

The Case for A People's Bank for Wales



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The Case for a People's Bank for Wales

About us

The **People's Bank for Wales Action Group** started in 2016 and is fortunate to have on board one of the world's leading Public Banking experts, Ellen Brown, founder of the Public Banking Institute.

The Group is chaired by Adrian Roper (Cartrefi Cymru Co-op) and secretarial support is provided by the Wales Co-operative Centre.

Corporate member organizations include:

Arian Cymru, Cartrefi Cymru Co-op, Co-operatives and Mutuals Wales, Responsible Finance, Wales Co-operative Centre and Wales Council for Voluntary Action.

Individual members include:

Alex Bird (consultancy.coop), Graham Brand, Ellen Brown (Public Banking Institute, USA), Mick Brown (Responsible Finance), Pat Conaty (Co-operatives UK), Ian Courtney (Alacrity Foundation), Richard Dooner (Observer - WLGA), Clive Haswell (ex Standard Chartered) Professor Gerry Holtham (Cardiff Metropolitan University), Alun Jones (Social Investment Cymru), Gruff Meredith (Arian Cymru), Adrian Roper (Cartrefi Cymru Co-op), Jane Taylor (ex ITN/HTV), John Waters, Tegid Roberts (Cadarn Consulting) and Mark Hooper (Indycube).

People's Bank for Wales Action Group is working with the Welsh Government, the WLGA, the Community Savings Bank Association and the Royal Society for the Arts.

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Introduction – why we need a mutually owned Bank

The Welsh Economy is not healthy. West Wales and the Valleys is the only part of Europe that has qualified for three rounds of EU Structural Funds, as the problems we suffer are both chronic and systemic, and the work done so far has not brought about a cure.

Our economy has become dominated by outside interests, largely because our economic development policies have been focussed on inward investment, the inevitable consequence of which is foreign ownership of our industries. Successive UK Governments have been seduced by the monetarist policies of Milton Friedman and the laissez faire capitalism of Ayn Rand, leading to austerity and the privatisation of much of the state. Sadly, they have given up on the proven policies of John Maynard Keynes, forgetting that his advice rescued us from the Great Depression of the 1930's.

Today the need is particularly strong for a redirecting of our economic policies towards developing an economy more rooted in Wales, more sustainable, and with a clear sense of social purpose. We need to address the issues of wealth redistribution, physical regeneration, social & economic development and the environment.

A key part of this reshaping of economic policy is the creation of a People's Bank for Wales – an independent, locally based, co-operatively governed, mutually owned Bank that would enable the Welsh Economy to be strengthened; to become more resilient and more sustainable. This, in turn, would provide more jobs, whilst helping to fill the financial access gap created by the closing down of local commercial Bank branches in towns and rural areas across Wales.

A People's Bank would need to have a clear set of immutable principles to guide its policies, and to this end we would also look to examples elsewhere, such as the Quebec Solidarity Fund, which although not a Bank, has clear ethical and social values¹ which govern how it invests its funds.

A People's Bank can also provide a number of things that the existing, and very useful, revolving loan funds cannot. Currently there is nowhere for individuals and/or corporate bodies to invest in the Welsh Economy. The three Welsh Building Societies offer a place to invest in the property market in Wales, but there are no easy ways to invest in our industry. In addition, a fully licensed Bank can capture our own money to prevent it leaving Wales, but also, it can actually create money as well.²

A People's Bank would provide Welsh Government, Local Authorities and the rest of the public sector with an excellent investment opportunity, as well as creating the low interest credit that they themselves may want to use for local infrastructure and public spending, over and above what is available from the National Loans Fund, Public Works Loan Board and European Funds. As the Welsh Government's borrowing allowance has been increased to £150million annually (£1billion overall)³. It would also provide a reliable and sympathetic source of investment capital to Small and Medium Enterprises (SMEs) across Wales, and as

¹ <https://www.fondsftq.com/en/a-propos/qui-sommes-nous.aspx>

² <https://www.Bankofengland.co.uk/quarterly-bulletin/2014/q1/money-creation-in-the-modern-economy>

³ <http://senedd.assembly.wales/documents/s57805/FIN5-01-17%20P1%20-%20The%20agreement%20between%20the%20Welsh%20Government%20and%20the%20United%20Kingdom%20Government%20on%20th.pdf>

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its customers would be part of its ownership and governance, would adapt to their needs rather than the needs of external shareholders.

We believe that the participation of the public sector, especially Local Authorities, is also a key component towards ensuring the success of the proposed People's Bank and will work with them to encourage their involvement. They will bring investor confidence, a valuable source of capital, and local economic knowledge and expertise.

Context - we lack financial infrastructure in Wales

At present, Wales lacks money supply infrastructure owned and controlled within its borders. By creating money and recirculating wealth within the Welsh Economy, a People's Bank for Wales has the potential to be a key agent in developing the resilient and sustainable economies and communities envisioned in Welsh Government policies and strategies such as the *Wellbeing of Future Generations Act* and *Prosperity for All*.

The People's Bank for Wales Action Group started in 2016, and partly as a result of our networking, campaigning and lobbying, the Welsh Government commissioned a report⁴ in August 2017 from the then Public Policy Institute Wales (PPIW)⁵. This concluded that a fully-fledged, publicly owned Bank could deliver a range of benefits including:

- Better access to investment for SMEs and regional economic development
- Reduced dependence on private sector capital
- The ability to create and retain jobs in Wales
- The ability to “create money” rather than recycle funds

The report noted that the power to “create money” is restricted to deposit-taking Banks which can leverage their capital by a factor of 10:1 or more and could be of real benefit to Wales. As the Bank of England's 2014 Report, *Money Creation in the Modern Economy*⁶ explained, the widespread view among the public and politicians as to how money is created is wrong.

