A Community Bank for Wales:

A discussion paper for

The Minister of Economy, Science and Transport,

The Welsh Government

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1. EXECUTIVE SUMMARY

The Welsh Economy is not robust. In fact, it is now particularly fragile. This state of affairs requires a strong financial sector to support the economy to grow and to sustain it during difficult economic periods. This paper will show that the present supply of banking services to Wales does neither of these things.

This situation partially reflects the peculiar demographics of Wales, with its large number of very small, microbusinesses, and relatively few large corporations, together with its lower than national average wage earners and its strong public sector employment focus. The paper will suggest that these factors makes Wales of marginal interest to the large London and Edinburgh HQ based banks; especially in recent years when their strategies have been heavily focused on building investment banking operations at the expense of their retail banking networks.

It will be argued that the UK retail banking system, especially as it serves Wales is, and has been for some time, dysfunctional and highly unlikely to change any time soon. Against this background, it will be proposed that the Welsh Government should set up a new bank, the Community Bank of Wales (CBW) adopting a business model similar to those of several countries where SME and local communities are better served with financial support and credit. Example of how banks can efficiently provide these services in many other countries will be shown.

Finally, it will also be shown that barriers to the creation of new banks in the UK have been significantly and progressively broken down since the weaknesses and failures of the UK's banking system have been exposed through events of the last few years. What once may have seemed improbable and wishful is now eminently achievable with strong political and financial support and a determination to provide the country with a bank focused on delivering a dedicated financial service to the SMEs and individuals of the Wales.

2. INTRODUCTION

This paper is intended to inform the Minister of the potential for the creation of a new banking institution with a specifically Welsh agenda, provisionally named, The Community Bank of Wales (CBW).

This new bank would have as its core business mission the provision of a wide range of retail banking services focused on both personal and SME customers. By definition CBW would be in clear competition with the existing retail banks and in certain areas with building societies, finance houses and other providers of financial services to this sector of the Welsh economy. There will, therefore, be many vested interests that will oppose the creation of a new competitor, especially at a time when their business performance continues to be under sustained pressure.

Objections raised from these sources will need to be balanced against the perceived continuing inability of the existing banks and financial institutions to service adequately the financial needs of the individual and SME sectors of Wales.

For a number of years the topic of the creation of a “Welsh Bank”, headquartered in Cardiff, designed to serve the needs of customers who might be described as financially excluded along with other traditional retail banking customers, has been informally debated in various circles. This paper will consider whether the subject should be pushed higher up the agenda surrounding the future economic development of Wales. The arguments presented will focus on behaviour and qualitative analysis of the topic. This is not to say that there is insufficient statistical and economic data to underpin the analysis. The fact is, that there is an abundance of data available from an extraordinary number of sources. Interpreting this data is more valuable than simply replicating the very many tables and graphs that are easily obtainable on-line and readily available from the WG’s own economics team. The analysis will, however, refer to the more significant official sources and highlight key statistics to support the evidence of its conclusions. It must be recognized that statistics can equally be used to distort evidence to support counter arguments, which is why qualitative and behavioural aspects assume greater relevance at this point in time.

3. BACKGROUND

The SME community in Wales, in common with all other regions of the UK, depends heavily on the sustained availability of credit to fund growth and expansion. Moreover, as a result of the economic recession that has now lasted for some five plus years, a significant number of SMEs are almost wholly dependent on banking facilities for the working capital needed to survive as viable businesses.

From a review of the Sunday Times Profit Track 100 report, April 14^{th} 2013, only two Welsh-based private companies make the list. In second place, SPTS Technologies, located in Newport and at 37^{th} place, Dawkins Construction of Swansea. Profit Track 100 ranks Britain's private companies by fastest-growing profits. Quite simply, Wales does not have a great tradition of starting and growing large and successful businesses. A Stats Wales table on Business Structure in Wales by size-band provides useful evidence of the distribution of businesses in Wales. In 2011, the table shows, amongst other things, that of 204,280 enterprises in Wales, 94.5 per cent were considered micro business employing between 0-9 people. Indeed, 74 per cent were single owner businesses employing no-one. "Large" employers, employing 250+ people, amounted to only 0.8 per cent of the enterprise count.

All of this is, of course, well-known as is the fact that a large percentage of those in employment in Wales work in the public sector. Between 1998 and 2007, 55 per cent of new job creation in Wales came from the public sector and what has been described as para-state employment. The consequence of this is that individuals who might otherwise start and grow business find it safer and more remunerative to work in the public sector. This tendency can only have been reinforced by the recessionary state of the economy since 2008.

