



RSA

The road to resilience:

how community financial services can help level-up Britain

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About the RSA

The RSA (Royal Society for the encouragement of Arts, Manufactures and Commerce) believes in a world where everyone is able to participate in creating a better future. Through our ideas, research and a 30,000 strong Fellowship we are a global community of proactive problem solvers, sharing powerful ideas, carrying out cutting edge research and building networks and opportunities for people to collaborate, influence and demonstrate practical solutions to realise change.

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All mistakes contained herein are our own.

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Foreword

At almost exactly the moment that the UK Government officially abandoned the austerity strategy which had framed policy since the 2008 global financial crisis, the Covid-19 pandemic struck. As, once again, we have to rebuild a shattered economy, the question of fitness for purpose of our financial services system has re-emerged. Some of the problems of that system may have changed in the last 12 years but it is still in need of major reform, especially if it is to serve the organisations, communities and places most in need of support.

This report combines an analysis of some of the problems in our financial services system with the story of a group of RSA Fellows who are seeking to build a new financial architecture from the ground up. In so doing it speaks to the history, methodology and values of the Society.

There is a long tradition of practical RSA-driven reform in financial services. These initiatives range from the first ‘Penny Banks’ – accounts that could be set up with tiny sums and thus radically altered the landscape of financial inclusion in Victorian England – to the creation of the modern ‘unforgeable’ bank note. In more recent times we have looked more systemically at the foundations for reform. Tomorrow’s Company, (a major RSA project before being spun off as an independent charity) contributed to a stronger focus on the purpose and governance of major businesses, while Tomorrow’s Investor has led directly to significant reforms of our pension system.

This report also reflects the methodology of today’s RSA, summarised as ‘thinking like a system and acting like an entrepreneur’. On the one hand, there is a broad analysis of the limitations of the UK’s financial services, particularly in relation to a lack of support to SMEs, failing to serve some of the communities which this government is aiming to ‘level-up’ and disregarding the needs of those who are being left behind by a ‘cashless’ economy. On the other hand, the report describes the work of growing group of social entrepreneurs – many of them RSA Fellows – seeking to create national network of local banks.

The report also embodies the values of the Society; a commitment to enabling individuals and communities to create their own better futures. Our financial services sector is vital to the entrepreneurial dynamism, social inclusiveness and environmental sustainability of the UK. To meet our goals, including those set by our current government, it needs major reform and practical, social, innovation. Reflecting our history, values and model of change the RSA intends to make a major contribution to that task.

Matthew Taylor
Chief executive, RSA

Box 1: Penny Banks

Sir George Bartley, son-in-law of Henry Cole (former chairman of the Society of Arts), was founder of the National Penny Bank; unlike other banks, this required only a small amount to set up an account, with the result that almost anyone could save and build assets.

Executive summary

This report details a three-year-long programme of RSA work that aimed to understand the evolving impact of financial services institutions on our wider life and identify what we as the RSA might do in practice to drive positive change.

The outcomes of that work and our findings are summarised below.

The trouble with British banks

- The activity, shape and composition of the British banking industry is a considerable contributing factor to Britain having some of the highest levels of regional inequality in Europe - and for Britain by some measures being as regionally unequal as the former East and West Germany were after the fall of the Berlin wall¹.
- Part of the reason for this is a deliberate failure to keep credit flowing through small and medium-sized businesses and within communities. Following the 2008 financial crisis, a £500bn bail out of British banks alongside new regulatory arrangements were seized upon by banks to, in fact, shrink the credit supply to small and medium-sized businesses and vulnerable citizens. In 2016, a survey from the Bank of England reported that 30 percent of small businesses were unable to access the necessary finance they needed to grow.
- At the same time communities, localities and the vulnerable and marginalised people within them suffer. The UK has lost almost two thirds of its bank branches in the last 30 years. In the past decade, the rate of closures has intensified, hitting rural and more deprived communities the hardest. Access to free-to-use ATMs has been following suit, with 13 percent of all free-to-use ATMs in the UK closing in the past year.
- Meanwhile, over one million adults in the UK still lack a full bank account and around 3.2 million people are in severe problem debt. This creates barriers to participation in the economy, which have been exacerbated during the Covid-19 crisis.

1. Ortega-Argiles, R. (2019) The Long-Run Consequences of Adverse Economic Shocks: UK Regional and Urban Inequalities [blog] 09 September. Available at: blog.bham.ac.uk/cityredi/the-long-run-consequences-of-adverse-economic-shocks-uk-regional-and-urban-inequalities/ [Accessed 04 June 2020].

- Part of the reason for these problems is that the UK banking sector is dominated by a few monolithic banks which have relatively little local knowledge of businesses, area needs and personal needs of customers. They rely on old-fashioned legacy systems (eg telephone banking) and find it difficult to provide tailored support.

Box 2: Struggling to access small business loans

Katrin Herrling, who went on to establish Funding Xchange in 2015, explains that when her bank “suddenly changed their lending criteria” and were unable to provide vital finance in the midst of the financial crisis, she felt stranded.

“I didn’t know where to turn ... I [knew] that just going to another bank where I didn’t have an established relationship wasn’t going to solve the issue. Outside of banks, I had no idea”.

- Moreover, the UK has an unusually high percentage of purely commercial banks in its industry. This skews the product offer away from ‘riskier’ loans towards safer asset-backed property investments. Small business lending and supporting vulnerable customers is hard work and much less profitable than other avenues, such as mortgages, which account for 50 percent of total bank lending.
- The majority of people (75 percent) hold their main bank account with one of the major four banks.
- And while the Herfindahl-Hirschman Index in 2018 shows that the UK’s five largest banks hold 31.8 percent of total assets, making it only marginally more concentrated than Germany *as per* the index at 29.1 percent – but less concentrated than say Spain – this should not be seen as a cause for optimism. The index is skewed by the presence of one or two major banks – in Spain’s case Santander. And it also says nothing about the service levels of banks and their relationships with poorer customers. That is the key here: not only are banks failing to provide credit, as well as failing to support growth and expansion in the economy, but they are leaving our most vulnerable high and dry and exposing them to a future shorn of participation in financial services. Regulation post 2008, especially around capital adequacy ratios, has only served to exacerbate these problems, as banks have yet more reasons to vacate whole swathes of our country.

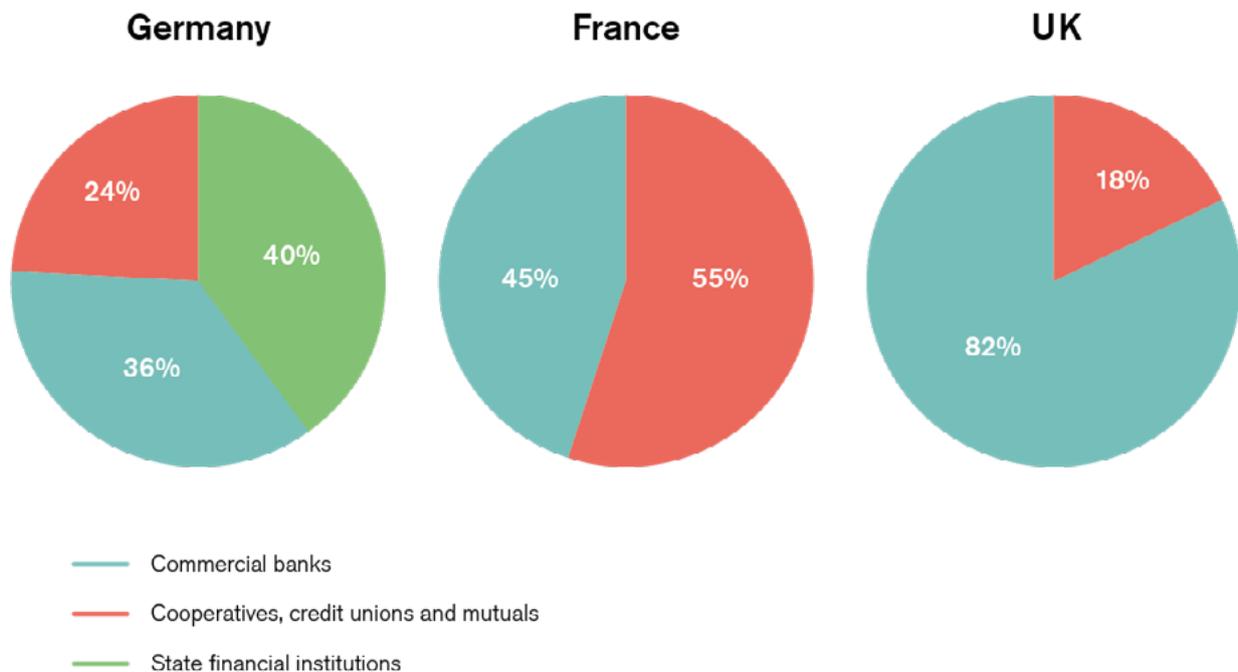


Figure 1: Market shares of deposits in Germany, France and the UK (World Bank 2011²)

The Covid-19 case study

- Covid-19 is an insightful case study that shows the shortcomings of government policy, and also British banks in terms of how it helps – or doesn't help – British businesses and vulnerable and marginalised people.
- The government stated from the outset that it would 'stand behind British business' through the crisis and called on the banks to do the same. Banks were invited by the government to perform an essential triaging function for the receipt of government aid.
- Yet the government's Coronavirus Business Interruption Loan Scheme proved quickly to be sluggish and complex. Businesses were struggling – with 6 percent of small British firms having already run out of cash at the beginning of April and 57 percent without enough liquidity to survive the next three months. The government reviewed the details of the scheme after only 1,000 loans were distributed nationwide in the first two weeks.

2. Prieg, L and Greenham, T (2013). Stakeholder Banks: benefits of banking diversity [pdf] Available at: neweconomics.org/uploads/files/eob3bd2b9423abfec8_pem6i6six.pdf [Accessed 26 May 2020]

"We must get more credit into local communities and small and medium-sized businesses if we are to truly level-up Britain".