“The reality of how money is created today differs from the description found in some economics textbooks: Rather than Banks receiving deposits when households save and lending them out, Bank lending creates deposits Whenever a Bank makes a loan, it simultaneously creates a matching deposit in the borrower's Bank account, thereby creating new money.”

Today over 97% of money in the UK is created in this way as loans by private sector Banks. As the PPIW⁷ report highlights: while publicly owned Banks that take deposits are not a feature of UK Banking, they are widespread in Germany, and, internationally, about 40% of Banks are publicly owned. The PPIW report has shown the potential and the benefits being delivered

⁴ <http://ppiwi.org.uk/ppiw-report-publication-time-for-a-full-public-Bank-in-wales/>

⁵ Now known as the Wales Centre for Public Policy

⁶ <https://www.Bankofengland.co.uk/quarterly-bulletin/2014/q1/money-creation-in-the-modern-economy>

⁷ <http://ppiwi.org.uk/ppiw-report-publication-time-for-a-full-public-Bank-in-wales/>

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today for citizens, communities, small businesses and Governmental bodies by public banking from Hamburg in Europe to North Dakota in the USA.

What leading economists say

In advising the People's Bank for Wales Action Group, Professor Gerry Holtham⁸ stated that there is evidence that there are serious gaps in the Welsh financial system that leave businesses and individuals without financial services of the calibre they need. In particular, Professor Holtham identifies a number of problems that a People's Bank could help solve:

"Small and medium sized businesses require three types of finance: equity; long term loans or "patient" capital; and shorter term working or bridging capital. Data from the British Venture Capital Association shows Wales receives proportionately less start-up and early stage equity finance than any other part of the UK.

"Wales shares with other parts of the UK a difficulty in finding long-term debt finance. Bond markets are developed only for very large companies and Banks tend to make long term loans only when collateralized against assets like property.

"Many smaller Welsh companies have complained that Banks, having moved to centralized loan assessment based on financial data, are reluctant to make even shorter loans without guarantees or collateral and then charge fees that make the loans expensive.

"These difficulties in obtaining credit in Wales contribute to a situation where Wales, although a relatively poor part of the UK, is probably a net exporter of private savings. Welsh pension funds take contributions and invest in assets and securities for the most part outside Wales. Furthermore, they pay asset managers based in London fees to manage those investments.

"The withdrawal of local Bank managers and loan assessors, while reducing Banks' cost bases, is very likely also to reduce the local knowledge that would enable them to make loans based on qualitative and more deeply informed judgement. By restricting loan assessment to centralized spreadsheet-based processes it could reduce local lending and exacerbate any savings outflow from Wales."

Another respected Welsh economist, Dylan Jones Evans, has identified an annual funding gap of £500 million for Welsh SMEs⁹. Whilst the Development Bank of Wales caters for some of this, there is still a gap that needs to be filled. The proposed People's Bank would be an addition source of funds, working alongside other Government, private sector and mutual financial organizations already in existence.

⁸ <http://www.cardiffmet.ac.uk/news/Pages/Enterprise-Centre-launches-research-project-into-Welsh-Economy-and-appoints-Gerry-Holtham-as-visiting-Professor.aspx>

⁹ <http://eprints.uwe.ac.uk/25608/1/access%20to%20finance%20stage%20%20review.pdf>

Legal structure of the People's Bank

Given that the Welsh Government can only raise a small part of its income via taxes and doesn't hold the bulk of its own funds, we don't consider the State Government owned Bank of North Dakota model, where the bulk of the Bank's business is holding State Government funds, to be a suitable option for Wales, especially so, as it would fall within the Public Sector Borrowing Requirement.

However, the Welsh Government may choose to support a People's Bank by banking with it, as well as encouraging the participation of Local Authorities, which do have substantial funds in their Bank accounts, and other parts of the public sector. Without the active participation of a healthy proportion of the Welsh public sector, the People's Bank would find it more difficult to raise sufficient funds or gain the confidence of sufficient investors in the short term.

In arriving at our preferred mutual co-operative model, we considered a number of other models, such as:

- A publicly owned not-for-profit trust in perpetuity that can never be sold. similar to the old Trustee Savings Bank (TSB), but with added protection to prevent it being broken up or sold off.
- A joint stock company model, with asset locking to ensure it can never be sold by operating as a subsidiary of a non-profit trust or charity. Examples of this form of asset lock operating in Wales include the John Lewis Partnership and Hodge Bank.

After much consideration, we have concluded that what Wales needs is an independent, mutually owned, co-operatively governed Bank, and we consider the Community Savings Bank Association's model¹⁰ to be the best available. This operates under Society legislation which allows for both withdrawable and redeemable shares to be issued, as well as permanent transferable shares and a variety of bonds. The CSBA model is specifically designed to allow the issuing of permanent Transferable Shares, which would qualify as Tier One capital under the Capital Requirements Directive IV (CRD IV).

The People's Bank for Wales would thus become one of a number of CSBA model regional co-operative Banks across the UK that are backed and invested in by Local Authorities and other public bodies. The Royal society for the Arts (RSA)¹¹ and New Economics Foundation¹² are supporting this model¹³ and have developed plans for up to 18 such regional co-operative Banks across the UK.