What relevance does all of this well-worn information have for considerations about the possible need for the creation of a new bank for Wales? Looking through and beyond these statistics it is possible to suggest that it governs the way that the traditional banks top management view Wales as a market for their services. It informs their strategies for Welsh branch networks, products and services, and much else including their attitude to credit and risk exposures. It is a proposition of this report that the underlying attitude of London and Edinburgh based HQs clearly influences the availability and quality of financial services in Wales. A behaviour that has been consistent over many years, but disguised during times of “easy credit”, seriously impacts in a negative way the sources of funding and capital available to Wales. There is no indication that this behavioural culture will change even after the recession has eventually turned the corner. This is not to suggest that Wales has been singled out for neglect, but more a recognition of what would appear to be rational decision-making from HQs.

As unacceptable as this view would be to the many good and professional retail bankers in Wales, the shots are called elsewhere, and later it will be argued that even the business models of all the retail banks in Wales militates against the provision of adequate credit and services vital to the economy.

4. THE PROBLEM FOR SMES IN WALES

Since the autumn of 2007 the crisis that has been labelled “The Credit Crunch” has had a devastating impact on global banking, with the UK and US banks amongst the most badly impacted, at least initially. The consequences of this crisis are far reaching and demonstrate most clearly the crucial role that banks play in the health of economies. There is limited value to this report in reciting the causes of the credit crunch, although some comments on the behaviour and ethics of the senior management of our largest banks would not go amiss. Resisting this and moving on, there are some significant lessons to be learned from the events of the last five years, not least those that bring into question the ways banks should be organized and managed in the future. First, however, and particularly significant for Wales, has been the impact on the economy of the drying up of the supply of credit. Until 2007, banks were desperately keen to lend money to expand their balance sheets and to produce ever increasing profits, to satisfy the insatiable demand for senior executive bonuses and consistently growing shareholder value. This was a period of “easy money” that came to an abrupt end in late 2007. Since then banks have been consistently reducing their assets, particularly their lending books, as a result of the need to clean up bad loans and to conserve capital in order to comply with tighter regulatory capital and liquidity controls. The impact on the UK economy generally and the Welsh economy particularly has created the double-dip recession and the continuing weakness that still today constrains economic growth.

Seriously reported anecdotal evidence gathered from a series of regional workshops led by Dyfrig John, Liz Davies and Gerald Davies for the previous Minister, consistently produced complaints about the retail banks inability in Wales to provide the loan facilities needed. In the series of economic summits originally chaired by Rhodri Morgan and subsequently by Carwyn Jones, the message from diverse sections of the Welsh economy, from the Federation of Small Business, from the Trade Unions, from the Confederation of British Industry, from leaders of specific sectors such as Construction, Retail and Technology, all argued that the scarcity of bank finance was seriously damaging Welsh businesses.

The banks’ response to this, remarkably consistent between them, was that reduced lending statistics reflected the lack of demand for new loans. They reported that around 85 per cent of all new loan applications were being approved. This may well have been at least superficially true, but went against the evidence being reported from all the sectors noted above. An explanation for this, and an example of statistical disingenuity, could be that demand was low because customers had anticipated being turned down, or had had their request refused at branch level.

In these circumstances, an 85 per cent approval rate of a much smaller number of loan applications would not be a meaningful measure of loan availability or commitment to lend.

If we considered the most valuable source of information on lending statistics, the Bank of England Quarterly reports on banking conditions and credit, a more accurate picture emerges. Banking lending to all business sectors, but especially SMEs, has reduced consistently throughout the recession. Even the most recent reports contain the following statements:

Bank of England Agent's Report May 2013:

"Many smaller firms without suitable collateral found their access to finance remained constrained, with little change in banks' risk appetite reported – sometimes exhibited in protracted decision-making processes around loan applications"

and,

"A growing use of non-bank finance was reported by SMEs, albeit from low levels, including from peer-to-peer lending, crowd funding, venture capital funds and insurance companies and pension funds".

The major UK banks, BARCLAYS, RBS, LLOYDS BANKING GROUP, HSBC, SANTANDER AND NATIONWIDE, together account for 70 per cent of lending to businesses. The annual growth in the stock of lending to UK businesses was negative in the Bank of England's "Trends in Lending Report", January 2013, with lending to SMEs contracting over the period.

