Re-banking the UK

How to create a diverse lending infrastructure

David Boyle

New Weather Institute

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Foreword

Anyone who knows me will know the close interest I have taken in the future of banking in the UK, as my party's Treasury spokesperson in the House of Lords and as a member of the Commission for Banking Standards.

I have spent some years now, in those roles and before, encouraging debate about what shape the UK banking system might need to be – if it is going to provide the kind of support for small businesses and social enterprises that seems to be possible in other countries.

This report is a contribution to that debate. It was begun with my help, before I became a government minister, and I am enormously grateful – both to David Boyle for the work he has done and to the Joseph Rowntree Reform Trust for making it possible, through their support under their Liberal Voices project.

It is important because it constitutes a set of practical proposals for other ways forward, and I hope it will encourage more open discussion – because it is open discussion that will, I believe, help us see clearly where we want to take banking in the decades ahead.

Baroness Kramer
House of Lords

Introduction

It is now five years since the investment bank Lehman Brothers collapsed, plunging the world into an unprecedented economic slowdown, especially in those countries where banks had most lost touch with reality.

The immediate cause of the collapse was the unravelling of the sub-prime lending market, the bizarre sale of bundles of mortgage debt, sold to the poorest people, and structured in such a way that the mortgages could not be paid off. But, behind that, there were two more fundamental flaws in the banking system.

The first flaw was that the combination of lax regulation and bonus-fuelled risk-taking had accelerated a series of disastrous financial crises that had begun over the previous generation, since the previous biggest bail-out, the bankruptcy of the American building societies, involving the biggest financial bail-out to date (around $125 billion).

The second flaw in the banking system, certainly in the UK, was that the biggest banks had begun to withdraw attention and resources from domestic banking, especially in poorer areas – closing bank branches and withdrawing from SME lending – because the potential rewards from investment banking (also as it turned out, the potential losses) were so much more exciting.Bank managers who knew their local areas were replaced with risk software operated from regional office.

This process took place across the western world, but it mattered more in the UK because the UK domestic banking market was so reliant on the big banks.

The problem was that UK banks had been consolidated to a rump of the Big Five (Barclays, Lloyds, Midland, National Provincial and Westminster), a situation which has really existed since 1919, so the UK banking market includes almost no competition from small, local banks, the kind of banking network which has done so much to redress the balance in so many of the countries we work, tradeand compete with in the UK.

The UK government has focused its attentions on the systemic risk to the financial system to banks operating under the safe umbrella of the government guarantee. Some measures have been taken to increase competition, seven-day account switching, and making it easier to enter the market, but creating that diverse market still has some way to go, in order to make sure the SME market is served as well as it is in other countries.

The closest to a proposed solution at the last general election in 2010 was in the Lib Dem manifesto, whichpromised to: "Break up the banks and get them lending again to protectreal businesses". This was translated in the coalition agreement along these lines:

> *"We wantthe bankingsystemtoservebusiness,not the other way round. We will bringforwarddetailedproposalstofosterdiversityin financialservices,promotemutualsandcreate amorecompetitivebankingindustry. We willdevelopeffectiveproposalstoensurethe flow ofcredittoviableSMEs."*[1]

This has not yet been achieved. It was Liberal Democrat peers who led the successful bid to make sure the new banking regulators should "have regard to" the diversity of the UK banking market, and that the main banks should reveal geographical lending data – as they have to in the USA. This has now taken place and covers 9,000 different postal districts.[2]

But there is still a great deal more to be done to re-bank the UK, and to create the diversity of banks that we so badly need to underpin a new era of local enterprise. This report suggests a way forward.

Section 1: The problem

There are a series of urgent and interlocking problems with the status quo in the UK, where there are five Big Banks in the UK retail banking market (HSBC, Barclays, Lloyds, RBS and Santander) – not the same as the Big Five in 1919 – plus one big building society and some challenger banks (TSB, Co-op, Metro, Handelsbankenetc). The sum total of the challengers do not yet amount to more than 17 per cent of the personal current account market.[3] They are not yet an effective competition, especially when they account for less than ten per cent of crucial SME bank loans.[4]

The challengers include:

- New challenger banks, like Metro Bank (the first new banking licence issued for a century) and new arrivals like Sainsbury's and Tesco banks, Virgin Money and Handelsbanken.
- Old banks carved out of the big ones, like TSB, which has 4 per cent of the UK market.
- The credit unions, which – although they are being geared up with help from the Department for Work and Pensions, and will eventually play a role in providing alternative savings options – are still small and not yet lending to SMEs.
- The CDFIs (community development finance institutions), which are geared up to play a useful role –especially in the social enterprise and housing retro-fitting markets, which the banks find especially difficult – but there are only 60 of them in the UK.

