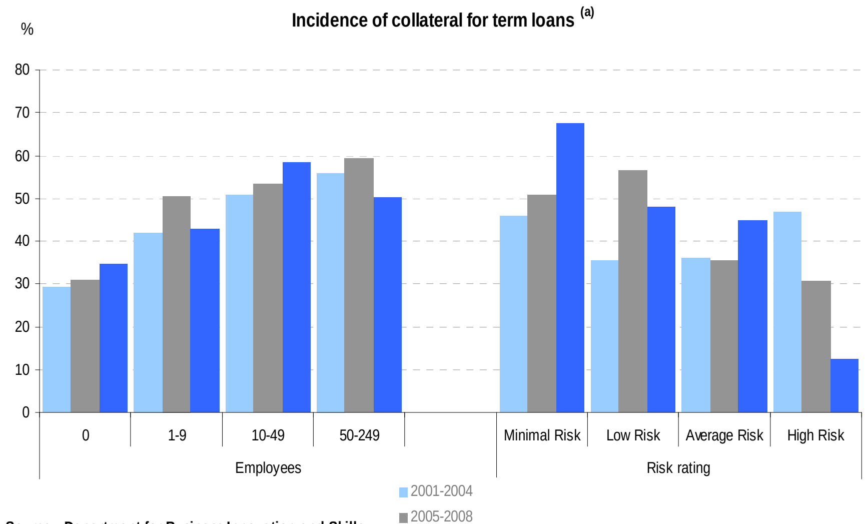
Arrangement fees on term loans are commensurate with larger loans for large SME employers, but there is little consistency across perceived default risk categories, suggesting other risk factors to be carrying greater weight.



Source : Department for Business Innovation and Skills
(a) 2008 Survey of SME Finances.

Chart 18

The incidence of collateral for term loans has remained fairly constant through most periods, but has dropped for businesses in high risk of perceived default



Source : Department for Business Innovation and Skills
(a) 2008 Survey of SME Finances.

Appendix C: Stakeholders who have contributed into the Taskforce

Authorities that have participated as observers

- HM Treasury
- Department for Business, Innovation and Skills
- Bank of England
- Export Credits Guarantee Department
- Financial Services Authority

Business trade associations / bodies

- British Chambers of Commerce
- Confederation of British Industry
- Forum of Private Business
- Federation of Small Businesses
- Institute of Directors
- Quoted Companies Alliance
- Institute of Chartered Accountants in England and Wales
- British Property Federation
- Scottish Finance Enterprise
- City of London Corporation

Financial trade associations

- Association of Corporate Treasurers
- Association of British Insurers
- Association for Financial Markets in Europe
- British Venture Capital Association

Banks

- Deutsche Bank
- Nationwide
- Arbuthnot Latham
- Citigroup
- Hampshire Trust
- Northern Rock
- The Co-operative

Appendix D: Glossary

Asset Backed Security: a security whose value and income payments are derived from and 'backed' by a specified pool of underlying assets.

Asset Finance: where balance sheet assets are used to obtain a loan or borrow money. The borrower provides a security interest in the assets to the lender.

BAFT-IFSA: the global financial services association formed by the merger of the Bankers' Association for Finance and Trade (BAFT) and the International Financial Services Association (IFSA).

Basel Committee on Banking Supervision: an international forum for regular cooperation on banking supervisory matters.

Basis point: One hundredth of a percentage point - 0.01%

BBA: British Bankers' Association

BIS: UK Department for Business Innovation and Skills

CEBS: Committee of European Banking Supervisors. Provides advice to the European Commission on policy and regulatory issues related to banking supervision.

Corporate Default Swaps: Contracts that insure against default of corporate debt

Covered Bond: a security backed from the cash flows from public sector loans or mortgage loans and placed within a separate legal entity, but (unlike asset-backed securities) remain on the issuer's consolidated balance sheet

Debt Finance: the process by which a firm raises money for working capital or other expenditures by selling bonds, bills, or notes to individual and/or individual investors.

ECB: European Central Bank. It is the central bank for Europe's single currency. The ECB's main task is to maintain the euro's purchasing power and thus stability in the euro area.

ECGD: Export Credits Guarantee Department. It is the UK's official export credit agency. It services include insuring UK exporters against non-payment by their overseas buyers, helping overseas buyers purchase goods and services from UK exporters, and insuring UK investors in overseas markets against political risk.

ECOFIN: European and Financial Affairs Council. Composed of the Economics and Finance Ministers of the European Union member states.

EFG: Enterprise Finance Guarantee. A facility for small businesses intended primarily to improve the availability of working capital through term loans and the consolidation of overdrafts. The EFG provides lenders with a government guarantee for 75% of lender exposures on individual loans, and is available to businesses throughout the UK through approved lenders.

Equator Principles: a voluntary set of standards for determining, assessing and managing social and environmental risk in project financing.

Haircut: the percentage by which an asset's market value is reduced for the purpose of calculating capital requirement, margin and collateral levels.

IMF: International Monetary Fund. An organisation of 187 countries, working to foster global monetary cooperation, secure financial stability and reduce poverty around the world.

Invoice Finance: an umbrella term for finance that is provided where the debtor book is used as a security.

LIBOR: London Interbank Offered Rate. It is a daily reference rate based on the interest rates at which banks borrow unsecured funds from other banks in the London wholesale money market (or interbank market).

PRIME: Prince's Initiative for Mature Enterprises. A UK charity that helps people over the age of fifty set up businesses for themselves.

Private Equity: consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of a public equity.

Private Placement: The sale of debt securities to a relatively small number of select investors (e.g. large banks, mutual funds, insurance companies and pension funds) as a way of raising capital. Private placement is the opposite of a public issue, in which securities are made available for sale on the open market.

Retained Earnings: The portion of net income which is retained by a business rather than distributed to its owners as dividends. This is available to support investment in the case of businesses, or support lending in the case of banks.

RMBS: Residential Mortgage Backed Security. A type of security where the cash flow comes from residential debt such as mortgages and home-equity loans.

RWA: risk weighted assets. A weighting of assets according to risk used to calculate the minimum amount of capital that is required to be held within banks to ensure adequate solvency.

Securitisation: the process through which an issuer creates a financial instrument by combining other financial assets and then marketing different tiers of the repackaged instruments to investors.

SFEDI: Small Firms Enterprise Development Initiative. Independent agency which aims to raise the standard of learning, training, coaching and business support available to prospective and existing small businesses.

Statement of Principles: defines how banks will work together with their small business customers when they need finance for the first time, and later as their needs change.

Syndicated facilities: A syndicated loan facility is provided by a group of lenders and is structured, arranged, and administered by one or several commercial banks or investment banks known as arrangers.

Taskforce banks: Barclays, Lloyds Banking Group, HSBC, RBS, Santander UK, Standard Chartered Bank

Trade Finance: the management of money, banking, credit, investments and assets for international trade transactions.

UCITS: Undertakings for Collective Investments in Transferable Securities. A set of European Union Directives that aim to allow collective investment schemes to operate freely throughout the EU on the basis of a single authorisation from one member state.

Vendor Finance: where a company lends to one of its customers to enable a customer to buy products from it.

Working Capital: the requirement to finance day to day activities such as paying suppliers and buying stock. Usually financed through overdrafts and short-term facilities.