Apart, therefore, from the obvious disingenuity in the banks continuing positioning around there being limited loan demand, the obvious consequence of this is that SMEs are being starved of credit. As SMES make up the largest majority of businesses in Wales we can safely say that the banks have not been operating effectively in their classical role of transforming the surplus funds of depositors into the loan demands of borrowers. SMEs in Wales have undoubtedly suffered badly in recent years. Indeed, even when lending has been available the cost of credit has increased at a time of historically low base rates.

The following is a quotation from the recently published book by two leading US academics, Admati and Hellwig, called "The Bankers' New Clothes":

"When banks get into trouble and cannot continue lending, the effects on small businesses tend to be particularly large. Reductions in bank lending to businesses play a major role in the transmission of banking problems to the rest of the economy."

This has without doubt or argument being exactly the problem caused to the Welsh economy by our malfunctioning banks in the UK.

5. FURTHER PROBLEMS FOR SMES FROM THE MAIN BANKS BUSINESS MODELS

Highlighting the problems Welsh SMEs face in obtaining funding for their businesses is fundamental to any consideration of whether a solution lies in the creation of a new bank specifically targeted on this sector of the economy. If, as we believe, each of the large retail banks essentially operates with the same constraints, it follows that there is no obvious immediate remedy to come from them to end this problem. If it is further anticipated that there is a continuing requirement by the regulators for UK bankers to increase their capital, then it is unlikely that in the near future there is going to be much change to their existing capacity for SME lending.

The UK Government has introduced and subsequently recently improved and extended its Funding for Lending Scheme aimed at encouraging lenders to provide more and cheaper loans to SMEs. While this is superficially good news, there is still no obvious sign of a significant increase in the banks' appetite for SME business. A recent quote in the Financial Times (April 25th, 2013) sums it up:

"Banks have become less and less important " said Jeff Barber, a corporate finance partner at Begbies Traynor, the professional services firm. " There is no choice in the banking sector because they are all the same. There is a herd mentality. They all over-lent in the boom and now they are either not lending at all, or very selectively." An accompanying chart shows SME lending falling from around £130 billion in 2009 to less than £100 billion mid-2012. As we know from the Bank of England Statistics SME lending has fallen further and continues to be constrained across the board of the large retail banks.

Other initiatives by the UK government to encourage competition in the market by introducing new banks have made it somewhat easier for new banks to be formed. Several banks have been formed in the last few years. Metro Bank PLC was granted a full-service banking licence in 2010. Another small bank, Aldermore was launched in 2009, supported by Anacap, Europe's largest private equity investor in financial services. According to Aldermore's website: "We believe that consumers and SMEs deserve better and we are putting more and more investment into delivering financial expertise that customers can trust."

On the 28th May, 2013 Dr. Vince Cable visited Aldermore's HQ in Reading and said:

"Recovery needs to be driven by SMEs. It's the SMEs that will turn this around. They need to be supported by banks". From Dr. Cable's remarks it is clear that Government sources at a senior level still do not believe that SMEs are getting the funding they need to kick-start the economy. The banks' continued insistence that there is insufficient credit demand has worn thin: they are not lending for at least two reasons.

First, they are capital constrained and they are focusing on restructuring their businesses by selling off assets and bad loans, and reducing their loan books to comply with tougher regulatory requirements. But second, and again this is something that will induce denial mode, the business models they all adopted during the boom years has left the banks short of trained lenders, capable of analysing small businesses in the traditional way.

The following analysis, by default will indicate the lessons a new Community Bank for Wales can learn from the failures of the traditional retail banks. As suggested above, one of the key reasons why SMEs cannot obtain credit, is that the banks have moved their experienced bank managers from their branches which have, by and large, been turned into “shops”. Credit approval authority has been lost with the wide scale adoption of remote credit approval departments relying heavily on computer driven, quantitative scoring technologies. This model has deprived the banks of the ability to assess creditworthiness based on knowledge of the customer personally. The branch banking model adopted by all the main clearing banks in fact leaves them vulnerable to bad debts. The traditional model of branch banking where the local manager personally knew his customers was largely abandoned in favour of the creation of a sales-driven culture. Loan applications analysed remotely are inherently dangerous. SMEs often depend on an owner- driver and the character and personality of the management as much as a rudimentary review of financials and collateral by someone in Mumbai or the Isle of Man.