- The introduction of the Bounce Back Loan Scheme on 1 May 2020 was the final iteration and removed all risk for the banks and this significantly ramped up the scale and speed of lending – with £14.8bn lent through BBLS in two weeks (4 May – 18 May) compared to £7.25bn lent via CBILS over eight weeks (23 March – 18 May). However, for many SMEs, even then the response was not enough. While around 36,000 applications had been approved for CBILS and nearly 270,000 for BBLS, there had also been 130,000 rejected applications, as well as hundreds of thousands of incomplete enquiries or SMEs who just couldn't get the funds in time to keep trading.
- The British Business Bank was designated by the government to implement this scheme and created a process that was far too slow and unwieldy. On 19 May there were 70 accredited lenders for CBILS and only 17 for BBLS. The concentration of these schemes around traditional lenders and the slow pace of bringing fintechs such as Starling Bank on board was disappointing. There is no doubt that it reduced choice and flexibility for SMEs, putting businesses that didn't already have an account with an approved lender at risk.
- It is absurd and antithetical to free market principles that good small, local businesses may therefore have gone under, not because they were bad businesses but because their current account was with the wrong bank.
- Fears around fraud and error may lie at the heart of limiting support for the self-employed, among others, but there does emerge the sense that the small, local British businesses and entrepreneurs were not prioritised adequately in the government's response, or were left to deal with banks whose structure meant they were not the best people to triage this system. The banks' failures in this regard have compounded problems with the government's economic policy response.

The solution: community banks

- Our research has led us to the view that if we are to overcome these issues, we need to reshape the British banking industry. We must get more credit into local communities and small and medium-sized businesses if we are to truly level-up Britain.
- Important lessons should be drawn from Europe and North America – both in terms of scheme design and diversity of banking sector to deliver.
- In Germany, after a slow start with banks reluctant to offer loans with the economy faltering, they increased guarantees for small businesses from 90 percent to 100 percent with interest rates capped at 3 percent. There was much less pressure on the big banks to make masses of quick risky decisions as they have a relatively low share of small business loans compared with the local savings and cooperative banks. Germany's state

development bank KfW also played a key role and was quickly able to distribute 8.5bn euros in loans to more than 13,000 companies, approving 98 percent of applications.

- In the US, 60 percent of the 1.66m loans worth \$300bn to small businesses approved in the first round of the Paycheck Protection Program (PPP) were distributed by the US' 5,000 community banks, providing a fundamental source of stability for small businesses early on in the Covid-19 crisis.
- Both countries have longstanding traditions of regional or community stakeholder banking.

Box 3: Community stakeholder banks are a key part of the US economy

Community stakeholder banks and credit unions play a particular role in times of crisis in the US. While after the 2008 financial crisis loans to small businesses declined steeply at big banks, small business lending grew relatively faster in community banks. Counties with a higher market share of community banks also faced fewer negative impacts following the crisis "on aggregate flow of small business credit; and the impacts on interest rates, business expansion, employment, and wages were more muted and rebounded more quickly during the recovery".

Community stakeholder banks in the US also act as local 'anchors' – providing key civic functions for the community.

"A local bank (is) an important civic institution. Banks do not just cash checks and make loans - they also place ads in small town newspapers, donate to local non-profits, and sponsor local Little League teams. As towns lose banks and bankers, they also lose important local leaders"
Randal Quarles, Vice Chair for Supervision, US Federal Reserve.

- Germany has a blend of commercial, cooperative and state-owned banks while in France the cooperative banking sector is larger than the commercial sector. These community stakeholder banks complement the presence of large national and global shareholder banks by pursuing a different business model and brings social and economic benefits, regionally and nationally, in four main ways:
 1. The resilience of the overall financial system is improved by the diversity provided by regional mission-led banks. Community stakeholder banks steadily increased credit to households and SMEs providing a cushioning effect for regional economies.
 2. The quality of credit allocation improves as a result of superior access to the soft information captured by good relationship managers close to the customer which is required for more marginal lending decisions.
 3. Community stakeholder banks usually have a commitment to financial inclusion, often specifically guaranteeing universal access to banking facilities on equal terms to all citizens in the region.
 4. The presence of a head office adds an important route for local career progression as an alternative to migrating to 'the big city'.

- As part of this programme of work we supported the development of a nationwide layer community stakeholder banks in the UK, not just in theory but in practice. In partnership with a body called the Community Savings Bank Association, RSA Fellows, bankers, economists, movement builders, project managers, researchers and many more from the RSA's networks and beyond, we have worked to make this happen, pooling the community's knowledge, expertise, and resources to take the movement forward at a local level.
- We have hosted events, designed sessions, supported social entrepreneurs to develop their plans and created key research. This work has been referenced in Westminster and the Senedd and was part of key party manifestos in the 2019 general election. At an event with Bristol City Council in 2019, Deputy Mayor, Craig Cheney concluded:

“This is a huge and exciting opportunity to bring a whole new model of banking to the UK”.

- Today, in the UK there are five organisations that are in the process of establishing a local cooperative bank having registered with the FCA. The most established of these are South West Mutual and Avon Mutual both of which have completed an initial round of fundraising, developed strong partnerships and secured initial seed funding from local authorities of all stripes – both hope to launch in 2022.

“We aim to become a key anchor institution supporting the growth of other community wealth building institutions, and focused on promoting sustainable and inclusive prosperity for our region”. Jules Peck, Founder, Avon Mutual.

- Banc Cambria has had initial seed funding from the Welsh government and is currently developing a road map to launch. North West Mutual is the latest body to be established with councils including Wirral, Liverpool and Preston collaborating on a bank for the region.
- These banks have an economic storm to weather but already the work we have done and the demand we have seen shows that their work must be supported in spirit and in form if we are to create the financial infrastructure we need to help us overcome regional inequalities in a post-Covid-19 world.

Building banks to level-up Britain: twelve recommendations

Community stakeholder banks are essential to levelling-up Britain. We outline as part of this work five paradigms for levelling-up. Community banks are essential to each.

Paradigm	Mission statement The way to achieve an inclusive economy is...	Policy Example	Role of Financial Services	Political nuance
'New Big Bang'	... by lowering taxes and encouraging the benefits to trickle down to - and raise - all	Freeports, tax free zones	Invest in high growth enterprises and lobby for facilitative tax regimes	Right-laissez faire
Financial Inclusion	...by targetting marginalised, underserved groups and bring them into the mainstream	Microfinance	Bring marginalised groups into the banking, asset building system	Centre-social democratic
Inclusive Growth	...by co-creating growth strategies that reflect the perspectives of the whole community and share proceeds according to a similarly broad range of social concerns	Deliberative budgeting	To provide capital for growth; to mitigate negative externalities; to facilitate economic expansion	Centre-left-social democratic
Community Wealth	...by redistributing power, taking economic agency away from multinationals and other extractive forces and creating a locally-owned and people-powered economic model	Anchor institutions supporting co-operative development; local wealth funds	To provide communities with additional base of power through mutual banking institutions – and to provide risk capital for locally-focussed initiatives	Centre-left – democratic socialist
Just Transition	...by directing all institutions in society to the end	Wide-ranging Green New Deal	Support overarching vision in pursuit of green and clean economic aims	Left-centre

Figure 2: Five parts of an inclusive economy (RSA summary)

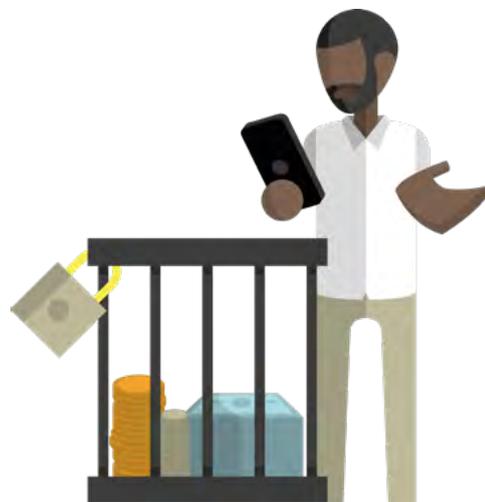
"Our immediate recommendation is to urge the Bank of England to play its role in this movement and fund the creation of Local Investment and Finance Trusts (LIFTs), whose function is to investigate, support and capitalise the community stakeholder banking layer".

1. Community stakeholder banking models need structural support. That means new community stakeholder banks and getting interest into the work of existing community stakeholder banks. It also means capital infrastructure. That's why our immediate recommendation is to urge the Bank of England to play its role in this movement and fund the creation of **Local Investment and Finance Trusts (LIFTs)**, whose function is to investigate, support and capitalise the community stakeholder banking layer.
LIFTs take the form of an endowment, with bond purchases or deposits topped up with further capitalisation from dormant accounts and proceeds from banking infractions. Local authority support for community banks through LIFTs could enable local banks to become a key anchor that can enable more inclusive economies to be designed, implemented and financed at the local level.
2. Beyond the development of LIFTs **central government can support the development of a the sector** by providing match funding to councils, allowing shares in mutual banks to be eligible for Enterprise Investment Scheme allowance and other tax reliefs, and aligning accounting and treasury guidance to local authorities to unlock investment, including preferential rates from the Public Works Loan Board. Barriers to regional banks cooperating in networks created by UK competition law should also be reviewed.
3. Local government should seek to convene discussion on their investment needs with Local Enterprise Partnerships, commercial banks, CDFIs, credit unions, charitable funds (including philanthropic grant-giving), major funders and impact investors in order to agree principles of investment for community financial support and to share best practice – as well as to nurture the development of their stakeholder banking infrastructure. Such meetings might be designated **LIFT boards** in areas with LIFTs that also offer some oversight of flow of public and private money into the agenda.
4. We need more **research and independent review into diversifying local investment and lending models**. This will help make the case for greater diversity of investment at local level and also inform the development of the banking layer. We would urge this review to be collaborative, build relationships between local councils, foundations and business networks – and ultimately have prototyping and practical action at its heart.

5. In light of the challenges encountered in implementing the CBILS and BBLS, there should be a **review of the British Business Bank**. We urge further consideration of calls made in the General Election for the British Business Bank to become a national development with a remit to support community stakeholder banking, as is the case in Germany, as well as wider community wealth-building approaches.
6. We need to ensure that those already financially excluded are not further cut off from financial services as cash continues to decline. **We urge the government to introduce already announced legislation to protect free access to cash** and work with key bodies such as the Industrial Strategy Council to ensure a smooth transition towards digital payments in a post-Covid-19 age.
7. To ensure there is not an abrupt end to cash that exacerbates financial exclusion, particularly in more rural or marginalised communities, the government should **work with the industry and communities to reduce the cost of cash infrastructure** and explore ways to recirculate cash within local economies, such as legislating to enable more local businesses to offer cashback services.
8. Immediate action is required to **outline the process of deciding which companies to back and which to let go when it comes to repaying government endorsed loans**. The question of who decides what and when repayment is due is considerable: local knowledge of a kind that generally eludes the major banks will be key. We urge that this work is conducted in conjunction with new community banking institutions outlined above as they emerge and surface – and in concert with movements on the ground developing these structures where they do not yet exist.
9. We need to get serious about futureproofing our financial services, to ensure everyone can participate in the digital economy in the longer-term. A future strategy should include a **Central Bank Digital Currency** in order to avoid private monopoly.
10. **Open Banking and Open Finance presents a huge opportunity** to give people more control over their financial data and drive digital innovation, so products work better for customers. **A social investment fund** should be introduced to support the development of new products that benefit citizens and should be seeded by a wholesale institution such as Big Society Capital with a line into government.