- Green or ethical institutions, includingthe Co-operative Bank, Ecology Building Society (the last new building society, started in 1980) and the Anglo-DutchTriodos Bank.

- The online challengers, P2P challengers, like Zopaand FundingCircle, which have potential to grow but are still very small and are not yet covered by any kind of banking guarantee.

- The emerging local banks, led by Cambridge & Counties but with more in the pipeline, many of them with encouragement from local authorities.

- Other unusual or more maverick solutions, like the heroic Bank on Dave in Burnley.

As well as these there are three new institutions under construction at national level: the Green Investment Bank, which specialises in loans for green infrastructure, the Big Society Bank, specialising in social enterprise lending), and the new Business Bank.

The Business Bank is important, though its remit remains uncertain and the interest it will charge – and the profits that the Treasury will demand – will make a huge difference to its impact beyond what is currently possible, but it seems likely that it will mainly be doing 'partnership banking', taking loans off the balance books of banks so that lending can go further.[5] The difficulty is the same as the other measures put in place since 2010 to increase SME lending: theBusiness Bank will be operating as a co-lender, using the local knowledge of their partner banks, which in practice lack that very same local knowledge.

Together, these do not yet amount to a solution to the basic problem. The UK still suffers from the debilitating lack of effective local banks and from a lending infrastructure that is no longer designed to encourage enterprise. That leaves us with the following problems:

1. Local lending is far more difficult than it should be

The argument continues about the reason for the drop in bank lending by the Big Five to SMEs. Is it that small business managers don't want bank loans or is it that the terms are so much more onerous than before?

What is undeniable is that the value of outstanding SME lending fell by nearly one-fifth after the financial crisis, and many more loan requests were turned down. One in four SMEs that applied for bank finance in 2010 were turned down outright, compared to just one-in-twenty five in 2007, and the smallest firms were hit the hardest.[6] The terms of loans were also changed, in ways that have yet to be properly researched.

The credit crunch obscures a much bigger trend. In search of cost efficiencies, the big banks have relied less onlocal managers and more heavily on 'credit scoring', which involves noting down the business's or person's characteristics and using algorithms and historicaldata to decide whether businesses or people are good risks.[7]The resulting under-provision to SMEsmay seem rational for individualcommercial banks, but it damages the economy becauseit means that wealth-creating enterprises also tend to fail to get the finance they need to expand.

Failure to meet credit scoring thresholds is the most common reason why SME loans are rejected, and about 40 per cent of applications fail because of this. Most rejected loan applications which are overturned in favour of the customer during formal appeal processes do so because of unreasonable credit scoring. Most SME credit applications get filtered out before they even reach the credit scoring stage. Evidence suggests that small banks are better at using the 'soft' information needed to assess the prospects of small firms.[8] What this amounts to is that big banks do not have the infrastructure to price local risk effectively.

For that reason, if no other, it matters that just 3 per cent of banks are local in the UK, compared to 34 per cent in the USA, 33 per cent in Germany and 44 per cent in Japan.[9]

2. Economic downturns last longer than they should.

The implication of this is that big banks do not play the role in recovery that local banks play in other European countries. Research seems to bear this out, suggesting that the UK is at an economic disadvantage.