The success of Sweden’s Handelsbanken in the UK is evidence of a different way of doing banking business. From their website:

“As a Handelsbanken customer you only ever deal with people you know by name and the discussions about your banking are made at your local branch”.

Handelsbanken opened its first branch in the UK in 1982 and now has over 150 branches across the country. The secret of success is that it operates the traditional branch banking model that used to be the way all UK clearing banks worked until the 1980s and 1990s when they all progressively migrated to the present retail shop model.

In contrast to the UK banks, the managers at Handelsbanken can make credit decisions locally based on their knowledge of the local community and its personalities. There is no intended criticism here of the employees of the retail banks in Wales. Their business models and work content derive from senior executive decisions. The ability to lend or not to lend to SMEs in Wales is for the most part taken out of their hands, with Head Office policy dictating limits on amounts and on business sectors. In the context of UK-wide lending policy, Wales will most probably be disadvantaged by the demographics we saw earlier. Too many very small businesses and not enough large business. A small population with a high proportion of lower-income earners or retired people is not especially exciting to bank retail strategists either. In this context, Wales does not appear to be a highly attractive market for traditional banks, especially those constrained by credit rationing, with high cost structures and under pressure to increase their capital ratios. In some ways it might appear that there is a legacy effect continuing to constrain the provision of banking services to the Welsh economy. In recent times the focus of the top management of the UK banks on profits and bonuses has crowded out traditional banking services. Apart from the wholly disproportionate focus on investment banking and trading activities (Casino Banking) over retail banking, it also became a feature that small offices dealing with corporate relationships would be more profitable than servicing the community through a branch network. Hence, the closure of many branches throughout the UK in recent years. With this strategy in the background it is easy to see why Wales would not have featured high on the agenda for investment in retail banking service. Obviously no bank would admit to this or accept it as a specific strategy of neglect. No matter, the consequences for the population and Welsh SMEs are the same. The Welsh business community along with individual customers have not received the service from the banks that they would have expected after all the courtship throughout the boom years. This is hard on the decent and competent employees of the retail banks in Wales, but their ability to influence things has been sadly low.

It has to be recognized, however, that not only has the business models adopted by the retail banks been a failure, but the traditional service standards of the industry have declined at an alarming rate. Customer dissatisfaction with banks is probably at an all-time high. UK Bank Complaints Statistics for 2011 reached 2.5 million incidents. Given the scandals such as Libor fixing, money laundering for Mexican drug barons, money laundering for the IRANIAN government despite UN sanctions, and a host of other corporate misdemeanours there is no doubt that complaints for 2012 will rise again, as they have for the last six consecutive years. This translates into an opportunity for newcomers to enter the UK banking scene with reputations untarnished by years of appallingly bad customer service standards by the traditional UK retail banks.

6. A PROPOSED SOLUTION

There has got to be a better way.

As long as the main banks continue their present strategy of rationing credit to those they consider "creditworthy" (a vague and challengeable concept), and to maintain the mantra that there is insufficient demand, then the Welsh SMEs and consumers will be badly served. There is already some evidence that SMEs are turning to alternative sources of funding, from friends and families, peer to peer lending groups and others not so scrupulous providers of "pay-day loans". This is an inappropriate and unacceptable situation for the country and the people of Wales.

In other parts of the world there exist within their financial systems, banks and institutions that are specifically focused on providing a more responsible economic development function and fulfilling the classic responsibilities of banks to their customers and communities. These organisations are thriving and have continued to do so through the credit crunch by retaining the trust and loyalty of their customers that the UK banks have largely now lost. This latter point is important, because the traditional reluctance of UK bank customers to switch banks has been changed as a result of the banks' behaviours, not only the bonus scandals and excessive greed of their senior executives, but also the events that have led to large multimillion pounds fines by regulators for various transactions that were not legitimate. Nor should it be assumed that new or smaller, or more community focused banks will be unprofitable.

Recent research by the Global Alliance for Banking on Values, a Netherlands-based membership organisation for microbanks, credit unions and community banks, has shown that "sustainable" banks can outperform the large banks when measured by a return on assets. They specifically focus on US Community Banks with assets between $100 million and $10 billion and consider their success due to the close linkage with the real economy and their local communities. Community Banks are typically funded largely by customer deposits and municipal bonds which are a more stable source of funding than the volatile money markets funding of the large global banks. A good example of US Community Banking can be found by visiting [www.gabv.org/ourbanks/sunrise-community-banks.](http://www.gabv.org/ourbanks/sunrise-community-banks)

The analysis will return more specifically to consider US community banking later, as there are also other interesting examples of banking models that differ from the UK retail banking sector and which provide a better solution to SME funding needs.