11. In order to tackle digital divides - that risk becoming mass disenfranchisement - this agenda needs to be underpinned by ensuring all homes can access **full fibre broadband by 2025**.

12. Our work also showed us something deeper about financial purpose. In line with our vision for a more democratic and civic minded financial industry we contend that the conversation about the civic purposes of financial services – well understood in many places better than here - must begin with people. Therefore, we propose a **Citizens’ Council on Financial Purpose** should be the starting point in developing a new shared vision of what a productive and purposeful financial sector that serves people and places might look like. This would also enable the performance of the industry as a whole and individual institutions (such as banks) to be deliberated by civil society against deliberately agreed purposes. This council should form the starting point for a broader action-research agenda in this space that seeks to empower a more purposeful and civic minded financial services industry whose obligations extend beyond corporate social responsibility doctrines.



Introduction: banking on change

Ten years after the crash

In 2017, the RSA commenced a programme of work to ask questions of the financial services industry. We wanted to understand the evolving impact of financial services institutions on our wider life. We were especially concerned with the following:

- Ten years on from the 2008 financial crash, how had banks and other financial services firms structured their offer to serve small and medium-sized businesses, civic institutions and vulnerable people?
- How the financial services industry (and in particular the banking sector) reformed – or more accurately has failed to reform – its practices in light of what happened?
- What we as the RSA might do in practice to drive positive change?

We didn't know when we started this work where it might lead. But over time, it has resulted in the RSA mobilising its resources behind a practical intervention of remarkable ambition, namely the building of an entirely new set of institutions across the country: local, mutual, community-owned banks.

What we mean by this is that actual banks are being built, not in theory, but real bricks-and-mortar institutions, all over the country. These banks are designed to be locally rooted organisations that meet a series of unmet needs in that local economy.

The nature of these needs and the solutions on which we alighted to meet them emerged from our research into the financial services system, our institutional design work and our sense-making of the system's signals, all of which forms the core of the RSA method. We will share both this research and this method in the chapters ahead.

We think of these community banks as a modern iteration of the Penny Banks that our chief executive Matthew Taylor recalls in his introduction to this work. Their future is in their hands and the journey so far towards their formation has been insightful. This report in part tells that story, at a staging point before these banks surface in the public eye, which reveals much about the nature of financial services in the UK and the challenge of building financial services that empower people and places.

It offers recommendations for policy change but also an indication of how these banks and, by extension, how UK banking and the government's support for local, inclusive economies, might change, for the better, in future.

Box 4: Case study - South West Mutual

South West Mutual is aiming to establish the first high street cooperative bank for the south west of England. Their purpose is to support the people of Cornwall, Devon, Dorset and Somerset to live fulfilling and meaningful lives, to get the most out of the region and to put the most back in to support the local economy. Their mission is to finance and facilitate a just transition to a net zero carbon economy in the south west.

They will offer a full range of retail banking products and services including current and savings accounts, personal and business loans, and mortgages with multi-channel access through mobile and internet banking, as well as a commitment to branches. A key part of their business model is the role of locally based branch managers, who know their communities well, can build strong relationships with their customers and make effective lending decisions - helping individuals, families, SMEs and social enterprises in the region to thrive. South West Mutual is currently in the process of applying for a banking licence and raising start-up capital, having already received support from several local authorities and the Open Society Foundations' Economic Justice Programme. They hope to secure a provisional licence in 2021 and a full public launch in 2022.

Packages for a pandemic

The story does not end there. In 2020 the Covid-19 pandemic hit. Governments of all stripes inaugurated financial packages of considerable scope and size to support people and businesses through the crisis augured by the pandemic. These schemes sought to match the scale and scope of the Covid-19 challenge, its threat to our economy and to our way of life.

Some of these schemes – such as the furlough scheme - were relatively successful as mitigating measures. Others were not so successful, especially those that sought to support small businesses and charities. What has been noticeable is how predictable this was. In many ways the failings of these schemes can be tied to those initial failings of the UK financial services system post 2008. There is a direct line between what happened then and banks' inability now to deliver timely, appropriate support to local economies and businesses on the ground.

Community banks offer a potential way out of the bottleneck tendencies of the UK banking system. There remain real, ongoing concerns with the continuing tendency of the financial services sector to absent itself from where it is most needed; to flee places and fail to serve people when the going gets tough. Capital flight from our most marginalised places is real; capital flows where it is easiest, especially in times of crisis. But simply accepting this as a fact of life is no longer enough given the economic crisis with which we are now confronted. Community financial services, mutually owned, are part of the answer that unlocks the future.

This report shows how we do this. It is structured as follows. In the first chapter, we discuss some of the major failings of the UK banking system. In the second, we report on the specific failures yielded by the Covid-19 crisis and contrast our financial sector's underperformance with that of our global counterparts. In the third, we explore alternatives to the current status quo, which leads us to the fourth chapter, and a dispatch from the RSA's experience of helping to build a new layer of community banks. This is necessarily an evolving story, as the project is still underway, but we finish with some preliminary recommendations to banks and to policymakers to build better frameworks for a more prosperous and financially secure future, and to level-up our nation one and all, at this most crucial time.

Chapter 1: Banks matter!

What are banks for? And why should we care? The public are often confused about banks' functions and whether they are discharging them ethically - and little wonder. Consider the following statement from research by RSA Fellows David Pitt-Watson and Dr Harinder Mann:

“No regulator has tried to define purpose and to measure whether or not it is being fulfilled. If you only get what you measure, then it is scant wonder that regulators have failed to encourage a purposeful industry. Instead they have focused on micro regulation believing this to be the best way to protect customers.

If regulators take this approach, and if the boards of banks believe their only purpose is to profit, while the regulator has sole responsibility for financial stability, we must anticipate trouble ahead¹.”

"What we mean by this is that actual banks are being built, not in theory, but real bricks-and-mortar institutions, all over the country".

If, as per the authors, our regulators are unclear, what chance do ordinary people have? Little wonder statistics show that, more than a decade after the 2008 crash, suspicion of banks remains rife. Consider:

- 66 percent of Britons don't trust banks to work in the best interests of UK society
- 72 percent believe banks should have faced more severe penalties for their role in the financial crisis
- 63 percent are worried that banks may cause another financial crisis²

The purpose of banks is indeed a tricky subject, because how you view the way money works in society depends entirely on where you come from. These differing perspectives on the purpose of financial services are crucial to the analysis of this report.

1. Pitt-Watson, D and Mann, H (2017). The Purpose of Finance [online] Available at: www.transparencytaskforce.org/app/download/5810024460/The+Purpose+of+Finance+Report.pdf [Accessed 01 June].

2. Positive Money (2018). Polling: 10 years after the financial crisis, the British public still don't trust banks [online] Available at: positivemoney.org/2018/08/british-public-dont-trust-banks/ [Accessed 05 June 2020].

The purposes of banking: in perspective

Consider a consumer-focused perspective on banks' purposes.

Banks were originally par excellence about economic security: they enabled us to save and move money around for the moments in life when we needed it. The life-moments included getting a home, starting a business, having children, keeping our lives and livelihoods progressing and flourishing. Broadly, these purposes persist today, yet often banking is a byword for the opposite: for economic insecurity, casino activity, unfathomable profits and negative externalities which fall, ultimately, on ordinary people.

In the wake of the 2008 crash, banks were accused of privatising the profits and socialising the losses. For all intents and purposes this charge still holds, albeit in more subtle ways.

Consider the question of purpose next from a business-perspective. Banks have two here: retail and investment. The first involves activities we as consumers are mostly familiar with; taking deposits, issuing cheques, and making loans to individuals and businesses.

While the major UK banks still perform these tasks, it is no longer their primary function, and hasn't been for some time. They are pursuing highly profitable activities on the investment side. From playing the stock markets to packaging and repackaging derivatives: the casino that was the UK banking sector did not shut down following the 2008 crash, it just went elsewhere, into new markets and new playgrounds.

Over time this has rendered the retail functions of major banks ever more diminished – and jettisoned some of the most vulnerable people in our society in the process. The more 'financialised' society as a whole has become, the more opportunities banks have to flee difficult markets and reduce service offerings – such as cashpoints and branches – to marginalised communities.

What about a third, often neglected idea: the democratic or civic perspective? Even commentators on banks often ignore this one – which is, as we will see over the course of this report, hugely problematic. Banks are licensed by the government to print money. This, naturally, gives them considerable power to shape society. Consider, 97 percent of our money is created by banks in the form of debt³.

3. For more information see: positivemoney.org/how-money-%20works/how-banks-%20create-money/#:~:text=Most%20of%20the%20money%20in,just%203%25%20is%20physical%20cash.

There is also a secondary element to the democratic or civic perspective: that of banks as community anchors. There is a long-held tradition of such community banking in the US. Consider this quote from Randal Quarles, Vice Chair for Supervision, US Federal Reserve:

“The loss of a local bank meant the loss of an important civic institution. Banks do not just cash checks and make loans - they also place ads in small town newspapers, donate to local non-profits, and sponsor local Little League teams. As towns lose banks and bankers, they also lose important local leaders”.

We will get further into the tradition of the US community banking tradition in chapter 4 of this report. For now, compare and contrast this vision of a local bank with the statistics we shared above about how ordinary people in the UK view our financial services industry.

How purpose plays out in practise

Delve deeper into all this with ordinary British folks – as we at the RSA did during our year-long national roadshow entitled the Citizens’ Economic Council – and the concerns proliferate. For now, we see how purpose shapes an entire industry in practice – and indeed is shaped by it – and how ordinary people are affected on the ground.

Consider the structure of UK banks and the banking market. All the major retail banks in the UK are shareholder banks. As such, it is expected that they pursue profitable activities, seek economies of scale, and develop products that can be easily replicated for maximum return and minimum risk.

