GROWTH STREET

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3 February 2016

Making APR mandatory within the ABFA Code of Conduct – your reply

I am writing to you in my capacity as CEO of Growth Street, a business overdraft provider to SMEs, responding to the points made in your rebuttal of the RABF's suggestion that ABFA members include an APR on their financial promotions to SMEs.

I also wanted to highlight our submission to HM Treasury in advance of the Chancellor's 2016 Budget statement, attached for your reference. We are proposing that all providers of commercial finance should, by law, carry clear and accurate details of an APR on SME finance products, in all forms that this is required.

I would like to respond to the points made in your rebuttal of the RABF's proposal, and would welcome your response.

"There would be a technical difficulty with your proposal inasmuch as asset based finance will generally be provided on the basis of debt purchase. In that sense, it is not lending and interest is not charged. So strictly speaking it would be misleading and potentially illegal to use interest rates or APRs."

While we understand and recognise that asset based finance is not legally considered lending at present (a technical loophole in our opinion) and therefore 'interest' is not a word in your industry's vocabulary, we disagree that this minor technicality obstructs ABFA and its members from adopting APR for several reasons:

1. Most ABFA members present discount fees as a percentage (often referred to as the discount 'rate') multiplied by the amount of finance. The percentage is usually expressed by using bank interest rates as a benchmark plus a margin on top (i.e. discount rates are based on, and vary with changes to, a bank reference interest rate e.g. Bank of England Base Rate, LIBOR etc.). As such, the discount rate is a percentage that more closely resembles an interest rate than it does a fee, at least from a SME's perspective.
2. Asset based finance is, after all, *finance* – and as a *debt* purchase mechanism, certainly more closely resembles debt, than it does, say, equity.

3. APR is a metric for establishing and comparing the cost of credit, and in so doing takes both interest *and fees* into account. Therefore whether the charges ABFA members construct are deemed interest or fees is frankly irrelevant to the suitability of using APR as a uniform metric for comparing the cost of finance.
4. Placing APR on a financial promotion is not a legal requirement for commercial finance, but this is exactly why we think ABFA should take a leadership position and self-regulate. The absence of an APR, and the myriad fees charged by ABFA members that apply under various conditions makes it extremely difficult for SMEs to compare, let alone predict, the cost of asset based finance. While it would be illegal not to carry an APR in certain consumer credit situations, we are aware of no legal impediment to ABFA members voluntarily adopting APR.
5. To suggest that by carrying an APR SMEs would be misled is very hard to understand – more transparency and comparability of cost by using a well-used and widely understood metric, is, in our opinion, a measure that should be welcomed and is badly needed in the asset based finance industry.

"However I appreciate the underlying point that you are making which is transparency about the overall costs of finance to businesses and that is something the ABFA fully supports."

6. We are glad you support cost of finance transparency. If you don't think APR is suitable – what is your alternative?

"An asset based finance facility will often be a bespoke service tailored to the specific requirements and circumstances of the client."

7. This is exactly why an APR is needed – bespoke services and charges used by ABFA members make it extremely difficult for SMEs to compare the cost of finance. The nature of bespoke charges for SMEs was directly referenced in the preliminary findings of the Competition and Markets Authority report into the supply of SME banking as having an adverse effect on competition.

"The two primary costs to a client of an ABF facility will be a service charge and a discount charge; with the latter being payable only on the funding drawn down. These charges will be easily comparable between providers."

8. We reiterate our previous point #1 above – given the discount charge applies to drawn funds, can you not see that from a SME perspective this charge closely resembles interest against debt finance, and when comparing a variety of financing options, this is the parallel that is most readily drawn?
9. More importantly, we believe ABFA members have a responsibility to help SMEs not only compare different asset based finance providers, but also to compare asset based finance to other non-asset based debt products from across the whole finance spectrum.

"There are likely to be other contractual charges that will be specified in the contract to reflect any additional services that a client requests or to cover other events outside the normal running of the facility. Again, these will be easily comparable between providers."

10. It is possible to calculate APR across various financial services products and providers e.g. credit cards and mortgages. We therefore see no impediment for ABFA members to adopt APR. Are you suggesting that members' contractual charges and tariff structures are so complex that this makes it difficult to calculate APR?
11. In our opinion, it is the very fact that so many different fees are incurred by a SME using asset based finance that APR is a much needed mechanism to radically reduce the tariff complexity across your industry.
12. We reiterate our point #9 above – APR is needed by SMEs not only to compare asset based finance products, but also a variety of different debt finance products that are not asset based.

"The market is extremely competitive and I would always recommend that potential clients shop around to ensure they get the most appropriate facility for them, although the most appropriate facility might not always be the cheapest."