Both German and Switzerland, two of Europe's most successful economies, have banks with specific business models that are different from the UK's largest retail banks. In Germany, the saving banks (Sparkasse) hold about 1/3rd of the country's bank assets. In Switzerland, the Cantonal Banks also play a major role in funding businesses and individuals. Both the German Savings Banks and the Swiss Cantonal Banks are legally restricted to operating within a defined geographical area, and second they must function as commercially sound businesses, whilst serving the interests of their local communities. They are legally obliged to provide bank accounts for all and to make loans and other financial services available for local businesses. They are not expected to be profit maximising, but nonetheless commercially viable while providing social objectives. This model is known as "the dual bottom line".

The German Sparkasse are public-sector institutions. The funds they have available for lending are primarily customer deposits which must be safeguarded. Germany also has credit guarantee banks that are non-profit associations of lenders within each federal region. Historically these guarantee banks would provide sureties worth 80% of loan value with the borrower's risk being 20%. As a result of the recent financial crisis the German Government has encouraged guarantee banks to cover 90% of the loan risk.

In contrast to the UK situation, a report by the German Central Bank, Deutsche Bundesbank, in August 2010, showed that while credit conditions in the UK had become more constrained, the German Savings Banks saw an overall positive change in lending volume. However, during the same period, 2009/2010, as in the UK, larger firms borrowing from the large German banks suffered a reduction in lending from those banks. So, the 75% of SMEs in Germany that are clients of the savings banks did not witness a credit squeeze. This is in stark contrast to the experience of Welsh SMEs and no doubt why the German economy remained relatively strong during the early stages of the recession.

Statistically, according to evidence by the Warwick Business School, Centre for SMEs, in 2009, in Germany start-ups obtained 27% of their finance from banks compare to 12% in the UK. This means that UK entrepreneurs have to use far more of their savings or other sources of finance than their German counterparts.

As public bodies, German savings banks are governed by regional laws that stipulate that they must encourage prudent and successful financial management by their customers and satisfy the credit demands of local business. Linked to these laws is the further stipulation that any trading surplus must be used to pursue wider social objectives. German savings banks also focus on relationship banking based on qualitative risk assessment rather than the UK's transactional lending based on quantitative, credit scoring techniques. So yet again this contrasts completely with the way the UK retail banks have developed their lending policies in the last couple of decades.

Switzerland likewise offers a very different picture for SMEs from the UK. The large Swiss banks like UBS and Credit Suisse, in common with the large German and UK banks, suffered badly from the credit crunch. However, unlike the UK, Switzerland has other retail banks, Cantonal Banks, which have maintained their lending. Cantonal Banks belong to the 26 federal states, or Cantons, that have their own legislature, constitutions, courts and governments. Each Canton has its own Cantonal Bank, either wholly-owned or at least 1/3rd owned by the Canton. Interestingly, when considering the Welsh Government's potential interest in creating a Community Bank of Wales, some Cantonal banks are jointly owned by private sector shareholders and the Cantonal Government. Like the German Saving Banks, Cantonal Banks have the "dual bottom line" purpose and likewise the majority of Cantonal banks have stuck to the business of supporting local business and not got involved in investment banking activities.

What is apparent from the above is that there are alternative financial systems and banking institutions that can perhaps better serve the SME Community and by so doing, the wider economy.

In many ways the contribution to the UK economy from financial services, based largely on the City of London, has concealed the fact that for many years the retail banks have not serviced the SME and consumer sectors as efficiently as may be thought.

The City of London is arguably the world's largest financial centre, along with New York. The contribution to the Exchequer has been so large that some of the more dangerous weaknesses were not exposed until the recent crises. This situation has now changed and it is more essential than ever to consider new ways of serving the SME sector that contributes so importantly to the economy.

