

CSFI

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Competing with the banks: non-bank sources of consumer finance. A round-table discussion with Stephen Sklaroff (FLA), Giles Andrews (Zopa), Nigel Cates (Office of Fair Trading) and Bruce Davis. Held on Thursday, October 29, 2009, at the City of London Club, 19 Old Broad Street, London, EC2N 1DS, from 12:30-2:15pm.

Speaker one began by highlighting that both bank and non-bank lending are essential, but economic recovery would be speedier if borrowers were able to access non-bank lending. For example, of the £234bn in credit last year, 57% was from banks and the remainder was from non banks. A key attribute of non-bank lending was that it had nowhere else to go but directly into the economy, i.e. it was used to fund purchases, pay salaries, etc.

The pressure on consumer lending had been exacerbated by the fact that many foreign lenders had pulled resources out of the UK. Had non-bank lending taken up the slack? The answer, indicated by the fall in new asset financing and shrinkage in many other areas (such as second charge mortgages), was no. The speaker also noted that there was no government help for non-banks and specialist providers, which were excluded from government schemes. Non-banks faced increased costs, reducing consumer choice. Vulnerable consumers, who may then turn to more unscrupulous sources of credit, loan sharks, for example, and small businesses were at particular risk as alternative sources of finance shrank.

Government policy must change so that assistance was given to the non-bank sector. In addition, new regulations on lending were coming at the 'wrong-time' in the sense that more lending was needed to some sectors. There was a call for new policy initiatives

Another speaker described the attributes of a lender-borrower exchange as a source of non-bank credit. He described how it was possible to get good data on borrowers and felt that it was empowering for consumers to realise that banks do not 'own' credit data. Rates were, on average, 20-25% cheaper than banks for borrowers and the returns to lenders, on average, 8% (the range quoted was 5-15% reflecting different levels of risk).

Another characteristic was the direct relationship between borrower and lender and the speaker felt that was a real advantage vs. the traditional bank, particularly given the post-crisis mistrust of banks. There was no balance sheet in the sense that no deposits were held and all monies were held in trust before they were lent. The combination of trust (crucial to the brand) and operational efficiency made for a viable and dynamic alternative to traditional banks. Whilst noting that there was a lot of room for growth in this type of lender-borrower exchange, the speaker emphasise the need for better regulation. As these types of exchanges were not banks and did not perform a regulated

activity, they fell outside the FSA's jurisdiction. In fact, the speaker noted, the firm would like (within reason) to be regulated.

An additional speaker spoke from a different viewpoint on the topic of money. He questioned how people use money from an anthropological perspective. The establishment of lender/borrower exchanges highlighted the need for new forms of money and more innovation. There were many missed opportunities to harness the trust within communities to create wealth and new credit relationships. For the consumer, cost was a key element in addition to trust. He noted the types of projects taking place in many parts of the developing world that were creating new forms of money/credit but without large financial institutions.

The need for both innovation and safety in non-bank lending was highlighted by one of the speakers. A new proactive regulatory approach was needed to ensure fairness to those in distress and to promote more competition in lending markets. He also noted that competition in lending was essentially over new borrowers and that switching costs remained high so those with a smaller market share (non-banks) had more to gain from increased transparency. The speaker pointed to the big difference in rates between existing banks and new entrants, while noting, however, that once a certain level was reached, new institutions begin to behave like the established banks. Again, there was a strong link between switching and transparency.

The danger was that irresponsible lending (second charge lending on mortgages, for example) could lead to calls for greater regulation which, in turn, would stifle innovation and lead to increased costs for the consumer. The speaker noted that it was better to require transparency than to attempt to regulate specific products.

The discussion then moved on to the subject of the appropriate policy response and the unintended consequences of regulation; good customers being shut out and the vulnerable, with very few options, at a real risk of being taken advantage of.

A speaker emphasised the need for joined up regulation. Whatever shape new regulatory regimes may take, there would always be overlapping boundaries and it was the flow of information between agencies and individuals that was vital.