Large banks seem to lend proportionally less to SMEs than smaller banks, despite the critical role that SMEs have in recovery.[10] For example, in 2010, co-operative banks had a significantly larger share of SME loans than their overall market share in Austria (46 per cent of SME loans, compared with 33 per cent of all loans), Germany (28 per cent versus 17 per cent)and the Netherlands (43 per cent versus 29 per cent).[11]

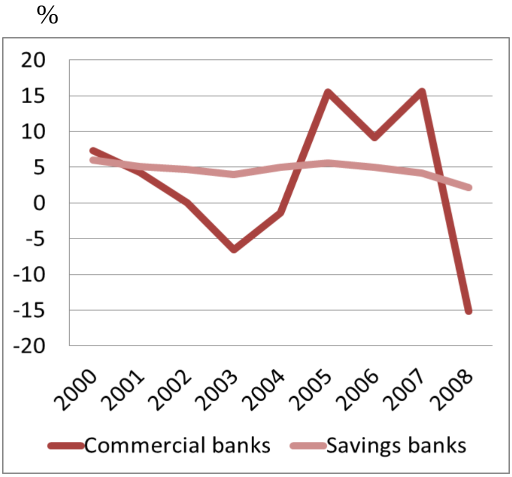
The implication of this is that, if the UK had a similar local banking infrastructure – able to deal with small business lending more effectively – then recessions could be shorter and less pronounced.

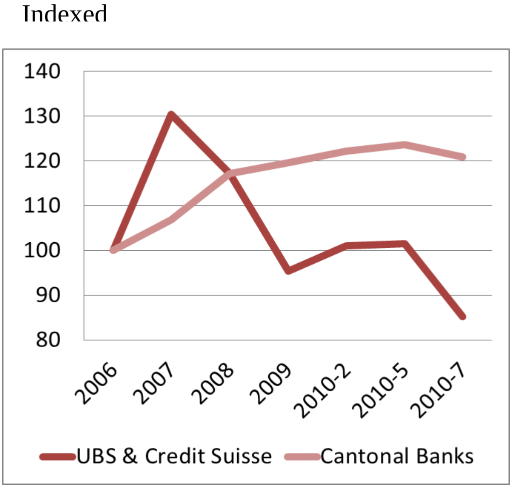
3. The economy is more unstable than it could be.

Studies in Italy and Germany found that co-operative and savings banks help reduce the drain of capital from urban centres and foster regional equality because of their ability to lend to SMEs.[12] It is also important that, although they accounted for one fifth of the European banking market, co-operative banks suffered only 8 per cent of total losses incurred during the financial crisis.[13]

If you look at the graphs with the wobbly, unstable line showing the collapse and recovery of the big banks after the 2008 crisis, it looks similar in most European countries. Where it looks different, it is because – in other European countries – there is often another stable line representing the small banks. See for example, the graph comparing performance of local banks in Switzerland and Germany during the period of the bank crash.[14]The UK graph is similar, except there is no balancing line for local banks, because – as we know – there are hardly any.

German banks' return on capital (top) and (below) Swiss banks' credit provision.





*Source:*New Economics Foundation graphs based on Civitas report *German savings banks and Swiss cantonal banks, lessons for the UK*, by Stephen L. Clarke, 2010. See the **nef** report *Stakeholder Banks.*

The clear implication is that, if our banking infrastructure is less stable when it comes to supporting local economies, then so is our economy.

4. The economy puts too much emphasis on property.

Bank lending in the UK is overwhelmingly weighted in favour of property. Lending on property reached a peak in 2008, but has still not fallen much below that and it still dwarfs lending for productive enterprise. In the decade before the crisis, 84 per cent of the money lent to British residents by British banks went into property and financial services.[15]

It isn't clear how much this is because the value of property can be computed more easily using risk software (though it has its own risks, of course) or whether the big banks are – consciously or unconsciously – pursuing policies that would replicate the last housing bubble, and allow them to profit, or at least revalue the assets on their balance sheets. Either way, it puts an unhealthy reliance on property, raising its value disastrously and unbalancing the economy away from know-how and enterprise

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We have lived with the problem of the highly centralised and highly consolidated UK banking system in a whole new way since 2008. It has an impact on access to finance and on social inequality, but the real impact it has is on the economy – adding an extra burden on productive local enterprise, especially in areas deemed less competitive by risk software – compared to other European economies.

