Cross Party Group on Monetary Reform

June 17th 2014 at 12:15 in the Senedd Media Briefing Room

Darren Millar AM: The Cross Party Group on Monetary Reform was established in November 2012 to raise awareness of the financial system and the social problems it causes and to collectively identify solutions and to influence government policy where possible. The last presentation was given by Fran Boait of Positive Money UK in March 2014.

> "Money is fundamental to our daily lives and many of our social and economic problems relate to it. How much do we really understand about money? What difference does it make who creates money for society and how can a greater awareness help?"

We know how Banks create money through lending and how this is not always in the public interest. What we need to know is what is the current situation in Wales and what can the Welsh Assembly Government do to improve the situation for businesses and people?

Key Speech

Access to Finance in Wales with Dylan Jones Evans

There is an acceptance that people and businesses in Wales may be having problems accessing finance. The Minister for Business has asked for a review of 'Access to Finance in Wales' following complaints from local businesses about High Street Banks reluctant to lend to them. The first two stages of the report are attached and can be downloaded from the website. The first review looks at the current situation and the second looks at some of the gaps that still exist and what alternatives are available.

The data is not a complete picture because Banks are not eager to come forward and some of the alternative lenders such as Funding Circle do not look at regional data. During the course of the study 140 people were interviewed over six months. Some of the international models that were compared include:-

- Sparkassen in Germany
- Finnvera in Finland
- The Bank of North Dakota, USA
- The Development Bank of Canada

In 2013 there were 12,000 loans made in Wales amounting to £863,000,000. In comparison the State-owned-arms-length organization Finance Wales has £30,000,000 per year to lend.

Following the Financial Crisis lending to SMEs fell 30% though it briefly recovered to 14% it is now falling again relative to the rest of the UK. The SME Monitor estimates a lending gap of up to £10,000,000,000 across the UK. This roughly means a £500,000,000 gap for Wales with businesses seeking credit and not finding it. Bank lending to medium sized businesses may have risen but it has fallen to small businesses according to the data. The decline to small business borrowing may be as much as 55%. Across the same period, borrowing by small Scottish firms increased, so why is this? Why did lending briefly recover in 2013 before starting to fall again?

A large part of this problem may be attributed to the way that banks are currently assessing risk, valuing collateral and choosing whether to invest in certain sectors. According to the Asset Based Finance Association they are seeing more demand for credit though there is still a problem with awareness about borrowing away from banks. Types of alternative lending that are taking off include invoice discounting, leasing and peer to peer lending models.

Nesta suggest the peer to peer model has a big role to play and the message from the likes of Funding Circle is that Wales is doing well. Crowdcube however does not have any business in Wales and Seeders only has one, which is based in Swansea.

With businesses seeking credit the data shows that 85% go to their bank and nowhere else. That means that only 15% currently find their way to alternative lenders and we need a big drive for education and raising awareness about this emerging part of the finance industry.

Banks may say they approve 85% of loans but it is probably more like 25%. Of businesses in Wales, the estimates say up to 3,000 are not getting the access to finance they need. The reasons why may be related to their business plan or credit rating but really comes down to how banks assess risk and make decisions.

Of the UK Government’s Business Bank Wales is not getting its representative share and when the Business Secretary was asked if Wales could have a ‘Barnett’s share’ the answer was a flat “No”. Through the Enterprise Guarantee Scheme, Wales does quite well with Wales having the lowest average of defaults in all UK regions.

Starts up loans of £5,000 at 6% are available plus business support and mentoring from a number of organizations in Wales. Non-repayable Grants are available but they are in short supply and have fierce competition. Angel Co-funds do exist for development of business and this is something to look at promoting.

The UK Innovation Investment fund has made no impact in Wales though the Enterprise Capital Fund has brought in £5,100,000. The Business Growth Fund has made one investment in three years compared to fourteen in Scotland. Wales has achieved only 1.5% of the total amount. Equity investment amount to around £23,000,000 which is about one third of the potential. The Angel Network, Xenos is playing it’s part in Wales just as Link Scotland is doing for firms.

Venture Capitalists tend to restrict their activity to London and though the Welsh Assembly Government is trying to stimulate business through as much as £70,000,000 in grants there is still a shortfall in credit available for business investment. Finance Wales is able to make loans of up to £200,000 due to capital from the Jeremie Fund. The issue with Finance Wales is the interest rate they charge and the remit of this State-owned institution. We are seeing falling investment from Finance Wales as the Jeremie Fund shrinks. More investment is being made in England and Finance Wales are being asked to manage more funds with the same amount of resources.

