

# Market Building and the Capital Markets Union: Addressing Information Barriers in the SME Funding Market

by

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*The Capital Markets Union (CMU) is one of the flagship policy initiatives of the Juncker Commission. The Commission's strategy for realizing a CMU is set out in its White Paper on building a CMU. Besides describing the Commission's vision of a CMU, the white paper includes an action plan which details the measures that are needed to build a CMU. The aim of this article is to consider the Commission's measures in one particular area of the action plan. Specifically, this article examines the Commission's strategy for overcoming information barriers to SME investment. By acting in this area, the Commission's objective is to facilitate access to finance, but also to diversify sources of funding for SMEs, which are traditionally heavily dependent on bank-based finance. This article evaluates the Commission's strategy and its prospects of success. After assessing the relevant policy measures, it will argue for a paradigm shift which is based on three pillars: a greater emphasis on market building measures; a greater emphasis on information sharing duties as one mechanism that can help to address information barriers; and a market correcting strategy to dovetail greater market building.*

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*I. Introduction*

The Capital Markets Union (CMU) is one of the Commission’s flagship projects. It is a policy initiative that is meant to be about market building. It is supposed to create the conditions for an integrated market for capital which complements the banking sector and helps to bring about a more diversified financial system. At the heart of the Commission’s market building strategy is its White Paper on building a CMU.<sup>1</sup> The White Paper sets out a list of policy actions. These actions are meant to benefit a range of actors, notably small and medium sized enterprises (SMEs). SMEs were among the victims of the financial crisis, especially as banks tightened their lending policies in the years that followed the financial crisis. Given SMEs’ importance for the real economy, SME funding has not surprisingly become a focus of attention for policy-makers around the world. Traditionally, SME funding is viewed as suffering from several problems. Among them are informational issues which affect both the funding demand side and the funding supply side. They make it more difficult for SMEs to navigate the funding market and identify funding options. They also make it harder for finance providers to assess the creditworthiness of SMEs. The White Paper attempts to offer solutions to these issues. Among its policy measures is a set of actions on ‘overcom[ing] information barriers to SME investment’.<sup>2</sup> The immediate objective of these measures is to improve access to finance for SMEs (a long-standing objective of the Commission), but also, crucially, to offer SMEs a more diverse range of non-bank funding options. This is in accordance with the White Paper’s broader objective of creating the conditions for the development of a more balanced financial system that is less based on bank-based finance.

1 Commission (EC), ‘Action Plan on Building a Capital Markets Union’ COM(2015) 468 final, September 2015).  
2 Ibid 29.

The aim of this article is to contribute to the literature on the CMU by considering the Commission's market-building agenda under the White Paper.<sup>3</sup> In particular, this article focusses on the SME funding market and the question of how to overcome the information barriers which the Commission identifies in its White Paper. The Commission's ambitions are by no means small. There is a wealth of empirical research on the funding behavior of SMEs. Empirical data shows consistently that SMEs prefer bank-based finance to non-bank finance.<sup>4</sup> Moreover, designing policy solutions for the SME funding market is complicated by the fact that SMEs are an eclectic group.<sup>5</sup> They differ considerably in terms of their size, growth ambitions, sectors of activity, etc. Generally, however, SMEs are especially sensitive to increases in regulatory burden. Moreover, the amount of external finance which SMEs require is relatively small. Empirical data shows that in the EU most SMEs will aim to

- 3 For representative contributions, see D Valiante, *Europe's Untapped Capital Market: Rethinking Integration after the Great Financial Crisis* (CEPS Paperback, Rowman & Littlefield International, London 2016); N Moloney, 'Institutional Governance and Capital Markets Union: Incrementalism or a "Big Bang"?' (2016) 13 *European Company and Financial Law Review* 376; N Moloney, 'Capital Markets Union: Ever Closer Union for the EU Financial System?' (2016) 3 *European Law Review* 307; N Dorn, 'Capital Cohabitation: EU Capital Markets Union as Public and Private Co-Regulation' (2016) 11 *Capital Markets Law Journal* 84; T Beck, 'Does Europe need a Capital Markets Union? And How Would We Get There?' in F Allen, E Carletti and J Gray (eds), *The New Financial Architecture of the Eurozone* (European University Institute, RSCAS, Florence School of Banking and Finance 2015) 115; P Schammo, 'Capital Markets Union and Small and Medium-sized Enterprises (SMEs): a Preliminary Assessment', in *ibid*, 137; K Lannoo, 'Which Union for Europe's Capital Markets?' (ECMI Policy Brief no. 22, February 2015) <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2565722](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2565722)>; V Bavoso, 'Good Securitisation, Bad Securitisation and the Quest for Sustainable EU Capital Markets' (2015) 30 *Butterworths Journal of International Banking and Financial Law* 221-225.
- 4 See, eg, Commission (EC), 'Survey on the Access to Finance of Enterprises (SAFE): Analytical Report 2016', November 2016, p. 108, <<http://ec.europa.eu/DocsRoom/documents/20403>>.
- 5 See, eg, Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises [2003] OJ L124/36. According to the Commission Recommendation, SMEs, which category also includes microenterprises, are enterprises 'which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million'. Within this category, a small enterprise is 'an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million' and a microenterprise is 'an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million'. Note however that there is no universally accepted definition. See, eg, Schammo (n 3) 150-1.

obtain external funding of less than 1,000,000 euros in order to achieve their growth ambitions, with the largest proportion of SMEs (almost one out of four) anticipating that their funding needs will be in the range of 25,000–100,000 euros.<sup>6</sup>

The main message of this paper concerns the White Paper's policy actions on overcoming information barriers in the SME funding market. While the White Paper has ambitious policy objectives, I will argue that there is a certain disconnect in the White Paper's thinking between problem definition and policy solution. Thus, I will argue that the Commission's policy solution to overcoming information barriers is at risk of falling short of what is required to deal with informational issues. I will suggest that to overcome information barriers to SME investment a paradigm shift is needed, which is based on three pillars: a greater emphasis on market building; a greater emphasis on (quasi-mandatory) data sharing as one mechanism that can help to address information barriers; and a market correcting strategy that dovetails a market building strategy.

In developing this line of argument, I will draw attention to several policy initiatives on quasi-mandatory data sharing that have emerged outside the CMU context: in the UK, but also at EU level. Banks will be among those that will be required to share data. I will describe these mechanisms as 'quasi-mandatory' because information sharing remains subject to a customer's consent. I will argue that much can be learned from these initiatives. Recent efforts by the EU legislature to lower the prospectus disclosure burden to attract SMEs away from bank-based finance are unlikely to make a meaningful difference for most SMEs.

This article proceeds as follows. Section II begins by identifying the market building narrative which underpins the CMU agenda. It will consider the CMU's broad ambitions, and objectives, but also its limitations. Section III turns to the SME funding market and the information issues which affect it. It begins by setting out a framework for analysis, after which it considers the Commission's strategy for addressing these issues. Having assessed the Commission's approach, Section IV sets out my favoured approach. Section V concludes.

6 SAFE (n 4) 114.

## II. The CMU: ‘market building’ for Member States

To get a better sense of the CMU’s ambitions, I will begin by differentiating between two types of policies: market building and market correcting policies.<sup>7</sup> Market building is about eliminating obstacles to market integration. In an EU context, market building is closely associated with the free movement provisions of the EU Treaties (negative integration), but not exclusively since market building is also pursued through harmonisation (positive integration). Market correcting policies can be defined as measures whose purpose is to deal with the harmful or socially undesirable effects of unfettered markets. Thus, I will describe these measures loosely – by reference to their purpose – as re-regulatory. Admittedly, the distinction between these two types of policies is somewhat crude. Some authors add further distinctions: by differentiating between market correcting and market cushioning policies for example.<sup>8</sup> Moreover, in many instances, policy measures combine aspects of market making and market correcting: for example, in the case of harmonisation.<sup>9</sup> That said, the distinction is nevertheless a useful simplification. I feel free to put aside definitional subtleties because the distinction between market building and market correcting is good enough to capture the relevant traits of the CMU initiative.

The CMU was presented as an initiative that is intrinsically about market building. Thus, the Commission White Paper describes the CMU as a typical internal market initiative: ‘a classic single market project’.<sup>10</sup> The CMU is supposed to contribute to realising the EU’s long standing ambition of a single market for capital that will offer benefits to all the Member States: ‘a Capital Markets Union for all 28 Member States’.<sup>11</sup> The emphasis is on breaking down

7 This dichotomy (market-building (or market-making) vs market-correcting) is found in the political science literature. See eg, F Scharpf, *Governing in Europe – Effective and Democratic?* (OUP, Oxford 1999) 45; E Posner and N Véron, ‘The EU and Financial Regulation: Power without Purpose?’ (2010) 17 *Journal of European Public Policy* 400.

8 Eg, L Buonanno and N Nugent, *Policies and Policy Processes of the European Union* (Palgrave Macmillan, Basingstoke 2013), 14. See also D Kenealy, J Peterson and R Corbett, *The European Union – How does it work?* (OUP Oxford, 2015) 114.

9 See e.g. AG Maduro in Case C-58/08 *Vodafone Ltd and Others v Secretary of State for Business, Enterprise and Regulatory Reform* ECLI:EU:C:2009:596, para 8 who points out that if a common harmonisation provision such as Art 114 TFEU [Art 95 EC] were only about eliminating restrictions to the free movement, this would entail that such a provision ‘could promote market integration only through the deregulation of national markets. Such an interpretation would enshrine in Article [114] a particular policy preference when there is nothing in the Treaty to support such a view’.

10 Action Plan (n 1) 27.

11 Ibid 3.

barriers to free movement while staying clear of heavy institution-building and an overly prescriptive top-down re-regulatory agenda. As the Commission put it in its White Paper: '[t]he direction to take is clear: to build a single market for capital from the bottom up, identifying barriers and knocking them down one by one...'<sup>12</sup>

Through market building, the CMU's ambition is to bring about a more diversified financial system that is less reliant on the banking sector, and to stimulate growth, jobs and investment in a post financial crisis era – a core priority of the Juncker Commission.<sup>13</sup> Specifically, by diversifying funding sources, a CMU is supposed to offer greater access to finance for businesses – especially for SMEs which have been heavily reliant on bank based finance. It is also meant to offer more investment opportunities and better returns for finance providers.<sup>14</sup> However, the CMU initiative is also supposed to contribute to financial stability by creating the conditions for greater and better private risk sharing through cross-border integration and financial diversification.<sup>15</sup> The argument is that in the event of an economic shock affecting an economy, increased private risk sharing enables losses to be spread across multiple jurisdictions, thus enabling the consequences of a shock to become more widely dispersed and thereby lowering the prospect of instability in the economy exposed to a shock.<sup>16</sup> Market building under the CMU initiative has

12 Ibid 6.

13 J-C Juncker, 'A New Start for Europe: my Agenda for Jobs, Growth, Fairness and Democratic Change' (Strasbourg 15 July 2014) <[http://ec.europa.eu/priorities/docs/pg\\_en.pdf](http://ec.europa.eu/priorities/docs/pg_en.pdf)>.

14 Action Plan (n 1) 3.

15 There is support for the idea that a well-functioning CMU *prima facie* not only promotes growth (through better preference matching), but can also improve economic and financial stability (through greater private risk sharing). See N Anderson, M Brooke, M Hume and M Kürtösiová, 'A European Capital Markets Union: Implications for Growth and Stability', Bank of England Financial Stability Paper No. 33, February 2015 <[http://www.bankofengland.co.uk/financialstability/Documents/fpc/fspapers/fs\\_paper33.pdf](http://www.bankofengland.co.uk/financialstability/Documents/fpc/fspapers/fs_paper33.pdf)>. See also V Constâncio, 'Capital Markets Union and the European Monetary and Financial Framework' Chatham House, 21 March 2016 <[https://www.ecb.europa.eu/press/key/date/2016/html/sp160321\\_1.en.html](https://www.ecb.europa.eu/press/key/date/2016/html/sp160321_1.en.html)>. See also C Furse, 'Taking the Long View: How Market-Based Finance can Support Stability' Bank of England speech, 28 March 2014 <<http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech718.pdf>>.

16 Eg, Commission (EC), 'European Financial Stability and Integration Review (EFSIR): a Focus on Capital Markets Union' SWD(2016) 146 final, April 2016, 66 noting that '[a] well-functioning CMU will diversify and increase funding sources for the economy and strengthen its resilience. Truly integrated capital markets will also strengthen cross-border risk distribution, notably by deepening the integration of bond and equity markets. This will entail a broader dispersion of the impact of shocks. All this will

therefore several functions: to be growth enabling, but also stability enhancing.