This remains a problem, even after the recovery, because the structural problems still remain, further unbalancing the UK economy. A study by the University of Oxford published in April this year by the Building Societies Association shows that – across both the savings and mortgage markets – the diversity of providershas dropped by about 20 per cent since 2004.[16] The report concludes:

> *"If the government is to fulfil its commitment to foster diversity it will need to do more to ensure that a variety of organisations are able to operate in financial services markets in the future, with the aim of reversing the decline in diversity... since 2004.... Consumers are likely to benefit less from competition than a decade ago and if another crisis were to hit, the system is more vulnerable than it was".*

One of the side-effects of this loss of diversity is that all-important link between local savings and local enterprise is effectively broken. It means that even local savings tend to be siphoned elsewhere, when they could have been used to rebuild struggling local economies. A more diverse banking system makes this possible again, so that depositors have more if a choice about how their savings are used, which is a basic necessity if the economy is going to be rebalanced.

The implication is that we need a new local banking infrastructure which is diverse enough to support a diverse range of enterprises, and to do so at a reasonable profit, and is also able to take local deposits as well as have the local intelligence to make productive loans. The next section suggests how this might be achieved.

Section 2:
The solution

This is a complex problem and it is easy to over-simplify it when it comes to policy solutions. Thelast section suggested that the UK needs a diverse, competitive and effective banking infrastructure, locally and nationally – not to favour any one kind of bank, because it is the very diversity of banking systems in other countries which seems to provide it with its strength.

It is no longer credible to complain that the banks are failing to lend enough, given that this has been a problem in the UK since the Macmillan Report in 1930, without some action to do something about it. It now seems to be clear that the big banks are no longer set up to do so, have too little interest in doing so, and lack the local infrastructure they need to do so. Continuing the pretence that the current situation is caused by a decision on their part to drag their feet on lending simply delays a more effective solution; the truth is not that they don't want to, but they are no longer structured to lend locally, except when the economy is performing at full stretch.

There is an alternative argument which we need to think about, which is that this is primarily an information problem rather than a diversity problem. The solution would then be to improve the variables which the big banks use to assess loans, so that the solution would be to provide more sophisticated scoring systems. The argument is that the alternative, a local lending infrastructure which could provide genuine local intelligence, would be too expensive to provide – and are anyway open to the kind of blind cronyism that local decisions can often lead to.

The counter to this argument is as follows:

- Other European countries manage to make local lending decisions profitable, and half the money in deposit in US banks is lent out effectively by local banks. There is no reason to assume that UK bankers are uniquely incompetent.

- In practice, the networks of small banks in Austria and Netherlands do manage to lend effectively to SMEs, and more effectively than big banks.[17]

- This argument assumes that the existing big banks want to expand effectively into local lending, when most evidence suggests that they would prefer to leave those markets to organisations geared up to serve them more effectively.

This last argument is important. A great deal of government time has been wasted trying to persuade, cajole and batter the big banks into lending more to small business, assuming that they were just unwilling to. In practice, the situation suggests that they would be more willing to take part in the kind of partnership which would cover the SME market more effectively, like the one set out below. If so, then we need to consider how best to put in place the three crucial elements that would allow the re-banking of Britain to go ahead:

1. Scale up a new local banking sector, with help and financial support from the big banks.

2. Regionalise and localise RBS, while it is in public ownership.

3. Provide a level playing field for banking diversity.

1. Scaling up the local banking sector

The UK needs to replicate the 'stakeholder banks' that are such a mainstay of the local economies of other European nations, able indifferent ways to deliver broader social andeconomic value, as part of a new local banking infrastructure. They also tend to deliver more stable returns and lending than commercial banks – and they performed well during the financial crisis,as explained so effectively in the New Economics Foundation's study *Stakeholder Banks*.[18]

It is no longer tenable for the UK to believe its highly centralised banking sector is somehow more effective than those on the continent, when it lacks this local infrastructure. We therefore need to build a local banking sector here, which as far as possible will need to replicate the co-operative sector on the continent. This means it mustinclude players that have:

- A local remit, permitted to take deposits, open accounts and make loans to individuals and companies whose registered address is with their defined geographical area of operation.

- A supportive network, with other banks in the same networks, sharing systems, marketing, specialist financial productsand wholesale funding – and also mutual guarantees and self-regulation so that failing local managements and banks are dealt with within the network with no recourse to the taxpayer.

- Stakeholder representation, determined locally.

