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ORAL EVIDENCE

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PARLIAMENTARY COMMISSION ON BANKING STANDARDS

BANKING STANDARDS

TUESDAY 5 FEBRUARY 2013

BILL WINTERS

SIR BRIAN POMEROY and SIAN WILLIAMS

Evidence heard in Public Questions 3668 - 3765

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Oral Evidence

Taken before the Parliamentary Commission on Banking Standards

on Tuesday 5 February 2013

Members present:
Mr Andrew Tyrie (Chair)
Mark Garnier
Baroness Kramer
Lord Lawson of Blaby
Mr Andrew Love
Mr Pat McFadden
Lord McFall of Alcluith
John Thurso
Lord Turnbull

Examination of Witnesses

Witnesses: Bill Winters, former member of the Independent Commission on Banking and former Co-Chief Executive Officer of JP Morgan Investment Bank, examined.

Q3668 Chair: Good afternoon. You are a specialist adviser to the Commission as well as a witness. We are very grateful to you for performing both roles, today as a witness. May I begin by asking you about regulatory arbitrage? Do US banks currently have an advantage over UK banks in the international capital markets?

Bill Winters: The short answer is yes, but it comes from a number of different sources. It is not straightforward. I say yes, overwhelmingly because the US banks have an advantage in terms of their cost of funding relative to UK and other European banks. That advantage derives from a number of different things. One is that as a group US banks are better capitalised—at least they are perceived to be better capitalised—than European banks, perhaps also better capitalised than UK banks. That is a good reason, or a fair reason, for the advantage. The second is that they are considered to be more explicitly supported by the sovereign, so there is a stronger belief in capital markets, at least relative to the UK. For the US, despite provisions in the Dodd-Frank Bill that would preclude a Government bail-out of a bank, the Government would nevertheless find a way to protect creditors should an American bank get into trouble. That has filtered its way through to a perception that American banks are stronger.

Third, of course, is that the United States sovereign itself is a very good credit, certainly relative to some of the weaker European credits, so that would give them an advantage. Fourth, the US domestic economy is relatively strong. I say relatively, because of course it is not very strong. For those reasons, they have an advantage.

Most relevant for this Committee, if I could offer it, would be the observation that there is more implicit support coming from the sovereign than is the case here. I think the
Government in the UK, obviously supported by your initial report, has made it reasonably clear that British banks will not be bailed out and that creditors should expect to incur loss should they fail at some point in the future, as was designed in the Vickers recommendations and agreed by the Government. At a rhetorical level, the American Government has said the same thing, but as a practical matter the market sees a difference.

**Q3669 Chair:** Do you think there is any regulatory or judicial bias in favour of American institutions over foreign institutions based in America?

**Bill Winters:** I think that’s really debatable. I am not an expert on each individual case, so I cannot offer an objective or very informed view, but certainly in the anti-money-laundering cases recently, with Standard Chartered and HSBC, and the way that the fines around the LIBOR scandal have played out, it would appear that there is a focus on non-American firms over American firms. At the same time, though, I note the tenacity with which the various authorities in the United States—the State Attorneys General, the regulators, the SEC, the Fed and the Department of Justice—have gone after American banks in relation to mortgage lending, for example. It has been quite aggressive and the fines have been extremely large, dwarfing in fact the fines that have been levied in the money laundering and LIBOR scandals. Arguably those were also much larger infractions or crimes, given the magnitude of losses incurred by the victims.

It certainly appears that more recently the US has been focusing on foreign firms, not just in terms of the courts and system of fines, which of course come from many different sources, but also the degree to which the US is—like many countries, including to some extent Britain—focusing extraordinarily on the banking market within its borders, for example forcing foreign banks to separately and fully capitalise their US operations, rather than banks being able to rely on capital from their own country to some extent, as they had in the past. So there is an element of nationalism and protectionism that is creeping in in the US, as it has in other jurisdictions in the world.

**Q3670 Chair:** Is that what is making the US less attractive as an offshore banking market than the UK?

**Bill Winters:** The UK has a history as an offshore banking market. If we go back to the 1970s, when the UK really established itself as an offshore centre for finance, that was precisely because the Americans were unwilling to accommodate benchmarks like LIBOR inside US borders, so dollar interest rates ended up being set outside US borders. That was a feature of policy in the 1960s and 1970s and through to this day. Britain has established itself as a, if not the, leading global financial centre for international business. It happens to be a place where there is also a meaningful domestic banking market—not the size of the US, of course, but nevertheless substantial.

The two things have very little to do with each other, but the US has focused very much on its domestic banking market and protecting that banking market and domestic banks, and has never encouraged the creation of a real offshore financial centre in the US. The tax policy regulation and other incentives that Governments can put in place to support an offshore financial centre have never existed in the US to the same degree.

**Q3671 Chair:** Do you think the measures we have taken, or are in the process of putting in place, will erode that advantage that we appear to have had as an offshore banking market?
**Bill Winters:** Not at all. When I look at the various pieces of legislation working their way through the process, as well as the recommendations from the Independent Commission on Banking, on which I sat, they are all targeted at supporting and protecting the UK economy, the UK consumer and the UK sovereign from the excesses of any aspect of the banking market, be it onshore or offshore. For a pure offshore player operating in the UK, who has never relied on support from the Government in any way, there should be absolutely no effect. The people who will be affected are the banks that have substantial UK operations, which are primarily, but not exclusively, the UK banks. To the extent that the UK banks, most obviously Barclays and RBS as the two large domestic banks, also have large entrepot or international businesses based in London, or at least operating out of the London headquarters, it is the separation of those two activities that will be impactful for those firms, as you know from this Commission. But that should have no effect on international operators who are purely international. If they want to take retail deposits in the UK, then they will be put on the same footing as Barclays, RBS, Lloyds and so on.

**Q3672 Chair:** Therefore we should not be concerned that we have taken a strategy that is, as far as possible, to eliminate the implicit guarantee—certainly to bear down more heavily on it than the Americans have done so far?

**Bill Winters:** No, it should have no direct consequences on the competitiveness of the UK as a financial centre. I have seen the reports that suggest the contrary—I think they are flat-out wrong. I would argue that, indirectly, it should be very beneficial. What we saw through the crisis and the aftermath, the problems that originated from UK banks either via their UK operations—Northern Rock—or via their international operations—RBS, at least to a degree—the after-effect of those failures was a series of policy actions, including taxes on balance sheets, taxes on bonuses and intrusive regulation, to use that term, that were applied relatively broadly across the financial sector in the UK, whether it happened to be onshore or offshore and whether it happened to be really putting the UK taxpayer at risk or not. That is a bad thing for the competitiveness of the UK as a financial centre. Banker bashing is a bad thing, broadly. If you wake up every morning and are lambasted in the press, you are less likely to want to work in that field or work in this town.

Those are reactions to the financial crisis that hurt the UK economy substantially and fundamentally. To the extent that, through the various processes in motion, we get it right, prospectively, international financiers could operate in London without fear that the actions of a domestic bank could have repercussions for them in terms of the way they operate their business, I think that should make it a more attractive place for London to work, and to the extent that the reverse happens, it makes it a less attractive place for people to position their UK employees.

To sum up quickly, the direct impact is zero in terms of the attractiveness of the UK as an international financial centre. The indirect impact of the actions that you are taking is a positive.

**Q3673 Chair:** But the banker bashing could be damaging. When I asked Donald Kohn a similar question about banker bashing in the Treasury Committee, and asked him to compare the US and the UK in that respect, to my surprise, he replied—I am summarising very heavily quite a long answer—that banker bashing was pretty much the same in the US and had been going on for a lot longer, going back all the way back to the '30s, whereas here it is a relative novelty, at least by comparison. Do you agree with that view?

**Bill Winters:** Yes, probably.
Q3674 Chair: Both parts: both the level of bashing—I am using that term—and that the level of having a go at banks is pretty similar?

Bill Winters: I think that it was at a low enough level prior to 2007 that, while it was always there, it was not impacting on the way people behaved or certainly on how they chose to invest in jobs and infrastructure, etc. Since 2007, the level of vitriol in the US was substantially higher in the early stages of the crisis—late 2007 through probably 2009.

The actions of the US Government were quite firm in terms of forcefully recapitalising and quite visibly shutting down, I guess, 600 banks at this point, which were liquidated one way or another through the regulatory process. Obviously, there were 7,000 banks to start with, so as a percentage it is not that big. Those were visible actions that dampened down the banker bashing.

I came back from a visit to the US this morning, and my sense is that it is not anywhere near as topical as it is in the UK today, but nor have there been ongoing PPI scandals that have affected a very large group of consumers. The US has not had that sort of a scandal—recently—and, as much as I imagine that the US banks will eventually be dragged into the LIBOR resolutions, they have not been in the headlines yet.

I should make one more comment. A lot of home mortgages in the US are linked to LIBOR, so if it turns out that one of the American banks was involved in LIBOR-rigging and if there is a suggestion that they were rigging it to the disfavour of mortgage lenders, then I think we can expect a real spike in banker bashing.

Chair: That is a very helpful reply.

Q3675 Mr McFadden: And some lawsuits, no doubt.

Bill Winters: I think that they have already begun.

Q3676 Mr McFadden: We have had a lot of talk in the last 24 hours about ring fences, electrified ring fences and so on, but I want to ask you a couple of things that are not quite on this structural area.

One of the recommendations in the Vickers report was about leverage, and the overall amount of capital that a bank could hold—the rather curious and precise figure of 4.06%. I think Sir John said that he was prepared to drop the 0.06%, but he still believed that it was important to have a figure of around that. The Governor of the Bank of England has already told us in evidence that he thinks that this is important to make banks safer in the future and to insulate them against risk. On the other hand, we have had representations from building societies saying, “This makes it difficult for us,” and the Government appear to be more with the building societies than with the Vickers report or the Governor of the Bank of England. What is your view of this, in terms of the UK going for an international standard of 3% capital overall in relation to the balance sheet or sticking with the original figures?

Bill Winters: There is one other relevant data point out there, which is that the American leverage ratio is 5%, and they have been operating with a 5% ratio since, I think, 1936. It is a feature of the American market, and it is higher than any of the other numbers that have been mooted.

As I am sure you know and have heard from Sir John, the logic of the 4.06% was that, as we were recommending that the risk-related ratios be increased above what at the time was the Basel minimum that had been articulated, we thought that the level of ratio should be increased by a similar proportion, hence the mathematical 4.06%. The figure of 4%, which is
25 times leverage, is still extremely leveraged and at 33 times leveraged, it is even more extremely leveraged. One is only more inappropriate than the other, so I support clearly moving to the higher ratio that we recommended.

I understand the building societies’ concern, which I think is a very legitimate concern. As we have seen time and again, the mechanism for calculating risk-weighted assets is imperfect. The Basel Committee has delivered studies recently that give an idea just how disparate different banks are in their calculation of risk-weighted assets. Equally, leverage ratios are a brute-force approach. I may have said at the Treasury Select Committee last year that probably the one thing on which I changed my view from the beginning of the Banking Commission to the end was the need for a leverage ratio. I went into that process thinking that the leverage ratio is a very imprecise, very brute-force, effectively easily arbitraged method for limiting bank exposure. As we went through the process, I gained some information and objectivity. It became clear to me that to rely exclusively on a risk-weighted asset calculation would be imprudent.