The Commission's case for a stability enhancing CMU received support from influential actors. The ECB for example offered its support. Given the limitations of the ECB's monetary policy for addressing country specific asymmetric shocks, the ECB sees benefits in a fully-fledged CMU which establishes conditions for increased private risk sharing.<sup>17</sup>

However, the level of integration that is required to deliver a fully functioning CMU, which contributes through effective private risk sharing to economic and financial stability, is demanding to achieve.<sup>18</sup> For one thing, it would require a truly level playing field. It would mean overcoming legal and extra-legal obstacles which have plagued the EU for so long,<sup>19</sup> including hurdles such as 'home bias' – that is, the disposition of investors to prefer their home market to other markets.<sup>20</sup> It might require promoting equity over debt finance given that the former is seen as supporting a more desirable form of financial integration.<sup>21</sup> Last but not least, integration is not a risk-free endeavour. High levels of integration come with risks which might defeat the very objectives that the Commission set itself: for example, the risk of capital flight,<sup>22</sup> the risk of cross-border contagion and financial instability.<sup>23</sup> In short, in the 'real world', building a true CMU will be complicated to achieve and market building will, in and of itself, not be enough to address the risks of greater financial integration.

contribute to increasing financial stability'. For a detailed assessment of the risk sharing argument, see Anderson *et al.* (n 15); Valiante (n 3).

17 Constâncio (n 15).

18 The point has been acknowledged. See eg, V Constâncio, 'Monetary Policy and the European Recovery' XXXI Reunión Círculo de Economía, Barcelona 30 May 2015 <<https://www.ecb.europa.eu/press/key/date/2015/html/sp150530.en.html>>.

19 For a detailed assessment, see Valiante (n 3).

20 See generally K Lewis, 'Trying to Explain Home Bias in Equities and Consumption' (1999) 37 *Journal of Economic Literature* 571; C Pacchioli, 'Is the EU Internal Market Suffering from an Integration Deficit? Estimating the "Home-Bias Effect"' CEPS Working Document No. 348, May 2011.

21 Eg ECB, 'Financial Integration in Europe' April 2016, 82-83 <<https://www.ecb.europa.eu/pub/pdf/other/financialintegrationineurope201604.en.pdf>>.

22 See eg, Anderson *et al.* (n 15), 19, highlighting the risk of capital flight during times of crisis, but noting that '[e]xperience from the crisis suggests that fixed income assets covering both loans and bonds proved vulnerable to redenomination risk and capital flight. Other assets, notably equities, proved less vulnerable to this risk...'.<sup>23</sup>

23 See generally, J Stiglitz, 'Risk and Global Economic Architecture: Why Full Financial Integration May Be Undesirable' (2010) 100 *American Economic Review: Papers & Proceedings* 388; J Stiglitz, 'Capital Market Liberalization, Economic Growth, and Instability' (2000) 28 *World Development* 1075, highlighting issues raised by short term capital flows in case of capital market liberalization.

To be sure, the CMU White Paper is not inimical to concerns about greater market building and risks to financial stability that typically call for market correcting measures. However, the CMU initiative was right from the beginning insulated from controversies linked to a prescriptive market correcting agenda. Thus the White Paper refers to several existing measures (pre-CMU initiatives).<sup>24</sup> It also highlights initiatives that are in progress elsewhere (e.g. CCP recovery and resolution) or that are supposed to be taken forward elsewhere (changes to macro-prudential tools which will be addressed in the context of the review of the European Systemic Risk Board).<sup>25</sup> As far as supervision is concerned – the indispensable corollary of effective regulation – the White Paper (like the Green Paper) stays clear of controversy. It advocates strengthening supervisory convergence.<sup>26</sup> As such, it does not meaningfully depart from the status quo. As far as ESMA's governance is concerned which is essential for ESMA to deliver its objectives, the White Paper notes that it will (together with matters concerning ESMA's funding) be dealt with in a separate White Paper.<sup>27</sup>

In trying to understand the White Paper's approach to market correcting measures, the policy preferences of the UK are clearly important to flag up. The White Paper was published in September 2015; a demanding market-correcting agenda superimposed on the CMU market-building policies would have been at loggerheads with several red lines for the UK, notably on further transfers of powers to the EU in the supervisory or resolution fields. However, clearly, since June 2016 the UK's policy preferences for a CMU no longer matter that much. Indeed, since the UK's referendum on the EU, subsequent communications on the CMU appear to signal a certain détente on market correcting policy aspects. Thus, the CMU initiative might well be the place where in the future more forceful action on EU day-to-day supervision is contemplated,<sup>28</sup> thereby echoing suggestions made in the Five Presidents' report, which suggestions the Commission had skilfully sidestepped in its CMU White Paper.<sup>29</sup> It remains to be seen how much market correcting action

24 Action Plan (n 1) 26.

25 Ibid.

26 Ibid.

27 Ibid 27.

28 Day-to-day supervision involves vesting EU agencies such as ESMA with supervisory competence over market actors or activities. See eg, P Schammo, 'EU Day-to-Day Supervision or Intervention-Based Supervision: Which Way Forward for the European System of Financial Supervision?' (2012) 32 *Oxford Journal of Legal Studies* 771.

29 See subsequently, Commission (EC), 'Capital Markets Union – Accelerating Reform' COM(2016) 601 final, September 2016) 7 noting that '[t]he Five Presidents' Report highlighted the need to strengthen the supervisory framework in order to ensure the solidity of all financial actors, which should lead ultimately to a single European capital

will be injected into the market building agenda of the CMU. Clearly however the market building policy ambitions of the CMU will continue to contrast markedly with the market correcting orientations of its ‘closest cousin’, the Banking Union.

### *III. CMU market building in the SME funding market*

Section II described the general orientations and ambitions of the CMU initiative. It highlighted the challenges of effective market building, but also underlined its risks. This section zooms in on one area – i.e., SME funding – in order to consider how the CMU’s market building ambitions are translated into proposed actions. Facilitating access to finance for SMEs is among the CMU’s key aims. The Commission’s action plan resolves among other things to ‘overcome information barriers to SME investment’,<sup>30</sup> a prerequisite for facilitating financial integration. I will begin this section by elaborating on the information issues that affect the SME funding market (1), after which I will assess the White Paper’s strategy for overcoming information barriers (2).

#### *1. Framework for analysis*

##### *a. Problem definition: information barriers in the SME funding market*

Facilitating access to finance for SMEs has been a long-standing ambition of the EU. It has been a theme in many Commission communications, white or green papers.<sup>31</sup> The CMU initiative is among the latest efforts in this area.

markets supervisor. The Commission will consider, in close consultation with the European Parliament and the Council, the further steps in relation to the supervisory framework that are necessary to reap the full potential of CMU’. See also Commission (Five Presidents’ Report), ‘Completing Europe’s Economic and Monetary Union’ 12 <[https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report\\_en.pdf](https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf)>.

<sup>30</sup> Action Plan (n 1) 29.

<sup>31</sup> Eg, Commission (EC), ‘Risk Capital: a Key to Job Creation in the European Union’ April 1998, 2 <<http://cordis.europa.eu/documents/documentlibrary/30636641EN19.doc>>; Commission (EC), ‘“Think Small First” – A “Small Business Act” for Europe’ COM(2008) 394 final, June 2008; Commission (EC), ‘An Action Plan to Improve Access to Finance for SMEs’ COM(2011) 870 final, December 2011; Commission (EC), ‘Entrepreneurship 2020 Action Plan – Reigniting the Entrepreneurial Spirit in Europe’ COM(2012) 795 final, January 2013; Commission (EC), ‘A stronger European Industry for Growth and Economic Recovery’ COM(2012) 582 final, October 2012; Commission (EC), ‘Review of the “Small Business Act” for Europe’ COM(2011) 78 final,

Under the CMU, access to finance for SMEs has several connecting rationales: to better match supply and demand, but also to address structural vulnerabilities caused by Europe's over-reliance on bank-based finance. Bank-based finance has traditionally been the main source of external finance for SMEs. This has led SMEs to be over-exposed to tightening bank lending policies,<sup>32</sup> but also, it has been reported, to lengthy lending decision-making processes which have contributed to dampening demand in the past.<sup>33</sup> The fact that there is a macro- or structural dimension to the issue of SME funding under the CMU is worth noting. It means that facilitating access to SME finance cannot be reduced solely to the question of whether the banking sector is willing or able to supply external finance to SMEs. Positive developments in the availability of bank finance for SMEs, which have been witnessed more recently,<sup>34</sup> are not enough to lay the issue of SME funding to rest under the CMU agenda.

Clearly however creating a more diversified pan-EU financial system where SMEs are able and willing to look beyond the banking sector for external finance is a considerable challenge. For one thing, the banking sector is the most obvious choice for many SMEs. Empirical data shows consistently that

February 2011; Commission (EC), 'Long-term financing of the European Economy COM(2013) 150 final, March 2013. The EU legislature too has sought to address the issue in various ways in the past. See eg, see rec (132) and art 33 of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ L 173/349; Regulation (EU) No 45/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds [2013] OJ L115/1; rec (44) and art 501 of Regulation (EU) No 75/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 48/2012 [2013] OJ L176/1; Regulation (EU) No 46/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds [2013] OJ L115/18; Regulation (EU) No 287/2013 of the European Parliament and of the Council of 11 December 2013 establishing a Programme for the Competitiveness of Enterprises and small and medium-sized enterprises (COSME) (2014–2020) and repealing Decision No 639/2006/EC [2013] OJ L347/33.

32 Eg, G Wehinger, 'Bank Deleveraging, the Move from Bank to Market-Based Financing and SME Financing' OECD Journal: Financial Market Trends (Volume 2012/1), 1.

33 Institute of International Finance and Bain & Company, 'Restoring Financing and Growth to Europe's SMEs: Four Sets of Impediments and How to Overcome Them' 2013, 4 [http://www.bain.com/Images/REPORT\\_Restoring\\_financing\\_and\\_growth\\_to\\_Europe's\\_SMEs.pdf](http://www.bain.com/Images/REPORT_Restoring_financing_and_growth_to_Europe's_SMEs.pdf).

34 Recent data on access to finance in the euro area suggests that availability of bank finance is improving. See ECB, 'Survey on the Access to Finance of Enterprises in the Euro Area (October 2015 to March 2016)' June 2016, 18–20 <<https://www.ecb.europa.eu/pub/pdf/other/accesstofinancesmallmediumsizedenterprises201606.en.pdf?c96d449e601cbe6c87d2e67d54e68c70>>.

SMEs prefer bank-based finance over non-bank finance.<sup>35</sup> Raising finance on capital markets is particularly unattractive for many SMEs: for example, because of the cost associated with raising capital, because the decision to raise capital on such markets has implications for the business's ownership/governance,<sup>36</sup> or because SMEs are unwilling to make their information public: say, because revealing such information could benefit competitors.<sup>37</sup> Admittedly, much effort is going into trying to lower cost and make a listing on a market, or for that matter, a public offer which is subject to prospectus regulation, more attractive to SMEs. However, given the amount of external finance that SMEs typically require for realising their growth ambitions, these efforts will only ever matter for a fraction of SMEs. Empirical data shows that in the EU most SMEs will aim to obtain external funding of less than 1,000,000 euros to achieve their growth ambitions, with the largest proportion of SMEs (almost one out of four) anticipating that their funding needs will be in the range of 25,000–100,000 euros.<sup>38</sup>

That said, there are other complicating factors which stand in the way of better matchmaking in the SME funding market. Specifically, widening funding options for SMEs presupposes that informational issues which are present in the SME funding market are addressed.<sup>39</sup> They hinder or complicate effective

35 SAFE (n 4) 108, reporting that '[d]ebt financing in the form of loans is much more popular than financing through equity investments. In 2016, 64% of EU28 SMEs indicates that they prefer bank loans to finance their future growth ambitions and another 16% reported loans from other sources. Equity investment is the preferred type for 6% of SMEs. These proportions vary relatively little over the survey years since 2011. Only other alternatives are less popular in 2016'.

36 International Organization of Securities Commissions, 'SME Financing Through Capital Markets' Final report, July 2015, 38 <<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD493.pdf>>.

37 Ibid; O Yosha, 'Information Disclosure Costs and the Choice of Financing Source' (1995) 4 *Journal of Financial Intermediation* 3.

38 SAFE (n 4) 114, which finds that 14% of SMEs look for funding of less than EUR25,000; 24% of SMEs look for funding of EUR25,000 to EUR100,000; 17% of SMEs look for funding of EUR100,000 to EUR250,000; 17% of SMEs look for funding of EUR250,000 to EUR1,000,000; and only 13% look for funding in the range over EUR1,000,000. A remaining 14% was reported as 'no answer/don't know'.

39 There is plenty of empirical research on the topic, both at domestic level and at European level. See eg, Commission (EC), 'Economic Analysis ... on Building a Capital Markets Union' SWD(2015) 183 final, September 2015, 43-45; Commission (EC), 'European Financial Stability and Integration' SWD(2015) 98 final, April 2015, 200-221; Competition & Markets Authority, 'Retail Banking Market Investigation' Final Report, 9 August 2016 <<https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6-c00007a/retail-banking-market-investigation-full-final-report.pdf>>. See also Breedon Review, 'Boosting Finance Options for Business' (2012) <<https://www.gov.uk/govern>

matchmaking between SMEs and finance providers; they might cause adverse selection.<sup>40</sup> Information issues can affect the funding demand side (SMEs) and the funding supply side (finance providers). On the funding supply side, the supply of information for assessing the creditworthiness of an SME has proved to be inadequate.<sup>41</sup> Information that is used for deciding on an SME's creditworthiness typically includes non-financial information (eg business details), but also crucially financial information. The latter commonly includes information found in a business' annual accounts, information about its credit history, information on its repayment capacity and payment performance: that is, its positive payment performance (i.e., information about payments that were made) and negative payment performance (i.e., information about payments that were missed).