- Social purpose, making it clear that directors have no duty to maximise profits. Instead, they have a duty to be profitably and financially sustainable while supporting the economy of their region and financial inclusion.

That implies that the regulation for the credit union network, the CDFI network and other networks of local banks, might also include a condition to join a mutual support network that can underpin and regulate their safe expansion.

The expansion of the credit union network is, in some ways, under way now with resources from the Department for Work and Pensions. There is a small amount of investment going via the CDFIs from the Regional Growth Fund.These local banks are only in their earliest phases of development, and they are being supported by expertise and some financial support from the big banks.

But this report proposes that the development of such a critical infrastructure needs to be organised on a more formal basis, as it is in the USA where the Community Reinvestment Act (CRA) requires banks to lend money wherever they are prepared to accept deposits. It has developed considerably since it became law in 1977, especially under Bill Clinton, who introduced a $150m CDFI development fund, and is now developing further. It has been suggested that this new development will emerge as a new injunction on the banks in the US to serve all customers in any markets where they do business.

The US branches of British banks are already dealing successfully with the CRA, and the Labour policy review has discussed a similar measure here.[19] But there have been suggestions that a CRA is too American to work in the UK, and too focussed on the specific problems of American cities – though some form of UK CRA has been described, rather ambiguously, as Labour Party policy.[20]Certainly a UK version of CRA would need to reflect the role of other institutions, apart from banks, in providing credit. On the other hand, the resources that are required to build the new local banking infrastructure are only likely to come from the big banks.

There are precedents in the UK for policy instruments that extract money from the banks for broader economic purpose. Project Merlin was not regarded as a success in the UK because it failed to link the amounts the banks were paying to their success or failure in specific areas, and failed to tackle the causes of the lending problem.[21] Funding for Lending has also been disappointing (siphoned into mortgage lending) because of its failure to see beyond the current dysfunctional infrastructure.[22] What both disappointments have in common is that they are both measures designed to solve the problems that banks could not lend in the necessary sectors, both of which tried to do so through existing banks which clearly lacked the infrastructure they needed to do so successfully. It was hardly surprising the results were disappointing.

But there is a different approach that could be used. From December 2013, the seven largest lenders revealed their lending data down to 9,000 different postcodes. It may be that they can be persuaded, with the prospect of legislation if they don't, to funnel the money they should have lent to the worst-served areas through a new community and local lending infrastructure, which they fund. This encourages both sides to maximise the success of the project.[23] Transparency was achieved voluntarily thanks to a similar threat of statutory action, when the banks would have been forced to act. The Re-banking Project would work along similar lines.[24]

This would mean using the new data as a basis for working out how much the banks need to pay each year into a new lending infrastructure fund, administered by the Department for Business, Innovation and Skills. It would replace Project Merlin with something much more effective, paid for by the big banks in line with their ability to re-balance the economy.

The Re-banking Project would launch a more formal partnership between the big banks and the new local banking sector, as well as existing local players like CDFIs, which recognises that the existing banking business model does not allow them to lend effectively to the SME sector, especially in deprived areas. This would allow them to do so, at a small profit, via a new independent infrastructure they have set up. It would also:

- Provide for the banks to fund the new infrastructure, and to provide funds for lending at a reasonable profit via CDFIs, and via the local banking sector before local deposits can be attracted.

- Broker partnerships between big banks and little ones to provide expertise, IT and other systems.

- Put credit disclosure on a statutory footing, covering the community sector too.

- Set up a rating system on the lines of the one used in the USA which would measure bank lending records in more accessible form.

- Support the new lending to micro-enterprises via a community finance facility at the new Business Bank, ring-fenced for community lending, which provides guarantees to make commercial lending possible at lower but still profitable interest rates.

There is also a need to replace Funding for Lending so that the government's ability to borrow money at lower rates is passed on, not to the big banks – which have not used it as effectively as they could have done – but to the CDFIs, credit unions and local banks to lend on effectively to small businesses.

How much will it cost?

