BRIEFING

Green Party

A BANK FOR LONDON – BRIEFING FROM LONDON GREEN PARTY

The Green Party in London has put forward in its 2016 manifesto the idea of creating a Bank for London, specifically tasked with providing loans and finance to small businesses, which would also be an ethical choice for the city's savers.

This briefing expands upon the reasons why this idea is needed in London, and explores how our next Mayor could go about taking a project to create a Bank for London forward, in collaboration with boroughs and businesses, and how this could have a significant impact on making London's economy stronger and more resilient.

1. WHY LONDON NEEDS A REGIONAL BANK

Regional and local stakeholder banks can be the powerhouses of lending to small and medium-sized businesses.

The Green Party wants to build a stronger, more diverse economy, and in 2014 proposed that RBS, then owned by the public, should be broken up and turned into local community banks, based on the German regional banking system.[1]

"A system of local community banks has been the engine of the German economy, supporting a thriving small and medium-sized enterprise sector. It is time for a community banking revolution and only the Green Party has the resolve to bring this about."

Molly Scott Cato MEP, Green Party spokesperson for Economy and Finance

Banking in the UK is very concentrated, and has seen a dramatic reduction in mutuals

[1] http://www.bristolgreenparty.org.uk/break-up-rbs-into-local-community-banks

and co-operative options for saving and borrowing. In the 100 years to 2010 the number biof Building Society mutuals was reduced from 1,723 to just 49.[2]

The big banks have a poor record on lending to small business, particularly when it comes to long-term loans and working capital.[3] They also currently suffer from a very cautious approach to building relationships and giving advice to customers, in the wake of mis-selling scandals.

There is therefore a real gap for quality, personal, locally focused small business banking, which the GLA and London's boroughs can help fill by setting up a Bank for London. This bank could also provide a safe and ethical choice for people who are interested in their savings going to help build a more diverse and circular economy for the city.

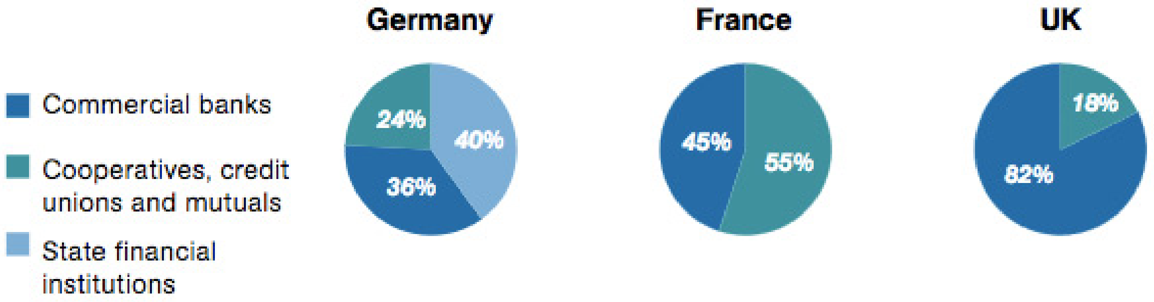
STAKEHOLDER BANKING IN OTHER COUNTRIES

Regional and local stakeholder banks are a common feature of banking systems around the world, and have been shown to bring a range of benefits to local businesses and the wider economy. We believe this idea is long overdue for London.

The banking market in other European countries is very different to here in the UK, where we see a small number of very large commercial banks dominating the market, with a range of public, mutual and co-operative banks (stakeholder banks) and credit unions taking a much greater share of banking services.

Banking in other European countries:[4]

Figure 1 – Market shares of deposits in Germany, France and the UK



Source: World Bank (2011)[2]

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[2] Stakeholder Banks - benefits of banking diversity. New Economics Foundation, 2013 http://www.neweconomics.org/publications/entry/stakeholder-banks
[3] Federation of Small Businesses Greater London Manifesto 2016 http://www.fsb.org.uk/regions/greater-london/policy-and-lobbying/fsb-greater-london-manifesto
[4] Figure from ref 2. World Bank financial inclusion data 2011 http://data.worldbank.org/data-catalog/financial_inclusion

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The key difference between commercial banks and the different kinds of stakeholder banks is that rather than being driven by the single goal of maximising shareholder value, they balance profit with a range of social goals, maximising value instead for their different groups of stakeholders (such as customers and local communities). There is good evidence that this enables them both to offer customers a better deal, and to focus on less profitable but more economically useful activities, such as small business lending.