However, informational problems are not just a funding supply side issue. They affect the demand side as well. SMEs are neither owned nor managed by omnipotent beings with perfect information and infinite computational capabilities. In the real world, many have issues navigating the SME funding market and are not sufficiently aware of the existence of the full range of available suppliers of external finance.<sup>42</sup> Many do not 'shop around' when seeking external finance;<sup>43</sup> indeed empirical research suggests that conveni-

ment/uploads/system/uploads/attachment\_data/file/32230/12-668-boosting-finance-options-for-business.pdf>; Business Finance Taskforce 'Supporting UK business' (October 2010) 42, <[https://www.betterbusinessfinance.co.uk/images/pdfs/Business\\_Finance\\_Taskforce\\_report.pdf](https://www.betterbusinessfinance.co.uk/images/pdfs/Business_Finance_Taskforce_report.pdf)>.

40 On adverse selection, see J Stiglitz and A Weiss, 'Credit Rationing in Markets with Imperfect Information' (1981) 71 *American Economic Review* 393. See also G Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 *Quarterly Journal of Economics* 488.

41 In the UK context, see HM Treasury, 'Competition in Banking: Improving Access to SME Credit Data' consultation, 15 December 2014 <<https://www.gov.uk/government/consultations/competition-in-banking-improving-access-to-sme-credit-data/competition-in-banking-improving-access-to-sme-credit-data>>. At EU level, see 'Economic Analysis ... on Building a Capital Markets Union' (n 39) 43-4.

42 Eg, AFME and the Boston Consulting Group, 'Bridging the Growth Gap: Investor Views on European and US Capital Markets and How they Drive Investment and Economic Growth' (2015) 30 <<http://www.afme.eu/en/reports/publications-and-data/publications/bridging-the-growth-gap>>; 'Economic Analysis ... on Building a Capital Markets Union' (n 39) 44. See also British Business Bank, 'Small Business Finance Markets 2014' <[http://british-business-bank.co.uk/wp-content/uploads/2014/12/BBB\\_Small-Business-Finance-Markets-2014\\_Online\\_Interactive.pdf](http://british-business-bank.co.uk/wp-content/uploads/2014/12/BBB_Small-Business-Finance-Markets-2014_Online_Interactive.pdf)> (finding an increase in awareness about alternative sources of finance, but noting that in comparison to bank finance, awareness is still lower).

43 Eg, 'Retail Banking Market Investigation' (n 39) xxv-xxvi; BMG Research and Department of Business, Innovation and Skills, 'Small and Medium-Sized Enterprise (SME)

ence, time and effort are important factors for explaining SMEs' funding choices.<sup>44</sup> Many SMEs lack the confidence to talk to alternative finance providers such as venture capitalists or equity financiers.<sup>45</sup> Especially micro- or small enterprises may not be sufficiently experienced or educated on matters such as corporate finance or on how to present themselves and their businesses to financiers,<sup>46</sup> which may affect the prospect of them reaching out to alternative providers of finance. Even if they do reach out, it may affect their prospect of securing finance. Finally, the number of potential funding choices might also work against SMEs by obscuring the best funding choice and making them less able to choose.<sup>47</sup>

Information barriers in the SME funding market are generally seen as working to the benefit of banks. Admittedly, there are noteworthy differences between banks in Europe. They differ in terms of their type (eg multinational/global commercial banks, savings banks, cooperative banks), their risk

Journey Towards Raising External Finance' October 2013, 1, <<http://british-business-bank.co.uk/wp-content/uploads/2013/10/SME-Journey-Towards-Raising-Finance.pdf>>.

- 44 Retail Banking Market Investigation' (n 39) 299; 'Small and Medium-Sized Enterprise (SME) Journey Towards Raising External Finance' (n 43) 1, noting that '[m]ost SMEs spend less than an hour considering their finance options and less than an hour filling in the application forms'.

- 45 SAFE (n 4) 105.

- 46 Eg Minutes of the CMU workshop on advisory support for SME access to finance (Brussels, 12–13 September 2016) <[http://ec.europa.eu/finance/events/2016/0912-workshop-advisory-support-sme/docs/160912-minutes\\_en.pdf](http://ec.europa.eu/finance/events/2016/0912-workshop-advisory-support-sme/docs/160912-minutes_en.pdf)> noting that '[r]esearch confirms a lack of awareness and understanding of alternative finance among entrepreneurs' and '... SMEs should be better prepared to dialogue with alternative lenders and investors – the difficulty to properly draft a business plan was repeatedly cited ...'. In the UK, see eg, Department for Business Innovation & Skills (Institute of Employment Studies), 'SME Lending and Competition: an International Comparison of Markets' BIS Research Paper No. 270, May 2016, 15 <[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/522490/bis-16-105-small-and-medium-sized-enterprise-lending.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/522490/bis-16-105-small-and-medium-sized-enterprise-lending.pdf)> noting that 'SMEs are, in the main, relatively unsophisticated in terms of their financial accounting and expertise, and this encourages a preference for basic banking and lending requirements'; Department for Business, Innovation & Skills, 'SME Access to External Finance' BIS Economics Paper no. 16, January 2012, 8, <[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/32263/12-539-sme-access-external-finance.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32263/12-539-sme-access-external-finance.pdf)>.

- 47 In the literature, see eg, R Thaler and C Sunstein, *Nudge – Improving Decisions About Health, Wealth and Happiness* (Penguin Books, London 2009) 83–4; C Sunstein, 'Behaviorally Informed Regulation, Part 1' in R Frantz, S-H Chen, K Dopfer, F Heukelom and S Mousavi (eds), *Routledge Handbook of Behavioral Economics*, (Routledge, Abingdon 2017) 199, 200–1.

appetite, their client focus, their approach to ratings, etc. However, at the risk of generalising, banks commonly have several advantages over other finance providers. At the outset, they have an infrastructure (a branch network) that facilitates access to SMEs. Often they also benefit from an ongoing relationship with SME customers. This relationship may produce information over time and across different banking services (loans, current accounts, credit card accounts, etc.).<sup>48</sup> The information helps banks to reduce information asymmetries. It might lead to efficiency gains. However, it might also lead to information monopolies which may 'lock in' customers and allow banks to extract informational rents from borrowers (e.g. higher interest rates).<sup>49</sup>

Hence, besides gaining information because of their lending business, banks will typically gain information by providing additional services such as current accounts. This additional information will add to their comparative advantage.<sup>50</sup> For example, by accessing current account data, a bank will be able to gain information on how an account performs and behaves over time:<sup>51</sup> for example, by monitoring movements of funds in and out of the account; by watching maximum/minimum account balances or overdraft limits (eg, whether and for how long overdraft limits are exceeded). This type of data can

48 A Boot, 'Relationship Banking: What do we Know?' (2000) 9 *Journal of Financial Intermediation* 7, 11; H Degryse, 'Relationship Lending within a Bank-Based System: Evidence from European Small Business Data' (2000) 9 *Journal of Financial Intermediation* 90, 93.

49 There is a large literature on the topic. Note that the theoretical and empirical literature offers mixed messages as to the benefits and costs of relationship banking. For representative contributions see eg, D Diamond, 'Financial Intermediation and Delegated Monitoring' (1984) 51 *Review of Economic Studies* 393; A Berger and G Udell, 'Relationship Lending and Lines of Credit in Small Firm Finance' (1995) 68 *Journal of Business* 351; 'Relationship Banking: What do we Know?' (n 48); R Rajan, 'Insiders and Outsiders: The Choice Between Informed and Arm's-Length Debt' (1992) 47 *Journal of Finance* 1367; M Petersen and R Rajan, 'The Benefits of Lending Relationships: Evidence from Small Business Data' (1994) 49 *Journal of Finance* 3; C Schenone, 'Lending Relationships and Information Rents: do Banks Exploit Their Information Advantage?' (2009) 23 *Review of Financial Studies* 1149; J Santos and A Winton, 'Bank Loans, Bonds and Information Monopolies across the Business Cycle' (2008) 63 *Journal of Finance* 1315; G Hale and J Santos, 'Do Banks Price Their Informational Monopoly' (2009) 93 *Journal of Financial Economics* 185; G López-Espinosa, S Mayordomo and A Moreno, 'When Does Relationship Lending Start to Pay?' (2016) *Journal of Financial Intermediation*, <<http://dx.doi.org/10.1016/j.jfi.2016.11.001>>.

50 'Relationship Banking: What do we Know?' (n 48); 'Relationship Lending within a Bank-Based System' (n 48).

51 Centre for Strategy & Evaluation Services, 'Evaluation of Market Practices and Policies on SME Rating: Final Report' 18–9 <<http://www.european-microfinance.org/docs/news/Study%20on%20SME%20rating%20and%20scoring.pdf>>.

be very valuable for assessing the creditworthiness of a business.<sup>52</sup> Often it offers the first signs of financial stress.<sup>53</sup> In case of smaller businesses, where publicly available information on the financial performance and the trading activities is missing, current account data can be especially valuable.<sup>54</sup>

Admittedly, there are differences in terms of the amount or type of information that banks collect (eg, raw quantitative data, qualitative data, soft data) and related thereto the investment, in terms of time and effort, which banks make for collecting and processing such information.<sup>55</sup> However, it is worth noting that most of what I will say below concerns only raw (or quantitative) data as opposed to soft data or qualitative data.<sup>56</sup> Raw data can be further broken down into ‘provided data’ and ‘observed data’. ‘Provided data’ is information that is provided by a customer, for example, when applying for a bank loan. It includes for example information about the amount of funding that an SME seeks or the type of finance facility that it requests. ‘Observed data’ is information that can be observed from the use which a customer makes of a bank service (eg, balance movements in an online current account or credit card account). Raw data can be distinguished from ‘inferred data’ such as internal credit scores. Inferred data is data which a bank creates by using information relating to its customers (quantitative data, qualitative data), but which involves further analysis and processing by a bank.<sup>57</sup>

52 See in this context, ‘Competition in Banking’ (n 41) noting that ‘SME current account data is the most valuable source of data in assessing the creditworthiness of an SME’.

53 Bank of England, ‘Should the Availability of UK Credit Data be Improved’ Discussion paper, May 2014, 13 <<http://www.bankofengland.co.uk/publications/Documents/news/2014/dp300514.pdf>>.

54 ‘Retail Banking Market Investigation’ (n 39) 401. See also ‘When Does Relationship Lending Start to Pay?’ (n 49) 3 noting that SMEs ‘tend to generate much less public information, they have lower quality financial statements, and they are often not audited nor studied by professional analysts’.

55 For details, see ‘Evaluation of Market Practices and Policies on SME Rating’ (n 51).

56 See *ibid* 16–21, for details on the distinction between quantitative and qualitative data.

57 I am loosely adapting distinctions that were drawn elsewhere. See Article 29 Data Protection Working Party, ‘Guidelines on the Right to Data Portability’, 16/EN WP 242, 8 <[http://ec.europa.eu/information\\_society/newsroom/image/document/2016-51/wp242\\_en\\_40852.pdf](http://ec.europa.eu/information_society/newsroom/image/document/2016-51/wp242_en_40852.pdf)>; OECD, ‘Working Party on Security and Privacy in the Digital Economy, Protecting Privacy in a Data-Driven Economy: Taking Stock of Current Thinking’ DSTI/ICCP/REG(2014)3, May 2014, 5 <<http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=dsti/iccp/reg%282014%293&doclanguage=en>>.

*b. Designing a strategy for addressing information barriers in the SME funding market*

A major question for an SME funding strategy that has as an objective to diversify sources of funding and widen access to finance is how to improve the flow of information in the SME funding market. In a capital markets context, information asymmetries are typically addressed by way of disclosure regulation. However, as noted above, only a fraction of SMEs will be interested in raising finance on capital markets and many SMEs will be unable or unwilling to incur the cost associated with prospectus or ongoing disclosure duties. One complicating factor is that outside the capital markets/IPO context, there is less agreement among Member States on the paradigms, rules or institutions that are needed to address information barriers. Hereinafter, I will focus on information sharing as a mechanism for improving the availability of SME information. My aim is to identify and discuss key aspects of an information sharing strategy that helps to mitigate informational issues which affect SMEs and finance providers. By information, I mean mainly raw (or quantitative) data. Insights can be drawn from a variety of sources including empirical findings and national initiatives.