Local banks: The Labour Party's small business task force is suggesting that regional banks should be funded to the tune of about £200m to create a network of 20 of these banks, which they call *Sparks*.[25] The £10m of public investment in each would be balanced by bond issues worth £90m per Spark to give them lending capital. This is important, and will provide deposit-taking and deposit-recycling institutions at a regional level, but – even though this is envisaged as a first stage – it is inadequate. The regional banks need to be networked together and need an explicit mutual support function, and it may be that the Labour task force proposal for a *Spark Umbrella* would provide this. But they will still lack the specialist capabilities of the CDFI network, which requires less up-front investment but are also necessary to funnel housing and social enterprise finance where it is most needed. *Cost: £200m.*

Community banks: We estimate that the cost of building a network of 150 community banking partnerships, with a CDFI at their core will be about £15m. They would also need a common operating platform and referral platforms with key partners like banks or chambers of commerce. This network would then need a capital injection of at least £120m to build the balance sheets of the local providers. *Cost: £138m.*

Some of this money can come directly from fines levied on the big banks (£4.7 billion in 2012 alone), but the basic set up costs of £338mwill otherwise be paid by them in proportion to their lending record. It would be paid into a central fund, administered jointly by BIS, and other institutions, perhaps including the BBA and the CDFA, which will create, shape and invest in the new infrastructure, and it would be used later to create more local and community banks and provide finance for lending through them, in lieu of money not able to be lent through their branch networks.

2. Regionalising RBS

The Royal Bank of Scotland is unlikely to return to profitability in the short term, and perhaps not for longer than that.It would be a waste if its period in public ownership was not used to encourage the creation of an infrastructure that is capable of meeting the legitimate business needs of regional and local business. This must not rule out recouping the Treasury's investment, because European regulations insist that it must be paid back, but there is an imperative to turn RBS into a more effective lending infrastructure in the meantime.

There are two broad options, both of which are opposite extremes and both suffer from disadvantages:

- Splitting up the bank into local or regional units. The Treasury has ruled this out, and it would undermine the few advantages of a large, centralised banking structure, in terms of reserves and the ability of the units to support each other.

- Regionalising the bank into local branches or local branches, giving them local autonomy in lending decisions and local accountability. But this would make it difficult then for the regulators to hold the bank to account.

An alternative would be to draw from the best of both solutions. RBS currently includes 30 subsidiary companies. Some of these are overseas networks, but the others would be turned into separate regional or local groups of banks, divided geographically and with close regional allegiance, and using powers under the Control of Business Transfer Process (under Part VII of the Financial Services and Markets Act 2000). Each new company would be regulated directly.

It might be argued that dividing RBS up too fundamentally at this stage would de-stabilise it at a crucial moment, but there is already agreement with EU regulators that some 'rainbow assets' – some of their local banking network – will be sold or hived off to encourage competition.Williams & Glyn's (312 branches) will be hived off and sold to a consortium in 2014, though RBS is providing most of the finance. This new bank will have a 2 per cent market share. It also represents about a sixth of the RBS branch network.

So one alternative approach would be to make sure that more rainbow assets should be identified to be taken out of direct control of the RBS group, so that another 1,000 branches, divided into regional or local groupings, rather as Williams & Glyn's is clustered mainly in the North West. There were at least three rival bidders for the 312 branches, and – although the deal had to be significantly leveraged to appeal to the investors it would need – there is no reason to doubt there would be interest in buying into the new banks.

These ten or so new regional and local banks will become separate legal entities, owing allegiance to local or regional economies and taking the majority of their deposits from there.But the RBS group would continue to exist, as a network that operates as the local banking networks do in Germany and Switzerland. This would leave RBS partly as a network of regional groups of local branches, which are autonomous in terms of governance, and publish separate reports and accounts, but which collaborate with other network members to share central services such as the provision of systems, marketing, specialist financial products, and wholesale funding. The network would also maintain appropriate mutual guarantees and self-regulation within the group to find ways that failing local management and branches are dealt with within the group with no recourse to the taxpayer.

Precisely what the relationship should be between central and local may depend partly on the need for the Treasury to recover their money. This is the key difference between a model that left RBS as a networking unit, without value in its own right, or as an owner or part-owner of the regional banks. The need to raise finance through the group will rule out, for the medium-term, embedding a broader social purpose in the new network, or a geographical principle (as operated by the German local banks), both of which would lower the conventional investment value.