The Labour Party is also in support of creating a UK wide National Investment Bank¹⁴ which could work in partnership with such regional co-operative Banks. In Scotland there is work

¹⁰ <http://www.csba.co.uk>

¹¹ <https://www.thersa.org/discover/publications-and-articles/rsa-blogs/2017/06/everyone-a-Banker-welcome-to-the-new-co-operative-Banking-movement>

¹² https://neweconomics.org/uploads/files/051add837ec5b0ca02_s2m6bo0c0.pdf

¹³ <https://neweconomics.org/2014/02/co-operative-Banks-international-evidence>

¹⁴ <https://labour.org.uk/wp-content/uploads/2017/10/National-Investment-Bank-Plans-Report.pdf>

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underway to develop a Scottish National Investment Bank. This would be different to the existing Scottish Investment Bank¹⁵ that, like the Development Bank of Wales¹⁶, does not have a Banking licence to take deposits, and is in effect a Government owned revolving investment fund providing finance to businesses and other organisations.

Governance of the People's Bank

We favour a multi-stakeholder Board, with members drawn from public life, Government, investors and borrowers in a similar model to the Welsh Housing Mutual model favoured by Welsh Government for Registered Social Landlords. Thus, the People's Bank would have a representative Board made up of the citizens of Wales and have a specific remit stating that any loans would be prudent, would have a social or ethical purpose, and could only be lent within the Welsh Local Authorities' areas.

The Bank of England's licensing requirements re: the expertise of Directors may constrain this, and we would work with them to develop a hybrid structure, to ensure that their need to have qualified and experienced Directors in charge of the Bank can be combined with a multi-stakeholder model.

The governance model would ensure complete independence from the public sector, whilst maintaining a partnership approach with them. This is important to ensure that the People's Bank is not considered to be part of the Public Sector Borrowing Requirement, even if a majority of its investment were to come from Government and the public sector.

The People's Bank will have a centralized administrative and IT structure with a devolved network of local operations along the lines of the German Sparkassen¹⁷ Banking model. Each local organization would have a degree of autonomy, and each could choose to have its own local brand if it so wished, whilst gaining from the economies of scale of a Wales wide operation.

Learning from other Public and Co-operative models

Richard Werner, Professor of International Banking at Southampton University, has developed a similar, but public sector owned model for the Hampshire Community Bank¹⁸ which has already applied for a Banking licence, and which, using investment from Local Authorities and the local University, is currently operating as a revolving loan fund.

Ellen Brown, a US Attorney and founder of the Public Banking Institute,¹⁹ is a valued member of our Group, and is also on hand with her unrivalled expertise. In the USA, the Public Banking movement is starting to gain momentum, particularly so as 2019 is the centennial of the Bank of North Dakota:

¹⁵ <https://www.scottish-enterprise.com/our-organisation/about-us/who-we-work-with/scottish-investment-Bank>