Likewise, to rely exclusively on a leverage ratio would be imprudent, and to the extent that somebody like a building society, because of the way in which risk-weighted assets are calculated, finds that the leverage ratio becomes the only really binding constraint, I think the regulator would need to look carefully at whether the risk-weighted assets were being properly calculated or whether there should be some adjustment in the leverage ratio for a subset of the business, which is constrained.

Building societies are constrained in what they can do, so they have other constraints beyond capital and leverage ratios. I think it would be very legitimate to consider some sort of differential treatment for somebody who is constrained by other mechanisms, such as the building societies. Others could come up, but that would not detract from my overall view that 25 times leverage is plenty.

Q3677 Mr McFadden: I am interested in the final thing that you said: you think that it would be a legitimate policy response to do something special for the building societies here, but still be concerned with increasing the recommended rate for the banks from 3% to 4%. That would be a rational thing—

Bill Winters: That would be a rational response, yes.

Building societies, as I understand it, are discouraged from a regulatory perspective from holding mortgages with greater than 70% loan to value. That is considered to be a pretty low-risk mortgage. It has historically been a very low-risk mortgage, except in California and Arizona where that entitled you to a loss of about 20% of your loan balance. It would be appropriate for a regulator to consider the building society protests because they are constrained in what they can do, so there are other ways to control them. But I would not automatically conclude that the building society model is a very low-risk model, and that that should entitle them to a much higher leverage than would apply to a high street bank.

Mr McFadden: So presumably, given your argument, you would be pretty sceptical about the bank objection that we hear not only in this territory, but in some others—“If you do this to us, we won’t be able to lend to SMEs, home owners and so on.” We had it even from the BBA yesterday about enforcing the ring fence in relation to this 4% issue. Are you sceptical about that argument?

Bill Winters: We have to acknowledge, and we did in the ICB report, that regulatory actions that are taken have the effect of either decreasing leverage, increasing the amount of capital or otherwise increasing the cost of funding, and we stated very clearly that we thought
that the ring fence and associated recommendations could create an increase in cost to the British banking industry of between £4 billion and £7 billion.

We have not updated that analysis, but the amount has probably gone down as the rest of the world have recalibrated their capital levels up. It was a material amount of money, certainly in the context of the profitability of British banks. Assuming that all of that cost was passed through to the consumer, it was not particularly material in terms of the cost of borrowing for the consumer, but it was there. There is a cost, which will either be borne by the bank’s shareholders or the consumer. Those are the only two parties, although there is the Government—and therefore, ultimately, the taxpayer—but I would not suggest that they step in to take up that cost.

Going from 3% to 4% on the margin either increases the cost of borrowing, which should decrease the demand for borrowing, or reduces the quantity, because the available capital effectively reduces. I think it is marginal, however, in the context and relative to the value that we get as a society from having safer banks.

**Q3678 Mr McFadden:** Thank you. I just want to ask you one other thing on a slightly different subject. Martin Taylor gave evidence last week and he told us that his position against allowing ring-fenced banks to provide derivatives to customers has hardened. He said that he was now really worried about that and described it as a category error to allow it. He sees this as a gaping hole in the ring fence, not to tire the metaphor too much, precisely because of the way that everything is hedged these days, which makes the balance sheet grow if the banks are then hedging against the risks and so on. What is your view on that?

**Bill Winters:** We debated this issue at length inside the Independent Commission on Banking and it is safe to say that none of us thought that it was very straightforward one way or the other. There are clearly synergies for the bank and its customers, especially small businesses, which have real risks. They export to the eurozone or to the US or to Asia and they have currency risks, which need to be hedged. While it has been unfortunate for anybody who locked in their interest rates over the past three or four years, because interest rates have only gone down, we all know that interest rates also occasionally go up and most certainly will go up at some future point. No one would accept the idea that small businesses should find it harder to hedge their real risk than large businesses. They should be able to manage their risk appropriately. Of course, we have seen that small businesses are also vulnerable to mis-selling, and that is a separate but related issue to the question.

The flipside is that it relates to the efficacy of the ring fence. Derivatives, particularly as they become more complicated, provide all sorts of avenues for banks—or corporations for that matter—to effectively move around value and cash from one place to another in ways that cannot easily be tracked. I read with interest this Commission’s first report, which had what I sensed was a reluctant conclusion.

**Q3679 Mr McFadden:** It was a “yes, but” conclusion.

**Bill Winters:** Yes. It was about keeping it simple, making it transparent and ensuring that the derivatives are for bona fide customer-driven reasons, rather than for banks somehow to manage their liquidity position. I do not think it was in your report, although it was certainly in ours, that banks, as building societies do today, need to be able to manage their own risks. To the extent that banks are offering fixed-rate mortgages out of their ring-fenced bank, they will need to enter into interest rate derivatives to manage the interest rate risk. We would never want to preclude them from engaging in proper risk management.
There will be simple derivatives, of one form or another, inside the ring fence in any case, because there have to be for the treasury operations of the bank, otherwise we would be forcing them to take imprudent risk, which no one is suggesting. The question is: can regulators properly police this concept of “simple” or the underlying motives? I say that it will be difficult, but not impossible. The alternative is to say, “You simply cannot manage your risk, either for yourself or for your customers inside the ring fence”, which would be the wrong conclusion in my opinion.

**Q3680 Chair:** What about our suggestion that we cap it out against some measure, such as assets?

**Bill Winters:** I think the benefit of a cap would be to provoke a conversation where you go from a high level of diligence to an extraordinarily high level of diligence, by giving the regulator a trigger point to go in and ensure that things are on track. I am not sure it would be that straightforward to identify what the cap is at the outset. If you took a cap approach, but effectively were open-minded about adjusting that cap as appropriate, it would seem like a useful tool for a regulator to be sure that the bank stayed on its toes and that the regulator had an ability to intervene naturally.

**Q3681 Lord Lawson of Blaby:** May I move, Mr Winters, from financial stability and the stability of the banking sector, which was quite rightly the concern of the ICB, to the question of culture which we have been specifically asked to address as a Commission? Our first witness on this was Paul Volcker. He said, apropos of proprietary trading: “I guess that my biggest concern is not actually the risks; it is the damage that it does to the culture of the whole institution.” Are you concerned as he was, and obviously Parliament was in setting this up, about the culture of banking?

**Bill Winters:** I am very concerned about the culture of banking, how it drifted before the crisis, how it responded to the crisis and where we will end up. It will be different, for sure. Yes, I am very concerned about the culture. On Paul Volcker’s point, culture or the migration or the perversion of the culture no doubt had a lot to do with the incentives that were in place along the way. I think the incentives in turn really came both endogenously and exogenously. Endogenously, they came as much as anything from the fact that Governments were implicitly allowing banks to operate with tremendous advantages relative to any other participating capital markets. That was the transfer of value from taxpayers to banks and from banks to bankers, not just proprietary traders but clearly they were part of the beneficiary.

What we can see in retrospect was grotesque and completely inappropriate and highly damaging. That is a clear observation. Certainly through the ICB’s work we have tried very hard to remove that transfer from the taxpayer to shareholders or to the bank. We did not address, because we were not asked to, the incentives issues directly. Clearly plenty of other people have addressed the incentive issue. I think the progress that has been made on the regulatory front, but also in terms of bank governance, has been very helpful in that regard, and much closer to what I think is an appropriate alignment of incentives between banks, bankers and their customers and their ultimate back-stop, which is the taxpayer. I don’t see the need to identify proprietary trading as particularly different in that regard from any other activity engaged in by a bank, whether that was providing advice or selling risk management products to a customer, recognising that those risk-management products, it would appear in retrospect, were frequently mis-sold.

There were incentives for people working inside banks to misbehave. The incentives were straightforward. If you misbehaved and didn’t get caught, you got paid a lot of money. The money was available, either as a result of the misbehaviour or as a result of the
Government subsidy or some combination of the two. We need to flush that all out. I don’t see proprietary trading, from a cultural perspective, as any more damaging, egregious or likely to create the wrong sort of culture in a bank than any other banking activity. We have seen plenty of instances of misbehaviour. Almost certainly we have seen many more instances of misbehaviour outside of proprietary trading than inside.

Perhaps what Paul Volcker was getting at was that if you have people sitting on a trading floor who are paid a percentage of their profit—recognising that they are given a lot of capital to deal with so the profits can be very large, which means that their bonuses could be very large—that just is not consistent with good customer service or traditional banking with the guy sitting next door. So this person over here is paid £60,000 and this person over here might make £6 million if he happens to roll seven at the right time and in the right sequence. That is a very fair point. Certainly in my experience that was a difficult management challenge. The best way that I have developed to deal with that spectrum of activities within one organisation and one culture is to say that everybody has the opportunity to out-perform against their specific targets, subject to behavioural and capital constraints; if you out-perform, good things will happen—you will get a better job or a bigger job, or you will be paid more money, or some combination the two—and he or she who misbehaves will lose their entitlement to a position altogether.

If the person who is processing mortgage foreclosures really wants to be a proprietary trader, then, like the proprietary trader could at the beginning of his or her career, he can apply for that job. If he cuts the mustard on the first pass, he will get a little bit of capital to play with, and if he continues to cut the mustard, he will continue to move up. Basically: be my guest—give it a shot if you really think you have it, and we will treat you like anybody. Of course, very few people ever did. There is a particular type of person who processes mortgage foreclosures and a different type who has the attributes of a very strong risk-taking trader.

I do not reach the same conclusions as Paul Volcker does, that proprietary trading should be an area of particular focus. I certainly don’t agree that the Volcker rule, which was not primarily a cultural tool, but was primarily a financial stability tool, is the most effective way to achieve the objectives that he, quite correctly, set out.

**Q3682 Lord Lawson of Blaby:** I deliberately did not mention the Volcker rule, because the context was different. You in the ICB discussed the Volcker rule in a different context, not the one I am talking about.

I was interested in everything you said. It seems to me that the culture is very difficult to deal with and no one course of action will be sufficient; perhaps a whole battery will still be insufficient, but it might help. My question is will this help? I was surprised to hear you say that there is no difference between the culture of serving a client and the culture of proprietary trading. Most of our witnesses—I will not quote names, but they are all on the record—have said that there is a distinction between the culture of serving a client and the culture of trying to maximise your own profits on your own book.

**Bill Winters:** Just to be clear, the culture is very different. I probably didn’t explain it properly, but my observation was that the two cultures do not need to be incompatible in a single organisation, but it is very difficult to manage.