13. If the asset based finance market is so competitive, why is it therefore the case that the industry exhibits (a) highly concentrated market share in the hands of a few major players (b) that the few major players are the high street banks i.e. the major providers of commercial finance in the round and (c) most businesses take asset based finance from the provider of their business current account? (These conclusions are drawn from the preliminary findings of the recent CMA investigation into the supply of SME banking, which concluded there are adverse effects on competition, and that remedial action is needed.)

"Comparison between a single rate or metric like an APR can work for a standard off the shelf product like a credit card or a personal loan. But for a service-oriented facility intended for businesses rather than consumers, there is a risk that one ends up comparing apples with pears."

14. We fundamentally disagree. APR works extremely well across myriad consumer products, including relatively complex products such as mortgages, where disclosure of an APR is a regulatory requirement. One could argue that by making APR mandatory, complex products have been purposely made simpler, benefiting users and increasing competition.
15. To argue that APR does not work for a 'service-orientate facility' is simply false – all credit products include a service element to varying degrees, and APR remains a useful metric for cost comparison.
16. The distinction between businesses and consumers is becoming increasingly blurred. Sole traders for example could be considered both, while the FCA, in its report into the mis-selling of interest rate swaps to SMEs by banks, recently concluded that Limited companies below certain size thresholds should be deemed non sophisticated and treated more akin to consumers.
17. APR is a metric that cuts across artificial boundaries – it is, by its very definition, a measure that allows consumers (and could therefore allow businesses) to draw a meaningful apples-to-apples comparison, independent of the provider and form of debt finance.

"A prospective facility needs to be considered qualitatively, not just quantitatively. For instance, there are some client businesses that use factoring for the service element (ledger management and collections) and don't even draw down funding. "

18. There will always been an argument for considering qualitative and quantitative factors. But without a robust method for easily comparing price by using a simple, single metric such as an APR, trying to establish a cost comparison is difficult and time consuming for an SME. Put another way: it is near impossible for an SME to balance price vs quality considerations when it's difficult to compare prices in the first place.

"What is key is that SMEs understand the options available to them, what the benefits and costs are and are able to make an informed choice. Transparency about the overall costs of finance is key to that and is something that the ABFA fully supports and encourages amongst its Members."

19. We're glad ABFA agrees and we would be interested to hear how ABFA plans to achieve cost of finance transparency without adopting a simple, single metric like APR.
20. Further, we hope ABFA recognizes that in order for SMEs to fully understand the options available, they need to be able to draw comparisons across the full spectrum of financing options, where asset based finance is only one of a variety of different products that need to be considered. This is where APR could be of great use.

"I note that you have copied in Lucy Armstrong, the chair of the Professional Standards Council, which, as you know, is independently responsible for maintaining and enforcing the Standards Framework which all our Members work under. How to ensure transparency in fees and charges is something that the PSC considers on an ongoing basis - if you do have any specific examples or evidence of what you believe is poor practice I would encourage you to bring them to Lucy's attention."

21. I am sure the RABF will provide Lucy with specific examples and we will also gladly provide examples and evidence of the opacity of asset based finance terms and conditions for her review if this is helpful.
22. But we would also like to turn the question round – as an example, can ABFA point to a simple cost (or even quality) comparison tool to help users shop around, and that explains the full cost of an asset based finance facility, assuming a specific financing need, over the cost of a single unit of time, e.g. 1 year? Most users we talk to find asset based finance highly confusing, and many report that they end up paying significantly more than they originally expected due to hidden costs and unanticipated charges – a symptom we think is entirely related to the absence of a simple, single price metric such as APR.

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Jeff, I hope you can tell from the above that we believe strongly that making the calculation and display of APR mandatory for ABFA members is a change that is badly needed, and that the arguments in favour are clear and robust. I hope that ABFA will reconsider its position, and in the spirit of self-regulation, make the necessary changes to its code of conduct to fulfil its goal of achieving cost of finance transparency, thus making it easier for SMEs to compare finance options, and ultimately increasing competitiveness.

I support the APR4SMEs campaign that is raising awareness of this issue, which I believe constitutes another UK financial scandal in the making. The campaign's supporters are engaging the media, using the tag #APR4SMEs to provoke debate, and have started a petition and an APR calculator to help small businesses think carefully about the cost of finance – both of which can be found at http://apr4smes.co.uk.

Thank you for taking the time to read this letter and the enclosed submission. I would be delighted to meet with you to discuss our proposals in greater detail, encourage you to join the #APR4SMEs campaign and answer any questions you may have. As a first step, I will contact your office to see if a suitable time can be found to meet.

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