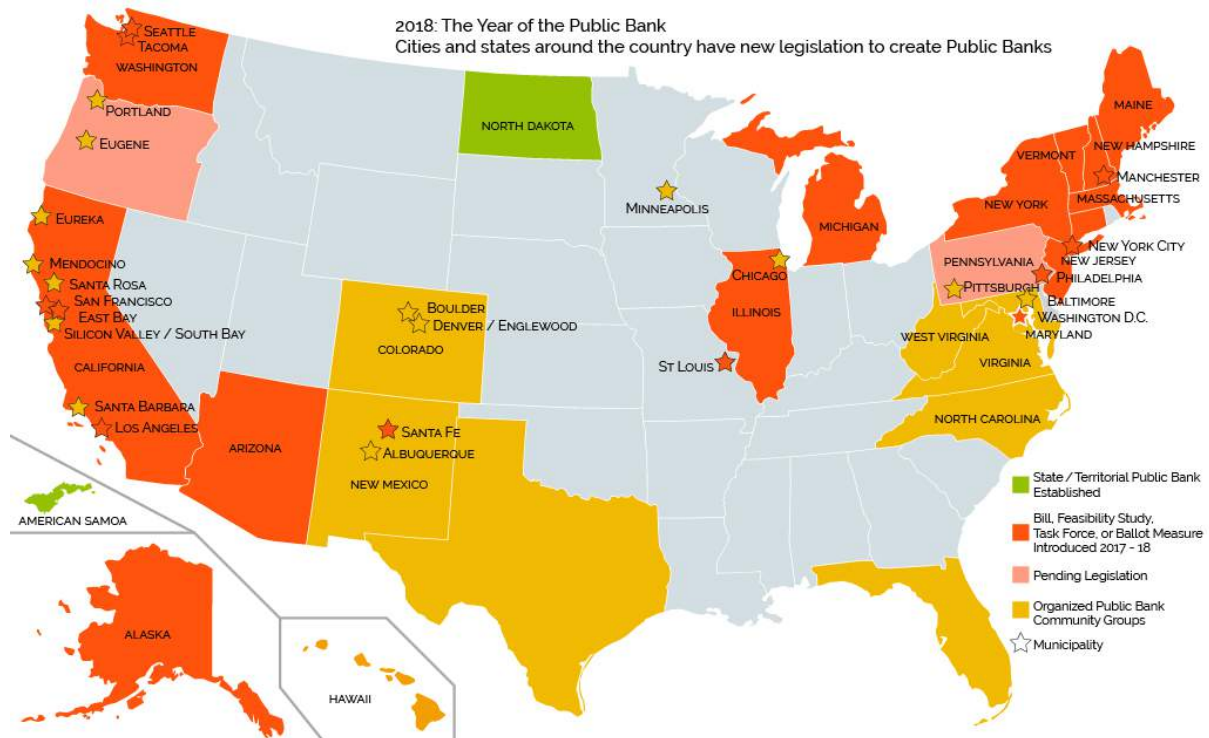
¹⁶ <https://developmentBank.wales>

¹⁷ https://en.wikipedia.org/wiki/German_public_Bank

¹⁸ <http://hampshireBank.org>

¹⁹ <http://www.publicBankinginstitute.org>

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- In San Francisco, Treasurer José Cisnerosis has set up a Task Force to explore the feasibility of creating a Municipal Public Bank and to recommend opportunities to leverage the City's Banking and investment portfolios.
- In New Jersey, the new Governor elect, former Goldman Sachs Banker and Democrat, Phil Murphy, is promising a Public Bank, saying: *"This is money that belongs to the taxpayers of New Jersey, so it should be invested in them."*
- In Los Angeles a ballot measure for a city-owned bank introduced by the president of the City Council in July 2018 won 44 percent of the vote, indicating that round two, already in process, is likely to succeed.
- The Washington State public banking caucus has 23 senate members — nearly a majority — pursuing a state-owned bank that will include cities and counties as participating members. The legislature has allocated \$480,000 for a business plan needed to apply for a bank charter, due to be completed in June 2019.
- Oakland City Council has approved a \$100,000 public bank feasibility study.
- Public banks have been introduced at the federal level as a funding mechanism for the Green New Deal put forward by Alexandria Ocasio-Cortez (D-NY), which is now supported by 31 members of the House.
- Across the nation, from Maine to Hawaii, Alaska, West Virginia, Connecticut, and Texas, more than 25 initiatives for public banks are actively being pursued; and over 60 organizations are promoting public banks.

Members of the Public Banking Forum Ireland,²⁰ have indicated they would be happy to come to Cardiff to assist and share experience. The Forum have presented a Comprehensive Public

²⁰ <http://republicirelandBank.com>

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Banking System Proposal for Ireland “*Creating Ireland's Alternative Banking Force, Preliminary Proposal Document*”²¹ to the Irish Government Finance Committee. The Forum proposes a network of up to 10 regional Banks with a shared back-office services centre.

The expertise of Germany's Savings Banks Foundation for International Cooperation (SBFIC) is also available to help establish the People's Bank for Wales. Niclaus Bergmann, managing director of the German-based Savings Banks Foundation for International Co-operation,²² speaking at a conference organized by the Public Banking Forum Ireland in Dublin said:

“A network of regional Banks with close links to the local economy are the most effective type of SME lenders. A system of regional publicly owned Banks with a focus on lending to the SME sector could play an important role in restoring faith in the Banking system and supporting economic growth”.

His proposal is that, in Ireland, each Bank would have core capital funded by private investors and possibly local Government. Each Bank would need a core capital level of roughly €10m, although this could be as little as €5m, depending on its business plans. Liquidity would be provided exclusively from deposits.

The aim would be to have up to 10 regional Banks spread throughout the republic with a shared services centre. This centre would provide information technology, risk management, tax advice and other services for all the federated Banks in order to keep the cost base as low as possible.

Mr Bergmann said:

“It is unlikely that AIB and Bank of Ireland would support the concept of public Banks, but the pillar Banks still have big problems. They are in no position to serve the entire economy, particularly SMEs. Credit Unions also have problems, particularly with consumer loans. The public Banks would be regulated as normal and consequently covered by the deposit guarantee scheme”. Public Banks would put a huge focus on ethical behaviour, which is critical if the public are to have their faith restored in the Banking system.”

Raising the Capital Investment

The Welsh Government could play an important enabling role by providing help towards the start-up costs and the Banking licence. If it were able to invest in the Bank and use its services, it could benefit the Welsh Economy through the Bank's money creation capability.

Capital investment would normally be acquired through issuing transferable shares, which are limited to Welsh resident individuals and businesses, but can be bought and sold with the agreement of the Board. Another source of patient capital for a mutual model could be through issuing Perpetual Bonds, or Core Capital Deferred Shares (CCDS) which can be held by anyone.

Core Capital Deferred Shares (CCDS) are a form of Common Equity Tier 1 (CET1) capital consistent with the mutual ethos which are now being used by Building Societies to replace

²¹ <http://www.chg.gov.ie/app/uploads/2017/04/submission-by-pbfi.pdf>

²² <http://www.sparkassenstiftung.de/en/>

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Permanent Interest-Bearing Shares (PIBS) and other forms of Subordinated Debt which no longer meet regulatory requirements under Capital Requirements Directive IV (CRD IV). The PRA and the European Banking Authority have confirmed that they have no objection to CCDS qualifying as capital under CRD IV / CRR.

These could be attractive to public sector pension funds and other investors who wish to invest in Wales. As Dwr Cymru, the mutual that runs Welsh Water, has shown, bonds can be very successful for securing long-term capital, and its initial bond issue in 1989 was £19 billion – the largest ever in the UK.

Investment in the People's Bank could be attractive for other reasons. The success of the ethical investment movement through online platforms such as Ethex, Seedrs or Crowdcube would indicate there is considerable investment looking for a socially responsible home, which could be attracted to a People's Bank with a social mission.

Deposits are also needed

Deposits are needed by any Bank, public or private, to provide liquidity. Deposits in public Banks internationally are primarily provided by public sector investor members in addition to the Bank core capital they invest in as shares. As deposits from Government and the public-sector grow, this will help to strengthen public trust in, and support for, the Bank.