I worked in a small investment bank—small on the global scale—that was acquired by and merged into a big universal bank. During that experience, one of the things I noticed was the degree to which the investment banking culture—a bonus culture, a high compensation culture, relatively short-term oriented—had infected the retail portion of the commercial bank into which we merged. There were people running mid-sized businesses in credit cards,
mortgages, consumer loans or small business lending who were paid well above their counterparts at pure retail banks, because they were being measured against investment banking-type metrics—return on equity, for example. That struck me as very bad management of two different cultures within a single organisation. As we refined the management of that company and as new bosses came in, they were much more deliberate in terms of recognising that these are very different cultures that need to be managed differently. To the extent that they can co-exist in a single organisation, each subset needs to understand why they are different and how they are going to be treated differently. As I tried to explain, but probably not very completely, the safety valve, so that you didn’t get deep resentment between one division and another, was to say to people, “If you want to switch divisions, be my guest. It’s not easy, but you can give it a shot.” That released a lot of the tension.

Q3683 Lord Lawson of Blaby: You have expressed very clearly and eloquently the concern you felt about the culture of investment banking somehow infecting the culture of retail banking, and these are different cultures. Do you accept also that there is a risk of the hedge fund culture, if I may put it that way, infecting the investment banking culture? That being so, what do you have to lose by leaving proprietary trading to the hedge funds and saying that banks should not engage in it? They would be prohibited.

Bill Winters: I am very sympathetic to Paul Volcker’s overarching observation, which is, as I understand it, that it is neither right, nor fair, nor safe for taxpayer-sponsored, taxpayer-supported, or taxpayer-funded private organisations to be risking their capital where the gains go disproportionately to employees and shareholders, and the losses, in extremis, go disproportionately to the taxpayer. It is hard to refute that.

The question is what is the best way to get to that problem. First, that lack of alignment between the ultimate back-stop—the taxpayer—and the employees or shareholders is not limited to proprietary trading. It is any risk decision that the bank takes—it is mortgage lending, consumer lending, corporate lending, trade finance, market-making trading and underwriting of public securities. I just wouldn’t make the distinction, although proprietary trading is clearly the most pure version of the selfish activity. There is no particular societal value to proprietary trading, beyond a relatively small amount that is necessary for efficient, functioning markets. So I would call that the discretionary risk-taking part of a market-making business. If you talk to Paul Volcker, as you did, or others who advocate something like a Volcker rule, they will say that, of course, some risk-taking is appropriate to facilitate the good functioning of markets. It is when it becomes purely discretionary and beyond what is necessary to promote liquidity of markets that we would like to put a stop to it—or at least put a stop to inside banks. [Interruption.]

Chair: We will have a 10-minute intermission to allow their lordships to vote.

Sitting suspended for a Division in the House.

On resuming—

Chair: Let us recommence.

Q3684 Lord Lawson of Blaby: I was going to ask a question following on from your last answer, but I regret to say, Mr Winters, that I cannot remember what your last answer was, because of the lapse of time. However, where would you draw the line if it were decided for a cultural reason—not for any other reason, although you accept there is some validity in being concerned about the culture—to prohibit this hedge fund activity to bankers? Of course, sometimes, hedge fund activity is in conflict with what the bank’s customers wish. Where
would you draw the line? Clearly, you want to allow market making—that is important—but where would you say is the most practical place to draw the line?

*Bill Winters:* It is a really vexing question. The US authorities have tried to define the Volcker rule that was passed in law in the United States under Dodd-Frank. The concept is pretty straightforward and, if I am not mistaken, Mr Volcker made some sort of reference to knowing what it is when he sees it, but that is harder to put in the rule book.

As I understand it, although I am not an expert on the matter, the Fed, the CFTC and others attempted defining the rule book—they have put the most work into this subject—and it runs to a couple of hundred pages of different types of measures. The bankers to whom I have spoken about this have said that they think it is a pretty fulsome attempt to capture the idea that you want to preclude purely discretionary, for-profit proprietary risk taking and separate that from risk taking that is incidental to the provision of liquidity in the capital markets. The sort of measure that you would put in place could be the value at risk, although I know it is not a popular measure, as a proportion of total revenue, so that is: does it look like you are making a lot more money in that book than the risk entails? That would be a good thing, because it would suggest that you are making money by servicing your customers—or servicing somebody—rather than making money purely out of risk. If the profit-and-loss results are volatile, it would suggest that there is more discretionary risk taking and less service provision for which you are being paid.

A series of those sorts of measures could be put in place, and by the time that is converted into a set of rules of what you are allowed to do and what you cannot do, each of the measures needs a number or some sort of algorithm attached to it, and that needs to be implemented and monitored. It is very complicated—bordering on impossible—but that is not a good reason not to try if you have decided, from a policy perspective, that banks will not do this particular thing. That is the process that you would have to go through.

Q3685 Lord Lawson of Blaby: In their written evidence, most of the banks, including Barclays, say that they favour a ban on proprietary trading provided that it is drawn sufficiently narrowly. Presumably that is partly because, on the whole, proprietary trading desks have now stopped.

*Bill Winters:* I think that they have been shut down, yes.

Q3686 Lord Lawson of Blaby: So if something is to be done in this area, might it not be less disruptive to do it now, while they are shut down, rather than waiting for them to reopen and then doing it?

*Bill Winters:* I think that is right, but it is interesting to explore a little why the banks have shut down their proprietary trading activities. In the US, at least in part, it is because they saw the implementation of the Volcker rule coming in two years and thought that they had better get started on winding this stuff down. That is the No. 1 thing. The No. 2, which is really the important part, especially in the UK, is that when banks looked at how profitable proprietary trading really was and properly factored in the cost of funds—as I mentioned earlier, that will certainly go up in a non-ring-fenced bank; it already has—they saw it was not profitable, because banks cannot compete with hedge funds that are unconstrained by the regulatory and political pressures that we are all correctly introducing for banks. That is not to say that there are no good traders in banks—of course there are good traders—but even in the pre-crisis days, the best traders tended to drift out of banks and into non-banks, because that was the more natural place for proprietary trading to take place.
The proprietary trading that became very large inside banks almost always involved the funding cost benefit that was coming from the transfer from taxpayers to the banks. The decision that most banks took to shut most of their proprietary trading was purely an economic one, and it is unlikely to be changed with the passage of time, as long as we do not allow Government subsidy to slip back in. Of course, it has not been completely excised yet, but the objective is to remove that subsidy completely. Once we have done that, most proprietary trading will naturally reside outside a bank.

Q3687 Lord Turnbull: In the ICB report, you were content to leave proprietary trading in the non ring-fenced banks. You will have seen that our first report recommended going one stage further, not by creating ex ante a second fence for the non ring-fenced bank, but we asked the Government to consider a reserve power that if a regulator thought that an activity was going on in a particular bank that imperilled the various objectives, it could be asked or instructed to move it over to the other side of the fence. It did not go as far as proposing that power across the board for all banks. Do you think that this reserve power is worth having and do you have any second thoughts, when looking at our wider work on standards as well as structure, about whether it is worth creating the reserve power, or even going one step further?

Bill Winters: Sorry. Is this the reserve power to force a complete separation of the ring-fenced from the non ring-fenced bank?

Q3688 Lord Turnbull: No, to take proprietary trading out of the normal ring-fenced bank and put it on the other side of the fence.

Bill Winters: To force a second ring-fencing within the non ring-fenced bank for proprietary trading?

Q3689 Lord Turnbull: It would take proprietary trading, which would currently be allowed in the non ring-fenced bank, and say, “You are running this in a way that could imperil either part of the banking group and we think you should take it out of the banking group altogether on a selective basis.” That is as far as our thinking has got. The question is whether we should go further.

Bill Winters: First, as I understand the proposition, that is a down-the-road implementation of a Volcker rule, but reinforced by a prohibition rather than an activity, a requirement that it be separately capitalised in a separate legal entity?

Q3690 Lord Turnbull: Yes. Not part of the banking group.

Bill Winters: Not part of the banking group. Neither the ring-fenced, nor the non ring-fenced bank?

Q3691 Lord Turnbull: Yes, you could divest yourself of it.

Bill Winters: So I guess I’d be hard pressed to think of a group of bank shareholders that could continue to operate on that basis. Presumably, the regulator would have come in if it thought that the risk being taken was imprudent or somehow inappropriately leveraging the capital base of the daughter firm. I think the extraordinary focus on proprietary trading is not without relevance, but is misplaced in terms of prioritisations. That is my first observation. Secondly, if the view is taken for whatever reason that proprietary trading is going to be discriminated against relative to other forms of dangerous risk taking or inappropriate activity,
then something that requires a bank to physically separate or segregate that activity, rather than simply shut it down, is probably marginally better.

As soon as we define a set of activities as being treated separately, the bank needs to be monitored. So going back to Lord Lawson’s question about where you would draw the line, you would have to decide where to draw the line. As the US has realised, it is really hard to know how to express where you want to draw the line. The idea that the regulator has that reserve power could in some scenarios be helpful, but it would be very difficult to actually implement it. I suspect that the regulator has many more tools at its disposal to encourage or force banks to behave in a way that is different from how they are behaving without having that particular reserve power.

**Q3692 Lord Turnbull:** By the capital requirement it imposes, for example.

**Bill Winters:** By the capital requirement it imposes? I know from my experience in banking there were different degrees of being in the doghouse with the regulator. You were never completely out. In the worst degree of being in the doghouse you were on a very short leash and the regulator had all sorts of ways to make your life miserable if it wanted to. As an aside, though I understand it is not your question, it is a dangerous and somewhat arbitrary power for a regulator to have, but nevertheless highly effective. There is no sign that those have been reined in at all. Quite the contrary.

**Q3693 Lord Turnbull:** But this would be a world in which they are actually policing two fences: the one between the ring-fenced and the non ring-fenced and the one between those and the outside world.

**Bill Winters:** Indeed, and it is layering complexity on complexity. I can imagine a lot of human beings needing to try to figure this out. All else being equal, I think I would rather have either fewer human beings, who were better trained, or those human beings focused on whatever the most compelling problem of the day was. It may be proprietary trading, in which case that is what they should focus on. I think it is more likely to be the things that have caused recurring banking crises through time, which are increasing laxity in lending standards—

**Q3694 Lord Turnbull:** That could happen in the ring-fenced banks.

**Bill Winters:** That could happen anywhere in the group; absolutely.

**Q3695 Chair:** You weren’t asked to look at culture in the Vickers commission, but if you had been, would you have recommended a Volcker rule in addition to the ring fence?

**Bill Winters:** No, and we didn’t consider culture specifically, although in the evidence that we took and in the deliberations that we undertook ourselves, a number of the witnesses that we met observed that one of the reasons for a separation of banking groups is precisely the cultural divide that we have been talking about here. Of course, we were asked to address the question whether retail and wholesale banking divisions should be separated in banks, either completely or, as it turned out we recommended, via this capital ring fence. So the culture did come up in the evidence and we discussed it, even though the culture itself wasn’t part of our mandate. I’m not sure that there was a consensus in any case that these two cultures are incompatible or impossible to manage in a single group. We didn’t need to bottom out that question. But we certainly did not conclude that the interests of the British customer—the bank product consumer—were best served by separating these two cultures in
some sort of formal, legal way, despite the fact that that was the basis of a number of the recommendations that we got from people who gave evidence.