Another country where a different institutional structure seems to better serve local small enterprises and lower-income individuals in the USA, where Community Banking is long established and ingrained into the financial system. An important piece of US legislation has also driven support for localised borrowers who are perceived to have special needs. In 1977 the US Congress passed the Community Reinvestment Act (CRA) aimed at reducing discriminatory credit practices against low-income neighbourhoods. This law was designed to encourage commercial banks and savings and loan associates (akin to UK building societies) to help meet the needs of borrowers in all segments of their communities. To enforce the law, federal regulatory agencies examine banking institutions for CRA compliance. In December 2010, amendments to the CRA were made to encourage financial institutions to participate in activities aimed at revitalizing neighbourhoods particularly damaged by the credit crisis. In addition, the Small Business Jobs Act of 2010, empowered federal banking agencies, the Federal Reserve and the US Treasury, to implement its Small Business Lending Fund Programme (SBLF). The SBLF is intended to facilitate new lending to credit worthy SME borrowers by providing affordable capital to support Community Banks.

Community Banking in the US is currently experiencing a surge of growth owing to a number of factors that are relevant to the Welsh experience. The large US big name banks, Citibank, Bank of

America, Wells Fargo, JPMorgan Chase along with the larger regional banks have all been cutting back on their loan books, “deleveraging” as it is known. Against this background, Community Banks have seen their more conservative, simple products, relationship management style of banking become increasingly attractive. According to a leading Community Banking expert, Vincent Boberski, in his 2010 book entitled “Community Banking Strategies”, when looking at the competition with the larger US banks, stated: “Client relationships are there for the picking.” This would undoubtedly also be true in the UK.

A simple review of the website of one typical community bank easily reveals the difference that a US SME or individual customer would experience compared to a Welsh SME customer. On the site of the Community Banks of Colorado, a full range of traditional banking products and services are clearly displayed, including costs. Checking out the section on commercial loans for SMEs, the first thing to read says:

“Tired of waiting for loan committees to answer your financial needs? Community Banks of Colorado does not have loan committees, just highly qualified bankers ready and empowered to serve your business financial needs”.

Under “Small Business Solutions” the loans are clearly displayed in a matrix of loan amount, uses, minimum payment terms, duration of loan and the interest rate. Accompanying this is a promise of decisions in as little as 1 day and the decision to be made locally.

This approach, which is typical of the US Community Banking business model, contrasts completely with the sort of experience a SME in Wales would get from the bank. In the UK the loan decision will not be made locally (unless it's a quick no!), where the time between the loan application and approval/refusal will be certainly much longer than 1 day; where the pricing of the loan will be expensive and opaque.

Now the large US banks suffer from the same lack of customer trust and confidence as the UK banks, but there are signs of some forms of partnership between the big commercial banks and the Community finance sector. According to research by Mr. Tony Greenham, Head of Finance and Business at the New Economics Foundation think tank:

"The US community development finance institutions are particularly good at lending to low-income groups. The big banks support them with capital, systems support and training, because the regulatory system has forced them to do that under the Community Reinvestment Act."

The US banking system also has very developed Credit Unions providing banking services to low-income families and small businesses. US Credit Unions are not unsubstantial either. The annual report for 2012 for one Colorado Credit Union, Bellco, provides interesting reading:

"Our assets increased by $175million in 2012, bringing total assets to $2.2billion. Membership also increased by a record breaking 20,530 new members. We originated over $1.1 billion in loans to help members meet financial goals. In 2012, we also made a greater commitment to business lending, and saw this area increase by 100%, doubling our portfolio. Member satisfaction rating increased to 94%.

Bellco, the credit union, has 214,000 members. Bellco is a not-for-profit banking service, where profits are returned to members in the form of lower loan rates. Bellco has 19 locations in

Colorado, a US State with a population not much larger than Wales. As part of its social responsibility mandate, Bellco supports the arts and entertainment fields, sponsoring concerts and lectures at the Bellco Theatre.

Financial exclusion is a social concept that is surely present in Wales. Financial exclusion applies to individuals and microbusinesses deemed too poor and not sufficiently attractive to be worth providing banking services from the large commercial banks. For these people, credit unions exist in various shapes and sizes around the UK. Many are staffed by volunteers. According to the Credit Unions National Association, UKCU, membership is rising as more people are seeking an alternative to the big banks. Credit Unions may well continue to grow, but a specific financial exclusion problem looms with the imminent introduction of the UK Government's new universal welfare benefit, which will oblige recipients to have a bank account, and in addition they will receive their payments monthly in arrears.

This may provide an interesting opportunity for a new bank, if the example of the National Australia Bank (NAB) is something to go by. Since 2011, NAB has launched a series of products and services, including the NAB Microenterprise Loans Programme and its Indigenous Money Mentor programme. In the two years since the launch of this initiative, NAB has gained over 1 million new customers.