However, for the People's Bank to attract deposits, it must offer the same or better security as other deposit taking Banks and Building Societies and the interest on offer will need to offer comparable rates. As a licensed Bank, the People's Bank would be covered by the UK Government's Financial Services Compensation Scheme²³ which protects deposits up to £85,000 for both individuals and companies.

If the Welsh public sector agreed to Bank through the People's Bank, it could quickly build up an appreciable deposit base. Local Authorities have substantial accounts, as do Health Authorities, Universities and other public bodies such as the Emergency Services. For example, according to Welsh Government Accounts 2016/2017 the amount of general and unallocated reserves in all County and County Borough Councils was £199.8 million, and the total usable reserves for all County and County Borough Councils in Wales was £1.415 billion.²⁴ It is estimated, also, that Welsh Credit Unions have around £15 million on deposit in commercial Banks.

The Welsh Government's cash transactions are small since it relies on transfers from the consolidated fund, but it could transfer its current account to the People's Bank. About half of the £1.5 billion promised to Welsh Government is in this form, including the £650 million referred to in the budget as additional capital funding. The People's Bank would have to satisfy criteria to justify the acquisition of that business otherwise it could be subject to challenge for illegal state aid or other anti-competitive practices. A substantial amount of State funding is

²³ <https://www.Bankofengland.co.uk/prudential-regulation/authorisations/financial-services-compensation-scheme>

²⁴ <http://gov.wales/docs/dsjlg/publications/localgov/171116-wga-reserves-2016-17v2-en.pdf>

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provided in the form of “Financial Transactions”, a type of Government loan. There is unique potential for a People's Bank to help manage this funding.

Creating Capital

As the Bank of England makes clear, a licensed Bank can create capital by lending, using the mechanism known as Fractional Reserve Banking.²⁵ This enables a Bank to lend out more than the deposits it holds, subject to suitable capital being available from its shareholdings and other assets. This is strictly regulated by the Bank of England, which allows most UK Banks to operate to a ratio of 12.5:1 (Risk Weighted Assets [Loans] to Tier One Capital).²⁶ However, it is likely that the Bank of England would initially only permit a lower ratio for a new Bank such as the People's Bank for Wales, and our intention, to ensure the stability and sustainability of the Bank, is to seek to use only a 5:1 ratio for the first few years. This ratio for money creation is deliberately prudent, as is the case in the responses to Government consultation for a Public Bank in Scotland.²⁷

Thus, a People's Bank for Wales could be established with, say, £40million per annum of start-up share capital subscribed over the first six years (£240 million cumulatively). For example, using our prudent 5:1 ratio of this core capital, the People's Bank would have the initial capacity to have created new money by year six of £1.2 billion in loans.

This new money sum of £1.2 billion will increase further as the People's Bank expands its capital base through both additional investment and retained earnings. Thus, the money creation capacity will expand organically as the People's Bank becomes more firmly established as a lender with a proven track record.

Working with other organisations to develop locally-based Banking

A key role of the People's Bank for Wales would be to restore locally-based Banking, making it easier for smaller local businesses to obtain finance and enabling local deposits to be recycled within the local or regional economy. Having a team of local loan officers with knowledge of the local economy, whilst expensive relative to the increasingly centralized methods of commercial Banks, will be beneficial for renewing local Welsh economies around Wales. In some cases these may be direct employees, but in others they may be associates based in partner organisations.

The People's Bank intends to work with other organizations that are operating in closely related areas and benefit from their local knowledge, e.g. Credit Unions, Building Societies, Community Development Financial Institutions (CDFIs), and other local co-operative or public-interest lenders. This would support and optimize the use of human judgement in credit assessment, whilst including those without a credit history (or a credit history that is damaged

²⁵ <https://www.bankofengland.co.uk/quarterly-bulletin/2014/q1/money-creation-in-the-modern-economy>

²⁶ Tier One Capital is defined by the Bank of England and includes paid up share capital (not withdrawable shares), PIBS (or the equivalent) and accumulated retained profits

²⁷ Common Weal (2017) Scottish National Investment Bank: Submission to the Scottish Government consultation, November 2017.