*i. Public sector versus market driven approaches to sharing SME information*

As noted, there is no single approach to sharing SME information at Member State level. Information such as credit data can for example be shared through credit registers that are maintained by public authorities such as central banks or financial supervisors.<sup>58</sup> However information sharing can also take place by establishing privately owned credit bureaus or credit reference agencies.<sup>59</sup> At least some of the differences at Member State level appear to reflect cultural or historical preferences. In France, for instance, credit data is available through the *Banque de France*. It maintains a central credit registry which collects data on business loans above a certain threshold, allowing lenders who have access to the registry to make more informed lending decisions.<sup>60</sup> On the other hand, jurisdictions such as the UK are at the forefront of a market driven approach to disseminating SME information. Private sector credit reference agencies (pri-

58 'Should the Availability of UK Credit Data be Improved' (n 53) 5.

59 Note that public and private initiatives are not necessarily compatible: for example, because of 'crowding out' effects. See T Jappelli and M Pagano, 'Information Sharing in Credit Markets: a Survey' Centre for Studies in Economics and Finance, Working Paper no. 36, March 2000, 17 <<http://www.csef.it/WP/wp36.pdf>>.

60 Note that the *Banque de France* also produces ratings of businesses' creditworthiness. See 'Should the Availability of UK Credit Data be Improved' (n 53) 37.

vate credit bureaus) have long been in place in the UK. They collect financial and non-financial information from various sources and use this data to offer analytical or information services to their clients.<sup>61</sup> Credit reference agencies are however not the only actors in the market for SME information in the UK. The UK legislature recently adopted the Small Business, Enterprise and Employment Act 2015 (SBEE Act) which makes provision for the establishment of private sector ‘finance platforms’.<sup>62</sup> The role of these platforms is to bring finance providers and SMEs together. To facilitate this matchmaking process, finance platforms receive specified information about the funding needs of SMEs from designated banks. The latter will share this information in case where an SME’s finance application with a (designated) bank proved unsuccessful<sup>63</sup> and the (unsuccessful) application related to a loan, an overdraft, a credit card, an invoice discounting or factoring agreement, a hire purchase or finance leasing agreement.<sup>64</sup> The information which a finance platform receives relates *inter alia* to the amount and type of funding sought, the length for which the SME has been operating and receiving income, information regarding contact details, legal structure and the funding timetable.<sup>65</sup> Finance platforms are designated by the UK government. Currently all of them are part of the Fintech sector. They are online platforms; they are essentially comparison sites.<sup>66</sup>

Finance platforms are expected to become key players in the market for SME information. They change the dynamic between borrower and funder. Once information is referred to finance platforms, SMEs are essentially put in a reactive mode: while they remain in control of the process via consent requirements,<sup>67</sup> the initiative rests with the finance platform and its panel of lenders.<sup>68</sup> SMEs are no longer required to actively search for finance alter-

61 Ibid 12.

62 SBEE Act, s. 5. See also the Small and Medium Sized Business (Finance Platforms) Regulations 2015 [SI 2015/1946].

63 Note that ‘unsuccessful’ is a defined term. For details, see text to notes 101–103.

64 The Small and Medium Sized Business (Finance Platforms) Regulations 2015, reg 2(1). The relevant agreement must be denominated in sterling.

65 Schedule of The Small and Medium Sized Business (Finance Platforms) Regulations 2015.

66 Three platforms have been designated so far: <<https://www.fundingxchange.co.uk>>; <<https://www.fundingoptions.com>>; <<https://www.businessfinancecompared.com>>.

67 The SME’s consent is required at the stage where a bank offers a referral to its customers. It is also required where a finance provider, which is a member of the finance platform’s lending panel, requests access to the SME’s identifying information.

68 This is not to say that SMEs might not be asked to provide additional information on top of the information specified in the regulations. Presumably such information can be collected through the platform’s online portal.

natives. Instead, finance providers search for funding opportunities via finance platforms. Hence finance platforms provide *prima facie* a way to address or to mitigate issues which I highlighted above and which affect the funding demand side: for example, a lack experience in navigating the SME funding market or in approaching alternative finance providers; or simply an unwillingness on the part of SMEs to invest time and effort in researching finance options.

The provisions on finance platforms are supposed to work in tandem with a second measure that was adopted in the SBEE Act. Section 4 of the Act seeks to address information asymmetries in the SME funding market by improving access to credit information which is shared through credit reference agencies. Thus, under section 4, designated credit rating agencies will receive SME credit information from designated banks.<sup>69</sup> The information in question relates to loans made to the business, as well as data relating to credit card accounts or current accounts held in the name of the business.<sup>70</sup> Under the scheme, designated credit reference agencies will pass on this information to finance providers, provided the latter meet certain requirements.<sup>71</sup> As in the case of finance platforms, information sharing is subject to the consent of the SME to which the information pertains.<sup>72</sup>

The UK's preference for a market driven approach to information sharing is also apparent in the case of the UK Competition and Markets Authority (CMA). As part of its retail banking market investigation, it concluded that informational advantages of incumbent banks in the UK had contributed to affect competition in the SME funding market.<sup>73</sup> In response, the CMA adopted a series of measures. These include a requirement made to the largest retail banks to adopt an *open API* banking standard. APIs (Application Programming Interfaces) are standards which make it possible for software components to interact with each other and to share data.<sup>74</sup> An open API banking

69 For details, see the Small and Medium Sized Business (Credit Information) Regulations 2015 [SI 2015/1945].

70 For details on the information that must be referred, see the schedule of the Small and Medium Sized Business (Credit Information) Regulations 2015.

71 For details, see Small and Medium Sized Business (Credit Information) Regulations 2015, reg 6. See also text to notes 90–91 below.

72 The Small and Medium Sized Business (Credit Information) Regulations 2015, reg 3(2), reg 5 and reg 6(1)(b).

73 For a summary, see 'Retail Banking Market Investigation' (n 39) xix–xxxiv.

74 Open Data Institute and Fingleton Associates, 'Data Sharing and Open Data for Banks: a Report for HM Treasury and Cabinet Office' September 2014 16, <[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/382273/141202\\_API\\_Report\\_FINAL.PDF](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382273/141202_API_Report_FINAL.PDF)>.

standard is expected to advance technological change in the banking sector and crucially to make it easier for bank customers to share account information such as their transaction history with third parties who they trust.<sup>75</sup> According to the CMA, it will offer customers greater control of their banking arrangements; it will facilitate competition and offer a stimulus to private sector innovation. Moreover, the CMA's set of measures also includes a requirement made to banks to support Nesta. The latter is an independent charity which is launching a 'challenge prize' in order to identify, through a competitive process, new solutions that will help SMEs to improve access to information on banking services.<sup>76</sup> Here too, it is apparent that the CMA wishes to promote innovation and market driven solutions to information problems.

## *ii. Mandatory versus voluntary information sharing*

Closely related to the above issues is the question of whether information sharing should be voluntary or whether it should be mandatory. At the outset, it is worth noting that information duties can be placed on several different actors. *Prima facie*, an obvious starting point is to rely on SMEs to improve information asymmetries by voluntarily disclosing information. For example, in a world without disclosure regulation, SMEs that wished to raise capital on public markets could simply of their own volition make information about their business, their financial situation, etc. public and thus signal to markets that they are worth financing.<sup>77</sup> Likewise SMEs might simply of their own volition supply credit information to alternative finance providers.

Of course, however, all is not that simple in the real world. For one thing, if information is provided voluntarily by an SME, it may still be difficult to use such information if it is not independently verified. More generally, an SME is unlikely to have the right incentives to disclose all the relevant information about its business or its financial situation.<sup>78</sup> Mandatory reporting require-

75 'Retail Banking Market Investigation' (n 39) xxxvii–xxxviii.

76 *Ibid* xlv.

77 M Fox, 'Regulating Public Offerings of Truly New Securities: First Principles' (2016) 66 *Duke Law Journal* 673, 687.

78 In a credit market context, see eg, A Karapetyan and B Stacescu, 'Information Sharing and Information Acquisition in Credit Markets' (2014) 18 *Review of Finance* 1583, 1588 (noting that a business is unlikely to disclose negative information). Note that the issue of mandatory versus voluntary disclosure has a long history in the securities disclosure field. Among common arguments in favour of mandatory disclosure is that businesses may be unwilling to voluntarily disclose certain information: for example, information which could benefit their competitors (see eg, 'Truly New Securities' (n 77) 687; M Fox, 'The issuer choice debate' (2001) 2 *Theoretical Inquiries in Law* 563, 570).

ments help to mitigate this type of issue. However, increasing reporting requirements has a cost and this point has special resonance in an SME context. This is because SMEs tend to be particularly sensitive to increases in regulatory burden. Indeed, empirical surveys suggests that regulation is among the more pressing issues for SMEs – in fact, a more pressing issue than access to finance in recent surveys.<sup>79</sup> Unsurprisingly, there is a reluctance in policy circles to add to the regulatory burden of SMEs. SMEs' greater sensitivity to regulatory burden is also acknowledged in initiatives such as the 'Think Small First' principle whose ambition is (inter alia) to keep the regulatory burden imposed on SMEs in check.<sup>80</sup>

Admittedly, there are other ways to address information barriers in the SME funding market. One way is to turn to those that hold and collect information about SMEs. Banks might for example voluntarily share credit information about their SME customers. This voluntary sharing might take place via private sector credit bureaus or, as in the UK, through private sector credit reference agencies. There is a rich literature in finance and economics on information sharing via credit bureaus. This literature seeks to elucidate the causes and effects of information sharing via credit bureaus – either theoretically (and at times in a highly stylized form) or empirically. It suggests, inter alia, that information sharing through credit bureaus contributes to reducing adverse selection by helping lenders to identify good from bad borrowers.<sup>81</sup> It might discipline borrowers who fear the negative consequences of a lender sharing bad news (ie, borrower default information) with other lenders.<sup>82</sup> It might also reduce borrowers' incentives to borrow excessively from multiple lenders.<sup>83</sup>

Hence the literature associates several benefits with voluntary information sharing arrangements. But it also reports complications and possible drawbacks. For one thing, information sharing can make lenders vulnerable to greater competition if it eliminates their information advantages. Hence, in competitive markets, lenders may be less likely to share information.<sup>84</sup> How-

79 SAFE (n 4) 134-5.

80 'Think Small First' (n 31). See also Interinstitutional agreement between the European Parliament, the Council of the European Union and the European Commission on Better Law-Making [2016] L123/4 (highlighting the need for impact assessments to have 'particular regard to SMEs').

81 'Information Sharing in Credit Markets: a Survey' (n 59) 10–11; M Pagano and T Japelli, 'Information Sharing in Credit Markets' (1993) 48 *Journal of Finance* 1693.

82 'Information Sharing in Credit Markets: a Survey' (n 59) 11.

83 Ibid 12–13. A Bennardo, M Pagano and S Piccolo, 'Multiple Banking Lending, Credit Rights, and Information Sharing' (2015) 19 *Review of Finance* 519.

ever, it has also been suggested that voluntary information sharing via credit bureaus may stymie competition if it can be used ‘as a collective tool’ by incumbents to prevent challengers to enter the market, leaving the latter at a ‘strong informational disadvantage’.<sup>85</sup> In the UK, the government appears to have drawn somewhat similar conclusions. As noted earlier, the sharing of credit information is organized around credit reference agencies in the UK. However, important SME credit information was only shared in closed user groups on a like-for-like basis. Thus, a company which shares credit performance information would only be entitled to ‘information of the same level that they contribute ...’.<sup>86</sup> The benefits of these arrangements came under scrutiny in a number of high-level reviews, notably because they allowed closed user groups which are organized around specific products – eg, business current accounts – to refuse to share data with market entrants that are not able – as opposed to unwilling – to supply like-for-like information.<sup>87</sup> The government decided to take action, considering that the lack of access to credit information constituted a barrier to entry into the market for SME funding.<sup>88</sup> Section 4 of the SBEE Act was introduced and the Small and Medium Sized Business (Credit Information) Regulations 2015, which flesh out the requirements of section 4, were subsequently adopted. I presented the provisions above. Suffices to add that under these provisions designated banks must (subject to an SME customer’s approval) refer specified credit information about an SME customer to designated credit reference agencies.<sup>89</sup> The latter are in turn by law required to share this information with finance providers who meet a number of requirements. Among these requirements is that the SME has consented to the information being shared; that the finance provider agrees to the standard terms of the credit reference agency; and that it uses the information only for the purposes specified in the regulations.<sup>90</sup> Importantly the finance provider must agree reciprocally to share ‘all credit information’ that it holds about its – consenting – SME customers with the credit reference

84 M Brown and C Zehnder, ‘The emergence of information sharing in credit markets’ (2010) 19 *Journal of Financial Intermediation* 255; ‘Information Sharing in Credit Markets (1993)’ (n 81).

85 ‘Information Sharing in Credit Markets: a Survey’ (n 59) 19.

86 ‘Should the Availability of UK Credit Data be Improved’ (n 53) 12, noting further that ‘if a lender only contributes negative credit information (ie that pertaining to defaults or other adverse credit events) they will only be able to access negative credit information from the [credit reference agency].’

87 Ibid 12. For details, see also ‘Competition in Banking’ (n 41).

88 ‘Competition in Banking’ (n 41).