This naturally skews their product offer. To take one example, a mortgage is far less risky and easier to replicate than a small business loan, so it is unsurprising that mortgages form the bulk of retail activity.⁴ There are serious questions around whether shareholding is the right or, indeed, an adequate structure to govern these incredibly powerful institutions. And as our everyday lives are increasingly shaped by the activities of banks and the broader financialisation of society, these democratic questions become increasingly existential.

We should be concerned also that the UK market is dominated by a relatively small number of major banks. Looking at the data from the Herfindahl-Hirschman Index in 2018 – an industry-leading metric - might give the impression that the UK banking sector is in fact under concentrated when it comes to the provision of credit. The index shows that the UK’s five largest banks hold 31.8 percent of total assets, placing it just a fraction behind Germany on the index (29.1 percent). Indeed, other countries in the index appear to have a higher concentration.

However, this should be caveated, especially when prayed in aid by the industry or by regulators. Spain’s markets, for example (68.5 percent), are heavily skewed by one major bank, Santander. Having one major player throws the calculation off because of the way the equation works (as a sum of the market shares squared rather than the market shares themselves).

4. Silver, N. (2017). *Finance, Society and Sustainability: how to make the financial system work for the economy, people and planet*. London: Macmillan.

Secondly, even per Herfindahl-Hirschman, there are clearly areas of the UK's banking sector which are heavily concentrated. A super-majority of people in the UK (75 percent) for example, hold their personal current account with one of four biggest banks⁵. While there has been a recent trend of more businesses switching to the smaller digital banks, the majority of SMEs still hold their main account with one of the big four. That is before we consider the skew towards commercial banking in the UK.

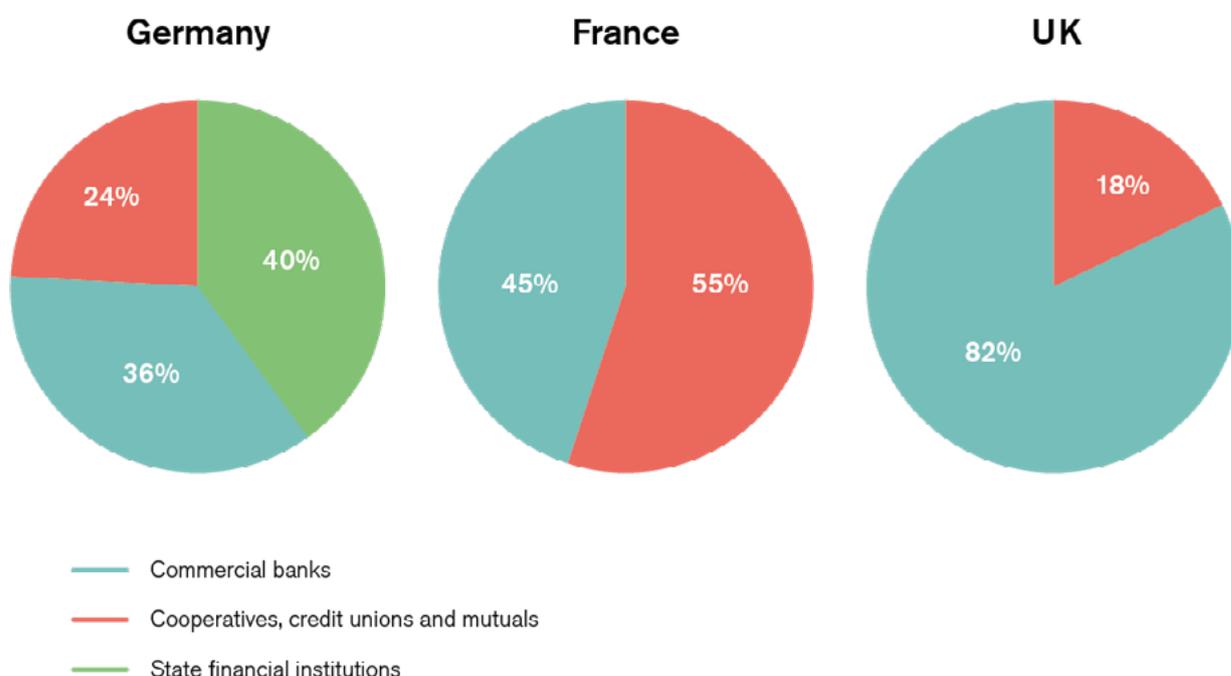


Figure 3: Market shares of deposits in Germany, France and the UK (World Bank 2011⁶), duplicate of Figure 1

Indeed, we contend that the UK banking market is a uniquely homogenous sector with concerning hallmarks of an oligopoly.

We note here that there are respected financial commentators who argue that the UK's banking market ought to be diversified even less in some respects, and should seek to become less heterogenous, as this would enable even further economies of scale and efficiencies. Analysis like this speaks to a certain detachment from responsibility of banks, their relationship to power, and the democratic or civic purpose we outlined above. This approach, naturally, is highly attractive to many banks themselves and the shareholders who smack their lips at the idea of economies of scale and the bottom-line benefits they bring.

And lest we forget, while thinking about monopolies: banks also have a hand on the throat of the future for they have a de facto monopoly on creating digital money.

5. For more information: www.economicsonline.co.uk/Business_economics/Banks.html

6. Prieg, L and Greenham, T (2013). Stakeholder Banks: benefits of banking diversity [pdf] Available at: neweconomics.org/uploads/files/eob3bd2b9423abfec8_pem6i6six.pdf [Accessed 26 May 2020]

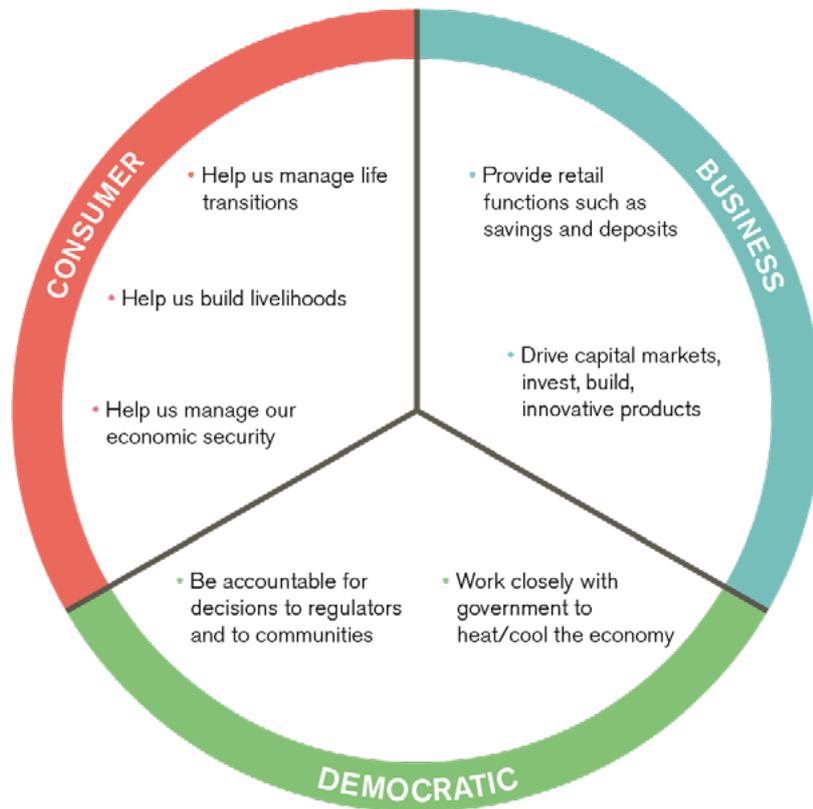


Figure 4: RSA summary diagram – purposes of banks: consumer, business, democratic

Failing small businesses: the numbers

What does this mean for small and medium-sized businesses and for vulnerable and marginalised people? These were two major constituencies who, our research revealed, are currently being particularly sold short. Let's delve deeper into each, starting with the former.

The UK has 5.9 million SMEs, 5.82 million (99.3 percent) of these are small businesses that employ less than 50 employees, with 4.5 million of these micro businesses or sole traders that have no employees⁷. These are the life blood of the UK economy – the hairdressers, window cleaners, newsagents that are so important to local economies. The photographers that capture our weddings and local tradesmen and women who change our locks and fix our boilers. British manufacturers who have stepped in to help make Personal Protective Equipment and ventilators for the NHS during the Covid-19 crisis. By supporting small and usually local businesses, money flows through the local economy, rather than being extracted by bigger national or global organisations. Indeed, without small businesses there is no local economy.

7. FSB (2018). UK Small Business Statistics [online]. Available at: www.fsb.org.uk/uk-small-business-statistics.html [Accessed 04 April 2020]

If we look at bank lending across SMEs we can see that it is these small and micro firms that struggle the most to access the finance needed to grow. In the years following the 2008 financial crash the banks further shrank the credit supply to SMEs exacerbating the problem⁸. While there has been a recovery in the past five years this has primarily been in favour of medium-sized businesses, while small business lending has failed to recover, even to 2008 levels⁹. Despite a major bailout of taxpayer's money for the banks, this support has not been passed down to the millions of small businesses in the UK. This is not due to lack of demand - a Bank of England survey in 2016 found that 30 percent of small businesses have been unable to access the necessary finance they need to grow, with 16 percent not even applying through fear of rejection¹⁰.

Indeed, only a small fraction of the money that flows through banks is channelled towards small and medium-sized businesses. Most of this finance is used to inflate the price of assets that already exist, such as housing, or on things that don't exist at all in a tangible sense, such as financial derivatives.