Examples of well-established public stakeholder banks supporting local economies in other countries include:

Germany: Sparkassen
A network of public savings banks, owned in trust for the public benefit and run by local stakeholder boards, with a public interest mandate restricting them to lending within their geographic area. The Sparkassen co-own regional banks (Landesbanken) to help them manage liquidity and engage in investment banking activities. The Sparkassen suffered few losses during the financial crisis and required no government bail-outs. Although the Landesbanken did suffer more serious problems, this was arguably because they came under pressure to compete more directly with shareholder-owned banks – investing in risky mortgage-backed securities to boost profitability.[5]

Switzerland: Cantonal banks
A network of 24 banks owned by the government (although in the process of being part-privatised), which account for around 30% of the banking sector in Switzerland.[6] Like the Sparkassen, the Swiss cantonal banks maintained and increased their lending to businesses after the financial crisis, at a time when commercial banks were withdrawing lending. This was an important factor in the Swiss economy's recovery.

Spain: Cajas
The Spanish cajas are often cited as proof that local banks do not work, or that they are vulnerable to political interference. In fact, the fate of the cajas shows what happens when such institutions are deregulated and pressured to behave like commercial banks.

Before 1989, cajas were restricted to serving their local area with a limited range of retail banking activities. When these restrictions were lifted in the name of efficiency and competition, the sector became more concentrated, more focused on growth and short-term profitability, less safe in terms of its funding model, and more exposed to the Spanish housing bubble.

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[5] See Prieg et al, 2013. Stakeholder banks: Benefits of banking diversity. London: NEF.
[6] Available at: http://www.kantonalbank.ch/e/mediencenter/publikationen.php

INITIATIVES IN OTHER PARTS OF THE UK

In recent years, there has been renewed interest in setting up new stakeholder banks of various kinds across the UK.

The creation of a Hampshire Community Bank is progressing slowly with support from Portsmouth City Council, the Future Solent coalition of business groups and the local enterprise partnership. The plans involve supporting SMEs and building up a green economy for the region.

The Cambridge & Counties Bank is an example of a local authority pension fund setting up its own bank. Although this model is not planned to be democratically controlled by the council itself and would essentially be a privately owned bank, it is creating a range of products to help small and medium-sized enterprises in the area to grow.

The Community Savings Bank Association (CSBA) aims to support a network of community banks, working with the only independent savings bank in the UK, Airdrie Savings Bank. The project has already won the agreement of the Financial Conduct Authority for a model co-operative community bank constitution, on the basis of one member one vote, regardless of investment.

2. HOW IT COULD WORK

IN BRIEF:

- The Bank for London would be set up by the Mayor and the Greater London Authority, working with boroughs and banking professionals. Its structure and governance would most likely be that of a regional public savings bank, and it would be capitalised at first with investment provided from the reserves of the GLA and local authorities.

- The bank would be specifically tasked with providing loans and finance to small businesses in Greater London.

- The bank would also be available as an ethical choice for London's savers, and would have branches on the high street as well as online banking options for customers. Branches would be important to the way the bank operates, as many small businesses need a place to deposit cash at the end of the day and an accessible, locally knowledgeable account manager to deal with for loans and banking services.

- Branches of the bank could co-locate with public-facing offices for the London Energy Company also proposed in the London Green Party manifesto for 2016, and with advice services for business that are provided by the London Enterprise Panel. With council budget cuts, many borough advice centres and offices are also being centralised and local offices closed, so the bank's branches could also act as information and contact points for other public services.

PREPARATION, SET-UP COSTS AND CAPITALISATION

In the first stage of preparation, it is anticipated that grants would be provided from the GLA, and possible from the London Enterprise Panel to allow for an expert feasibility study, discussions with potential investors and the creation of a project board to take it forward.

More funding would be needed in the next stage - setting up the bank itself - and the aim would be to recruit boroughs across the capital to become partners in the bank, investing from their reserves alongside a contribution from GLA Group reserves.