89 The Small and Medium Sized Business (Credit Information) Regulations 2015, reg 3.

90 Reg 6.

agency.<sup>91</sup> However, the regulations do not require like-for-like sharing. Hence, over time, credit reference agencies will be fed information by a variety of actors. Designated banks will be able to benefit from this as well.

Another nail in the coffin of voluntary information sharing in the UK are the CMA's measures on retail banking. Recall that the CMA's measures require the largest retail banks to adopt an open API banking standard. The aim is to put customers in a position where they can seamlessly share account information with other finance providers. Except for the bank customer's consent, very little manual input will presumably be required from a customer to share account data with third party applications.

That said, information barriers are not just affecting the supply side. They affect SMEs as well. Recall in this context that section 5 of the SBEE Act makes provision for the establishment of finance platforms. Recall also that these platforms are fed information about the funding needs of SMEs by designated banks. The basic mechanism which underpins this information sharing process is a mandatory referral obligation. In essence, a designated bank is by law required to share information about an SME customer's funding needs where it declines to offer funding to its customer and the latter consents to its information being shared. The adoption of these arrangements followed attempts by banks to self-regulate. Thus, in 2010, a number of high street banks committed to a set of measures aimed at SME customers that had failed to secure funding with them. These commitments were set out in a taskforce report which concluded that:

'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. ... 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. ...'.<sup>92</sup>

However, these commitments failed to deliver sufficiently meaningful results.<sup>93</sup> It is plain that banks had few incentives to facilitate a process of financial diversification for SME customers. Ultimately, this experience only strengthened the authorities' case for enacting a mandatory referral scheme.

91 Ibid. However, information sharing will not be required for information that relates to the period prior to the time where a credit reference agency first provided credit information to the finance provider (reg 6(1)(e)(ii))

92 Report of the Business Finance Taskforce, 'Supporting UK business' October 2010, 42 <[https://www.betterbusinessfinance.co.uk/images/pdfs/Business\\_Finance\\_Taskforce\\_report.pdf](https://www.betterbusinessfinance.co.uk/images/pdfs/Business_Finance_Taskforce_report.pdf)>.

93 For details, see 'Capital Markets Union and Small and Medium-sized Enterprises' (n 3).

Hence, the UK is clearly vigorously pursuing initiatives that require banks to share information. These arrangements are quasi-mandatory: banks are subject to information sharing duties, but information sharing remains subject to the agreement of the bank's customer. Unlike other countries where mandatory information sharing typically takes place via credit registries which are maintained by public authorities, the above measures differ in two important respects: first, the information that is shared extends to information about the funding needs of SMEs; second, information is shared, subject to an SME's consent, via private actors: credit reference agencies or finance platforms.

Admittedly, mandatory information sharing can raise issues too. Jappelli and Pagano for example, suggest that mandatory information sharing may 'kill relationship lending'.<sup>94</sup> According to the authors, this is because mandatory sharing may discourage banks to invest in screening and monitoring activities, which are central to relationship banking, if others can free ride on their efforts.<sup>95</sup> They note that mandatory sharing is unlike voluntary information sharing where banks can decide to only share some of their information or simply not share at all.<sup>96</sup> On the other hand however, Karapetyan and Stacescu suggest that when hard information is shared, banks' incentives to invest in the acquisition of soft information that cannot be communicated reliably (eg, information such as whether a manager is honest or hard working), will increase.<sup>97</sup> Thus, they note that incumbents 'overall knowledge' of their borrowers may increase under information sharing arrangements and that such arrangements may in fact result in deeper relationships 'with likely positive welfare effects'.<sup>98</sup>

94 'Information Sharing in Credit Markets: a Survey' (n 59) 15.

95 Ibid.

96 Ibid.

97 'Information Sharing and Information Acquisition in Credit Markets' (n 78). When describing soft information, the authors refer to M Peterson, 'Information: Hard and Soft' (draft paper, July 2004), 3 <<http://www.kellogg.northwestern.edu/faculty/petersen/htm/papers/softhard.pdf>> who notes that banks 'collect information which is neither initially available in hard numbers (the ability of the manager, their honesty, the way they react under pressure), nor are they easily or accurately reducible to a numerical score'. On soft information, see also J Stein, 'Information Production and Capital Allocation: Decentralized versus Hierarchical Firms' (2002) 57 *Journal of Finance* 1891.

98 'Information Sharing and Information Acquisition in Credit Markets' (n 78) 1584. Note that the authors examine information sharing through credit bureaus which is typically voluntary. However, they also focus on information sharing via credit registers which is generally mandatory. The debate on the impact of information sharing on relationship banking overlaps with the debate on the effects of competition for relationship banking. The literature offers mixed messages, but see eg R Gropp, C Gruendl and A Guettler, 'Hidden Gems and Borrowers with Dirty Little Secrets: Investment in Soft Information, Borrower Self-Selection and Competition' (ECB Working Paper Series No 555, June

Hence, the literature offers contrasting conclusions. At any rate, in the case of the UK, it is plain that concerns about possible negative effects did not prevent efforts to increase bank information sharing requirements. The policy objectives – especially improving competition and access to finance for SMEs – outweighed any potential concern about the effects of information sharing on the banking sector. That is not to say that the UK's new information sharing arrangements are limitless. As far as credit information is concerned, it is apparent that only certain types of raw data must be shared.<sup>99</sup> There is for example no requirement to share inferred data such as credit scores. Moreover, the arrangements only target the largest banks in the UK.<sup>100</sup> The mandatory referral obligation, which attempts to remedy informational issues affecting SMEs, has also been calibrated to only apply to the largest banks and only where an SME customer's application for bank finance is 'unsuccessful'. This will be the case where a designated bank simply decides to reject a customer's finance application. It also covers the situation where the bank offers its customer a finance facility 'on a different basis', which its customer goes on to reject for reasons which do *not* concern the fees or interests that the bank wishes to charge.<sup>101</sup> In other words, the mandatory referral obligation will not apply if a customer rejects a finance offer because of pricing reasons (i.e., fees or interest rate).<sup>102</sup> Hence, this policy measure does not target customers who seek access to finance at a lower cost. However, it will apply to SMEs that are potentially fundable, but whose application is rejected by a bank because, say,

2013) <<https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1555.pdf?41ef35b1eba6623c695928ae86bca3d5>> suggesting that relationship banks tend to augment their investment in collecting soft information, in contrast to transaction banks which reduce it.

99 For details, see text to note 70 above.

100 Recall that the credit information sharing arrangements of the SBEE Act only apply to designated banks. See HM Treasury, 'Notice of designation: Small and Medium Sized Business (Credit Information) Regulations 2015' <[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/512982/Designated\\_CRA.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/512982/Designated_CRA.pdf)> designating AIB Group (UK) Plc, Bank of Ireland (UK) Plc, Barclays Bank Plc, Clydesdale Bank Plc, Northern Bank Ltd, HSBC Bank Plc, Lloyds Banking Group Plc, Royal Bank of Scotland Group Plc and Santander UK Plc. Likewise, the CMA's open API requirement, which is supposed to make the sharing of account information seamless, also only applies to a portion of banks. See 'Retail Banking Market Investigation' (n 39) xxxvii, referring to Royal Bank of Scotland Group Plc, Lloyds Banking Group Plc, Barclays Bank Plc, HSBC Bank Plc, Santander UK Plc, Nationwide Wide Building Society, Danske Bank, Bank of Ireland (UK) Plc, AIB Group (UK) Plc.

101 The Small and Medium Sized Business (Finance Platforms) Regulations 2015, reg 2(3) (b).

102 Arguably, this may also offer banks a way to evade their obligation to refer an SME customer. Instead of simply rejecting an application, a bank might thus decide to offer a finance facility at an interest rate which it anticipates a customer will reject.

it does not fit its risk appetite. The mandatory referral scheme offers these SMEs the prospect of finding finance for projects that might otherwise have been lost. As far as designated banks are concerned, it has been suggested that they might also stand to benefit from referral duties: since it is not uncommon for banks to offer SMEs a range of services (eg, current accounts), the relationship between a designated bank and an SME will not necessarily be cut off following a successful referral. If an SME is able to grow as a result of successful investments, it may well return to its bank at a future date in order to seek funding at a lower cost there.<sup>103</sup> Designated banks may of course also decide to join a platform if it is in their commercial interest to do so.

It remains to be seen how effective the UK arrangements will prove to be, whether they will meet their objectives and what impact they will have on the banking sector. For the present purposes, suffices to note that there are ways to calibrate information sharing duties and that calibration is *prima facie* the way forward for dealing with any possible concerns over such duties.<sup>104</sup>

### *iii. Advice and Education*

How best to support SMEs through advice and education is another key consideration for designing a strategy that addresses information barriers. Education and advice has several dimensions. On the one hand, it is education and advice to improve the odds of an SME finding funding ('business support'). However, as information sharing becomes increasingly seamless (eg, through open API functionality), education and advice is increasingly also about addressing security and confidentiality risks ('business awareness').<sup>105</sup>

103 Finance platforms have noted that alternative finance providers are unlikely to be able to compete with banks on pricing. See Funding Options, 'CMA Retail Banking Market Investigation: Working Paper on SME Comparison Sites', 21 March 2016 <[https://assets.publishing.service.gov.uk/media/56f3b5b1ed915d117d000023/Funding\\_Options\\_resp\\_to\\_role\\_of\\_PCWs\\_WP.pdf](https://assets.publishing.service.gov.uk/media/56f3b5b1ed915d117d000023/Funding_Options_resp_to_role_of_PCWs_WP.pdf)>.

104 See also Jappelli and Pagano ('Information Sharing in Credit Markets: a Survey' (n 59) 15) who suggest that calibration through access fees may be the way forward. However, they also note that if calibration is not feasible, 'forced communication between lenders can reduce their information production'.

105 See in this context, Open Banking Working Group, 'The Open Banking Standard: Unlocking the Potential of Open Banking to Improve Competition, Efficiency and Stimulate Innovation' (undated), para 4.3. <<https://theodi.org/open-banking-standard>>.

Consent requirements have an important role to play in addressing confidentiality issues.<sup>106</sup> However, relying on the consent of a person or a business to legitimize information sharing is not always the answer: for example, because a financial transaction history includes data pertaining to third parties (so-called ‘silent parties’) who will not have given their consent to information sharing.<sup>107</sup> Finding solutions to these issues requires careful consideration of the enabling or constraining effects of the law.<sup>108</sup> Practical steps might need to be taken. For example, one solution, which has been tried out in the UK in relation to silent parties is to redact the ‘transaction description’ field in financial transaction records.<sup>109</sup> It might also be possible to address concerns by only sharing key measures of account performance (minimum balance, maximum balance, average balance, etc.).

In delivering business support and business awareness, both the public sector and the private sector have *prima facie* a role to play. As far as business awareness is concerned, the Open Banking Working Group, a group of industry experts who were put in charge of developing a framework for an open API banking standard in the UK, concluded that the responsibility should be shared between several actors: banks, the FinTech sector, consumers, business groups and the public sector.<sup>110</sup> As far as business support is concerned, various national schemes appear to co-exist. I have queried elsewhere whether this diversity is necessarily beneficial.<sup>111</sup> Indeed, besides national schemes, the EU also seeks to play a role in this field through the Enterprise Europe Network (EEN). The latter operates at national level through its member organisations.<sup>112</sup> However, the EU has also tried to contribute to business support in other ways: for example, by adopting

106 Note that data protection legislation does commonly not apply to legal persons. See also note 156 below. However, consent requirements can have another origin: for example, legislation such as the SBEE Act.

107 ‘The Open Banking Standard’ (n 105) para 8.4.3.3.

108 Data protection legislation might be relevant to consider in this context if the data subject is an individual who benefits from the protection of this legislation. Under art 6 of the General Data Protection Regulation (GDPR) (Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) OJ [2016] L119/1), consent is not the only ground that makes processing of personal data lawful. Note that the GDPR does not yet apply at Member State level.

109 This approach has been tried out in the context of the Midata initiative which was targeted at consumers. See ‘The Open Banking Standard’ (n 105) para 8.4.3.3.

110 ‘The Open Banking Standard’ (n 105) para 4.3.1.

111 ‘Capital Markets Union and Small and Medium-sized Enterprises’ (n 3) 168.

112 On the EEN’s functions, see art 10 of Regulation (EU) No 287/2013 of the European Parliament and of the Council of 11 December 2013 establishing a Programme for the

Article 431(4) of the Capital Requirements Regulation (CRR).<sup>113</sup> The latter is a feedback provision. It requires banks, ‘if requested, [to] explain their rating decisions to SMEs and other corporate applicants for loans ...’. Prima facie, it is a useful educational measure. It replaced former Article 145(4) of the Capital Requirements Directive which equally required banks to provide feedback if requested.<sup>114</sup>

## 2. *Information issues in the SME funding market: the Commission Approach*

At this stage, it seems useful to summarise some of the findings so far. I began this section by highlighting key issues affecting the SME funding market and which complicate matchmaking between SMEs and finance providers. Specifically, I identified informational issues on both the funding supply side and the funding demand side. Next, I discussed several key considerations for the design of a strategy aimed at addressing these barriers: the role of the public sector versus the role of the market; mandatory versus voluntary information sharing; and the importance of education, as a means to provide business support but also ensure business awareness. The aim of this part is to use these insights to consider the Commission’s approach to overcoming information barriers. Recall that ‘[o]vercom[ing] information barriers to SME investment’,<sup>115</sup> is among the areas which the Commission’s CMU action plan singles out. I will begin by considering the Commission Green Paper, after which I will turn to the White Paper.