**Q3696 Chair:** Let’s say that you were part of a group that had concluded that there was some benefit—that one could secure additional protection at proportionate cost with a Volcker rule in addition to the ring fence. I think you’ve answered this question; I just want to be clear on whether I’ve understood your answer. Let’s say you’re faced with the choice of either putting it in now, given there’s very little activity—the point that Nigel Lawson was making a moment ago—or waiting to see whether the American definitions work and how they operate. Between those two choices, am I right in thinking that you’ve come out in favour of the former—that we would be better advised to implement it now—or did I get that wrong?

**Bill Winters:** I don’t think I shared a particular view on that. The argument for now would be that there’s enough uncertainty surrounding the operation of UK banks today that it’s better to get the bad news out now than to have a longer period of uncertainty, with the prospect of bad news down the road. Clarity is a good thing; it’s a good objective. British banks need to be able to have access to capital markets to properly capitalise themselves and to serve their customers. Clarity is good, and that would argue for now. But since I don’t think that the Volcker rule is a particularly helpful tool for our economy and for the regulator to impose, I would suggest we wait, because we may change our mind. Whatever we think today, we may have a different view a year, two years or five years from now, especially having benefited from whatever experience the Americans have.

I think the Europeans will have a similar experience as they try to introduce the Liikanen proposals. The French and the Germans, at least in their early response to Liikanen or pre-emption of Liikanen—I think that would be a better way to say it—have introduced something that looks a lot like a Volcker rule in terms of separate capitalisation of proprietary trading activities; there’s some other stuff in there as well. I suspect that the Europeans don’t really have any intention of doing anything at all and that this is a bit of a head fake, but that remains to be seen.

Dodd-Frank and the Volcker rule are being implemented. As I understand it, they are making good progress in terms of defining the boundaries of a Volcker rule. It’s exactly as, I think, the insiders expected, which is that it’s very hard but they’re doing it and banks are responding to what they think the final rules will look like. The nature of banking in the US will be somewhat different as a result. We can judge that through time.

You would appropriately ask, “Which is more important—the clarity that comes from now versus the options that we keep for ourselves in waiting?”

**Q3697 Chair:** That’s what I was about to ask you.

**Bill Winters:** That would be a fair question. I think, on balance, and recognising my bias against the Volcker rule as a practical matter, I’ll say waiting is better.

**Q3698 John Thurso:** May I ask you about a different aspect of culture, namely what happens when you take organisations and put them together? To a certain extent, we have just seen this with the extraordinary revelations about Barclays Wealth in America, which, of course, was a Lehmans enclave that had hung on to its culture. At least, that’s the alibi that we are getting.
You, of course, have first-hand experience. You talked earlier about being in a small investment bank that got swallowed by a large retail bank, if I heard you rightly. I assume that that is JP Morgan disappearing into Chase.

**Bill Winters:** That’s right.

**Q3699 John Thurso:** That was a curious time. I should be very grateful to know what observations you have on how the cultures crashed together, how one became dominant over the other and what the end result was.

**Bill Winters:** These mergers are extraordinarily complicated. Statistically, in human capital businesses—in banking, it is human capital leveraged by a lot of financial capital—very few of them work. Every one is different, so it is hard to generalise, but part of the earlier set of discussions and questions was around the merger of a commercial banking type culture—longer-term, customer service, but also lending money, which typically is a five to 10-year type of financial relationship—versus the investment banking culture, which is typically much more transactional. Certainly historically, the former has been less well paid per capita and the former has been better paid per capita. Those are converging, interestingly. They may converge all the way, so that prospectively there may be no difference in terms of extended pay, although no doubt the transactional-type culture will always be more volatile than the long-term-relationship-type culture.

“More volatile” means that there will be highs—that they will feel much higher. Typically, when cultures are clashing, they are looking at the extremes rather than the mean, so that the retail banker looks over at the high-paid trader and says, “Why can’t I have one of those jobs? Why can’t I be paid like that?” They don’t realise that three out of 10 of those traders lose their jobs the next year because they have given it back, but that is an aside.

The norm in mergers is to try to accommodate the two cultures side by side for a period of time. That leads to compromise in decision making and complexity in the organisation. Typically, it also leads to the best performers wondering whether they should stick around or go take a job someplace else. That is not so much an issue today, when the job market is loose, but certainly in the heady days prior to the crisis it was a big concern. It leads to some unhealthy types of competition inside an organisation. Any incentives that the manager had to indulge in short-term risks to generate profits and perhaps earn money are exacerbated by a desire either to gain a job or to hold on to a job. Mergers are dangerous in that regard. I need to be very careful—

**Q3700 John Thurso:** Is there an upside? That is a hell of a catalogue of downside.

**Bill Winters:** To the extent that the merger is some sort of a bolting together of two businesses that do not overlap materially, there is potentially a lot of upside—cross-selling of product.

This may be a bit of a digression, so if you don’t want to go down this route, we will shut it off. The biggest motivator of the mergers that created universal banks was the fact that you could do more business with less capital. By bolting together a retail bank with an investment bank, you improved the liquidity profile of the combined group—retail deposits, funding, trading activities—but also just the way that the capital rules were constructed at the time, the diversification benefits that one firm derived meant that you could take 20 units of capital for the retail bank, 20 units of capital for the investment bank and run the combined operation with 30 units of capital. Voilà! You have created 10 units of capital for free, which you can give to your shareholders and they can feel like they are wealthier. Of course, they
are not actually wealthier because they have the same two businesses they had before, and they have just taken 10 units out and done something else with it.

That diversification benefit, of course, was ephemeral. When the crisis set in, it turned out that all these things were very highly correlated and you really needed the 20+20. You needed the full 40.

**Q3701 John Thurso:** I would mark that one on the downside as well, actually.

**Bill Winters:** Absolutely. So what motivates mergers? The motivations were capital synergies, which I think were ephemeral; cost synergies, which could be real—some work was needed to get them out so it was risky to execute, but those, of course, could be very real. The cost synergies are biggest where the overlap is the greatest, and where the overlap is the greatest you have the most propensity to make fudged, compromise-type decisions in terms of management structure, which leads to a lack of crispness and clarity in decision making.

Certainly in the 2000s, scale was an advantage in the markets. Scale meant you could influence markets and satisfy the largest customers, be they sovereigns or corporations. So there was the race to scale, capital synergy, cost synergy, cross-selling, and they were probably the motivations in that order. Regulation has reduced a number of those synergies or eliminated them completely. The capital synergies—the diversification benefit that comes from lumping a bunch of things together—for the most part no longer exist, given the recognition that when these markets collapse, they tend to collapse together. There are a couple of exceptions—for example, there is still some tolerance for having an insurance company inside a bank. But those are different businesses as well, to some degree. For the most part, those capital synergies have been excised.

The cost synergies are still there, but regulators—and bank boards—are much more concerned about operational effectiveness than simply extracting costs. So the cost synergies come slower than they did.

The cross-selling-type benefits are still real, whether it is a predominantly European firm merging with a predominantly American firm in order to become global—that is still a legitimate motivation. I have probably strayed from your line of questioning—

**Q3702 John Thurso:** From what you have said, and weighing the pros and cons, the general advice today would be, “If you’re not a universal bank, don’t become one.” That is the strong steer that I got from that answer.

**Bill Winters:** That certainly reflects my personal view.

**Q3703 John Thurso:** The reverse of that is then to ask ourselves, “Should we reverse out of universal banks?” One of the things that has interested me is the number of our witnesses who have talked about size and complexity. I paraphrase about four or five different people, but broadly what they have said is, “You can either be big and simple or you can be complex, in which case stay small. But don’t, under any circumstances, be big and complex, because you will be frankly ungovernable.” Would you agree or disagree with that?

**Bill Winters:** The first two are clear: you can be big and simple, and small, well-focused firms can manage complexity. So I accept the first two. Can you be big and complex? You can, but it is hard and in my opinion—this is a management theory more than anything else, but borne out by some experience—you can be big and complex if you segment the managerial lines of your business in such a way that each piece is small, so that the complexity is managed at a small level, and if you do not allow an over-emphasis on
overarching synergies across these small fiefdoms that you have created. So the very argument for being big is reduced as you slice the business up into silos that are manageable.

One UK bank, which shall remain nameless, in the pre-crisis days set up a cost synergy. They were going to take all of their back office processing and infrastructure across the investment bank, the retail bank, credit cards, Asia, India, US and UK out of the business and put it into a thing on the side, because clearly an operational manager, a factory manager, would be better at managing that on behalf of all these businesses, than having the person running the trading business also manage the infrastructure of the trading business.

John Thurso: What you are really describing is what Jack Welch did at GE, which is largely to say, “The only way I can run this business is to turn it into businesses that one person can manage, and then be a conglomerate manager at the top.” Very simply, is that possible in a bank?

Bill Winters: Yes.

Q3704 Mark Garnier: I have three questions. You spoke a bit earlier, in response to the Chairman’s questions, about relocation and international competitiveness. My first question is about the difference between re-domiciling, where a bank restates where its primary location is, and relocation of activities, whether that is of the London office of, say, Goldman Sachs, or a trading division within the organisation. Which should we be more worried about?

Bill Winters: I wouldn’t be particularly worried about re-domiciling. That is an enormous decision for a bank to take. There are only a few candidates for re-domiciling, but I admit they are very important: HSBC, Santander, Barclays perhaps—very important banks locally. I think the Government and you should have the objective of not doing things that, all else equal, would cause them to consider re-domiciling. Nothing that I have seen so far suggests to me that these banks would be better off somewhere else than in the UK. Of course, they could have all sorts of complexity in terms of their taxation or other countries’ regulation that I am not aware of, so that they could have very good reasons to re-domicile, but I don’t think it is the result of the ICB recommendations or the legislation that is in the process of working its way through.

Q3705 Mark Garnier: Professor Thomas Huertas made quite a convincing argument about having very strong and robust regulation, because of course at the end of the day that will attract money into that particular country because it is safer, and the implication of that is that your funding costs as a bank, notwithstanding any implicit guarantees, then go down. Is that a very valid argument which you would use?

Bill Winters: I think so. To the extent that the UK has a reputation for being very thorough, not necessarily more conservative—it is not just a matter of cranking up the level of required capital, but of having a thoughtful, complete and very consistent approach to regulation—it will cause jobs, money and talent to flow into the UK.

Q3706 Mark Garnier: My last question is looking at it the other way round. If you were, say, Singapore, and you were trying to expand your financial services activity, and you suddenly had HSBC knocking on the Foreign Secretary’s door saying, “We would like to move into Singapore and domicile ourselves there,” given that HSBC is nearly 10 times the size of Singapore’s entire economy, is that the sort of thing that will put off a small country from allowing them to domicile there? Is there a negative effect?
Bill Winters: The effect of any large bank moving into a relatively small country is to make it perfectly clear that that bank has no underlying sovereign support. Forget about the intentions for a moment. That is not to say that the market would assume that the HSBC UK branch network would not be supported by Her Majesty’s Government in the event of a collapse of the group, or that the HSBC US operation, likewise, would not be supported in the US; I think the market would assume that they probably would be. Even large depositors in the UK would take some comfort from the fact that they are operating in a country with a sovereign that has a history of supporting its banks. No one would expect the Singaporean Government to offer up a shilling in that event. And HSBC have said over and over again that they organise their business in such a way that they will never need to rely on state support. They have never organised their business that way in any country—certainly not globally; which is why I think they have weathered these crises relatively well, despite having made some of the mistakes that everybody else made.