But there should be no legal reason why the regionalisation of RBS needs to undermine ambitions to return RBS to the private sector, under certain conditions. It means that shares will be sold in the new banks, or the new RBS, rather than in the old. The Lib Dems have backed a return to the private sector via a share giveaway to everyone – recouped once the value rises above the threshold of what the government originally paid – and there is no reason why this should not go ahead too, though its administration would be more complex.

3. Provide level playing field for diversity

Thanks to the efforts of the House of Lords, there is now a duty on regulators to "have regard" for the diversity of the banking sector. This needs to be strengthened so that it becomes a core consideration for regulators. The banking market must be diverse, and if the process of applying banking licences – or the equivalent for building societies – is so stringent that nobody applies, then this is in itself a regulatory failure.Again, there has been progress here too over the past year.

What is most important is that the UK stops pretending that small banks and big banks need similar regulatory frameworks. We therefore propose the following measures to increase diversity:

- Create a simple new banking licence for community and stakeholder banks, which is less onerous and is backed by an off-the-peg package including basic banking software and systems, so that these do not need to be re-invented for every applicant. The Treasury seems to be going part of the way towards this already with a new system that allows banks to be started with only £1m in capital.[26]

- We also need a legal structure for co-operative banks, which does not yet exist in the UK as it does on the continent, and which could be used by the new generation of community banks.

- Regulate peer-to-peer lending. The sector is now growing so fast, and has huge potential in the medium-term to filling the gap left by the big banks. The Financial Conduct Authority has suggested ways in which the sector can be regulated in a sensible way, in order to help it grow, but this has not yet taken place. It needs to, but so does some resolution about protection for investors, which is not yet in place. This puts the sector at risk from the activities of rogue elements who lead customers to lose money on any scale.

- Provide German-style protection from privatisation for community banks. The new community banking network must remain local and dedicated to local custom, and it makes no sense to allow it to become part of a much bigger national or international conglomerate. We propose a similar rule which protects the new co-operative banking network from a repeat of the demutualisation fiasco.

- Tweak the Basel requirements to make small business lending easier. There has been no debate in the UK, as there has in the USA, about the impact of the new Basel capital requirements, which regulate each loan differently and makes SME lending much more expensive. National opt-outs are possible, and are being considered in the USA, and this urgently needs to be addressed here as well.

- Ask the Local Government Association to play an intermediary role for the emerging local government banking sector, providing an arms-length body that can network those banks together – plus any new ones – and provide basic IT and regulatory packages and for mutual support. They would need to be geared up for this.

Section 3: Conclusion

This report sets out a way to achieve the replanting of a local banking infrastructure in the UK, aware that it is the crucial missing element that rebalances the economies of continental Europe which is currently missing from our own economy. It argues that the lending problem is not simply an issue about the information used by existing banks to decide loans, and that there is a more fundamental problem that needs to be addressed – the serious lack of diversity in the UK system compared with its competitors. It argues that only a diverse local banking system will be able to provide for the diverse needs of local SMEs, micro-enterprises and social enterprises, and that the shift is required on three levels:

- Short-term, by carving a new network of local and regional banks out of the existing RBS network.

- Medium-term, using the resources of existing banks in partnership with the new local infrastructure, aware that – to lend in this sector – the existing banks need to work hand in hand with a new lending infrastructure that covers those parts of the economy they are no longer set up to reach.

- Long-term, by encouraging new entrants to the local banking market.

The big banks clearly have a vital role to play in the re-banking of the UK. But the four biggest are currently receiving subsidies from the taxpayer worth £37.7 billion a year, in the form of the too-big-to-fail guarantee.[27] They need to rise to the challenge to play a constructive role in return.

Endnotes

[1] **www.gov.uk/government/uploads/system/uploads/attachment_data/file /78977/coalition_programme_for_government.pdf**

[2] **www.gov.uk/government/news/lending-data-for-10000-postcodes-to-be-published**

[3] **www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/612/61204.htm**

[4] Andy Davis (2011), *Beyond the Banks: Innovative ways to finance Britain's small businesses*, NESTA, London.

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[19] **www.thirdsector.co.uk/news/1151573/Labour-considers-requiring-banks-lend-deprived-communities/**

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