### a. *The Commission Green Paper*

The CMU Green Paper was the Commission’s first step in defining a market building agenda for a CMU.<sup>116</sup> As a green paper, it was followed by a consulta-

Competitiveness of Enterprises and small and medium-sized enterprises (COSME) (2014–2020) and repealing Decision No 639/2006/EC [2013] OJ L347/33.

113 Regulation (EU) No 75/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 48/2012 [2013] OJ L176/1.

114 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions [2006] OJ L177/1 (repealed).

115 Action Plan (n 1) 29.

116 On the green paper, see P Schammo, ‘Commission Consultation on a Capital Markets Union’, submission to the Commission consultation, 13 May 2015 <<https://ec.europa>.

tion and subsequently by a white paper which set out the Commission's action plan for building a CMU. The Green Paper identified a wide range of issues and areas for possible action. In particular, it identified information issues on the funding demand and funding supply side. Informational issues on the supply side were identified as a priority area for early action. Thus, the Commission noted that:

'[t]ypically, information on SMEs is limited and usually held by banks ... Improving credit information would help build an efficient and sustainable capital market for SMEs'.<sup>117</sup>

Regarding information issues that affect the funding demand side, the Green Paper touched on several problems, including on the question of financial reporting standards for SMEs.<sup>118</sup> However, it also addressed the role of banks in offering feedback to SME customers or in advising them on possible alternative funding options:

'[b]anks could be encouraged to provide better feedback to SMEs whose credit applications are declined and to raise awareness about alternative financing opportunities for SMEs whose credit was declined'.<sup>119</sup>

The Green Paper represented the Commission's 'early thinking' on a CMU and as a green paper, its suggestions were merely indications of a possible future agenda. Nevertheless, the Commission's suggestions had a number of noteworthy features. In particular, the Commission's suggestions on improving bank feedback and on helping SMEs to identify alternative sources of funding were couched in the language of self-regulation. The Green Paper showed little awareness of the likely conflict of interests which banks face when asked to support a process of financial diversification. It was also noteworthy that the Green Paper made no mention of Article 431(4) CRR. As we saw earlier, this provision requires banks, if requested, to explain their rating decisions for loans. Finally, the Green Paper did also not refer to the Enterprise Europe Network (EEN). Recall that the EEN is part of the EU's business support strategy.

eu/eusurvey/publication/capital-markets-union-2015>; 'Capital Markets Union and Small and Medium-sized Enterprises' (n 3).

117 Commission (EC), 'Green Paper: Building a Capital Markets Union' COM(2015) 63 final, 10.

118 Ibid 14.

119 Ibid.

*b. The Commission White Paper*

The White Paper which followed the Green Paper was informed by a consultation process which saw considerable interest.<sup>120</sup> Unsurprisingly, the White Paper was better informed. The EEN was mentioned and Art 431(4) CRR was referenced.<sup>121</sup> The Commission White Paper also recognized the need for a ‘comprehensive strategy’ to deal with information barriers in the SME funding market.<sup>122</sup> Specifically, the White Paper identified three pillars for an SME strategy: better bank feedback; support and advice for SMEs; and better access to information/improved matchmaking.<sup>123</sup>

However, the Commission appeared to continue to favour self-regulation and best practice on various aspects of this strategy. For example, on the provision of bank feedback on rejected credit applications, the Commission noted in its first status report on the CMU White Paper that:

‘[t]he Commission Services have asked leading European banking associations to look at ways to strengthen banks’ feedback to SMEs applying for credit by promoting best practices recently developed in some Member States across the EU’.<sup>124</sup>

Article 431(4) CRR, which requires banks, if requested, to explain their rating decisions for loans, was not given much attention. Although the White Paper referred to the provision (albeit in a footnote), the Commission stayed clear of suggesting that more effective monitoring and enforcement of the application of Article 431(4) CRR (former Article 145(4) CRD) was in order. This is so even though the implementation of the provision appeared in most cases to have been unsuccessful.<sup>125</sup>

120 For details, see <[http://ec.europa.eu/finance/consultations/2015/capital-markets-union/index\\_en.htm](http://ec.europa.eu/finance/consultations/2015/capital-markets-union/index_en.htm)>.

121 Action Plan (n 1) 9–10.

122 Highlighting the need for a comprehensive strategy, see my submission to the Commission consultation (‘Commission Consultation on a Capital Markets Union’ (n 116) 7–8).

123 Action Plan (n 1) 10.

124 Commission (EC), ‘Capital Markets Union: First Status Report’ SWD(2016) 147 final, April 2016, 6. It is not the first time that the Commission sought to address the issue by relying on self-regulation: see Commission (EC), ‘Communication on Long-Term Financing of the European Economy’ COM(2014) 168 final, March 2014, 12, noting that ‘[t]he Commission services will revive the dialogue between banks and SMEs with the aim of improving financial literacy of SMEs, particularly with regards to feedback provided by banks on loan applications. The Commission services will also assess best practices on helping SMEs to access capital markets’.

125 ‘Evaluation of Market Practices and Policies on SME Rating’ (n 51) 48.

On advice and support for SMEs, the preference for supporting best practice is apparent as well. Thus, the Commission committed in its White Paper to ‘map existing local or national support and advisory capacities across the EU in order to promote best practices...’.<sup>126</sup> On better access to information/improved matchmaking, the Commission suggested to investigate the possible establishment of ‘pan-European information systems’ whose purpose would be to connect existing national systems. Here too, the Commission seemed to prefer encouraging best practice. In its first status report, it thus noted that:

‘[t]he Commission Services will also support the development of information systems to help small businesses to navigate new funding opportunities more effectively. The intention is to promote best practices in delivering relevant information to firms which could benefit from alternative funding sources and seek to build pathways between the most successful national or regional support platforms’.<sup>127</sup>

It is also noteworthy that the White Paper no longer prioritized action on SME credit information; recall that the latter was among the suggested areas for early action in the Green Paper. In the White Paper, suggestions on facilitating access to credit information were made together with the Commission’s proposal on pan-European information systems. Specifically, the White Paper suggested that a pan-European system could enable SMEs to share credit information with investors at EU level on a voluntary basis, provided that there was ‘sufficient comparability of key data’.<sup>128</sup> However, few details were given about the so-called pan-European information systems. Nor were there any details in the White Paper on how SMEs would disseminate information via pan-EU platforms.

By concentrating on the need to promote best practice, the Commission appears to have answered some of the tougher and controversial questions in the negative: in particular, whether a bank should be required (as opposed to encouraged) to take a more active role in helping an SME customer to identify alternative sources of funding in case where it rejects its customer’s application.

In summary, it appears that the CMU strategy on overcoming information barriers is mostly a soft strategy which aims to support Member State actions and to encourage the banking sector as well as industry/business organisations to find solutions. Time will tell whether this strategy will make a difference. However, it does not appear to meaningfully depart from the status quo. Nor does this strategy recognize the conflict of interests which banks will naturally face when asked to support a process of financial diversification that is supposed to benefit their SME customers.

126 Action Plan (n 1) 10.

127 ‘First Status Report’ (n 124) 6.

128 Action Plan (n 1) 10.

#### *IV. CMU market building in the SME funding market: a paradigm shift*

At the time of writing, the Commission's thinking on how to address information barriers in the SME funding market still appears to be somewhat in flux. The aim of this final section is to make a number of recommendations on how the Commission's strategy could develop. In short, I will argue in favour of a paradigm shift which is based on three pillars: first, a greater emphasis on market building measures (1); secondly, a greater emphasis on policies of (quasi-mandatory) information sharing (2); and thirdly, a greater emphasis on market correcting measures to dovetail a market building agenda (3). In making these proposals, my aim is to encourage a deeper discussion on the type of measures that are required to deliver the CMU's objectives.

##### *1. Information barriers in the SME funding market require market-building measures*

As noted, the Commission's strategy on overcoming information barriers to SME investment has several features: it rests on diffusing best practice and on supporting Member State initiatives. None of the CMU action points on 'overcom[ing] information barriers to SME investment' commits the Commission to true market-building measures, such as for example a proposal that requires, as opposed to encourages, greater SME information sharing.

Yet, there is clearly a case to be made for going beyond promoting best practice and consider the role and place of 'market building' (legislative) measures.<sup>129</sup> Information barriers such as the one that I described earlier affect both the funding demand side and the funding supply side: they make it more difficult for SMEs to identify and access sources of external finance; they make it harder for alternative finance providers to accurately assess investment opportunities. Importantly, they also hinder new actors from entering the market for SME information and SME funding. They affect competition and lead to inefficiencies in the allocation of credit/funding. To be sure, the severity of such information barriers is likely to vary between Member States. Recall that Member States adopt very different approaches to information issues affecting the SME funding market. However, such diversity is also likely to affect the establish-

129 There are a few other complicating factors in this area. Art 173(3) TFEU on industrial policy excludes harmonisation. However, the provision does not stand in the way of acting under, say, Art 114 TFEU to remove obstacles within the internal market which are likely to disrupt the internal market for SME funding. See Case C-377/98 *Netherlands vs European Parliament and Council* [2001] ECR I-07079, para 26–29.

ment or the functioning of an internal market for SME funding by reinforcing market fragmentation.<sup>130</sup>

To be sure, several objections can be leveled against my argument. A first objection is that most SMEs are simply not interested in a cross-border market for SME funding. If an SME requires finance, it will prefer to find finance locally or nationally. The second objection is that under the CMU initiative market building measures have in fact been adopted with a view to removing information asymmetries and facilitating market integration. Hence, some might take the view that I misinterpret the reality of market building under the CMU. I will consider each of these objections in turn.

The first objection is essentially about ‘home bias’. The point is that SMEs, like investors, suffer from home bias. However, even if a majority of SMEs continue to be affected by home bias, the point is that other actors may well be interested in cross-border opportunities. Specifically, improving the flow of information is likely to encourage the emergence of a new tier of information service actors which will have incentives to operate on a pan-EU basis. Hence, while SMEs might continue seeking finance domestically, they might in doing so still benefit from information services offered by pan-EU information actors that operate both domestically and abroad. With respect to the second objection, it is indeed worth acknowledging that market-building measures have been adopted in the context of the CMU. Only recently, the EU legislature adopted a new Prospectus Regulation (PR).<sup>131</sup> Disclosure regulation has been the method of choice – especially in a capital markets/public offer context – for dealing with information asymmetries and for facilitating market integration. Given the CMU’s ambition to diversify the financial system and since disclosure regulation has been a major plank of the EU’s strategy to reduce information asymmetries, it did not come as a surprise that the CMU White Paper called for early action on prospectus regulation.<sup>132</sup> The PR testifies to the EU’s attempt to ease the disclosure burden for SMEs. The regulation is set to replace the Prospectus Directive which was adopted in 2003 and provides for the drawing up, approval and publication of a prospectus in case where a company seeks to raise capital on a

130 The Commission noted itself that the absence of standardised and available credit information acts as a ‘significant barrier’ to SME investment; it considered action in this area to be a prerequisite to offer SMEs more funding choices. See ‘Economic Analysis ... on Building a Capital Markets Union’ (n 39) 44.

131 At the time of writing the regulation has not yet been published in the Official Journal. However, the compromise text agreed between the European Parliament and the Council is available at <<http://data.consilium.europa.eu/doc/document/ST-15574-2016-ADD-1/en/pdf>>.

132 Attempts to ease the regulatory burden in the wake of the financial crisis can be witnessed elsewhere as well. See ‘Truly New Securities’ (n 77) 676.

regulated market or where it offers securities to the public.<sup>133</sup> Attempts were made in the past to reduce administrative costs for issuers. It was a core theme of the 2010 Prospectus Amending Directive.<sup>134</sup> However, the outcome of these reforms was at best mixed.<sup>135</sup> The PR is a fresh attempt to make EU prospectus regulation more SME friendly. The regulation attempts to do so in different ways. First of all, the PR seeks to limit the reach of the obligation to prepare a public offer prospectus by carving out a prospectus free space for companies that wish to raise relatively small amounts of capital.<sup>136</sup> Thus, public offers of less than 1,000,000 euros will be outside the scope of the regulation.<sup>137</sup> Crucially, even though Member States can insist on disclosure duties for such offers under national law, Member States will not be able to use national law as a means to require prospectuses to be drawn up in accordance with the obligations of the PR, or to otherwise impose disclosure duties which would be inappropriate or unnecessary.<sup>138</sup> By adopting this provision, the PR seeks to prevent Member States from imposing extensive disclosure duties through the national backdoor. Secondly, for issuances that are within the scope of the directive (eg, because they are above 1,000,000 euros), the new regulation attempts to make prospectus regulation more SME friendly by providing for a new ‘EU growth prospectus’ which will (inter alia) be available to SMEs which contemplate making a public offer.<sup>139</sup> The disclosure burden associated with this new type of prospectus is expected to be lighter. According to the PR, a growth prospectus is supposed to

133 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L345/64 (as amended).