So the attraction to an HSBC of Singapore would have to be some combination of group-level regulation, taxation, some other cost of doing business, or an image that they would be creating in the minds of their customers and employees of being, in your example, a Singapore bank rather than a UK-based bank. I think it is pretty hard for a country like Singapore, or any other country on earth, to offer those kinds of advantages, because as soon as Singapore says, “The FSA is being super-equivalent, the PRA is being super-equivalent in terms of liquidity requirements, so we are going to be a little bit more relaxed so that we can bring HSBC into our economic zone,” that would be the last thing in the world that HSBC would want to endorse.

Q3707 Mark Garnier: In summary—a one-word answer will do—we shouldn’t worry too much about all these potential, hypothetical threats of people moving their domiciles offshore?

Bill Winters: You should listen to every complaint, but with a very sceptical eye, and not worry too much.

Q3708 Chair: And the converse risk—we shouldn’t worry too much that we won’t be frightening business away that would otherwise come?

Bill Winters: The regulatory actions I have seen or been part of, or are being implemented, should have no impact on the creation of jobs in the UK.

Chair: As we have discussed before.

Q3709 Baroness Kramer: Not that long ago, you spoke at a breakfast, which I think John McFall was chairing. One thing you said about looking back with hindsight at the ICB report is that given your druthers, you would actually have looked much more closely at the issue of competition. Would you care to expand on that?

Bill Winters: First observation: so much for Chatham House rules.

Baroness Kramer: Sorry.

Bill Winters: Fair enough. I have made that observation elsewhere. I think we felt that the work we did on the financial stability side was very full and similarly that the work we had done on the competition side was very full, but the impact of the recommendations we made on the competition side was far less severe in terms of our ability—the level of confidence that we had coming out of the process that we had cracked the nut. We thought the combination of capital, ring-fencing loss-absorbing capital, made a really substantial
contribution to breaking the back of the financial stability problem as it related to the structure of UK banks. The competition objective for the FCA, the promotion of a challenger bank via the disposition of Lloyds branches and the recommendations we made in terms of account transferability were all substantial, and we are very happy to see that they are being acted on. But those things in and of themselves are not going to break the back of the competition issue in the UK. That will require a long period of chipping away, hence the importance of the top-line competition objective for the FCA. If I gave the impression that I thought we had not paid enough attention to it, or had under-focused, it was the wrong impression. Certainly what I felt was that we had made a really fundamental impact on the financial stability side and that there was a lot more work to be done on the competition side.

**Q3710 Baroness Kramer:** I’m sorry if I put words into your mouth inappropriately.

Can we explore that a little bit? The ICB did not recommend full account portability, for example. Is that the kind of issue it would be logical to revisit? Do you have additional thoughts on whether or not it is going to be a necessary factor?

**Bill Winters:** No, we considered full account portability fully versus the recommendation we made, which was for the much more streamlined transferability of accounts over a seven-day period. From our extensive evidence taken from the banks themselves, the payment councils and some of the consumer organisations, we reached the conclusion that the objective of ready transfer of accounts could be satisfied in a much less costly and much less disruptive way, through a more modest approach than full account portability. Certainly the analysis we did around the incidence of account transfer suggested that the overwhelming reason for people not to transfer their accounts was inertia. They would complain in surveys, or perhaps even directly to banks, but recognising that it was relatively straightforward to transfer their account they still chose not to.

The shortcomings, where there were failures or delays in the transfer process, were usually down to the vendors—the people who were the beneficiaries of standing orders or direct debits. It seemed unnecessary to impose an extra layer of cost on the banks, which inevitably would find its way through to consumers, if there was a more direct way of dealing with the utilities and others that were themselves the primary cause of complaints in the bank transfer process. We fully considered account portability, decided it was not optimal, and nothing I have seen since then suggests we should reopen it.

**Q3711 Baroness Kramer:** Obviously we know about the concentrations in the banking market. If inertia is part of the reason people don’t shift, should the Government look at its stakes in RBS and Lloyds, and even beyond the identified divestitures, start looking at ways of possibly breaking them up or using them? Would that be a significant contribution from your perspective?

**Bill Winters:** Again, we looked specifically at the Lloyds branches, only because it was a pending, EU state-aid penalty-driven sale that held out the prospect of creating a proper challenger bank. We encouraged the Government very strongly to put some pressure on, or some mechanism in place, to have those branches somehow or other combined with some other body of branches to create a player that had a material market share—greater than 6% market share—which is what we would need for challenger-type status. Exactly how it came to pass I am not sure, but we ended up with a combination of the Co-op Bank with the Lloyds branches that created that challenger. At the time, there was the contracted sale of the RBS branches to Santander that has subsequently been—I suppose—cancelled, in favour of another sale, and it is not yet clear what the outcome of that process will be.
Certainly—not to speak on behalf of the other commissioners, because we did not discuss this hypothetical at the time, because the RBS branches were going to Santander—Santander was clearly a challenger as it built up its business, and an effective challenger. Arguably, Santander has arrived at the point where it is large enough that it is more an incumbent than a challenger. Co-op/Lloyds should be a challenger in the retail or high street banking side. The RBS branches, from a policy perspective, ideally would go into the hands of a challenger business bank. I am certain that they will not go to one of the other two big business banks in the UK, to exacerbate what is already quite a concentrated market—I am sure that that will not be allowed, although we cannot prescribe who they can be sold to. To the extent that a policy maker wants to wade into that debate, creating a robust business bank challenger to the incumbents in a pretty concentrated market would be a good policy objective.

Q3712 Baroness Kramer: Obviously, you know the US market extremely well. We are frequently told that the US has a much more competitive market, with numerous small banks filling different market gaps. Do you see the US market as, inherently, a more competitive one? If you do, are there measures that the UK could take to replicate some of those beneficial features?

Bill Winters: Yes, the US is a more competitive market for two reasons. One is that there are many more banks although, when you look at individual banking markets such as the New York metropolitan area or the Chicago metropolitan area, they are more concentrated than in the UK—JP Morgan Chase has a 40% market share in the New York metropolitan area, Bank of America has a 40%-plus market share in segments of the south-east—but across the country it is much more dispersed. So there are more banks, albeit with some concentration issues.

More importantly, for the purposes of understanding competition in small business lending, the small business lending is supplied disproportionately by non-banks, by hundreds of thousands of Government-incentivised business lenders—some business development corporations, where there is a tax advantage; small business investment corporations, where there is a more explicit Government-induced advantage; or other non-bank operators, such as insurance companies, which are more involved in small business lending, or unregulated funds, which are more involved in business lending. A much higher proportion of business credit is provided by the unregulated sector in the US than by the regulated sector, and that provides real competition for the banks—it keeps them honest.

If you look at the residential market in the UK, there are substantial non-bank participants as well. As a result, the residential mortgage market is very competitive in the UK and there is no indication that oligopolistic rents are being extracted by the big bank incumbents, whereas on the small business side there are some indications that there is an overconcentration in the market. Hard to tell that their rent is being extracted, because the returns just do not appear to be that strong, but arguably the level of customer service is lower than it need be if the UK market had more bank and non-bank competitors.

Q3713 Baroness Kramer: Can you see any steps or mechanisms to get there?

Bill Winters: The non-bank market will develop as the advantage the banks have had—this cost of capital advantage that we talked about before, this subsidy coming through from Governments, passed through to banks, which made the banks highly advantaged lenders to small businesses in the UK—goes away. To the extent that that funding subsidy does go away, and it is going away, either new-entry banks can come in or non-banks. I think, in this particular case, once you level the playing field—that is clearly what you are intending to
do—the market will chip away at the problem. It is very frustrating for small businesses right now, because this has taken years, and they have an acute problem right now. But as difficult a problem as that is, I am not sure it argues for taking extraordinary steps to further distort the market as you are working through the last distortion, which is being ironed out now, if that makes any sense.

Chair: We are extremely grateful for your evidence, which was lucid and thoughtful. We will want to continue discussing some of these points privately—not even under Chatham House rules—with you in your capacity as a specialist adviser to the Committee.
Examination of Witnesses

Witnesses: Sir Brian Pomeroy CBE, former Chairman of the Treasury’s Financial Inclusion Taskforce, and Sian Williams, Head of Financial Inclusion, Toynbee Hall, examined.

Q3714 Chair: Thank you very much for coming to give evidence to us this afternoon. I am sorry you have had to wait some time. Perhaps we could clarify what a basic bank account is. It is an in-kind tax on banks, isn’t it, Sir Brian?

Sir Brian Pomeroy: The product is like an ordinary current account, but it does not have an overdraft or a cheque book. That was the original concept, and basic bank accounts originally had broadly similar characteristics to a current account, but without those things. They have now diverged considerably.

Q3715 Chair: I am talking about the cost that is incurred by the bank.

Sir Brian Pomeroy: Well, the bank incurs the cost of providing this account, which is like a current account with some features taken out.

Q3716 Chair: And that can be thought of as akin to a tax?

Sir Brian Pomeroy: If the banks are providing it unwillingly, or if they have had their arms twisted to provide it, it can be thought of as a tax, yes.

Q3717 Chair: Do you think that if banks had never been asked to provide basic bank accounts, they would be providing the scale of basic bank accounting currently available?

Sir Brian Pomeroy: No.

Q3718 Chair: We do not have to talk about thumbscrews to come to the conclusion that they are providing something that costs their shareholders money and that they would not otherwise be providing.

Sir Brian Pomeroy: I think that is largely true.

Q3719 Chair: Therefore, we can think of this as an in-kind tax.

Sir Brian Pomeroy: You can think of it in those terms if you like. Yes, it is probably true that they would not provide them if it had not been for some Government or other stimulus.

Q3720 Chair: So I have got to first base, which I was hoping to do a moment ago. If it can be thought of as an in-kind tax, isn’t the crucial question: were we to recoup that tax as cash, could we think of better ways of using the money for the same purposes? Are we getting the best value for money from this approach to this in-kind tax?

Sir Brian Pomeroy: You then have to look at the functions of the basic bank account and ask whether those functions could be provided in any other way. The basic bank account has been the main means of bringing people who are unbanked into banking since about 2005, and it has been effective at that. There are other ways of bringing people into banking, and I will mention two. One is branchless banking models—they have arrived more recently. For example, there are debit cards—effectively bank accounts—linked with a mobile phone. That would be another way of doing this. Those products exist, but they are charged for. They
would not necessarily substitute for all basic bank accounts. The other is institutions that are not in the private sector that can provide this service. The obvious one is the Post Office. My task force, when it was meeting, campaigned long and hard—always unsuccessfully—for one of the Post Office’s products, the Post Office card account, to be upgraded to have more of the functionality of a basic bank account. That would be another way to provide that service.

**Q3721 Chair:** You have responded to my question by talking about the importance of providing that particular service.

**Sir Brian Pomeroy:** Yes.

**Q3722 Chair:** I was trying to elicit an answer about how best to increase financial inclusion, which may involve the provision of a service, or it may involve a more effective means of providing financial education, for example.