We estimate up to £10 million of investment would required to cover initial set-up costs, including IT and web infrastructure, recruitment and staffing, and finding locations for the first branches.

Because loans must grow in step with customer deposits and must be provided carefully, the bank would start relatively small and then grow organically as its deposits and loans increase. Initial capitalisation of a Bank for London could therefore start with as little as £30 million.

The total of all the balances and reserves held by London boroughs this year is £31.3 billion.[7] We would not expect all boroughs to want to take part, but with initial set-up and capitalisation totalling £40 million, the amount needed would be 0.13% of the overall balances and reserves of the boroughs.

The total amount of reserves held by Transport for London in 2016/17 is over £25 billion, with more than £23 billion in non-earmarked reserves.[8]

This initial investment could potentially be supplemented with subscribed capital from private investors (i.e. the new bank issuing bonds, or a crowdfunding campaign aimed at Londoners). This is the model for some existing national investment banks.

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[7] London Green Party research using publicly available treasury reports from the London boroughs, January 2016.
[8] Transport for London business plan 2016/17, table 9
http://content.tfl.gov.uk/board-160317-item07-budget-2016-17.pdf

It is also expected that boroughs would be willing to deposit balance sheet funds across a range of time periods once the bank was in operation. Local authorities are constantly in need of places to deposit reserves and balances to spread their risks and enable a range of liquidity options. A Bank for London would join a diverse range of secure places to deposit these funds, including commercial banks and other local authorities. Camden Council, for example, has £20 million currently deposited directly with Birmingham City Council and £5 million with North Tyneside Council.[9]

REGULATORY ISSUES

There are many regulatory and logistical hurdles to setting up a new bank, including licensing, gaining access to payment systems, complying with regulations and building a secure IT infrastructure.

These are significant undertakings and the Bank for London would need to recruit a very experienced senior management team to steer the new bank through them.

They would also need to seek advice from those involved in similar projects in the UK, for example those currently setting up Hampshire Community Bank and the CSBA.

IT in particular will be a large initial cost. The Office of Fair Trading estimated in 2010 that IT system costs account for up to two-thirds of all start-up costs for a new bank, with the actual cost being lower if a bank offers only a limited number of products, as the Bank for London would do initially.[10]

Nevertheless, there are high-level minimum IT requirements for being able to access common banking systems including the Clearing House Automated Payment System (CHAPS) and the Bankers' Automated Clearing System (Bacs).

GOVERNANCE

The model of governance envisaged for the Bank for London is that of a public savings bank, common in European countries. This is described by the New Economics Foundation in its 2013 report on the benefits of stakeholder banks:[11]

> *"Savings banks emerged in Europe to encourage thrift amongst the poor, and were typically set up by municipalities or local philanthropists. They now have a*

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[9] London Borough of Camden quarterly treasury report Dec 2015
http://democracy.camden.gov.uk/documents/s45834/2.%20Quarterly%20Treasury%20Management%20Report%20-%20Aug%20to%20Oct%20Q2.pdf

[10] Review of barriers to entry, expansion and exit in retail banking, Office of Fair Trading, 2010
http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/shared_oft/personal-current-accounts/oft1282

[11] Stakeholder Banks - benefits of banking diversity. New Economics Foundation, 2013
http://www.neweconomics.org/publications/entry/stakeholder-banks

dual financial and social mission to serve a defined local area and address financial exclusion, while operating on a commercial and financially sustainable basis.

"They concentrate on retail banking – SME financing, personal banking including mortgages and funding community projects – and are primarily funded by customer deposits rather than inter-bank or wholesale lending. They do not engage in trading or investment banking activities."

These institutions generally have a two-tier system of governance and a constitution that ensures against political influence, while being backed and guaranteed by public bodies.

For day-to-day management in this model there would be an Executive Board made up of banking professionals. This would report to a Supervisory Board consisting of staff, representatives of local government and customers.

RECRUITMENT AND STAFFING

There are many banking professionals in the 50+ age bracket with excellent skills in the kind of banking that gives personal business advice to its customers and uses local knowledge in making credit risk assessments, not just a computer model.

