The hidden cost of certainty in banking

RateSetter argues for divorcing deposits from lending

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RateSetter CEO Rhydian Lewis today delivered a keynote speech in Parliament, in which he presented the case for bank deposits to be separated from lending. The speech is the latest in a series of New City Agenda events looking at new ideas on financial services issues.

The central argument is that banks take money from depositors and promise to keep it safe. They then lend this money to borrowers – but lending money is inherently risky. Therefore banks have a mismatch: they promise to keep money safe, but put that money at risk by lending it out.

Regulation, capital requirements and deposit protection schemes have been introduced to mitigate the effects of this imbalance, but under this system, genuine safety is impossible to provide: even a bank sufficiently capitalised to cope with, say, a 1 in 50 year event would not be able to guarantee safety for a 1 in 100 year event. The result is that banks are over-capitalised for the good times but still under-capitalised for the one year when the worst happens.

> *"It is intuitively inefficient – and therefore value-destroying – for the entire banking system to be wrong one way or the other the whole time: too safe in the good times and not safe enough in the bad. And let's be clear: we all pay for that inefficiency. Capital requirements amount to nothing more than a sticking plaster over a flawed system."*

Lewis put forward a new system, in which banks provide the service of safekeeping money, charging a fee for that service rather than lending the money out – in this way they can reasonably guarantee safety.

Lending would instead be done via capital markets – efficient exchanges which match risk-seeking capital investment with loans. Investors receive a direct share of the upside (or downside) from the investments in the form of fair returns. In this way, the tension of trying to guarantee safety while putting money at risk simply doesn't arise – the system is balanced, sustainable and cleaner as a result.

> *"This may initially seem like a radical idea, but it's not as far-fetched as you might think. Banks already extract a price for certainty in the form of rock bottom interest rates for depositors. What's more, the end of free banking is a distinct possibility. In the last decade we also saw banks withdraw in a major way from lending (particularly to small businesses). At the same time more people are seeking better returns by investing through marketplace lenders."*

By separating deposit-taking from lending, Lewis argues, we can achieve certainty at a fair and transparent price; and good returns in exchange for a fair level of risk. Both sides of the deal are happy: there is clarity and no broken promises.

Lord Sharkey, co-founder of New City Agenda, commented:

> *"The growth of peer-to-peer lenders challenging the high street banks has played a part in enhancing competition and offering consumers better value personal loans. Personal loan rates are close to record lows whilst the cost of overdrafts and credit cards – products still dominated by the big banks – are at record highs."*

“The FCA and the CMA should ensure that regulation is focused on encouraging the development of a sustainable and competitive market and consider how the benefits of enhanced competition from P2P lenders can be expanded into more sectors.”

Notes to editors

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Rhydian Lewis launched RateSetter in October 2010. Rhydian’s objective in setting up RateSetter was to reduce the gap between what investors could reasonably earn and creditworthy borrowers could pay, cutting out the banks to deliver a better deal for both in a simple and secure way.

Prior to launching RateSetter, Rhydian spent six years at leading financial advisory firm, Lazard. In 2015, Rhydian was named FinTech Leader of the Year in the FinTech Innovation Awards. RateSetter has won multiple awards, including Best Peer-to-Peer Lender in the FT / Investors Chronicle awards in both 2014 and again in 2015.

RateSetter is one of the UK’s largest marketplace lenders, and has lent more than £1bn to UK individuals, businesses and property developers, including £500m in 2015 alone.

The platform offers a ground-breaking proposition that allows retail, institutional and corporate lenders to invest at interest rates set in an open market. RateSetter’s market rates can be found here. RateSetter is not covered by the FSCS and capital is at risk. RateSetter’s £17m Provision Fund has ensured that no individual investor has ever lost a penny since RateSetter launched in 2010 - a unique feat amongst the major platforms in the industry. All borrowers pay into the Provision Fund, which repays investors in the event that a borrower misses a payment.

In 2014, RateSetter became the first marketplace lender to launch with a retail license in Australia. In December 2015, the platform won Best Peer-to-Peer Lender in the FT and Investors Chronicle Wealth Management Awards for the second year running. RateSetter was the highest-rated platform by Which? readers in 2015.

RateSetter is authorised and regulated by the Financial Conduct Authority.

More info is available at www.ratesetter.com
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