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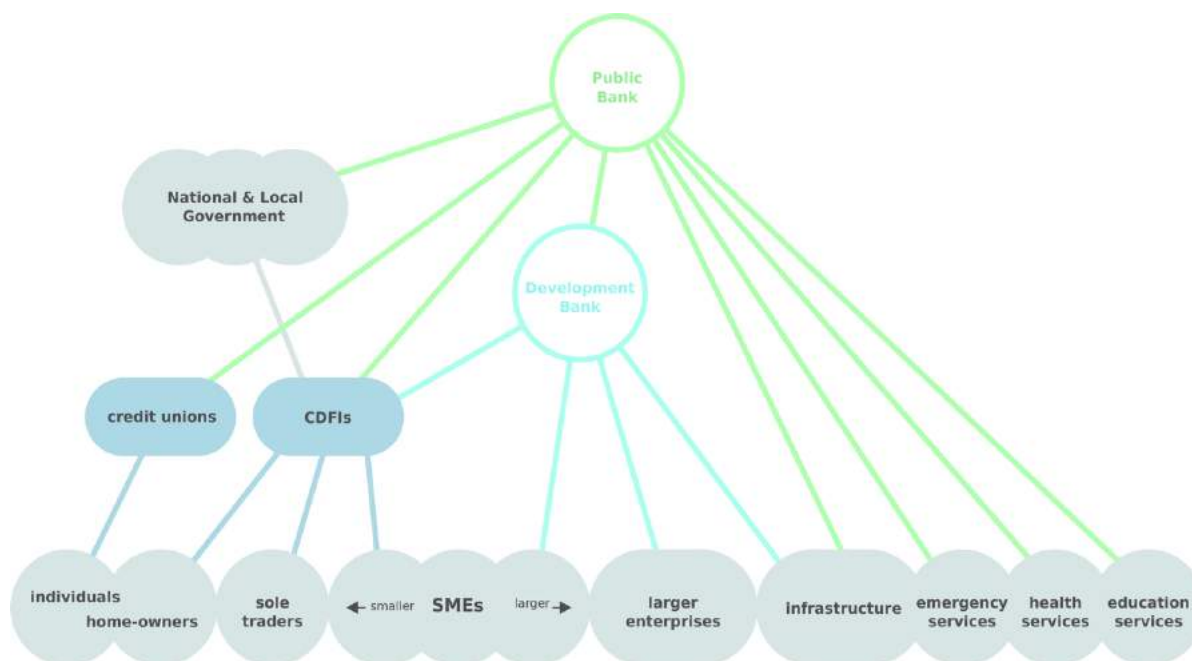
by past events, but repairable). Thus, the People's Bank will be able to strengthen and expand Credit Unions and CDFIs, which could improve the situation for small depositors and borrowers at the bottom of the loan size range and help to fulfil some social requirements to bring financial services to poorer people at a manageable cost. Co-operation with local Post Offices is another opportunity.

Such local investment & loan partnerships could build on the knowledge gained from the work of the Public Banking Forum Ireland's consultation with Credit Unions and the Irish Post Office on how such partnerships could be developed, as well as the experience gained by the CDFI and CU movements in Wales.

Through such partnerships, the People's Bank could build a network of local brokers or agents in each interested Local Authority area to provide a high street presence, in addition to its own branches. It will also make use of the new generation of Automated Bank Terminals²⁸ currently coming into use, which allow for withdrawals and deposits (cash and cheques), as well as providing a direct video link to an assistant in the head office, to help with any queries or problems the customer may have, and even an automated Safety Deposit Box facility if required. These can be located at many more sites around Wales to provide a comprehensive service to the public and are currently being trialled by the CSBA.

The People's Bank will also have to work with other Banks in order to process transactions between Banks, both in the UK and in other countries. To do so, it must work with other Banks in the clearing system. It could choose to either apply to be a Clearing Bank with access to the inter-bank market and with an account at the Bank of England or choose to clear through a partnership with an existing commercial Bank. This has yet to be decided, and will be part of the detailed compliance Business Plan that will need to be drawn up and presented to the Bank of England.

²⁸ A new generation of the established ATM – Automated Teller Machine



Gerry Holtham has suggested that the People's Bank could also organize a local interbank market for sub-Bank organizations (e.g. Credit Unions and CDFIs) and act as a lender of last resort, enabling them to step up the scale of their activities. To do so it would, of course, need to choose to become a Clearing Bank itself.

A People's Bank could also provide technical assistance and credit insurance to make them more attractive to depositors. The illustration above shows schematically how locally based Banking partnerships across Wales could be co-developed hand in hand with a People's Bank.

Working with an affiliated Mutual Guarantee Society for Wales

The People's Bank could reduce the associated risks of enterprise lending through the setting up of a Mutual Guarantee Society (MGS). MGSs are widely used as risk management partners by Public Banks in Europe.²⁹

A Mutual Guarantee Scheme (MGS) for Wales would not be directly under the control of the People's Bank but could be an affiliated organization that it helped promote. For lending to small, medium and social enterprises, when tangible security is often not available from the individual borrower, MGSs reduce the risk to the lender by providing a collective security from the other MGS members. A Mutual Guarantee Society³⁰ model for reducing the risk to the Bank of enterprise lending was developed in Italy for small businesses and co-operatives and has now spread across France, Belgium and the Netherlands to most EU countries successfully.

²⁹ Tony O'Rourke "Public Banks and small enterprise guarantee programmes", Discussion paper prepared for the Cardiff roundtable event on a People's Bank for Wales, held at the WCVA on 27 September 2017.

³⁰ Tony O'Rourke, "The role of Mutual Guarantee Societies", January 2017 - Briefing paper commissioned by Co-operatives UK

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In Germany, the MGS system integrates with other public loan guarantee schemes similar to the UK Enterprise Finance Guarantee scheme. The MGS supplements such public-sector loan guarantee schemes by operating as a complementary co-operative solution for both public Banking and private sector Banking lenders. An MGS for Wales would make an excellent partner for the People's Bank, and the Bank would work to support such a venture.

Providing social and environmental benefits

In other countries, Public Banks provide a range of solutions for financing infrastructure including hospitals, transport, affordable housing and finance for school buildings. The People's Bank could address this need, along with other financing needs in areas including residential care homes, renewable energy and sustainable forms of agriculture.

The People's Bank could also work with public and charitable funders to provide to enable it to finance a range of marginal (i.e. not quite bankable) projects with high social and environmental benefits. It could also cross-subsidize projects that best fitted its social, environmental and economic development aims. Thus, a given project could be supported, even if it is not very profitable, if it has strongly positive social returns and/or results in employment at higher wages than are otherwise available in a local area.