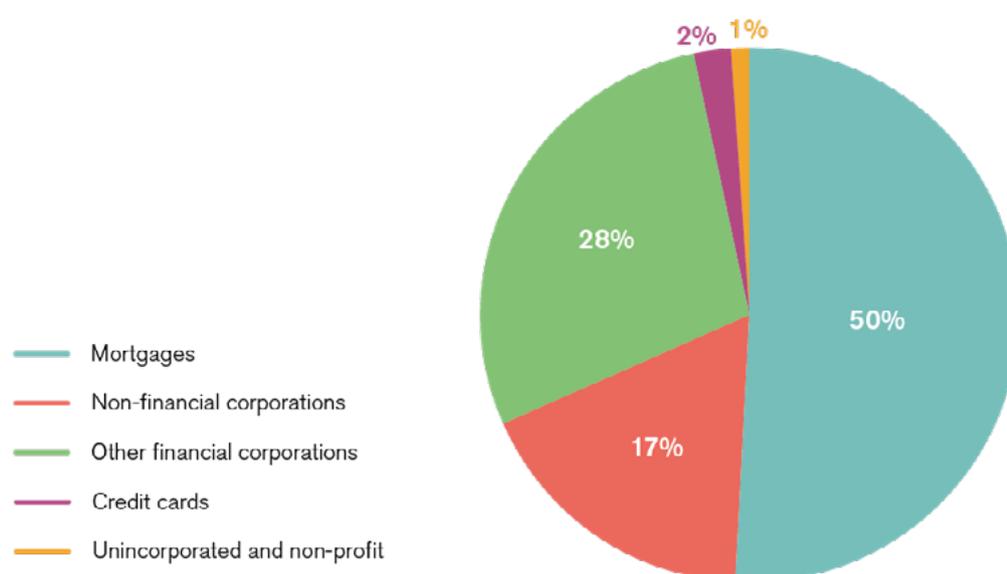


Figure 5: UK bank lending by sector 2015 (Bank of England Bankstats table A41¹¹)

8. Department for Business and Skills (2012). The impact of the financial crisis on bank lending to SMEs [online]. Available at: assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/34739/12-949-impact-financial-crisis-on-bank-lending-to-smes.pdf [Accessed 04 April 2020].

9. British Banking Association (2017). SME Lending 2012 – 2017 [online]. Available at: www.bba.org.uk/wp-content/uploads/2017/06/Graph-1.jpg [Accessed 04 April 2020].

10. Cunliffe, J. (2017). 'Are firms under investing – and if so why?' Speech at the Greater Birmingham Chamber of Commerce Wednesday 8 February 2017 [online]. Available at: www.bankofengland.co.uk/publications/Documents/speeches/2017/speech957.pdf [Accessed 01 May 2020]

11. Silver, N. (2017). Op cit.

The Covid-19 crisis has now shifted this from a problem of inhibiting business growth to a matter of mere survival for many. Less than three weeks into the UK's lockdown around 57 percent of small businesses had three months or less in cash reserves and 6 percent had already run out of cash¹². As we will explore in the next chapter, many of these businesses have been unable to access loans from either the Coronavirus Business Interruption Loan Scheme (CBILS) or Bounce Back Loan Scheme (BBLs), putting hundreds of thousands of businesses at risk of collapse.

Avoiding small business lending in practise

Just why are the major banks so reluctant to lend to small businesses? With one of the most developed financial services sectors in the world, how can nearly one in three small businesses not be able to finance their growth?



Here we see the lack of diversity within the UK banking sector at work: business models that seek ever greater rewards and economies at scale no matter the cost. Small business lending is hard. It requires local knowledge. Banks need to have information about a business to assess if it is likely to be able to repay the loan. Business diversity makes it hard to develop standard products or to automate processes – beloved of efficiency theorists - suited to the task. It is also hard to keep costs down, from the other side. Banks are not necessarily great innovators, they try to do a few things well and often rely on one-size-fits-all decades-old legacy systems. Indeed, economist Thomas Philippon actually contends that the efficiency of financial services has decreased over the last few decades (alongside de facto price gouging), remarkable when one considers how much profit the sector makes and how much public money has been invested post-2008 to keep it going.

All of this means that the big banks play it safe when it comes to small business loans. They raise the bar on qualifying requirements and then automate applications, and so small businesses are often rejected for loans without any guidance on how to qualify in the future. Without a major shakeup of SME bank financing this cycle will not be broken.

12. British Chambers of Commerce (2020). Coronavirus Business Impact Tracker [online]. Available at: www.britishchambers.org.uk/news/2020/04/bcc-coronavirus-business-impact-tracker-businesses-not-yet-successfully-accessing-government-loan-and-grant-schemes [Accessed 01 May 2020].

Box 5: Struggling to access small business loans

"I didn't know where to turn ... I [knew] that just going to another bank where I didn't have an established relationship wasn't going to solve the issue. Outside of banks, I had no idea"¹³.

Katrin Herrling's frustration in being unable to secure finance for her business in the midst of the financial crisis is a common one. At the time she had just inherited a dairy farm and needed support with cashflow. When her bank "suddenly changed their lending criteria" and were unable to provide this vital finance, she felt stranded.

Herrling made something of this: she eventually established Funding Xchange to make non-bank finance more accessible for entrepreneurs (and showed how even the most entrepreneurial people are often failed by the short-sightedness of the current system). Meanwhile, thousands of other small businesses face similar challenges every year. In 2013, the Department for Business, Innovation and Skills found that half of first-time borrower SMEs were rejected for finance, resulting in 37 percent giving up and cancelling their spending plans¹⁴. The British Business Bank estimates that banks reject 100,000 small businesses each year, representing an estimated shortfall of £4bn in funding¹⁵. Given everything we know about how our banks operate, it is highly likely that these issues speak to structural shortcomings – and are not justified in terms of the quality of proposition and the people putting them forward.

Elderly, marginalised, vulnerable

So much for local business, what about local people? An independent government inquiry into access to cash in 2019 reported that eight million people would find life 'near impossible' without cash¹⁶, yet the infrastructure that underpins it is starting to disappear as banks focus their attention on more profitable customers that are comfortable using digital channels. The UK has lost almost two thirds of its bank branches in the last 30 years¹⁷. In the past decade, the rate of closures has intensified, hitting rural and more deprived communities the hardest. Access to free-to-use ATMs has been following suit, with 13 percent of all free-to-use ATMs in the UK closing in the past year¹⁸.

13. Sheppard, E (2016). Bank turned down your small business loan? Now it must offer an alternative *The Guardian* [online] 01 November. Available at: www.theguardian.com/small-business-network/2016/nov/01/bank-turned-down-small-business-loan-alternative-funding-referral [Accessed 14 June 2020].

14. British Business Bank (2013). SME journey towards raising external finance [online] Available at www.british-business-bank.co.uk/wp-content/uploads/2013/10/SME-Journey-Towards-Raising-Finance.pdf [Accessed 14 June 2020].

15. British Business Bank (2016). Small business finance markets [online] Available at www.british-business-bank.co.uk/wp-content/uploads/2016/02/british-business-bank-small-business-finance-markets-report-2015-16.pdf [Accessed 14 June 2020].

16. Access to Cash Review (2020) [online]. Available at: www.accesstocash.org.uk/

17. Which? (2018). The UK has lost two-thirds of its bank branch network in 30 years, warns Which? [online]. Available at: press.which.co.uk/whichpressreleases/the-uk-has-lost-two-thirds-of-its-bank-branch-network-in-30-years-warns-which/ [Accessed 01 May 2020].

18. Makortoff, K (2020). UK cash economy close to collapse, campaigners tell chancellor. *The Guardian* [online] 19 February. Available at: www.theguardian.com/business/2020/feb/19/budget-2020-uk-cash-economy-close-to-collapse-campaigners-tell-chancellor [Accessed 04 May 2020].

Prior to Covid-19 the important role of cash and bank branches in supporting financial inclusion was recognised by the government. During his ill-fated budget 2020 speech, the Chancellor committed to introducing new laws and measures to protect cash for the millions of people across the UK who still rely on it. The Treasury was set to consider interventions such as granting watchdogs new powers to ensure banks continue to support their customers' cash needs properly and creating a new (and more affordable) system for moving money around the UK to keep cash accessible¹⁹.

Then came Covid-19. In the first month of the lockdown cash withdrawals were down around 60 percent compared to the same time in 2019, with around 54 percent of people saying they are avoiding cash. Despite this drop off, were still around 11 million cash withdrawals, totalling over £1bn, being dispensed from cash points each week during April²⁰. But it is clear many people are going digital.

One month into the UK's lockdown, an estimated six million people (12 percent of the adult population) downloaded a banking app for the first time²¹ and there has also been a huge rise in contactless payments. Legislation to increase the contactless payment limit from £30 to £45 was rushed through in April to enable people to make contactless payments on higher purchases - more than seven million contactless payments were made over £30 within the first month²². Changing payment habits will become permanent for many, with polling from the UK's main ATM operator, LINK, showing that almost three quarters of consumers (72 percent) think the coronavirus will have an impact on their future use of cash²³.

This gives a window into the future of the cash-digital payments nexus which appears to have been significantly accelerated by Covid-19. With this acceleration we risk sleep-sprinting rather than sleep-walking into an ever more financially exclusive world, where those without access to digital facilities are cast adrift. In part this is necessary: cash presents another vector for infection and there is real public health impetus now behind the shift. But it's vital that this shift is done in a way that leaves no one behind. Can we be sure this won't happen?

Regional inequality: banks against levelling-up

We suspect not, and that banks' behaviour, currently, is a major driver of regional inequalities. Branch closures are heavily skewed to more deprived areas as well as towns and rural communities. Wales has lost over two fifths of its branch network (43 percent, 239 branches) since 2015.

19. Which? (2020). Budget 2020: Government commits to protecting access to cash [online]. Available at: www.which.co.uk/news/2020/03/budget-2020-chancellor-poised-to-protect-access-to-cash/ [Accessed 04 May 2020].

20. LINK (2020). Coronavirus Crisis means cash use down but UK still withdrawing £1bn from ATMs each week [online]. Available at: www.link.co.uk/about/news/coronavirus-cash-usage-data/ [Accessed 08 May 2020].

21. Money Expert (2020). Millions Downloading Banking Apps for the First Time During Lockdown [online]. Available at: www.moneyexpert.com/news/millions-downloading-banking-app-first-time-lockdown/ [Accessed 08 May 2020].

22. Griffiths, M (2020). 7 million further contactless payments processed since limit increase *Money Age* [online] Available at: www.moneyage.co.uk/7-million-further-contactless-payments-processed-since-limit-increase.php [Accessed 01 May 2020].

23. LINK (2020). Op cit.

Wentworth and Dearne constituency in Yorkshire, which has a population of 98,000 no longer has a single bank branch²⁴. Northern Ireland has been one of the hardest places hit, with 16 percent of their free-to-use ATMs disappearing²⁵ – nearly double the rate of London and the south east. These are just a few examples.

It's not just individuals who are being hit by bank branch closures. Small businesses rely on physical branches to manage their cashflow and access vital finance. The RSA's previous report in this series, *Cashing Out*, showed that closing the last branch in a town can lead to a reduction in lending to small businesses²⁶. With nearly one in three small businesses unable to access the finance they need to grow²⁷, bank closures could further damage the UK's poor productivity. And that is before we begin to scale what our colleagues Matthew Taylor and Anthony Painter have called the post-Covid-19 stabilisation and recovery challenge.