In conclusion, small firms face very hard times. The current business support is fragmented in Wales and we have seen little support for alternative lenders like asset based finance, invoice leasing or peer to peer lending up until now. Overall, the figures suggest a £500,000,000 gap in funding. The current State-owned finance institution is there to make profit, not specifically to create job opportunities.

A new institution such as a Development Bank would not be there to help the public sector displace the private sector in financial services. Rather the role would be to augment the activity of private banks and to stimulate demand for investment by businesses in Wales. The other option for Welsh Government is to form a “challenger bank” that could offer a genuine alternative to the big six but Wales may not be ready for that yet… Thank you.

Q&A

<u>PB:</u> i) Why was Finance Wales allowed to become so expensive?

ii) The Welsh Development Agency found good opportunities, so why have others found it hard?

iii) Why does Wales have to have so many ‘silos’ of money?

iv) Why isn’t Wales ready for a challenger bank?

<u>DJE:</u> i) Finance Wales is self-funded and that is why it needs to charge the rates it does. If we want to give a better deal to SMEs the Welsh Government will have to bear the cost.

ii) That is another subject for another time.

iii) In Ireland they are going to create a Development Bank for more flexibility. For example, they could choose to offer a two year interest holiday and then charge a higher rate after the first two years. Paying 10p in every £1 to interest does not make sense to a lot of start-ups.

iv) The people may be ready for a more customer and client oriented banking service but it comes down to political will in establishing such a vehicle.

JM: How do banks organize decisions?

DJE: Collateral is not available in the same proportion and they are undervaluing a lot of property. To make loans more affordable they often encourage businesses to take out larger loans over a longer period but this is not always best for the business. They discriminate against sectors such as leisure, tourism and agriculture in Wales. Also, credit ratings of the individuals are now given more weight meaning a “computer says NO” situation can arise. The decision making has been detached from the locality of the business and the people in the community.

RP: You have made no pension funds as a means of accessing finance and this is down to the fact few people know about what pension funds can do to provide credit for business.

DJE: Good point. This is something that will be looked at in the third and final stage of the review.

CB: The WDA was forced to let go of £100,000,000 for start-ups and Finance Wales has not fully replaced it. A Welsh challenger bank would need£250,000,000* to acquire a banking license though we do need greater competition in Wales.

DJE: Banks such as Handelsbank are providing some competition to the ‘big six’ but it is correct that Wales is the most concentrated in finance of all developed nations. In discussions with the CEO of Metro Bank he revealed his wife was from Cardiff and they are looking at expanding from the South East in the West Country and Wales. Banks are not that popular so it is about finding ways to get a low cost of borrowing and get banks working better.

*Changes to Banking Law now means only £10,000,000 in capital reserves are now required.

AB: James Vaccaro of Triodos Bank talked about “where is our money and what is it doing?”. When we are not using our money we would like to know that it is being used for good purposes.

DJE: Jerry Halter is looking into the use of pension funds to invest in infrastructure so the whole economy can benefit. The perception of risk is still the major problem and more can be done to raise awareness and educate people about their money.

AH: The ethos of Islamic Banking has all been covered in the best practice you mention. The model looks at the business that want investment and the good that can be done to help them. Rather than charge interest there is an equity investment where both the risks and rewards and shared out fairly. In the Middle East there is huge potential investment that could be accessed with greater help from Welsh Government.

DJE: In looking at global best practice models we have looked into Islamic Banking and found some positives to think about.

DM: Would a Welsh Bank be able to bring money into creation for the public good?

DJE: In Finland, Finnvera offer loans of new money up to E40,000 at between 1-5-4% for SMEs. Above that threshold they offer enterprise guarantees which are the second most popular financial instrument in Europe. Getting the stimulus balance is important.

The Bank of North Dakota was set up in 1919 because of a market failure where farmers were denied credit. They have not just survived but succeeded by working with private banks and not against them.

Demand for overdrafts is falling because they are one of the most expensive forms of finance. Invoice discounting is seeing some growth as it is the cheapest. It is about finding what is appropriate for the business.

According to Finance Wales they would have to subsidize £18,000,000 on a default rate of 22%. Clearly, there is space for another institution in Wales that could balance financial instruments for economic development ensuring affordable rates of finance.

The time scale for the final review stage is for it to be ready for the Minister by the end of 2014. Before then we will be conducting more research and look forward to being able to publish our findings.

DM: Thank you Dylan. Thank you all for coming. It is good to see so much interest across parties in Wales and hopefully we can build a consensus and support the report.

To learn more and participate in the Welsh Assembly Cross Party Group for Monetary Reform

Contact: Justin – positivetrigger@gmail.com