What much of this report shows is that there is ample evidence from around the world to show that there is a growing awareness by customers that banks should work harder for their communities in order to regain respect and trust that in so many cases has been severely damaged. A more ethical approach to banking is something that globally seems to work better. In the UK and elsewhere customers are now more likely to reject the greed and poor behaviour of banks in favour of institutions with higher professional standards. According to "The Move Your Money" campaign, an estimated 500,000 people transferred their current accounts from the big retail banks in the UK to ethical alternatives between January and July 2012. These alternatives include Building Societies, Credit Unions and co-operatives. The Co-operative Bank claimed 100,000 new customers in the space of two months during the summer of 2012. A Netherlands-based ethical bank, Triodos Bank, was formed in 1980 with start-up capital of Euros 540,000. Since the beginning of the banking crisis in 2007/2008, Triodos has more than doubled in size. In 2012 Triodos Bank grew its balance sheet by 23% to Euros 5.3 billion, increased its loan book by 16% and customer members grew to 437,000 with a net profit of Euros 22.6 million. Clearly there is a demand for ethical banking. Recent financings by Triodos included a bond issue for Golden Lane Housing, a subsidiary of MENCAP, and financing for Jamie's Farm, a family run project that supports the development of vulnerable young people.

It is hard not to conclude from some of this evidence that the UK's retail banking system is dysfunctional when it comes to the provision of credit services to significant sections of the economy that is SMEs, lower-paid individuals and the unbanked. It is difficult to say that larger companies and middle to upper income customers fare much better.

What we can see from many different countries is that during the worse banking crisis in living memory, banks that have close links to their communities, with simple conservative business models, with a strong customer focus, with social and community responsibilities, with well-trained bankers capable of making credit decisions quickly and locally, banks not dependant on remote, quantitative credit scoring processes for risk management, banks that avoid casino banking and abstruse overly complex financial products; around the world such banks have largely continued to prosper.

The large UK banks have been characterized as “too big to fail”; they may also be “too big to change” and therein lies the opportunity for a new model bank, the Commercial Bank of Wales.

7. SETTING UP A NEW BANK

There has been quite a bit of interest in starting new UK banking institutions in the last few years, surprisingly so perhaps against the background of the global banking crisis. Some of this interest follows the publication in 2011 of the Vickers’ Report, officially known as the Independent Commission on Banking (ICB). Amongst other things, Vickers recommended that the banks should be referred for a competition investigation. Much of the report focused on the damaging consequences to the economy of the acute lack of competition between the banks. The report recommended a system to make it easier for customers to switch accounts from one bank to another. A key recommendation of the ICB is the ring fencing of retail banking from investment banking activities, over a period up to 2019.

Of more immediate relevance, however, was the finding that customers suffer from opaque charging structures on many accounts, particularly in relation to overdraft charges. This contrasts badly as we have already seen with the typical transparency of product pricing by the US community banks. The ICB recommended that there should be a strong new challenger in the market to provide a competitive alternative to the existing banks. More importantly that the new Financial Regulator, the Financial Conduct Authority (FCA) should have “a primary duty to promote effective competitive.”

Since the publication of the Report, the UK Government, especially the Chancellor George Osborne and the Business Minister Vince Cable, have repeatedly shared this receptivity to new banking formations in the UK. Recently, the outgoing Chairman of the FSA stated that new banks could need as little as Euros 5 million (£4.25m) of capital to get started. The FSA have announced plans to make it easier to establish a new bank, including cutting the time taken to get approval to 6 months from the previous up to 2 years. Sophisticated applicants with capital, it and experienced senior management in place are now expected to get a decision on authorisation in 6 months and a start-up will require only 4.5% of core tier one capital compared with up to 9.5% for the bigger banks.

This new regime will be policed by the two new regulators, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). These authorities will oversee the enforced disposal of branches by Lloyds Banking Group and RBS, both of whom need to release 600+ and 300+ branches respectively, following their taxpayer bailouts that prevented their certain bankruptcies during the financial crisis. Lloyds recent failure to conclude a sale to the Co-operative Bank has led them to announce that they will consider floating the branches under the TSB brand name. Meanwhile, RBS have mooted a similar exit model with the branches forming a new Williams & Glyn’s Bank, restoring a traditional banking brand name to the High Street. However, these plans proceed, the UK Government's support for new start-ups remains strong. A recently reported quotation from Mr Osborne is indicative of the new attitude to competition in retail banking:

"Our banking system is too concentrated. We want new banks on our high street offering real competition and challenging for better customer service. I am determined to fix that."