However, when the People's Bank puts a value on social as well as private benefits, this will require more skilful and disciplined loan assessment than if simple profitability is the sole criteria, and so a separate hypothecated fund would be created to ensure this class of lending could be separately authorised, monitored and controlled.

Proviso: Things the People's Bank will not do

There are some things the People's Bank will not do:

It will not attempt to plug the venture capital gap.

There are only a couple of private companies in Wales providing advice and introductions to smaller businesses looking for corporate finance and there is one business angel network, Xenos, sponsored by the Welsh Government.

Finance Wales, now renamed the Development Bank of Wales (DBW), also provides venture capital. DBW provides equity investment in companies up to £5 million per deal, which is significantly greater than the previous cap of £2 million under Finance Wales.

It will not be a subsidiary of Welsh Government in order to ensure it is not restricted by the Public Sector Borrowing Requirement (PSBR).

As a Welsh Government owned project, the new Development Bank of Wales's access to the wholesale debt markets is restricted, because its borrowing is counted by the UK Treasury against both the Departmental Expenditure Limit and the PSBR. DBW activities, therefore, have to compete with other Welsh Government spending budgets. This restricts the scale of operation of the DBW and means it must develop a function as an agent, syndicating loans, which are not on its own books, whenever large investment deals are required.

It will not duplicate the work of the new, publicly owned Development Bank of Wales

The Development Bank of Wales (DBW) is partly financed by Welsh Government, the European Union and Barclays Bank, and is not a deposit taking Bank, but a fixed size rotating loan fund. As such, DBW is targeting SMEs based in Wales with a mix of loan and investment funds from its central fund.

However, in order to raise any further funds through borrowing, DBW is restricted by the PWBR as above. If DBW proves unable to provide sufficient patient capital, other solutions must be found but it is imperative to let the institution develop its own, important space in the Welsh finance market.

The proposed People's Bank, having chosen to take deposits from public organizations, businesses and the public, is limited in size³¹ only by the confidence these investors have in it, and will be able to create new money to replace that part of the DBW's capital which comes from Europe, and which will be lost following Brexit.

The People's Bank for Wales would work alongside the Development Bank, sharing risk, as well as being able to finance larger public projects, and reaching micro businesses through its partnerships with Credit Unions and CDFIs, to which it can 'wholesale' funds.

³¹ It must be noted that if the People's Bank was itself an institution of the Welsh Government, it too would be restricted in access to the debt markets by the PSBR, hence our commitment to the independent co-operative model

Q & A: What will a People's Bank do, and why do we need one?

Q *What would be the unique benefit and selling point of a People's Bank?*

The provision or underwriting of long-term debt is classically the area of specialization of the Investment or Merchant Bank, which typically do not take deposits but raise funds on the wholesale debt markets and lends them on for a margin or a fee. Wales does not have such an institution operating at a significant scale. Commercial Banks can have departments operating in this area, but British ones have not been very successful, and none is currently very active in Wales.

The Development Bank for Wales is staffed mainly by people from the corporate finance departments of Commercial Banks rather than from an investment banking background. Consequently, Finance Wales and DBW concentrates mostly on the area in which it has expertise, i.e. more conventional loan packages to SMEs plus some venture capital.

The People's Bank for Wales would provide additional and complementary access to low cost and patient investment capital including for infrastructure, as well as a means for the public, and the public and private sectors, to invest in Wales.

Q *Won't a People's Bank simply replace the lending currently provided by the private sector Banks operating in Wales?*

A We envisage that the People's Bank's services will be delivered at the local level, much of it delivered with partner agencies, and some directly from its own branches. With a much better understanding of local needs and circumstances, and with no outside shareholders looking constantly for profit, the People's Bank will be able to reach those small enterprises that the Commercial Banks don't want to deal with or that lack the property collateral they require. These local linkages will also enable a People's Bank to better assess risk than the existing high street lenders.

We envisage the People's Bank's mission would be to achieve reasonable returns rather than to maximize profit for shareholders, and that this would be written in to its governing documents. For example, the German KfW Development Bank's (KfW EntwicklungsBank³²) mission is to secure the social, economic and ecological well-being of the people of Germany.

Q *All Banks create money, where there are lending opportunities that will be profitable for them and their shareholders – there are many private-sector Banks operating in Wales that do this, so why is a People's Bank needed in addition?*

³² <https://www.kfw.de/inlandsfoerderung/Öffentliche-Einrichtungen/index-3.html>

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- A** The primary purpose of the People's Bank would not be to make profits, but to create money to finance the Welsh Economy and public services. As the Bank of England makes clear, this money is generated by the act of lending itself, and can, in theory, be up to 12.5 times the actual Tier One³³ capital investment in the Bank.

This created money can be focussed on the economic needs of our society, rather than just being aimed at the most profitable lending opportunities. Also, any surplus generated would be retained within the Welsh Economy, whereas the profits generated by the private sector Banks (none of which, apart from Hodge Bank, are based in Wales) are extracted from the Welsh Economy and distributed to head offices, senior executives and shareholders across the rest of the world.

- Q** *Government, Welsh and Local Authorities, already borrow cheaply from the Public Works Loan Board (PWLB), so how does a People's Bank provide an advantage over this?*

- A** The PWLB is funded by the bond issues of the Westminster Government, and as its credit is good, it is able to obtain these investments at very low interest rates,³⁴ and passes this on in the form of low rates³⁵ to Local Authorities. As the People's Bank for Wales will follow prudent policies, it should also be regarded as low risk, and so could obtain investment at low rates, which would be reflected in the loan interest rates it is able to offer. Also, whilst the People's Bank would to an extent duplicate the work of the PWLB, it would be free of Westminster Government policy restrictions, as the People's Bank's borrowing and investment would not be part of the Public Sector Borrowing Requirement.