**Sir Brian Pomeroy:** I do not think they are substitutes. Financial education is very important and must be provided, but, at the end of the day, in an advanced economy in the 21st century, if you are not connected to the financial systems and do not have means of receiving money electronically, paying bills, storing money and other things, it is frankly as serious as not being connected to gas, water and electricity. It is a basic essential. Financial capability is important as well, but if you are not connected to the payments system and a number of key products that go alongside it, you are frankly very severely disadvantaged. I could explain what the disadvantages are if you wanted me to.

**Q3723 Chair:** I think they are already in the evidence and are indeed very well known. I was trying to make a point about value for money of the semi-coerced provision that has come from the banks.

Perhaps I could ask you if you would respond to any of the questions I have posed.

**Sian Williams:** To create a more financially inclusive UK, which is what you seem to be pushing for, we need to build a financially inclusive environment and then skill people up to that environment. Financial education is a crucial part of that, but, as Sir Brian said, if we do not have an inclusive environment in the first place, education will only lead to more frustration. In 2013, there is no doubt that having a transactional account is a utility, not a luxury. Being able to access financial services and the cheaper services and products that you can only access through a transactional account is an essential part of financial inclusion.

Is there a better way to do it? We need to ensure that people can access a transactional account. They also need to know how to use it effectively. You are talking about the basic bank account being an effective tax on banks, but actually if you look at some of the issues around basic banking, you see that because people often struggle to maintain that account in the black, despite the fact that there is no overdraft on it, people are already paying fees and charges. Banks are earning money from basic bank accounts, even though it looks completely free in the first instance.

We could definitely look at how we could spread the money better. On your point about whether banks would offer a basic bank account service unless they were coerced or forced to, they would not, no. I was very disappointed when we lost the Bill that was going to enshrine in law access to banking and universal banking. That would have been a very good way forward, because we are actually seeing banks pulling away from offering the service. The only bank that still offers a fully inclusive banking service is Barclays; every other bank has pulled away.
We need to address it. Is the money used in the most effective way? Probably not. The people who are really bearing the cost are not shareholders, to be perfectly honest, but the individuals who use basic bank accounts.

Chair: We won’t develop that point. You have given some very interesting responses there.

Q3724 Mr Love: May I come back to a point that you made earlier, Sir Brian, about alternative private sector solutions? Is not the drawback that they are expensive in comparison with a basic bank account? Would you care to touch upon the costs of each of the alternatives?

Sir Brian Pomeroy: First, you have to pay to them, whereas the basic bank account is ostensibly free, but as Sian pointed out, many people who use basic bank accounts accumulate charges, mainly for missed direct debits. They often have difficulty making sure that the money is there when it needs to be. There is a revenue to that—a revenue that, as Sian said, the banks get.

The alternatives cost money and you have to ask who would bear the cost. If the answer is the customer, obviously they would potentially be worse off than they are at the moment. It is worth saying however that we did some research on whether people on low incomes—those with basic bank accounts and the unbanked—would be prepared to pay a small change for their bank account. Interestingly, particularly if it would help them avoid surprises and unanticipated charges, a number of them would pay a small charge.

It is also interesting to note that the credit unions, some of which offer a bank account, do make a small charge—75p or 95p a week. Actually, there is a possible model in which people might pay a modest charge, although I am not saying that this is the mainstream answer when you talk about alternatives that might have a cost. As I say, some people—for example, those with credit union accounts—do pay a charge at the moment.

Q3725 Mr Love: In 2008-09, 96% of households had a transactional account, and 97% of adults had some form of transactional account. I don’t want to get into issues about how accurate those figures are, but you achieved a halving of the number of people without any account up to that period. What was your ambition? Many people would say it almost reached 100%. Was your ambition 100%?

Sir Brian Pomeroy: When we started, there were 3.7 million unbanked people, according to the definition we were using. We had a specific goal of reducing that number by half, which was agreed between the banks and the Government, and the job of our task force was to push that along. We reduced it by about 60%—it went down to 1.5 million—so we achieved that particular goal. But our ambition—I am talking about the task force, rather than the Government and the banks—definitely went further. We did not think it was a complete success. First, we knew that about half of the remaining unbanked were potentially bankable. They either said they would definitely or probably like a bank account. Secondly, we know that a number of people who were recently banked through the basic bank account were not making full use of the account. For example, their benefits and wages would go straight in, it would come out in cash and they would carry on in cash. There is a transitional element to that. It takes people time to get the confidence to use a bank account. But those two factors alone told us that although we had reached the formal goal, there was more to do.

Obviously, we stopped after six years. We had a six year life, so we did not continue. Had we continued, we would probably be saying to the Government, “Let’s attack the other
half”—the remaining unbanked—“and let’s have more sophisticated targeting, and measures that include usage of bank accounts, rather than the mere ownership of one.”

**Q3726 Mr Love:** Some would respond by saying that if you look at international comparisons, we do rather well. What are the international comparisons in relation to having a transactional bank account? Has any country reached 100%, and how have they done it?

**Sir Brian Pomeroy:** I cannot give you precise figures, but we have done well. It is somewhat higher in the States. I think we do well in the international league tables. But I don’t think that those of us who care about this matter really think that is a reason for stopping. If, of the remaining 1.5 million unbanked, 750,000 could be brought into banking—bear in mind the disadvantage of not being banked—we should do it.

**Q3727 Mr Love:** Of course, 2009 was a high water mark. We have seen some setbacks since then. Perhaps, Sian, you can tell us where we are today in terms of accounts and the services that a basic bank account offers.

**Sian Williams:** We do not have accurate figures because the Treasury stopped producing the figures at the end of the task force. Despite the best efforts of the third sector, we have not been able to produce accurate figures since then.

In terms of provision, we know that banks are rolling back from the level of provision in 2009, specifically around quality. The banks debate with each other about what percentage of the market share they have around basic bank accounts. When they talk about provision, they all want to claim that they have the largest market share in some form or another. They might say, “We have proportionally the largest market share based on our client base,” or, “We have the absolute largest number.” Each bank is trying to say that they are doing well, so they want to look good around this issue.

On the ground, the Co-operative has recently announced that it is not accepting any new undischarged bankrupts for basic banking, or banking of any kind. Lloyds TSB and Halifax—Lloyds Banking Group—have withdrawn access to cash from all non-group ATMs, and have withdrawn all counter services for any transaction services under £500. You cannot apply for an account in branch; you must do it by post or by internet. I do not think that is particularly inclusive banking. Despite the fact that Lloyds is addressing some of those issues, we have not seen any significant change on that. RBS has similar issues around accessing the ATM network and branch access. Those are the biggest issues in terms of provision.

In terms of the service and the quality of the service for the individual, which is a key point—it is about not just the numbers but the service to the individual—we are seeing a rolling back.

**Q3728 Mr Love:** Let me turn briefly to cost. Do we have any handle on how much the basic bank account is costing banks? We were told by representatives of Lloyds that its basic bank account costs £150 million and it claims to have a 45% share of that marketplace. You can do the maths, and work it out. Would that be an accurate figure for the cost of the basic bank account?

**Sir Brian Pomeroy:** I cannot really give a definitive answer. First, I have not been involved closely with the banks since the task force ended, which is getting on for two years ago.

**Q3729 Mr Love:** Were the banks communicative beforehand?
Sir Brian Pomeroy: At the time of the task force, we had meetings with all the banks, one to one, and we did ask them about costs. By the way, the orders of magnitude that you have described are consistent in my mind with what they said. We had a variety of answers. Some said that they were loss making while others said that they were marginally profit making. They did not all say that they were loss making. They were clearly all on a margin of some kind, which is not what they would normally expect. I think you received information from Lloyds Banking Group showing both the full cost and the marginal cost of its bank account. Interestingly, the marginal cost is quite a lot smaller, which means, in the short term, that it might even be making something out of it; I am not sure. I noticed that the marginal cost was much smaller than the costs that you get when you add all the overheads. Having said that, one would have to accept that it is a marginal product for the banks. Going back to the questions that the Chairman asked at the beginning, even if the basic bank account was slightly profitable, it is clearly not a product that they would particularly want to provide were it not for the outside pressure on them.

Q3730 Mr Love: I do not know whether either of you can answer this question, but I will put it to you anyway. In the same letter that Lloyds wrote indicating the figures, it also suggested that there were ways in which it could bear down on the transactional and other costs of the basic bank account. Do you see that as part of the way forward?

Sir Brian Pomeroy: It could be. I will, if I may, make a very general point about competition in banking. If it is the case that there is scope for more competition in retail banking, which, I think, is generally believed, and if more competition would drive down unit costs, which is what competition normally does where there is no competition, it is conceivable that some of the products that are not at the moment attractive for banks to provide might become more attractive if their infrastructure and unit costs were lower. That strikes me as being a possible consequence of more competition in banking, which I think everyone would like to see. I can say that, but I cannot give you at operational level specific examples of what they could do to produce those costs, if that is what you were asking.

Q3731 Mr Love: A number of the banks that have been before us have suggested that they have a social obligation. Indeed, in their response to the question, “Were you dragged kicking and screaming into the basic bank account?” they put a positive face on it; they said it is part of the social obligation. But why should banks promote the basic bank account?

Sir Brian Pomeroy: My personal view is that there are some social obligations that some providers of products take on, with their link to the product that they provide. Going back to the task force, the banks did agree a target with the Government to reduce the unbanked numbers by producing a basic bank account, and they stuck to it. We gave the banks credit for holding to that bargain and doing what they said they would do. Clearly, at that time, they were prepared to accept this as a social obligation. It appears now that they are less willing to accept a social obligation. It may be—this is a conjecture—that they thought that since the goal was met, there was not anything more to do. It may perhaps be that. Somebody has to secure the idea that these accounts are provided to people who are unbanked because of its essential nature. The ultimate responsibility to ensure they are provided lies with the Government, and it seems perfectly reasonable that the banks should be the medium through which they are provided. Given that it is ancillary to their business, or part of their business, I do not see why one would not ask them to do that as a matter of corporate social responsibility.
**Q3732 Mr Love:** Sian, you talked earlier about banks being a utility. Will you expand on that and give us the implications for banks?

**Sian Williams:** To try and get a job in 2013 in the UK, you are much more likely to be able to secure a job from an employer if you can offer up a bank account in which to be paid. If you imagine going to an employer and saying, “You employ 250,000 people, and I would like you to pay me in cash, please,” that is not going to go down well with the employer. We run a specialist banking service for people who struggle to get banked. One of the key reasons why people come to us is that they say, “I have been unemployed for a while for various reasons. I no longer have an active bank account that I can use. There is a potential job offer on the table, but until I have a bank account, I cannot take the job. I am desperate to get back into work.” It really is the lack of a bank account that is stopping certain types of people from having a job. That is one reason why I would call it a utility.

The second reason is, if you want to receive any form of income from the Government from October 2013, you must have an account into which that can be paid. DWP is advocating that the Post Office card account is not acceptable for universal credit going forwards. Our own Government is saying, “You must have a transactional account.” For me, that is a utility.