134 Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market [2010] OJ L327/1, recs (1)–(4).

135 Commission (EC), ‘Review of the Prospectus Directive’ Consultation Document, 18 February 2015, 13 <[http://ec.europa.eu/finance/consultations/2015/prospectus-directive/docs/consultation-document\\_en.pdf](http://ec.europa.eu/finance/consultations/2015/prospectus-directive/docs/consultation-document_en.pdf)> noting that the proportionate disclosure regime is ‘perceived as too burdensome’.

136 These provisions do not apply yet. I examined the existing provisions in P Schammo, *EU Prospectus Law – New Perspectives on Regulatory Competition in Securities Markets* (CUP Cambridge, 2011) 88–9.

137 Draft PR, art 1(2a). Note that the regulation also allows Member States to exempt domestic public offers of up to 8,000,000 euros from the obligation to publish a prospectus. See draft PR, art 3(2).

138 Draft PR, art 1(2a).

139 Draft PR, art 15. To benefit of the EU growth prospectus regime, an issuer must not have securities admitted to trading on a regulated market. There are other provisions

be a document in ‘standardised format, written in a simple language and which is easy for issuers to complete’.<sup>140</sup> The precise content of the new EU growth prospectus remains to be fleshed out.

While the objectives of the PR are laudable, it is plain that prospectus regulation, as a means to overcome information asymmetries, will continue to matter only for a fraction of SMEs. Indeed, because of the limited funding needs of most SMEs – recall that the funding needs of most SMEs are below 1,000,000 euros – prospectus regulation will most of the time not be the tool for dealing with information asymmetries in the SME funding market, or for that matter, for building a pan-EU SME funding market.<sup>141</sup> Outside the prospectus space, information barriers will need to be addressed by other means.

## 2. *A greater emphasis on policies of (quasi-mandatory) information sharing*

Designing a regulatory strategy on information barriers in the SME funding market is clearly rich in challenges. The fact that many SMEs are particularly sensitive to increases in regulatory burden is one such challenge. The fact that the types of businesses that are treated as SMEs vary considerably in size, capitalization and orientation; that they operate in very different sectors; and that they have widely differing funding needs and funding preferences is another challenge. Disclosure requirements are certainly part of the answer to information asymmetry problems, but they are not *the* answer given compliance cost issues. In fact, given the characteristics of the SME segment, it is unlikely that a single solution for dealing with information issues will emerge. Yet even in parts of the SME funding market where extensive disclosure duties are not the answer to information asymmetries, progress can be made by improving the availability and sharing of SME information. Such information is likely to come from a variety of sources. One such source is the banking sector.

It is apparent that significant developments on information sharing (that is, sharing of ‘raw’ information) are underway in the banking and financial sector.<sup>142</sup>

that might benefit a proportion of SMEs: eg, the provisions on a simplified disclosure regime for secondary issuances (see draft PR, art 14).

140 Draft PR, art 15(1).

141 It is worth noting that the PR makes it possible to voluntarily opt into the regulation in case of a public offer of less than 1,000,000 euros. An issuer will as a result become subject to the requirements of the new regulation, but it will also benefit from the prospectus passport rights (see draft PR, art 4). However, in practice, it is doubtful that this opt-in arrangement will raise much interest given the cost associated with prospectus regulation.

142 I described the meaning of raw data earlier (see text to notes 56–57).

We saw earlier that the UK is at the forefront of these efforts. It took action under the SBEE Act. Recall also that the CMA is requiring banks to implement an open API banking standard which, once implemented, should make it possible for customers to share account information with third party providers in a seamless manner. Admittedly, in the UK, competition concerns provided a powerful rationale for acting on information barriers and for justifying the cost of implementing information sharing arrangements. The aim is to encourage competition between banks and alternative finance providers, but also between the former and challenger banks. As far as the CMU is concerned, I already noted that the White Paper had no ambition to mandate banks to share information. Nor is encouraging competition part of the CMU White Paper's problem definition on information barriers in the SME funding market. Encouraging competition is part of the general ambitions of the CMU and a focus of attention in other specific areas, such as retail financial services.

That said, efforts to facilitate information sharing are not just underway at national level. In fact, the EU is also making inroads in this field, but outside the CMU context. Specifically, the second Payment Services Directive (PSD2), which was adopted in 2015 and which Member States are required to implement by 2018, brings within its regulatory scope new types of services such as payment initiation services and account information services.<sup>143</sup> The latter are services, accessed via online interfaces, which provide their users with aggregated information on one or several payment accounts held with one or several payment service providers (banks, for our purposes).<sup>144</sup> Account information service providers are a type of aggregator.<sup>145</sup> They collect and consolidate information relating to payment accounts, but to provide this service they must have access to these accounts. The PSD2 sets conditions and requirements for the exercise of this activity. However, it also seeks to remove barriers that have hindered the provision of account aggregator services.<sup>146</sup> Moreover,

143 Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 093/2010, and repealing Directive 2007/64/EC [2015] OJ L337/35.

144 PSD2, rec (28). See also the definition of account information services in art 4(16).

145 On aggregators, see S Madnick and M Siegel, 'Seizing the Opportunity: Exploiting Web Aggregation' (2002) 1 MIS Quarterly Executive 35; Deloitte 'The Impact of Innovation in the UK Retail Banking Market – a Final Report for the Competition and Markets Authority' (July 2015), 38-49, <[https://assets.publishing.service.gov.uk/media/55ba0461ed915d155c000013/The\\_impact\\_of\\_innovation\\_in\\_the\\_UK\\_retail\\_banking\\_market\\_\\_2\\_.pdf](https://assets.publishing.service.gov.uk/media/55ba0461ed915d155c000013/The_impact_of_innovation_in_the_UK_retail_banking_market__2_.pdf)>.

146 See PSD2, art 36 which requires Member States to make sure that account information service providers (as a type of payment institution; see art 33(2)) have access to credit institutions' payment accounts services on an 'objective, non-discriminatory and pro-

the PSD2 allows account information service providers to operate on a pan-European basis by granting them passporting rights.<sup>147</sup>

There are other significant EU developments that are worth flagging up. The general right to data portability, which was enacted in Article 20 of the General Data Protection Regulation (GDPR), is one such development.<sup>148</sup> Essentially, data portability allows an individual (a 'data subject') to obtain his/her personal data that s/he provided to a so-called data controller 'in a structured, commonly used and machine-readable format'.<sup>149</sup> Thus, data portability allows a person to reuse his/her data, but it also includes the right to transmit such data to another controller 'without hindrance'.<sup>150</sup> Where technically feasible, the data subject can have the personal data transmitted directly from one controller to another.<sup>151</sup>

Neither the PSD2, nor the GDPR are yet applicable at national level. The former must be implemented by 13 January 2018 and the implementing measures must apply from this date.<sup>152</sup> The GDPR will apply from 25 May 2018.<sup>153</sup> At the time of writing many details remain to be fleshed out. Questions about how to operationalize the above requirements (eg, by using an API?)<sup>154</sup> or how

portionate basis' and that such access is sufficient for them to provide their services in an 'unhindered and efficient manner'. See also art 67 which seeks *inter alia* to ensure that payment service users have the right to make use of services that enable access to account information. It also ensures that access to account information cannot be made conditional on a contractual relationship between the account information service provider and the account servicing payment service provider (art 67(4)). Note that the right to make use of such services only applies for payment accounts that are accessible online (art 67(1)). Various conditions must be satisfied regarding confidentiality and security. Among other things, the provision of the service presupposes that the user has given her 'explicit consent' (art 67(2)(a)).

147 PSD2, art 28, rec (48).

148 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) [2016] OJ L119/1.

149 GDPR, art 20(1). See also rec (68). 'Data controller' is defined in art 4(7) as a 'natural or legal person, public authority, agency or other body which, alone or jointly with others, determines the purposes and means of the processing of personal data...'.<sup>150</sup>

150 GDPR, art 20(1).

151 GDPR, art 20(2).

152 PSD2, art 115(1) and (2). Some provisions derogate from this timetable: see art 115(4).

153 GDPR Art 99(2).

154 In relation to the data portability provision of the GDPR, the Article 29 Data Working Party, which offers guidance to the Commission, suggested that one approach would be to make an API available (see 'Guidelines on the Right to Data Portability' (n 57) 15). In relation to the PSD2 provision, see also European Banking Authority, 'Con-

to deal with the concerns of ‘silent parties’ will need to be clarified.<sup>155</sup> However, the more important point for our purposes is that the above measures – that is, those adopted or to be adopted in the UK as well as the measures adopted under the PSD2 or the GDPR – represent significant developments on information sharing. They seek to empower customers, and promote competition and innovation. They are part of a wider trend of facilitating and regulating information or data sharing in the digital age. Seen against this background, the CMU action points on information barriers in the SME funding market appear markedly out of step. Indeed, the CMU White Paper is silent on the information sharing policies that were enacted under the PSD2 or the GDPR. Thus, my second suggestion is that the Commission engages with the policies on information sharing duties that are developing outside the CMU context – in the UK and at EU level – when defining a CMU specific strategy on information barriers.

To be sure, EU action that is taken outside the CMU context will *prima facie* benefit SMEs as well. However, not all of the EU information sharing provisions will be applicable to SMEs and none of them is specifically tailored to the issues which SMEs face when seeking external finance.<sup>156</sup> Recall that address-

sultation Paper on the Draft Regulatory Technical Standards Specifying the Requirements on Strong Customer Authentication and Common and Secure Communication under PSD2’ EBA-CP-2016-11, 12 August 2016.

- 155 See in this context GDPR art 20(4) which underlines that the right to data portability cannot prejudice the ‘rights and freedoms of others’. See also the proposals made by the Article 29 Data Protection Working Party, ‘Guidelines on the Right to Data Portability’ (n 57).
- 156 The PSD2 provisions on access to account information services will be available to SMEs. The PSD2 definition of payment service user includes both natural persons and legal persons (art 4(10)). However, the right to data portability will only apply to personal data of natural persons. Legal persons cannot avail themselves of this provision (see GDPR rec (14); art 1(1) on the subject matter of the regulation; and art 4(1) on the definition of personal data and data subjects). Currently in the UK, the UK Data Protection Act 1998, which implemented Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data [1995] OJ L281/31, defines personal data as data which relates to a ‘living individual’ (s. 1(1)). Hence information about legal entities is not personal data in the UK. However, information about a partnership or a sole trader (as opposed to information about legal persons) can be personal data in the UK. Recall that SME businesses can be organised in different forms: eg, as limited companies, but also as a partnership or they can be run by an individual self-employed persons. Directive 95/46/EC, which is currently in force at EU level, defines personal data as ‘information relating to an identified or identifiable natural person’ (see Art 2(a)). According to the Article 29 Data Protection Working Party, personal data includes ‘information touching the individual’s private and family life “*stricto sensu*”, but also information regarding whatever types of

sing barriers to SME investment requires addressing information issues on the funding demand and supply side. In the UK, the provisions of the SBEE Act on information sharing offer a solution which is specifically targeted at SMEs. The provisions on mandatory referrals and finance platforms help SMEs to navigate the SME funding market whilst the provisions on sharing SME credit information offer a wider set of key indicators of creditworthiness.<sup>157</sup>

Admittedly, implementing a more forceful approach to information sharing at EU level – especially a mandatory referral system – will face objections: for example, because of competition concerns, because of costs associated with updating legacy IT systems, because of costs associated with data standardisation; because of ‘free rider’ concerns, because of differences between national banking markets, etc. However, as already noted, information sharing as I contemplate it here only involves sharing raw data. This data can presumably be collected mechanistically through electronic means and will not include analytical input by a bank. Thus, it is not inferred data; it is not proprietary to a bank. Indeed, in the case of natural persons who are protected by data protection legislation, raw data (say, current account data) would be considered to be personal data of a bank customer. Moreover, while IT systems would need to be adapted in order to deal with new information sharing duties, the fact is that banks are already collecting and sharing information electronically and will be required to do more in the future.<sup>158</sup> To be sure, there is a need for a deeper reflection on how information sharing obligations would work; what their scope should be and how to deal with any legitimate concerns. Recall that

activity is undertaken by the individual, like that concerning working relations or the economic or social behaviour of the individual’. Moreover, according to the working party there may be circumstances where information about legal persons is considered as relating to natural persons ‘on their own merits’. See Article 29 Data Protection Working Party, ‘Opinion 4/2007 on the concept of personal data’ 01248/07/EN WP 126 <[http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2007/wp136\\_en.pdf](http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2007/wp136_en.pdf)>.