- Q** *Would a People's Bank not be another loss-making exercise needing constant subsidy to compensate for it taking risks on small businesses, and having high overheads by operating in marginal areas where other Banks have withdrawn?*

- A** No. Experience in Credit Unions and CDFIs operating in other countries is that small loans from a sympathetic lender actually have a lower recidivism rate than medium sized loans from commercial sources.

The experience of Co-operative and Public Banks in other countries, many of which are over 100 years old, is that they are profitable in their own right, and need no public subsidy, because they operate prudently.

Also, the business model proposed of working with existing financial institutions, can open up the availability of a range of high street outlets at low cost. Possible high street partnerships could include existing Credit Unions and CDFIs, as well as Welsh Building

³³ Tier One Capital is defined by the Bank of England and includes paid up share capital (not withdrawable or redeemable shares), PIBS (or the equivalent Core Capital Deferred Shares) and accumulated retained profits

³⁴ Currently 1.39% on a 10-year UK Government Bond (27/11/18)

<https://www.bloomberg.com/quote/GUKG10:IND>

³⁵ Currently 2.38% (10 years from 27/11/18) <https://www.dmo.gov.uk/data/pdfdatareport?reportCode=D7A.2>

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Societies, with which it is not intending to compete but to complement, all of whom already have a number of offices operated in partnership with other finance businesses. Other possible outlets could be in Local Authority premises where a small space could be rented at a low, but unsubsidized cost.

Q *Who would the People's Bank lend to, and why?*

A The People's Bank should have no restriction on who it lends to subject to meeting its mission. It should lend to start-ups, established and growing businesses, public sector infrastructure projects, and indeed any form of lending which both meets its mission and is considered to be a good investment. It needs to be demand-led, not product-led, and should seriously consider all request received.

Responsible Finance UK, which represents the emerging micro-finance companies in Wales that service harder to reach businesses, start-ups and social enterprises, believes they could quadruple their growth rate if they had a willing partner and better access to capital via a People's Bank.

Also, the People's Bank would be an important lender to the wider public-sector, as borrowing by the Welsh Government is constrained by Treasury rules,³⁶ and the rates charged by the Public Works Loan Board to Local Authorities, which are 1% above UK Gilt rates³⁷ on all standard rate loans. The People's Bank, as an independent body, would not be bound by these restrictions, and would provide additional and complementary access to low cost and patient capital.

The People's Bank for Wales will also work alongside the Development Bank of Wales, sharing risk, as well as being able to finance larger public projects, and reaching micro businesses through its partnerships with Credit Unions and CDFIs.

Q *How will the People's Bank minimize and control its risk?*

A It will work with local partners, as well as having close relationships with local regeneration teams, partner organizations and SME member organizations such as the Federation of Small Businesses (FSB). This will provide local and regional insights which will help to reduce risk.

It will develop a balanced portfolio of loans, with less risky public infrastructure loans making up a large part of its lending. Also, as already happens in Germany and in other EU countries with Co-operative and Public Banks, it will support the development of Mutual Guarantee Societies. These massively reduce the risk of lending to SMEs by spreading the loan risk across a number of inter-related partner SMEs who jointly underwrite the loan risk. It is worth noting that the German KfW's loan portfolio is not

³⁶ Public Sector Borrowing Requirement (PSBR)

³⁷ Currently 1.39% on a 10-year UK Government Bond (27/11/18) <https://www.bloomberg.com/quote/GUKG10:IND>

heavily SME exposed - in 2017 only 14% or €7.9 billion, out of an overall investment of €54.7 billion, went to SMEs and start-ups, with the rest going to long term public investment, including infrastructure and other secured assets. In this way the People's Bank will be less exposed to risk than the DBW.

Q *How would the People's Bank be capitalized?*

A The People's Bank for Wales should be a licensed Bank with full powers to take deposits and issue credit. This is vital if the Bank is going to be capitalized in such a way that it can make a serious impact on the development of the Welsh Economy as a whole. Credit creation should be based on a leverage ratio which is much safer than Commercial Banks to ensure the Bank is well capitalized. This should be less than the generally permitted 12.5:1 and we intend to operate a much lower ratio at first. Our view, in a similarly prudent vein to the Scottish proposals, is to stay at 5:1 for the first few years.³⁸

Local Authorities, the Welsh Government and other public bodies will be encouraged to invest in shares. From this starting point, the Bank will also establish a perpetual bond issue which should be an attractive option for private investors. Also, public pension funds in Wales should see a People's Bank for Wales as a very reliable investment, and the Welsh Government could work to encourage pension fund managers to take this approach.

It is worth noting that investors have great confidence in other mutual enterprises. Following on from its initial £19billion issue in 1989, Dwr Cymru, the non-profit mutual behind Welsh Water, has recently secured a further £300 million investment with an 18-year bond issue at 2.5%, which is a lower ticket than any of the private sector water companies can achieve.

³⁸ The BoE currently allows most Banks a ratio of Tier One to Risk Weighted Assets (principally loans) of 12.5:1, but prudent advice is to work to lower ratios. The Public Banking Institute recommends a maximum of 10:1, and the proposals for a Scottish National Investment Bank are considering a ratio as low as 2.5:1

This Report has been produced on behalf of the People's Bank for Wales Action Group
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