Some of these professionals are still working and some have taken early retirement, but these staff are exactly who we will need to help the Bank for London develop a model of relationship banking that is currently dwindling. They will also be vital in training new staff to manage risk and support small businesses in an effective way.

With final retirement age approaching for many of these professionals, we currently have only a short window of time to employ these staff, utilise them and train the next generation of community banking professionals. This is another good reason to take steps now to create a Bank for London on this model.

RISK

The bank would aim to minimise the risk of default in its loans to small businesses through careful expansion and the use of local knowledge and the relationship banking model outlined above. Local and regional public banks and credit unions elsewhere have good default records compared with private banks.

BENEFITS FOR LONDON'S ECONOMY

The evidence on local stakeholder banking networks in other countries suggests that a Bank for London could bring a number of economic and social benefits:

> *"We recommend that banking policy explicitly acknowledges the benefits of banking diversity – including to global financial stability – and seeks to nurture a vibrant stakeholder banking sector."*
>
> **New Economics Foundation**, Stakeholder Banks, 2013

- **Supporting small businesses:** Stakeholder banks are the powerhouses of lending to small and medium businesses in many countries. Large commercial banks lend proportionately less to businesses as a whole, but particularly to small businesses.
- **Patient lending:** for example, the German Sparkassen provided 45% of long-term business lending in 2012, compared to 20% from commercial banks.[12]
- **Serving customers better:** local stakeholder banks have been shown to offer more competitive products with lower loan rates, higher deposit rates and better customer service.[13]
- **Promoting financial inclusion:** through explicit aims to provide for customers who are under-served by commercial banks. Stakeholder banks also tend to operate more extensive branch networks.
- **A more stable economy:** Stakeholder banks had less volatile returns, higher levels of capital and less risky business models in the years before the 2008 crisis;[14] they also continued to expand their lending after the crash, when large commercial banks were withdrawing it.[15]

We are often told that London's economy relies on being the home of big international banking institutions. But in reality, this is a double-edged sword: it exposes us to huge financial risks which have not been dealt with by post-2008 reforms. Even in good times, our status as a global centre for speculative finance drives up inequality in the capital, contributes to making housing unaffordable for many, and neglects small businesses.

A Bank for London represents a different approach to London's development – one that is focused on helping Londoners themselves to create real wealth, not the illusory wealth generated by international trading and house price bubbles.

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[12] Deutsche Bundesbank figures cited in Prieg, L. and Greenham, T. 'Stakeholder banks: Benefits of banking diversity', New Economics Foundation (2013)
[13] See Prieg et al, 2013, op cit.
[14] See Prieg et al. 2013. Op cit.
[15] Greenham et al. 2015. Reforming RBS: Local banking for the public good. London: NEF.

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http://www.neweconomics.org/publications/entry/our-friends-in-the-city
http://www.neweconomics.org/publications/entry/stakeholder-banks

WIDER BENEFITS

International experience shows that local stakeholder banks are more successful and secure, and require fewer external guarantees, when they are linked together in a network of mutual support. The German Sparkassen, for example, have a mutual guarantee system to protect customer deposits. If one Sparkasse gets into trouble the others will support it.

The creation of a Bank for London could be a model for similar organisations in other areas of the UK, and both sides would benefit from sharing expertise in IT and risk management. In addition, it has been shown that local banks can help prevent capital flow from a region to larger financial centres, and this would help other parts of the country develop more sustainably and mitigate the current concentration of wealth in the capital.

4. NEXT STEPS FOR A BANK FOR LONDON

So far, this idea has not been put forward by any Mayor of London, and the first step to making it work would be to commission a full feasibility study.

Grants would be needed from the GLA for this work, and then for recruiting a project board to take it forward with detailed discussions with the regulatory authorities, similar banks in other countries and with other projects in the UK – for example with CSBA on their plans for collaboration in building IT systems.

Developing the project further would involve recruiting boroughs to join with the GLA in setting up the bank's governance structures, and providing initial investment capital, and then to recruit the first staff and make initial loans to small businesses in collaboration with the small business sector.

The aim would be to move from that initial basis to being a fully operational bank with a number of branches and expanding deposits and loans within five years.

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