157 In comparison to payment account information under the PSD2, the credit information that designated banks must provide pursuant to s. 5 of the SBEE Act is more extensive. For example, it includes information relating to a loan (see for details the Small and Medium Sized Business (Credit Information) Regulations 2015). It is unlikely that a loan account would be deemed a payment account (i.e., an account ‘for the execution of payment transactions’ according to PSD2, art 4(12)). In this sense, see Financial Conduct Authority Handbook PERG15.3 <<https://www.handbook.fca.org.uk/handbook/PERG/15/3.html>>.

158 Think for example of the PSD2 or the GDPR provisions on data sharing. The European Central Bank’s AnaCredit project will also require banks to share a substantial amount of information in a standardised form. AnaCredit is a project that seeks to establish a dataset ‘containing detailed information on individual bank loans in the euro area, harmonised across all Member States’. See <[https://www.ecb.europa.eu/stats/money\\_credit\\_banking/anacredit/html/index.en.html](https://www.ecb.europa.eu/stats/money_credit_banking/anacredit/html/index.en.html)>.

there are ways to calibrate information sharing. It might mean restricting certain requirements to certain types of banks (as in the UK). Calibrating information sharing duties might also involve considering whether information access fees are justified in order to address concerns of the banking sector. Hence, there are issues that will require a fuller discussion. However, at the very least, a CMU strategy on information barriers ought to consider how to maximize the benefits of information sharing mechanisms that are already enacted in EU law, especially the PSD2 provisions on information services which will also benefit SMEs, or the GDPR provision on data portability which is much more general in scope than the provision of the PSD2, but which only applies to personal data of natural persons.<sup>159</sup>

### *3. More effective action on information barriers needs a strategy on market correcting measures*

If the EU deems more significant inroads in the field of information sharing to be warranted, a CMU ‘market correcting’ strategy will also be required. Promoting data sharing is not a risk-free endeavor. There are risks involved in making information more widely available. Security risks or confidentiality risks are an obvious concern. But there is a myriad of other risks that require careful consideration,<sup>160</sup> including reputational risks for banks and at the apex of the risk pyramid, risks to financial stability. More generally, pursuing policies that encourage innovation is not risk free. There is good and bad innovation; the financial crisis offers evidence of the consequences of leaving the latter unaddressed. Moreover, greater competition might cause banks to take greater risks:<sup>161</sup> for example, if they face greater competition brought

159 See also (n 156). Note that the Article 29 Data Protection Working Party suggested that ‘provided data’ and ‘observed data’ (as opposed to ‘inferred data’) should be covered by the data portability requirement of the GDPR. See ‘Guidelines on the Right to Data Portability’ (n 57) 8.

160 See in this context, Joint Committee of the European Supervisory Authorities, ‘Joint Committee Discussion Paper on the Use of Big Data by Financial Institutions’ JC 2016 86; EBA ‘Discussion Paper on Innovative Uses of Consumer Data by Financial Institutions’ EBA/DP/2016/01, May 2016.

161 Greater competition might lower incentives to act prudently with respect to risks (see M Keeley, ‘Deposit Insurance, Risk, and Market Power in Banking’ (1990) 80 *American Economic Review* 1183). However, the relationship appears to be complex and there is a considerable debate on the topic. See eg, J H Boyd, G De Nicoló, ‘The Theory of Bank Risk Taking and Competition Revisited’ (2005) 60 *Journal of Finance* 1329; D Martínez-Miera and R Repullo, ‘Does Competition Reduce the Risk of Bank Failure?’ (2010) 23 *Review of Financial Studies* 3638–3664; G Jiménez, J A Lopez and J Saurina, ‘How Does Competition Affect Bank Risk-Taking’ (2013) 9 *Journal of*

about by greater information sharing.<sup>162</sup> Measures will need to be put in place in order to address concerns. That said, market correcting intervention is not just about addressing risks. Regulation and supervision will contribute to building trust in information sharing and thereby contribute to ensuring that it can deliver its full potential.<sup>163</sup>

Managing risks will be a common effort. SMEs will have a role to play; hence the importance of ensuring business awareness. Consent requirements will need to be put in place in order to protect SMEs' information (eg, SME credit information, account information or information about an SME's funding needs). General data protection legislation typically only applies to personal data of natural persons.<sup>164</sup> Regulatory and supervisory solutions will also be needed. Specifically, monitoring and supervision will be required in order to deal with the potential risks of greater information sharing and its possible impact on the banking sector and beyond. Some sort of authorization or registration scheme will be required for actors dealing in SME information sharing. However, solutions should be proportionate to the risks of information sharing. For instance, information sharing does not require holding client funds. Therefore, it does not raise the same concerns as these latter activities.<sup>165</sup> The extent of regulatory and supervisory intervention will of course also depend on what other activities information services actors carry out.

However, it is worth repeating that outside the CMU context, efforts are already being invested in regulating information sharing duties. It is plain that a CMU market correcting strategy on SME information sharing should engage with these developments. Indeed, recall that SMEs will be able to benefit from the provisions on account information services, irrespective of whether the business is run as a legal entity, a partnership or by a sole trader (an individual, self-employed person).<sup>166</sup> What is more, the PSD2 not only seeks to facilitate account information services; it seeks to regulate them. Account aggregation

Financial Stability 185. In the literature discussing relationship banking, the impact of increased competition on relationship banking is also open to debate. See eg, 'Relationship Banking: What Do We Know?' (n 48) 18–21; A Boot and A Thakor, 'Can Relationship Banking Survive Competition?' (2000) 55 *Journal of Finance* 679.

162 'Information Sharing in Credit Markets: a Survey' (n 59) 16.

163 'The Open Banking Standard' (n 105) para 4.3.1.

164 See also note 156 above.

165 See in this context PSD2, rec (35) noting that 'it would be disproportionate to impose own funds requirements' on account information service providers. In the UK, the provision of credit data on companies is not a 'regulated activity' for the purposes of the Financial Services and Markets Act 2000. See Financial Conduct Authority, FCA Handbook, EG 19.33.2, available at <https://www.handbook.fca.org.uk/handbook/EG/19/?view=chapter>. The exercise of this activity does therefore not attract the same level of regulatory scrutiny.

services already existed before the PSD2 was adopted, although aggregators faced obstacles in exercising their activity.<sup>167</sup> The EU legislature took the view that account information services should be brought within the scope of the PSD2 to offer greater protection and legal certainty.<sup>168</sup> The PSD2 sets conditions and requirements to the exercise of this activity. Thus, the PSD2 extends data protection requirements to the provision of account information services.<sup>169</sup> Account information service providers will need to be registered (but not authorized) and will be subject to prudential supervision.<sup>170</sup> They will need to hold professional indemnity insurance or a comparable guarantee.<sup>171</sup> They will need to comply with security rules and standards. EBA is currently working on the draft technical standards which will flesh out the provisions of the PSD2.<sup>172</sup> It will have an important role to play in determining whether and where to make trade-offs: trade-offs between security and innovation; or between promoting user-friendly solutions, and safe and secure solutions; or between promoting innovation and preventing fragmentation if differing market solutions emerge.<sup>173</sup>

Much can also be learned from the UK's initiatives. In fact, the UK's approach, which relies on designated finance platforms and designed credit reference agencies, offers a much more managed approach to SME information sharing. I have already discussed the mechanisms which underpin these arrangements. Suffices to add here that finance platforms do not require authorization from the FCA.<sup>174</sup> However, safeguards were put in place in order to offer SMEs a measure

166 Recall that the PSD2 applies to natural and legal persons. On the other hand, the data portability provision of the GDPR will only apply to personal data of natural persons. See note 156 for details.

167 Financial Conduct Authority, 'Cash Savings Market Study Report: Part I: Final findings, Part II: Proposed remedies' January 2015, 85 noting that 'many banks' terms and conditions prohibit the sharing of such information by customers to third parties' <<https://www.fca.org.uk/publication/market-studies/cash-savings-market-study-final-findings.pdf>>.

168 PSD2, rec (28).

169 The provision of this service is inter alia subject to the explicit consent of the payment service user (PSD 2, Art 67(2)(a)).

170 PSD, Art 33.

171 PSD2, rec (35); art 5(3).

172 EBA, 'Consultation Paper on the Draft Regulatory Technical Standards Specifying the Requirements on Strong Customer Authentication and Common and Secure Communication under PSD2' EBA-CP-2016-11, 12 August 2016.

173 Ibid 6.

174 However, the businesses which are given the 'finance platform' designation by the government may be authorised and regulated in another capacity. For example, currently all designated finance platforms are authorised and regulated by the Financial Conduct Authority as credit brokers.

of protection and ensure that they remain in control of the information sharing process. Thus, finance platforms must be designated by the UK government (the Treasury) which can also revoke their designation.<sup>175</sup> Before designating a finance platform, the Treasury consults the British Business Bank, a government owned bank, which carries out due diligence on applicants (eg, on the existence of systems and processes for data handling, on whether an applicant holds relevant regulatory authorisations).<sup>176</sup> The FCA will exercise oversight and enforcement powers over finance platforms in accordance with the provisions of the Small and Medium Sized Business (Finance Platforms) Regulations 2015. Furthermore, finance providers will only gain access to information referred to a platform if they join the platform's panel of lenders. This will presuppose that they meet the platform's terms and conditions.<sup>177</sup> SMEs are meant to stay in control of the referral process through specific consent requirements. Thus, an SME, which is offered a referral to a finance platform by a designated bank, must consent to its information being referred. Furthermore, finance providers which are members of the platform's panel will in the first instance only gain access to information in anonymous form. They will only be able to ask for identifying information about an SME applicant if the latter consents to such information being provided.<sup>178</sup>

Gaining access to SME credit information is also a managed process under the SBEE Act and the Small and Medium Sized Business (Credit Information) Regulations 2015. Like finance platforms, credit reference agencies will require designation by the Treasury in order to benefit from section 4 of the SBEE Act. To be designated, the credit reference agency will need to meet the requirements of the implementing regulations, notably on data handling.<sup>179</sup> Credit reference agencies which seek designation will be subject to a due diligence process carried out by the British Business Bank. Once designated, sharing of credit information between a designated bank and designated credit reference agencies is subject to the agreement of the bank's SME customer.<sup>180</sup> The latter's consent will also be required when a finance provider requests such information from a designated credit reference agency.<sup>181</sup> It will presuppose (inter alia) that the

175 The Small and Medium Sized Business (Finance Platforms) Regulations 2015, reg 9.

176 See British Business Bank, 'Finance Platforms – Call for Expressions of Interest' 1 July 2016 <<http://british-business-bank.co.uk/wp-content/uploads/2016/06/EOI-FP-template-2016.pdf>>.

177 The Small and Medium Sized Business (Finance Platforms) Regulations 2015, reg 6.

178 Ibid.

179 The Small and Medium Sized Business (Credit Information) Regulations 2015, reg 12.

180 The Small and Medium Sized Business (Credit Information) Regulations 2015, reg 3 (2). See also reg 5 on the way in which approval can be given.

181 The Small and Medium Sized Business (Credit Information) Regulations 2015, reg 6(1) (b).

finance provider agrees to the standard terms of the designated credit reference agency.<sup>182</sup> Furthermore, the FCA will have enforcement and oversight responsibilities in accordance with the provisions of the regulations.<sup>183</sup> Crucially, the regulations apply (and where necessary extend) protections afforded to SMEs against incorrect information held by designated credit reference agencies.<sup>184</sup>

### *V. Conclusion*

The aim of this article was to contribute to the ongoing debate on a CMU. It first looked at the general orientations of the CMU, after which it turned to the contemplated actions in the SME funding/information market. With respect to overcoming information barriers to SME investment, I submitted that there was a certain disconnect in the White Paper's thinking between problem definition and policy solution. I argued for a paradigm shift based on three pillars: a greater emphasis on market building measures; a greater emphasis on information sharing duties as one mechanism that can help to address information barriers; and a market correcting strategy that dovetails a market building strategy. When considering information sharing arrangements, I submitted that a CMU strategy on overcoming information barriers should consider the SBEE arrangements that were adopted in the UK. I highlighted the fact that information sharing obligations could be calibrated in order to address legitimate concerns, but I argued that at the very least, a CMU strategy ought to consider how to maximize the benefits of information sharing provisions that were adopted under the PSD2 or the GDPR. I argued for an approach which sought to improve access to finance and financial diversification, but which also had regard to the benefits of innovation and greater competition. When considering market correcting aspects, I acknowledged the potential drawbacks of information sharing obligations. I identified various types of risks and underlined the importance of monitoring the effects of greater information sharing and competition on the banking sector. Ultimately, I drew attention to the fact that the UK approach, which relies on designated finance platforms and designated credit reference agencies, offered a much more managed approach for dealing with SME information sharing.

182 For details, including on the subsequent duty of finance providers to provide credit information to the credit reference agency, see the Small and Medium Sized Business (Credit Information) Regulations 2015, reg 6.

183 See the Small and Medium Sized Business (Credit Information) Regulations 2015, part 6.

184 The Small and Medium Sized Business (Credit Information) Regulations 2015, regs 15 and 16.