The decline of the traditional bank branch will also likely mean a further reduction of financial sector jobs for many towns and smaller cities across the UK. The acquisition and merger of Clydesdale and Yorkshire Bank, due to become Virgin Money in October 2020, included plans to close 22 branches and consolidate of a further 30, with 500 jobs being cut across the UK²⁸. With the four major banks headquartered in London, along with many of the new challengers, the digital revolution is unlikely to offer an even spread of job opportunities across the UK to replace them.



Economic (non-)resilience

All of this leads to a deficit of national economic resilience. Despite a reduction in intra-financial trading and other non-productive activities post-2008, the UK still has among the largest, most concentrated, complex and interconnected financial systems in the developed world. At the same time, household debt continues to rise, and the proportion of local lending and liquidity is extremely low compared with other G7 economies, creating further systemic risks²⁹.

This is the context for the Covid-19 crisis.

Of course, no one can control when a new crisis will hit. While all eyes were on the potential impact of Brexit and the need for a just transition, Covid-19 crept up on us and truly shook the foundations of our economy.

24. Which? (2019) Over a third of bank branches closed in under five years, Which? reveals [online] 24 September. Available at: www.press.which.co.uk/whichpressreleases/over-a-third-of-bank-branches-closed-in-under-five-years-which-reveals/ [Accessed 05 May 2020].

25. Black, R (2019). Northern Ireland hardest hit by reduction of free-to-use ATMs, research finds. *Belfast Telegraph* [online] 17 September. Available at: www.belfasttelegraph.co.uk/news/northern-ireland/northern-ireland-hardest-hit-by-reduction-of-freetouse-atms-research-finds-38509365.html [Accessed 09 May 2020].

26. Greenham, T and Travers-Smith, F. (2019). *Cashing Out: The hidden costs and consequences of moving to a cashless society* [online]. Available at www.thersa.org/discover/publications-and-articles/reports/cashing-out/ [Accessed 10 May 2020].

27. Cunliffe, J. (2017) Op cit.

28. For more information see: www.thebusinessdesk.com/yorkshire/news/2054154-500-jobs-saved-as-bank-cancels-bank-closures.

29. For more information see: neweconomics.org/2015/06/financial-system-resilience-index.

And yet what came next was foreseeable. The failure of our financial system to support the small businesses and the marginalised and vulnerable in the wake of the last financial crisis was always going to leave us exposed and ill-prepared to deal with this one. Let us, this time, be honest, clear-eyed and hungry to learn the lessons.

Whither regulation?

It would be remiss not to mention regulation at this juncture, and how regulation helped – or not – alleviate some of these concerns.

Many of the changes made post-2008 have been useful but in truth, new rules have been easily gamed by the banks. This is not the place for a detailed analysis of banking regulation, and many other reports perform this task. Suffice to say here that regulation intended to insulate the financial sector from unnecessary systemic risk has tended to encourage greater financialisation, not lesser.

It has made it yet more profitable for banks to lend against properties rather than, say small businesses or to individuals in local communities. The post-2008 settlement saw banks having to adhere to strict capital adequacy ratios, to buffer against potential losses (and so reduce the risk of further bank bail outs). All assets are given a risk weighting and banks can hold much more in low risk loans, such as mortgages, without having to increase their capital levels.

So, we should not be surprised that today 50 percent of bank lending goes into property³⁰ and only around 4 percent finds its way to small businesses, while one in five firms underinvests due to lack of finance³¹.

Ellen Brown, author of *Banking on the People*, argues:

“The regulators are pursuing faulty models. If banks were merely intermediaries, taking in the deposits of savers and lending them out again, systemic risk could be avoided by increasing capital requirements or downsizing the largest banks. But banks are not just intermediaries. They create new money in the form of bank credit that did not exist before”³².

She is describing the US banking system, but we consider this also to be applicable in the UK. While banking regulation has better prepared banks internally to be able to deal with major shocks, such as Covid-19. It has not prepared them to perform their external, democratic, consumer-focused purposes as effectively as they might - and so stimulate the economy when we need them most. The key strategic, social function of banks in times of crisis and otherwise remains unfulfilled.

And there is no better case study for this than what happened in the UK with Covid-19, which is where our inquiry goes next.

30. Silver, N. (2017). Op cit.

31. Cunliffe, J. (2017). Op cit.

32. Brown, E. (2019). *Banking on the People: Democratizing money in the digital age*. Washington: The Democracy Collaborative.

Chapter 2: Banking in (Covid-19) crisis

In the previous chapter we noted the worrying lack of resilience of the UK economy and the role our banking system played in it. In this chapter we will take the UK as a case study and consider how the government, regulators, and crucially the banks have responded to the 2020 Covid-19 crisis - and how this compares with other countries.

This analysis is a necessarily provisional exercise: we do not know for sure whether the economic dip and recovery from Covid-19 will be a quick 'v', a medium sized 'u' or a long and depressing 'L'. However, we know what the entry point looks like – see the record single month contraction in the graph below, courtesy of the Financial Times - and can remark upon the way our institutions were able to mobilise and implement in response to the crisis – and how they did not.

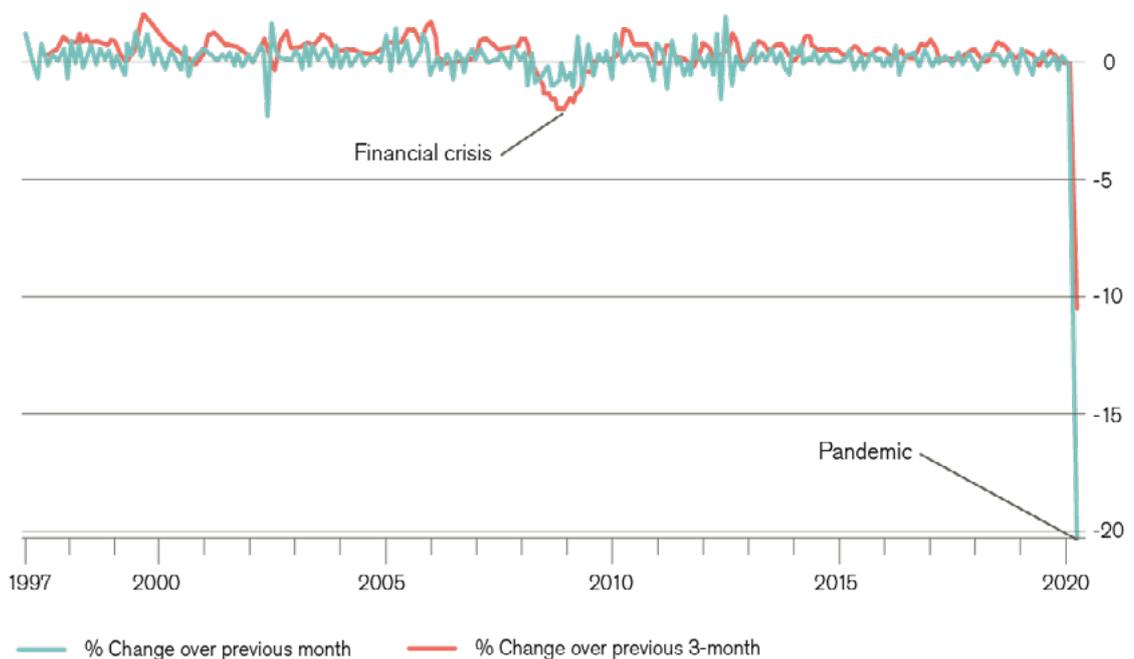


Figure 6: The UK economy shrank at a record pace (ONS, Refinitiv)

On the face of it, the changes made since 2008 ought to have made some improvement to our ability to respond effectively. Our banks are required to hold more capital against the loans they have on their books. Banks have restructured their activities, ring-fencing their retail banking activities and protecting them from investment and international banking activities³³. Lending to the financial sector has declined but there has been a significant rise in mortgage lending³⁴.

All of this may be so, and yet, as we will see in this chapter, the banking sector remained woefully underprepared and out-of-shape when Covid-19 hit. As a result, businesses and people have suffered and it is right to ask: what is it about our system that meant we could not do better by our people when they needed it most?

The Covid-19 response

Covid-19 has dealt the biggest blow to the economy since World War Two. The impact on businesses and employees' finances continues to be devastating.

Attempting to avoid outright catastrophe, the Chancellor was quick to rework his ill-fated spring budget and announce significant measures to protect people and business.

In this chapter we consider the nature of that response, how it played out and why. In so doing we will follow the contours of the previous chapter and consider in particular:

Small businesses:

- Coronavirus Business Interruption Loan Scheme
- Bounce Back Loan Scheme

Elderly: marginalised, vulnerable:

- Customer services, cash flow and 'mortgage holidays'

The numbers involved in the relevant schemes were eye-watering. It is important to note up front that much of the support was in the form of extra debt rather than grants and much power was ceded to the banks to deliver.

33. Britton, K. (2016). Ring-fencing: what is it and how will it affect banks and their customers? [online]. Available at: www.bankofengland.co.uk/-/media/boe/files/quarterly-bulletin/2016/ring-fencing-what-is-it-and-how-will-it-affect-banks-and-their-customers.pdf [Accessed 02 April 2020].

34. Bikas, K. (2018) How has bank lending fared since the crisis [blog] 15 June. Available at: positivemoney.org/2018/06/how-has-bank-lending-fared-since-the-crisis [Accessed 04 April 2020].

‘Standing behind British business’

The government said from the outset that it would ‘stand behind British business’ through the crisis and called on the banks to do the same. Banks were invited by the government to perform an essential triaging function for the receipt of government aid.

Alongside small grants and business rates tax relief provided directly by the government, the Coronavirus Business Interruption Loan Scheme was one of the flagship emergency responses to support British business, with the Chancellor announcing a £330bn loan fund to provide loans of up to £5m with 12 months interest free and an 80 percent government guarantee.

This was followed in May by the more streamlined Bounce Back Loan Scheme, providing loans of up to £50,000 fully guaranteed by the government.

Box 6: Bad omens: the EFG experience

It is worth noting that the CBILS framework was based on the well-established Enterprise Finance Guarantee (EFG) scheme which has facilitated lending to smaller businesses that are viable but unable to obtain finance from their lender as they have insufficient security to meet the lender’s normal requirements - the government guarantees 75 percent of these loans.