The third reason is simply that if you stretch every pound as far as you can make it go, that means being a responsible consumer, a responsible parent and a responsible member of the community. You are also much more likely to be able to access the best price for any given good or service if you can make an electronic payment or shop around, which includes having access to paying online or to direct debit. That leads to stretching your available income as far as possible and therefore avoiding the use of high-cost credit or debt. Again, that means that it is a utility.

**Q3733 Mr Love:** Let me ask one final question. The implication of the answer you have just given is that there will be more pressure on the banks. We know that a lot of the people who need a bank account are not particularly motivated to have one other than that they need it, for the very reasons you said, as a utility. What should the banks be doing in order to prepare? We have heard evidence that they are in discussions with DWP, and the indications, although they did not want to say it overtly, are that the Post Office card account cannot improve its functionality to the necessary level and will therefore be sidelined in all this, so they will come back to the banks. How should the banks respond to that?

**Sir Brian Pomeroy:** First, it is a great shame that the Post Office card cannot increase its functionality, because it is a trusted, accessible supplier. Many people would use an upgraded Post Office product. On the basis that that is not going to happen and on the basis, as Sian said, that there is likely to be an increase in demand for basic bank accounts because of universal credit, if for nothing else, the banks then need to be prepared to offer a product—let us say the basic bank account, because that is the product that is there at the moment—to people who ask for it and who meet the basic criteria. The situation has become particularly difficult recently, because whereas when the basic bank account was first introduced it was more or less a standard product—not exactly, but more or less across all banks—it is now very different, which makes it more difficult for people to decide which product to take.

There has been much talk about whether there should be a minimum standard, which is to say that basic bank accounts should all have some minimum features, and I think they should, because otherwise it would be very difficult for people looking for bank accounts to know whether they have the best model. There is also, as I know the Commission has explored with other witnesses, the idea of the race to the bottom, which means banks withdrawing features precisely to deter customers. If you accept the proposition that the banks
have an obligation to provide this—I know that that can be contended—and if that is the starting point, even though it is not what they would voluntarily do, you have to say that there should minimum standards. I really do think that. Otherwise, people will be in a very difficult position.

**Mr Love:** I think others will question you on that, but one of the minimum standards—

**Chair:** You did have your last question.

**Mr Love:** This is just a comment. One of the minimum standards that they should have is access to the Post Office network, because not all basic bank accounts allow access. We should consider that for the very reasons you said.

**Chair:** You are not allowed to respond to that, because it was only a comment.

**Q3734 Lord McFall of Alcluith:** Sian, are you saying that people who are currently financially excluded are socially excluded as well?

**Sian Williams:** Absolutely. The point about employment is absolutely significant. If we cannot create a product that allows people to receive their salary, accessing work becomes much harder. If you are not in work, all kinds of other activities and opportunities and social behaviours fall away. You just do not have those opportunities. It is also intergenerational. We are talking about parents who cannot work because they simply cannot get a bank account. I have clients who have had to turn down jobs and lose opportunities because they were turned away by six different banks for a basic bank account, despite the fact that they were completely eligible. The knock-on impact on the children goes on for another six months until they can find another job opportunity. It really worries me that people in banks do not always see that.

We also know that if you cannot use electronic payments as one of your payment options, all kinds of additional fees, charges and higher prices come into play for you. That takes money out of your pocket that could be spent on other things, like sending your children on a school trip.

**Q3735 Lord McFall of Alcluith:** It appears, Sir Brian, that the traction on financial inclusion has slowed down, and there is a race to the bottom to some extent. You would agree with that?

**Sir Brian Pomeroy:** Yes.

**Q3736 Lord McFall of Alcluith:** Major banks have committed not to further restrict ATM access. Do you believe that there is a risk that that will still happen? When we established the working party for free ATMs, the key was the interchange fee. Once you interfere with the interchange fee, the whole edifice could come down eventually. Do you agree with that view?

**Sir Brian Pomeroy:** I agree that that could happen. First, I do not have inside information on what any of the other banks are doing. The Treasury Committee has reported on this, which I hope would have provided a block on any further plans to reduce ATM access. But you are right. As the Treasury Committee pointed out, you could get a sort of negative domino effect. The people who no longer receive interchange fees but pay them could decide that they are not going to pay them, so you could get a vicious spiral. I agree in theory that that could happen. I very much hope that it will not happen, but in theory, yes, it could.
Q3737 Lord McFall of Alcluith: Are banks still compromising on the features of BBAs?

Sian Williams: BBAs vary enormously between banks. If you think about ATM access, access to a card or access to the branch counter as features, there are not many more features to a basic bank account. You do not have credit, and you do not normally have any other products or additional items. Yes, basic bank accounts vary between banks. I would say that despite the best will in the world, the only bank that offers a fully comprehensive basic bank account is Barclays. Others try to offer good service, but they are definitely reducing the service and the number of features.

Q3738 Lord McFall of Alcluith: CAB, Lloyds and the Co-op all agree that some sort of minimum standard is the right approach to stop the race to the bottom, but they differ on what those standards should be and how they should be enforced. What minimum features do you think every basic bank account should have? I am thinking of LINK ATMs and debit cards. Are there any features that definitely should not be there?

Sir Brian Pomeroy: I would say the minimum is clearly basic payments—receipt of payments from any source and making payments electronically in a way that is efficient for the recipient. As Sian has said, research indicates that people want a debit card and that it is useful. Today, it is now regarded as a normal means of payment. Access to cash at ATMs is absolutely essential. The other feature people want, or rather do not want, is surprise charges. They do not want to be hit. It used to be £30; it has come down to £12 or so, depending on the bank. People want something that does not unexpectedly hit them very hard every now and again. Those sorts of figures can throw out a household budget.

I think there is quite a strong case for a small buffer overdraft. For example, if you have only £6 in your account and you go to an ATM that will only give you £10, you will go overdrawn by £4. There is a case for some buffer to deal with that situation.

Q3739 Lord McFall of Alcluith: Can industry devise these minimum standards on its own?

Sir Brian Pomeroy: My answer would be, “If it was willing.” When you devise standards, by the way, you always ask the customers. You do not just make it up in a room: you go and ask customers and get up-to-date information about what customers want. I personally do not see—Sian may disagree—why the banks, if they were willing to do this, would not get together, just as in the early days of the basic bank account they got together and agreed to offer the basic bank account. They were collaborating, so to speak, because they did not regard it as a competitive area, and therefore did not fall foul of competition law—they regarded it as a collaborative rather than a competitive area. I do not see why they should not regard establishing minimum standards as a collaborative rather than a competitive action to take.

Q3740 Lord McFall of Alcluith: Perhaps that is an issue for us as a Commission to hear evidence on.

Sir Brian Pomeroy: Yes.

Q3741 Lord McFall of Alcluith: You said there are still around 1 million households unbanked. With the enclosure of the financial inclusion fund and the winding down of the financial inclusion taskforce activities, do you think the prospects for financial inclusion are
now bleaker for that group? Can you give us an idea of any insight into the socio-economic characteristics of that group? It seems as if you are nodding your head that yes, they are bleaker, but what are we talking about here?

_Sian Williams_: It is actually a really interesting picture. Despite the fact that we lost a government taskforce and a team within the Treasury focusing on financial inclusion, there is still a very active sector across the country thinking about how you take each pound for each family and stretch it as far as it can go. Recession really focuses the mind. We are thinking about how we make sure that every family is in control of its money, in a way that meets its own needs. It is not about telling people what they should do, but facilitating each family to be able to make its money go as far as possible.

The key points for us coming up in the next 18 months are obviously around welfare reform issues. If we separate welfare reform into caps and cuts—a reduction in the amount of money that people have and changes in the way that money is paid and passed on, with, for example, direct payment of housing benefit to the individual rather than to their landlord—as financial inclusion goes, we have two big things to do.

First, we have to work with families on understanding how to stretch their budget, so it is about intelligent purchasing and making sure that they are getting the best deal on any given service. For example, going back to the features about basic bank accounts, I would like to see an alternative to a direct debit payment: most people who have irregular or unreliable income find direct debits incredibly difficult to manage, because they cannot tell exactly how much money will come out of their account on which day, and they need to be able to do that. We are working with the Payments Council and looking at an alternative to a direct debit payment that will put more power in the hand of the purchaser.

Working with families on to stretch that money is one option; the second is to help people manage a different flow of money. Going from weekly and fortnightly payments to one monthly payment, in arrears, to a single adult in the household, into a transactional account is a big cultural shift. There are a lot of people across the country who are focusing on this.

Yes, we have lost a centralised Government approach to financial inclusion, but is there a lot of work going on around it? Absolutely. Although I have been quite critical of the basic bank account, the one thing I would say is that I think that banks are starting to wake up to these issues. They have been very slow to do so, mostly because their focus has been on other banking crisis issues, but now that they are starting to come out of some of those, they can take a deep breath and start to think about some of the more marginalised customers. We are pushing on the banks and saying it is not just low-income benefit recipients who need a budget account, for example. Students going off to university, people with Alzheimer’s and people with early dementia issues could all benefit from a more structured account that allows guaranteed payments.

So is it bleak? Yes. Is it worse? No, I do not think so.

_Q3742 Lord McFall of Alcluith:_ What message, as a Commission, should we be putting out to the industry in terms of ATMs and basic bank accounts? What should we do that would be helpful?

_Sir Brian Pomeroy_: The first message is that financial inclusion is still important—in other words, there is still work to do, the problem has not been solved. That is the important message to all concerned. As far as the industry is concerned, the message should be that we want them to continue to play their part.
By the way, can I say—we have not talked about this—that a lot of the work has to be done, not on the supply side, but on the demand side as well? There is an important role for NGOs and front-line organisations such as Sian’s, the advice sector and social landlords, because many people will not find their way to basic bank accounts even if the banks do everything perfectly. There is a message to go to the demand side supporters as well.

The message to the industry is to do just as they did, actually. We said, “Step up to the plate,” in the period I have described when they did help—they improved their practices, became more friendly and accommodating towards people on low incomes and they had roughly a standard product. Just think of those days and go back to that kind of approach and practice.

Q3743 Lord McFall of Alcluith: The industry working as a coherent whole.

Sir Brian Pomeroy: Yes.

Sian Williams: I would say: think more collaboratively, because this is not an area for competition, to be perfectly honest. Every piece of learning that we can apply will benefit a bank in helping it reduce its costs and provide a better service to the individual.

Q3744 Mr McFadden: Time is getting short, so I want to come directly to the welfare changes and the idea of a universal service or a utility function. You said that the welfare changes are about the amount of money and how it is paid. I am going to leave aside the amount of money, because we debate that elsewhere, and just concentrate on how it is paid. The concept is to move to a monthly payment more akin to a salary, which is paid through a bank. Can you tell me how a universal service obligation in banking would work? What would it look like?

Sian Williams: I do not necessarily think it is just banking. I think it is that as a payment provider sector, we need to make sure that everyone can access a transactional process. So it could be within credit unions, for example. I would like to bring other providers in to that universal obligation. I would like to bring other providers in to that universal obligation. I would like to bring other providers in to that universal obligation. I would like to bring other providers in to that universal obligation.

