Written evidence submitted by Funding Circle

Funding Circle welcomes the opportunity to respond to the latest stage of the Committee's inquiry into the economic impact of coronavirus. We believe it provides a timely opportunity to reflect on learnings from the UK's initial response to the crisis, and to understand how best to support its path towards recovery.

As an accredited lender on the Coronavirus Business Interruption Loan Scheme (CBILS) and the Bounce Back Loan Scheme (BBLS), our response focuses on the questions within the Terms of Reference relevant to business lending, corporate debt and future economic investment. We hope the Committee finds these responses useful and we would be more than happy to discuss these further.

Background to Funding Circle

Since 2010, a wide range of investors have used the Funding Circle platform to directly lend c. £6.8bn to more than 60,000 small businesses. As the UK's largest online small business loan provider, we are proud to be playing our part in helping SMEs access vital finance through CBILS. As of 15th November, Funding Circle had approved c. £1.85bn of CBILS loans, representing a c.24% share of the number of loans approved since we began participating. While our focus has been on delivering CBILS loans to both new and existing customers, we have also been providing existing customers with BBLS loans where needed.

To what extent are Government measures value for money for the taxpayer?

We recognise the extraordinary support the Government continues to provide individuals and businesses through this crisis, including to small businesses through the loan schemes such as CBILS and BBLS. While these schemes have required a significant fiscal commitment from the Government, they have been instrumental in providing much-needed funding and breathing space to firms during an unprecedented reduction in normal economic activity. These measures have provided a lifeline to many businesses, as can be seen in the reduction in the liquidation rate of UK businesses during the 12 months leading up to Q3 2020.[1]

In light of ongoing restrictions continuing to impact SMEs' ability to trade, we welcome HMT's extension of CBILS and BBLS until the end of March, especially as small businesses also navigate leaving the European Union. However, as the UK continues to roll out its vaccination programme and restrictions begin to ease, it will be important to eventually bring these schemes to an end to remove market distortion, enabling a level of 'business as usual' commercial lending to resume, whilst also reducing taxpayer costs.

While the most impacted businesses may continue to need targeted interventions, such as grants, many have been successful in pivoting their business during this period and are able to focus on further adaptation and growth. The businesses in adapt and grow mode will continue to require fast and simple access to finance. Given the prolonged nature of this crisis, we cannot expect however that normal commercial lending will resume as soon as the schemes end. In order to avoid a cliff-edge in SME access to finance, a guarantee scheme will still be necessary for the majority of SME lending initially, and will play an important role in tapering down government liability over time. We therefore welcomed the Government's announcement in September to introduce a successor scheme once the current schemes come to an end.

We believe this new scheme can support businesses while maximising value for taxpayers, by removing CBILS's most market distorting and expensive feature: the Business Interruption Payment. This sees the Government pay the first year of interest and fees. Its removal would significantly lower costs and eliminate a key barrier to the resumption of non-

[1] 'Quarterly Company Insolvency Statistics, Q3 July to September 2020' The Insolvency Service: October 2020

guaranteed lending, further reducing overall Government liability. Additionally, the re-introduction of Personal Guarantees into the successor scheme (below £250k), at least in some form, would remove further market distortion whilst improving recovery rates on behalf of the taxpayer.

This guarantee scheme can become long-term infrastructure to be scaled up and down through an economic cycle, always providing a level of additionality which will aid job creation and boost the UK's competitiveness.

How large a problem is corporate indebtedness?
Pre-pandemic, the UK suffered from a long-standing and sizeable SME lending gap, estimated by the National Audit Office (NAO) at £22bn.[2] While Government loan schemes such as CBILS and BBLS have provided a one-off increase in 2020 SME lending volumes, this underlying long-term structural gap has not been addressed and we do not believe that overall SME indebtedness levels are currently problematic for the UK economy.

We recognise there is a cohort of SMEs—particularly the youngest and smallest BBLS recipients—that will have accessed finance for the first time through this period and may need help repaying this in 2021. However, there is a larger pool of businesses whose overall debt position remains low. For example, Funding Circle has seen only a small increase in overall debt levels across the businesses in our loanbook since Jan 2020. This trend can also be seen in recent BVA BDRC data, with the 40% of small businesses currently using some form of external finance in Q3 2020 still below 2019 levels.[3]

The same data also suggests that the number of SMEs concerned about their ability to repay in Q3 has fallen from its Q2 2020 peak. In addition, following an initial spike in late payments during the first lockdown, more than 90% of Funding Circle UK borrowers are now making regular monthly repayments. With 61% of surveyed small businesses expecting to require finance within the next 12 months[4], we believe the UK economy has significant capacity, and need, for continued SME finance.

How effectively did the financial sector give assistance to businesses?
In our previous submission to the Committee we highlighted how effective and responsive both HMT and the British Business Bank (BBB) have been throughout the crisis, especially given the time pressure and constraints they were working under. Their work to accredit FinTech lenders onto CBILS and BBLS has increased these schemes' reach and helped thousands more businesses access finance during an acute phase of the pandemic.

However, the experience of FinTech lenders during this period has highlighted long-standing structural inequalities that have also restricted their ability to deliver funding, particularly BBLS. A key example has been the Bank of England's (BoE) Term Funding Scheme (TFSME). Incumbent bank lenders have direct access to this scheme, enabling them to use corporate loans as collateral in exchange for low-cost funding from the BoE. Pre-Covid, this funding meant finance could be offered to businesses at very low rates. It has also been important in facilitating BBLS. FinTech lenders have not benefited from this access, impacting their ability to deliver BBLS funding. By comparison, the US Federal Reserve's facility was open to both banks and FinTechs, with the latter playing an important role in the Paycheck Protection Programme.

HMT and BoE did seek to extend TFSME to FinTech lenders in the summer—which was greatly welcomed and appreciated—however the indirect structure proposed was complex, and the fast-paced environment meant the opportunity to deliver BBLS at the scale required to outweigh the costs had largely passed. The post-Covid recovery provides an opportunity to look at this issue again. Ensuring that there is a level playing field between incumbents

[2] 'Improving access to finance for SMEs' NAO: 2013
[3] 'The SME Finance Monitor Q3 2020' BVA BDRC/UK Finance: November 2020.
[4] Funding Circle survey of 200 SMEs, September 2020

and FinTechs will increase the effectiveness of future Government support by improving choice and competition for businesses underserved by traditional finance.

Is there a need for a new state sponsored investment bank? If so, what should it do?
The BBB’s response to the pandemic has demonstrated its effectiveness at working with private-sector lenders to deliver government-guaranteed SME funding at scale. As a result, we believe expanding the role, remit and resources of the existing Bank will help maximise its impact; similar to the experience in the US (SBA) and Germany (KfW), where development banks have partnered with commercial lenders to deliver billions in SME funding outside of crises. We believe this is a more efficient option than creating a new state sponsored investment bank.

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