At the time of writing, the EFG scheme has lent £3.3bn to 30,000 businesses since it was set up in 2009 after the financial crisis. That is just 2,700 loans per year across 40 partners averaging less than 70 loans per lender, with loans taking weeks, sometimes months, to get approved³⁵.

From the outset it was clear, then, that making some small tweaks to the EFG scheme and relying heavily on the big banks to deliver was not going to work at the scale or speed required.

Here’s how it initially worked. Businesses were required to have been turned down for a commercial loan before applying through the scheme; personal guarantees meant that the banks would be able to repossess the personal property of firms’ owners if they were unable to repay the loan before drawing down on the government guarantee, and there was no cap on interest rates the banks could charge beyond the interest free period. The risk of these loans would all have been borne by the business, not the government or the banks³⁶.

Despite these problems, around 20 percent of small businesses were interested in applying to the scheme. Only around one percent were able to secure a loan in the first two weeks it was announced, while 8 percent of small businesses were unable to access the scheme citing the ‘complexity of the application process’ and a ‘slow or lack of response’ from the relevant body as reasons for being unsuccessful³⁷.

35. Pagano, M. (2020). Government scheme to help business is much too slow and bureaucratic – SMEs will go bust [blog] 26 March. Available at: reaction.life/government-scheme-to-help-business-is-much-too-slow-and-bureaucratic-smes-will-go-bust [Accessed 06 April 2020].

36. BBC (2020). Denying coronavirus loans ‘completely unacceptable’ banks told [online]. Available at: www.bbc.co.uk/news/business-52126658 [Accessed 6 April 2020].

37. British Chambers of Commerce (2020). Op cit.

The schemes iterate

The government reviewed the details of the scheme after only 1,000 loans were distributed nationwide in the first two weeks³⁸.

Two significant changes were announced by the Chancellor on 3 April 2020 for small businesses – personal guarantees required for loans up to £250,000 were scrapped and the loans were made available to all viable small businesses, not just those who were unable to secure regular commercial financing³⁹.

While these changes were not insignificant and led to an improved conversion rate, it is clear that the banks did not consider this sufficient incentive to deliver at the scale of what was required – perhaps with the exception of the Royal Bank of Scotland (RBS) who had reportedly delivered over one third of loans in the CBILS at the time of writing (though it is no coincidence the major shareholder in RBS is the British government).

The introduction of the Bounce Back Loan Scheme on 1 May 2020 was the final iteration and removed all risk for the banks and this significantly ramped up the scale and speed of lending – with £14.8bn lent through BBLs in two weeks (4 May – 18 May) compared to £7.25bn lent via CBILS over eight weeks (23 March – 18 May)⁴⁰.

This was supposedly the government's trump card. However, for many SMEs, even then the response was not enough. While around 36,000 applications have been approved for CBILS and nearly 270,000 for BBLs, there have also been 130,000 rejected applications, as well as hundreds of thousands of incomplete enquiries or SMEs who just couldn't get the funds in time to keep trading⁴¹.

Over-complexity

While banks must take some responsibility for their unwillingness to lend, the government must accept some criticism for the grammar of its response. Action needed to be swift, simple and decisive. A survey from the British Chambers of Commerce at the beginning of April showed that 6 percent of small British firms were already out of cash, and 57 percent without enough liquidity to last three months or less⁴². Speed was essential to secure jobs, but it lacked decisiveness to start the guarantee at 80 percent and only increase incentives to lend by increasing the loan guarantee to 90 or 100 percent as in Germany and Switzerland at a later date. By then, for many, it was too late.

38. Gov.UK (2020). Chancellor strengthens support on offer for business as first government-backed loans reach firms in need [online] Available at: www.gov.uk/government/news/chancellor-strengthens-support-on-offer-for-business-as-first-government-backed-loans-reach-firms-in-need [Accessed May 2020].

39. Elliott, L. (2020). UK banks banned from requesting personal guarantees for loans. *The Guardian* [online], 2 April 2020. Available at: www.theguardian.com/politics/2020/apr/02/uk-banks-banned-from-requesting-personal-guarantees-for-loans [Accessed 08 April 2020]

40. Reuters (2020). UK lends 14 bln pounds to small firms hit by coronavirus *Financial Post* [online] 19 May Available at: business.financialpost.com/pmn/business-pmn/uk-lends-14-bln-pounds-to-small-firms-hit-by-coronavirus [Accessed 25 May 2020].

41. Fitzpatrick, J. (2020). Why FinTechs should be at the heart of rebuilding the post-Covid economy *The Fintech Times* [online]. 15 May. Available at: thefintechtimes.com/why-fintechs-should-be-at-the-heart-of-rebuilding-the-post-covid-economy [Accessed 20 May 2020].

42. British Chambers of Commerce (2020). Op cit.

The scheme also was too complex: in a difficult situation, the government ought to have provided universal liquidity – a basic income to individuals, as we at the RSA argued in various reports over the last few years and in our latest post-Covid-19, *A blueprint for good work: eight ideas for a new social contract*, and small grants to small businesses, bypassing the triaging of the banks, ensuring productive, entrepreneurial activity could continue and augur a faster fightback on the other side. We recognise the need to limit fraud and error but this was a remarkable situation and the shortcomings to the eventual scheme were not discussed in hindsight but widely, at the time. Thus, they were predictable.

Involving the banks at triage stage was always going to subject recipients to the banks' flaws and amplify our banking system's failings with regard to small businesses. In addition, a lack of transparency over which banks convert enquiries and applications into loans persists; UK Finance has only published aggregate data. The British Business Bank (BBB) publishes bank-by-bank data on its EFG initiative so it could easily be done for CBILS. Yet still the picture remains obfuscated.

We hope government can learn from these mis-steps – made in the fire of crisis - but we can also use these failures to understand where banks themselves must improve. Mike Cherry, chairman of Federation of Small Businesses (FSB) warned:

“Many members tell us it’s difficult to get to the formal application stage – banks are still slow to respond to CBILS enquiries. Even if you do get your forms through, the process is very demanding for the uninitiated. We need simplification: banks should look at pre-filling forms based on data they already have on customers, and we shouldn’t have behind the scenes reporting requirements holding up approvals⁴³.”

To speak to the government’s cause a moment, banks should have been able to financially meet this demand. In responding to the crisis regulators have allowed banks to knock £23bn off their countercyclical capital buffers (the amount they must keep in reserve to weather shocks) to support up to £190bn of extra lending - more than ten times the £16bn loaned last year. Sam Woods, deputy governor of the Bank of England claimed.

“Banks have ample capacity from a capital point of view. The capital treatment for these loans is strong enough to cover the losses that should arise in the normal way from making loans of this kind”.

This is particularly so when taking in to account the government guarantee applied to the loans.⁴⁴

43. FSB (2020). More work needed to make emergency loans a success, say small firms, as lending hits £1bn [press release] 15 April. Available at: www.fsb.org.uk/resources-page/more-work-needed-to-make-emergency-loans-a-success-say-small-firms-as-lending-hits-1-billion.html [Accessed 15 April 2020].

44. Jones, H and Milliken, D. (2020). UK banks have ample funds to help pandemic-hit economy: BoE’s Woods, *Reuters* [online] 15 April 2020. Available at: uk.reuters.com/article/us-health-coronavirus-boe-banks-idUKKCN21X2JH [Accessed 20 April 2020].



So what has gone wrong?

Put simply, banks must take some responsibility for good, viable businesses and hard-working entrepreneurs going under during this crisis. When one considers the government's puzzling failure also to provide adequate support schemes for the self-employed, among others – not the banks' responsibility, note – there does emerge the sense that the small British businesses and entrepreneurs were not in fact prioritised adequately in the government's response. The banks' failures in this regard have compounded the problem.

A breakdown in government innovation

'Sluggishness' is a term that might also be applied to the government's failure to rapidly enjoin the UK's fintech sector in the Covid-19 recovery effort.

This has been particularly problematic with the BBLS given it was designed to get instant liquidity into small businesses. As of 19 May there are 70 accredited lenders for CBILS and only 17 for BBLS⁴⁵. Fintech's challenger banks such as Starling and Tide, which we will encounter in more detail in the next chapter, were gradually added to the schemes with a slow drip feed of others joining the BBLS. In the first week of offering Bounce Back Loans, Starling received 18,161 applications and lent out £288m, approving 84 percent of loans that were processed⁴⁶.

The implementation wasn't perfect: rejected applicants took to social media to complain about certain aspects. But their approval rate was 11 percent above the industry average for the BBLS⁴⁷ and there is no doubt that widening the pool of lenders is adding much needed capacity to the system, particularly when they can move at speed.

The British Business Bank, designated by the government for implementing this scheme created a process that was far too slow and complex with lenders having to undergo training to become accredited intermediaries. The concentration of these schemes around traditional lenders also raises questions of fairness and competition. There is no doubt that it reduced choice and flexibility for SMEs, putting businesses that didn't already have an account with an approved lender at risk⁴⁸. Put simply: it is absurd and antithetical to free market principles that businesses may have gone under, not because they were bad businesses but because their current account was with the wrong bank.

Furthermore, lending caps imposed by the British Business Bank slowed down and restricted smaller lenders – with Tide creating a waiting list to manage demand and Starling having to prioritise existing customers and temporarily halt application from sole traders⁴⁹ at points.

45. UK Finance (2020). Over £22bn provided to half a million businesses through Covid-19 lending schemes [press release] 17 May. Available at: <https://www.ukfinance.org.uk/press/press-releases/over-22-billion-provided-half-million-businesses-through-covid-19-lending-schemes> [Accessed 20 May 2020].

46. Fintech Global (2020). Starling Bank CEO responds to Bounce Back Loan criticism from rejected would-be loan takers [online] Available at: member.fintech.global/2020/05/18/starling-bank-ceo-responds-to-bounce-back-loan-criticism-from-rejected-would-be-lenders/ [Accessed 01 June 2020].

47. UK Finance (2020). Ob cit.

48. Fitzpatrick, J. (2020). Ob cit.

49. Smith, O. (2020). What's going on with Tide and Starling Bank's Bounce Back Loans? *Altfi [online]*. Available at: www.altfi.com/article/6606_whats-going-on-with-tide-and-starling-banks-bounce-back-loans [Accessed 20 May 2020].

"It is absurd and antithetical to free market principles that businesses may have gone under, not because they were bad businesses but because their current account was with the wrong bank".

How else could we have done better?