As for how that is distributed across providers, I do not really care. We could, for example, look at market share. At each bank or each credit union, or whoever the provider is, we could look at their customer share in terms of a profit margin and then apportion: “Of the unbanked, this should roughly be your level.” The banks use those figures anyway—they think in those terms. The key thing is that a bank or any financial service provider should have an obligation not to turn a customer away with a blank no. There should always be another route, so it might be: “We can’t help you today, but another organisation can.” That is why I think collaboration is the key to this.

Q3745 Mr McFadden: Is that the difference from today? I am trying to get to the difference a universal service obligation would make. Is it the case that today, for one reason or another, the bank can just say, “No, we are not going to give you access to a basic bank account”?

Sian Williams: Yes.
Mr McFadden: But under this scenario, they would either have to take them or point them to somebody who could, so that no one ends up with everybody saying no.

Sian Williams: Yes.

Mr McFadden: You must have had some discussions with the Government on this in the light of the welfare changes that are coming up. What is the argument against doing that? Is it that it would be an extra tax on the banks?

Sian Williams: The arguments are that the banking sector is a competitive sector, and that the Government should not be telling banks, as companies, what to do.

Mr McFadden: Just tell me where the Post Office card account fits in with this. The Chairman said I had to declare a former interest as a former Post Office Minister, which is a new definition of parliamentary interest. How might the Post Office card account fit into the scenario that you are describing? You said in one of your answers to Lord McFall that the Government had decided that the Post Office card account was not going to be acceptable for the receipt of universal credit. Have I understood that correctly?

Sian Williams: They have not yet said it will not be, but they are moving towards a strong preference that it is not used. We do not know yet whether that will be a statement of fact—you cannot use this to receive it—or whether it will be a steer away.

What we know is that there are serious concerns about using a Post Office card account for the receipt of a monthly universal credit because of the very high level of a monthly payment of universal credit once housing benefit and all benefits are paid in one. At the moment, people are going into the post office and they are withdrawing £40 or £50 at a time, but once they receive universal credit once a month, including housing benefit, you are looking at several thousand pounds for some families. The idea that because you cannot make payments out of a POCA, you would have to walk down to the post office and withdraw up to several thousand pounds each time you need to receive your benefits, that puts a lot of cash on the streets of probably quite poor areas.

Mr McFadden: Hang on. There is an overall cap on the benefit of £26,000, so there will not be many families withdrawing several thousand pounds of overall benefits in one go.

Sian Williams: They are going to be withdrawing their entire benefit—the cap is only if you are not working more than 16 hours. There will be families who are receiving more than £26,000.

Mr McFadden: And they are all going to be withdrawing it on the same day.

Sian Williams: If you work on a cash budget, you will go to the post office and you will withdraw the money that you have got to budget with. That’s how people, in cash, work.

Mr McFadden: So you are saying that the fear about the Post Office card account is essentially a security fear about the amount of cash.

Sian Williams: Yes, and then you take your money home, put it somewhere, and you budget from there, as opposed to being able to take it out or make direct payments from it.
Q3752 Mr McFadden: But why is that different from walking out of the bank with the same amount of money?

Sian Williams: Because once you have a transactional account, you are more likely to set up your rent payment as a direct debit than to walk to the post office, withdraw it in cash, then get a bus or walking to the rent office.

Q3753 Mr McFadden: I see, so the lack of functionality in a Post Office card account makes you more likely to withdraw a lot of money.

Sian Williams: Yes, because you have absolutely no other choice.

Q3754 Mr McFadden: I understand just tell us—we are short of time, so we are bringing things to a close—have you given us written evidence on this idea of a universal service?

Sian Williams: Not yet. We were only approached on Friday for evidence.

Q3755 Mr McFadden: I would quite like to see your thoughts written down. What I would really like you to do, if possible, is not only paint a picture of how this works, but point out the differences between how it might work and the current situation, with the mix of the POCA and the basic bank accounts.

Sian Williams: Okay.

Q3756 Baroness Kramer: Can I just take you to the situation in the United States? As you know, there are myriad sophisticated credit unions there—community banks and community development banks—that service this clientele, and one could argue that they service it much better because they actually see it as their desirable target market, not a market that they have been landed with in order to meet some external obligation. Do you see any advantage in trying to get banks to use their social obligation, which we have heard is costing them fairly significant amounts of money, to support similar kinds of organisations in the UK? I know that at the moment it is an embryonic, fragmented area, but that social obligation could be put into, as it were, into “a man who can”, rather than trying to provide this service in a reluctant way themselves?

Sir Brian Pomeroy: This was very much on the taskforce’s agenda. Particularly when it came to affordable credit, but also banking services generally, we wanted the banks to support the credit unions and community development finance institutions, which are the third sector providers here. They are not quite the same as community banks. By the way, I too have visited community banks, in Chicago and Milwaukee. Exactly as you say, it is a bank serving a community in a corner of the city—perhaps an ethnic minority community. It is small scale and low cost, and I think having that kind of sector here would be very beneficial.

The nearest we have is credit unions, which do a terrific job. Many of them do now provide a bank account with functions. What we tried to do was get the banks to agree to support that sector as part of their corporate social responsibility, exactly as you say. There was even an agreement between bank chief executives and the then Chancellor that they would do that. Conversely, if you like, to the credit that we gave them for what they did on basic bank accounts, we felt that this was a commitment that they did not live up to. Indeed, they are aware of that, and we were very public about it. It has been tried, but it does not mean that it should not be tried again. The banks, frankly, did not meet the obligation that we wanted them to make to the third sector, but the idea is a very good one.
Baroness Kramer: Did you consider the option of trying to, as it were, let them translate their basic bank account obligation into that possibility? So instead of providing the basic bank account yourself, to have a responsibility to ensure that it is provided and therefore be able to do it, through a third party.

Sir Brian Pomeroy: No. We wanted them to give support—by the way, they do to some extent, but simply not to the extent that we expected. We simply wanted them to give support to third sector finance institutions, which, in our context, are the credit unions and the CDFIs. We did not specify that they ported over their products, as you described.

Sian Williams: Can I just say something about geographical access? Credit unions are patchy, CDFIs are very few and legislation has only been recently changed to allow credit unions to expand their geographical footprint, so it is a nascent sector. I would like to see a lot more development, and I am working closely with credit unions and other providers to try to develop better services. I keep coming back to the word “collaboration”. We will only tackle financial exclusion around this issue through working together, and that means banks working with CDFIs and credit unions. Most people who are very socially excluded feel uncomfortable in a classic high street banking environment, so new options, like Metro Bank and credit unions are good things and I would like to encourage that. It is definitely part of the solution, but it is not the whole solution.

Baroness Kramer: I am just trying to pursue this one area, not trying to get an answer to everything.

As you know, in the last Financial Services Bill there were two last-minute clauses, one which required a “have regard” for the FCA to financial access, which is completely new territory, and another that required disclosure by bank, by postcode and by financial service, to see where the vacuums are created. On that last one—what form the disclosure will take—have you thought about what the most useful kinds of metric would be for that and, if you have not, is that an area where you would be willing to provide us with a note? Obviously, the purpose of both those clauses is to try and get some action towards the kinds of goals that you have just described.

Sian Williams: Absolutely. On the access point, we are working with the FSA, to be the FCA, around what does that mean and how might we develop that. I think, on the disclosure, I should like to write a note, because there will be a lot of detail and we are tight on time.

Baroness Kramer: Yes, that would be very helpful.

Mark Garnier: How did you manage to persuade the banks to do simplified basic bank accounts?

Sir Brian Pomeroy: As a taskforce, we worked closely with them. Can I start with the composition of the taskforce? It was very broad and had not only front-line agencies, the advice sector and researchers, but also had senior bankers on it. That was very important. We had three or four senior bankers on the taskforce, typically at head of retail banking level in the major banks, so when we came to a collective view, as a taskforce, that carried some weight with the banks and, indeed, with the Treasury when advising them, and with others. That was helpful.

It was basically a matter of monitoring what they were doing and talking to them. We had regularly mystery shopping. People were sent into banks with all the different circumstances that you might get—“I’m an ex-offender. Can I get a bank account?”, “My aunt who’s 92, can she get a bank account?” We did a variety of those. We did mystery
shopping. We fed the results back to the bank. Year by year, the mystery shopping was mainly done by the Banking Code Standards Board, then latterly by ourselves. We fed that back.

We had the annual statistics, of course, of basic bank accounts and the figures that we have talked about earlier on the unbanked. We used that, basically, to persuade the banks to come along. It was against the background of the shared goal. It was also, frankly, important that there was strong political commitment behind this. We had the Treasury strongly behind us and although we as a taskforce had no powers—we were purely advisory—the fact that we had this board constituency and the Treasury clearly behind us enabled us to get some things done.

**Q3760 Mark Garnier:** It is quite interesting. To a certain extent we are losing that sort of buy-in element, with the loss of the taskforce and, without the will behind from the Government and the Treasury, that is going to go. So you think that this rate of change will lag.

**Sir Brian Pomeroy:** If there were that political commitment, which really ended after the election, and if there were some co-ordinating point. We would not necessarily have a taskforce, because as Sian said, the third sector—not least her own organisation, Transact—is very much a focal point, and there are other people doing that as well.

I think having political commitment is vital. I am not sure that there is strong commitment to financial inclusion at the moment. Having some co-ordinating point where everything can come together is valuable too.

**Sian Williams:** Pre-election, financial inclusion was an end in itself. Post-election, with welfare reform, financial inclusion is a means to an end. It is a means to deliver Government objectives on welfare reform.

**Q3761 Mark Garnier:** Can I ask one question, particularly of you, Sian, about my big bugbear?. Do you think financial education should be compulsory in the school curriculum?

**Sian Williams:** Yes.

**Q3762 Mark Garnier:** Sir Brian?

**Sir Brian Pomeroy:** Yes.

**Q3763 Mark Garnier:** Fantastic. Thank you very much.

**Q3764 Mr Love:** You talked about a co-ordinated body. One of the interesting recent developments is that the Financial Conduct Authority will have regard to financial exclusion. What promise does that hold out for this sector? Will the regulator play a much more active role?

**Sir Brian Pomeroy:** First of all, it does not have a specific financial inclusion remit.

**Baroness Kramer:** It is about financial access.

**Sir Brian Pomeroy:** Well, within one of its operational objectives, which is its competition objective, it may have regard to financial access—it is a “may have” and not a “must have”, by the way; it is permissive rather than mandatory. It may have regard to access. But that is an important late addition to the Bill, of course, that potentially enables the FCA to get to grips with the problems of people who are disconnected from financial services.
Potentially, that is very important, but as I said, it is a “may have regard to”, not a “must have regard to”, so it requires a decision by the FCA to adopt that before it becomes operational.

**Q3765 Mr Love:** No doubt this Commission will ask the regulators when they are in front of us in two week’s time.

**Chair:** Just after the short break.

Thank you very much for giving evidence. It has been extremely interesting. It is not the first time we have heard from you, Sir Brian—at least, we in the Treasury Committee have. Thank you very much, Sian.