Clearly then, a well-capitalised institution with say, £50 million of capital, unencumbered by legacy assets would be well placed to gain a banking licence.

Apart from Capital what else would be needed?

Without doubt much would depend on a well-researched and documented 5 year business plan demonstrating sufficient capital to withstand difficult economic conditions and provide appropriate start up investment. The new bank would need to demonstrate conservative lending policies, a robust IT system, an experienced team of FCA regulated directors, both executive and non-executive, and solid liquidity arrangements. Putting all this together would make a six month process seem unrealistic, but 12 months would certainly seem feasible with all the appropriate support mechanisms in place.

The specific business objective of the Community Bank of Wales would be to serve the microbusinesses, SMEs and lower and middle income individuals of the country; providing a banking service for all on a not-for-profit basis and with a community development focus as a clear mission. However, this should not rule out the provision of banking services to a broader range of customers, especially if Finance Wales were in some way linked to CBW. Perhaps a complication too far at this stage.

8. CONCLUSION

It is the writer's view that the Welsh economy has been badly served by the large UK retail banks for many years. The provision of credit and debt finance during the last five years has been dire. This is not pointing a finger at the local bank staff in Wales because they are employed in dysfunctional business models and have been constrained by poor senior executive decision made at Head Offices in London and Edinburgh.

There is no obvious evidence to suggest that this situation will change. The business demographics of Wales simply do not fit into the current retail banking strategies of very large organisations with their huge cost bases. In retrospect it is doubtful that Welsh businesses were adequately served even during the easy money period. Providing easy loans without due business consideration and then withdrawing the facilities at the first sign of difficulty is not good banking practice. The business models adopted by all the large retail banks have failed the business community, and continue to do so with serious economic consequences.

We have shown that other models are possible and better serve their local communities and hence produce a more robust larger economy. The Community Bank of Wales would not be inventing a new wheel. The focus should be to assess and adopt the best practices from community banks, Sparkasse, Cantonal Banks, Credit Unions and others that have a "dual bottom line" mission. The Welsh Government undoubtedly has the financial resource to set up a CBW and with sufficient determination to deal with the usual nay sayers could break the mold of a banking system that has failed our people, our businesses and ultimately our country.

ABOUT THE AUTHOR

Colyn Gardner began his banking career as a Graduate Trainee in 1970 at Natwest, 117 St Mary St, Cardiff branch. He was quickly transferred to the bank's flagship branch at Corn Street, Bristol, before further relocating to the bank's Head Office in the City of London. During this period Colyn completed his professional bankers examinations and qualified as an Associate of the Institute of Bankers (he has subsequently been awarded a Fellowship). Returning to University, Colyn took a M.Sc. in Financial Economics and a Ph.D in Corporate Finance before returning to his banking career, this time with the US Investment Bank, Bankers Trust Company, where he rose to be Vice President responsible for providing innovative investment banking services to some of the world's largest corporations.

In the mid-1980s Colyn set up his own banking consulting firm based in the City of London and over the next seven years the business was floated on the UK stock market, became a fully-listed main market public company, with offices in London, New York, Amsterdam, Sydney, Hong Kong, Singapore and Cardiff. The consultancy, at one time or other, had worked for over 90 of the largest banks in the world. The business was acquired by the Euromoney Group plc. in 1992 and remains the largest banking training company in the world.

Colyn subsequently founded and floated two further businesses, both listed quoted companies today, the Savile Group plc. and ILX plc. In 2005 Colyn returned to academia as Chief Executive of the Management Centre at Bangor Business School, Bangor University.

In his career, Colyn has practised as both a retail and investment banker; has been a corporate customer of banks through his chairmanship of public company businesses, and an academic and professor of banking and finance. He is currently Pro Vice Chancellor and Dean of the Business School at Sunway University in Malaysia, where he is building a specialist banking studies faculty at both undergraduate and postgraduate levels.

Colyn has been an advisor to the World Bank, The Saudi Arabian Monetary Authority (SAMA) the IMF and other central banks and government agencies in Nigeria, Egypt, the Sudan as well as a number of Middle East financial institutions. Colyn was also a Non-Executive Director of the Welsh Development Agency in the late 1980s early 1990s. He is a Fellow of the University of Wales.