We stress that such ‘lumpiness’ (for want of a better term) in response provision is inevitable during a crisis situation – and some good people inevitably going to miss out – yet it is clear from the above that we could have done better. The government deferred, largely, to our highly homogenous banking system in its triaging of its support schemes and ordinary people and businesses have suffered as a result.

What does this tell us about the structure of our banking system and more importantly, how we might do things differently and better? Important lessons should be drawn from Europe and the North America – both in terms of scheme design and diversity of banking sector to deliver.

One way of interpreting all this, as some commentators have, is to argue that we should actually have an even more concentrated banking sector. The ‘command and control model of banking’, if you will. Lessons on how to implement the scheme could have been drawn from Switzerland, where, similar to the UK, four big banks dominate much of the market. Their rescue scheme was much more effective, dispersed widely and included 122 lenders

Here a simple two-step process where participating lenders lent SFr15bn (approximately £12.5bn) in the first week. The first step allowed any business to get an interest free loan of 10 percent of their annual income capped at SFr500,000 (approximately £412,000), delivered through the banks and underwritten with a full credit guarantee from the government. In the second part the banks offer loans of up to SFr20m (approximately £17m), with 85 percent guaranteed by the government at 0.5 percent interest and the banks assuming the risk of the final 15 percent, offering competitive rates⁵⁰. Here, the command-control model meant gears could be flicked upwards with alacrity; we acknowledge its speed and elegance compared to the UK response.

Another way to think of this is that in a society as complex as ours, command-control, is not appropriate or sufficient. Other larger economies signpost the way. Lessons could have been taken from Germany, where after a slow start with banks reluctant to offer loans with the economy faltering, they increased guarantees for small businesses from 90 percent to 100 percent⁵¹ at a rate of 3 percent or better. In Germany there was much less pressure on the big banks to make masses of quick risk decisions as they have a relatively low share of small business loans compared with the local savings and cooperative banks⁵².

50. Financial Times (2020). Swiss lead way with crisis loans to small businesses. *Financial Times* [online]. Available at: www.ft.com/content/9ab135d3-f85e-4ca8-9bb4-0e487e134b10 [Accessed 20 May 2020].

51. Jennen, B (2020). Germany Eyes \$324 Billion Guarantee Program for Small Companies. *Bloomberg* [online] 03 April. Available at: www.bloomberg.com/news/articles/2020-04-03/germany-eyes-eu-300-billion-guarantee-program-for-small-companies [Accessed 20 May 2020].

52. O’Neill, D. (2020). Rewriting the rules: How Europe’s banks responded to Covid-19. *Euromoney* [online] 28 April. Available at: www.euromoney.com/article/b11ctw1ryqxdtz/rewriting-the-rules-how-europes-banks-responded-to-covid-19 [Accessed 20 May 2020].

Indeed, the case studies below, show such alternative banking models were able to respond much more effectively at speed and scale than their command-control counterparts – often working closely with government and in the local cases, pre-empting government actions to support their communities.

Box 7: Public development bank – Germany

At time of writing, Germany's state development bank KfW has received applications for 26bn euros of emergency coronavirus loans and has so far approved 8.5bn euros worth. The figures, compiled by the finance and economy ministries, show KfW approved 98 percent of loan applications from more than 13,000 companies, with a small number of applications requesting an unusually large amount of funds still being checked⁵³. The efficiency of the German system is in part down to the KfW's partnership with cooperative banks such as Volksbanken and Raiffeisenbanken who have an outstanding knowledge of the regional economy and act as on-bank lenders – examining the plans of applicants and deciding whether they will support them and apply for a loan from the development bank⁵⁴.



Box 8: Community bank – USA

The US has over 5,000 community banks. If effectively harnessed this network of small banks, rooted in local communities, could play a crucial role in limiting the damage to the US economy - which is likely to see levels of unemployment not seen since the Great Depression. As of 13 May 2020, Citizens Bank in Edmond, Oklahoma, a community bank founded 119 years ago, had delivered more than 240 loans to small businesses, lending over \$15.5m to businesses they are able to better understand and build relationships with than more distant lenders⁵⁵. This might seem small, but if all local banks in the US were lending at the same rate this would be a substantial boost to small business and local economies across the country. For local lenders like Citizens Bank, these customers are their priority so they are better placed to support these small businesses should they run in to problems with repayments, meaning they could be less likely to default and draw down on the government guarantee. By providing these loans they free the bigger banks up to focus on supporting bigger businesses.

53. For more information see: uk.reuters.com/article/uk-health-coronavirus-germany-loans/germanys-kfw-pays-out-8-5-billion-euros-in-coronavirus-aid-loans-idUKKCN2231LS

54. For more information see: www.genossenschaftsverband.de/newsroom/social-media/blog/how-regional-stakeholder-banks-could-strengthen-local-economies-in-the-uk-and-elsewhere

55. Francis-Smith, J (2020). \$4.6B loaned to Okla. businesses under paycheck program *The Journal Record* [online] 22 April. Available at www.journalrecord.com/2020/04/22/4-6b-loaned-to-okla-businesses-under-paycheck-program/ [Accessed 14 June 2020].

Box 9: Cooperative banking

Many European countries have strong cooperative banking sectors, with around 84 million members across Europe and 209 million customers⁵⁶. Research published in 2019 examining 18 cooperative banking groups in 13 European countries found that, compared to the wider banking sector, cooperative banks provided more new loans to the real economy, reported a higher deposit growth, and reduced their branch network and employment to a lesser extent than all other banks. Furthermore, the cooperative banking sector expanded its loan portfolio by 4.7 percent; the highest increase since 2011⁵⁷.

Gerhard Hofmann, President of the European Association of Cooperative Banks explains:

“Cooperative banks are committed by nature to fully support the local economy and can act as stabiliser in times like these. Cooperative banks are fully integrated in efforts to issue new loans, extend payment deadlines and provide liquidity to their corporate customers and SMEs⁵⁸”.

Caixa Popular, a Spanish cooperative, for example had lent 440m euros on advantageous terms by early April⁵⁹. As well as supporting SMEs through traditional lending cooperative banks across Europe they have been going the extra mile to support their members and local communities. Raiffeisen, a cooperative banking group in Switzerland opened up a free-to-use crowd-funding platform in mid-March enabling 164 SMEs to raise SFr500,000 (approximately £420,000) of essential liquidity with hospitality firms offering exclusive backstage experiences and vouchers for restaurants and bars after the lockdown⁶⁰. In Canada, Desjardins – the largest federations of credit unions in North America, has launched several initiatives to help relaunch the economy, including a \$150m fund to stimulate social and economic activity and a \$10m fund to stimulate local business development⁶¹.

Elderly, vulnerable, marginalised

Alongside the measures outlined in this chapter to support businesses, the government also announced a range of measures aimed at supporting people who were struggling to make repayments on personal debts. Alongside welcome changes to benefits and social security – and the wider effects of the innovative furlough scheme - this was most conspicuously in the form of payment freezes on mortgages, credit cards, loans and overdrafts. While these schemes were much needed there were two significant problems.

56. For more information see: www.eacb.coop/en/home.html

57. For more information see: www.thenews.coop/143682/sector/banking-and-insurance/europes-co-op-banks-increase-membership-and-market-share

58. EACB (2020). Gerhard Hofmann’s interview – EACB Newsletter special edition on Covid-19 [online]. Available at: www.eacb.coop/en/news/covid-19/gerhard-hofmann-interview-on-covid-19-eacb-newsletter.html [Accessed 20 May 2020].

59. Kendall, N. (2020). SME Lending: Latest support measures in Europe. *Finextra Blog* [blog] 06 April. Available at: www.finextra.com/blogposting/18623/sme-lending-latest-support-measures-in-europe [Accessed 20 May 2020].

60. Raiffeisen (2020). Half a million for SMEs [press release] 04 May. Available at: www.raiffeisen.ch/rch/de/ueber-uns/news/rch/lokalhelden-ch-eine-halbe-million-fuer-kmu.html [Accessed 20 May 2020].

61. Desjardins (2020). Desjardins Rolls Out Its Strategy to Help Get the Economy Back on Track and Support Regional Development [press release] 29 April. Available at: blogues.desjardins.com/press_release/2020/04/economy-relaunch-strategy.php [Accessed 20 May 2020].

First, in supporting people who had been financially impacted by Covid-19 to meet housing payments, the scheme was heavily skewed to supporting homeowners rather than people in rented accommodation. Many individuals that will have been hardest hit during the coronavirus crisis are in rented accommodation, with 590,000 people falling into rent arrears and now facing housing insecurity⁶². Many will be self-employed or furloughed workers on low-middle incomes that have lost at least 20 percent of their pay, or some of the one million people who have applied for Universal Credit since the crisis hit. Around 16 million people have savings of £100 or less⁶³ and would struggle to pay an unexpected bill. For those feeling the bite of economic insecurity, access to emergency finance could be essential to keeping up with rent payments and household bills. Had the government taken a different and more universal approach, adopting, say, the RSAs' proposals for a temporary Universal Basic Income⁶⁴, the power of distribution would not have been left in the hands of the banks.

Secondly, the schemes were designed to freeze payments but not the interest incurred on the debt. Therefore, the majority of payment freezes (with the exception of interest free credit cards and overdrafts) were increasing monthly payments and overall debt that will need to be repaid. For example, the mortgage scheme worked relatively well in terms of immediate savings, with mortgage providers approving 1.24 million mortgage holidays by 14 April with an average monthly deferral of £775 per household – meaning £2.6bn short-term saving (assuming all are taken for three months) for one in nine households that hold a mortgage⁶⁵.

This is helpful for the three to six months of the scheme's duration but not the following 12 months, when many households will still be getting their finances back on track. On an average £132,128 mortgage at 2.37 percent over 17 years, the total cost of the loan would typically be £160,656, a three month repayment holiday will drive the total bill to £161,164, an increase of £508⁶⁶, and many will pay much more. With interest rates slashed to 0.1 percent these savings could have easily been passed on to the customer. Instead the banks stand to profit £600m from these mortgage 'holidays'⁶⁷ – and this is likely a conservative estimate for the first phase of this scheme.

Britain's high street banks granted around 1.5m payment holidays to consumers struggling to repay their credit cards and personal loans during the pandemic. Relatively few people have been granted payment holidays so far, with less than 2 percent of the 51 million credit card accounts in

62. StepChange (2020). Coronavirus and personal debt: a financial recovery strategy for households [online] Available at: www.stepchange.org/Portals/0/assets/pdf/coronavirus-policy-briefing-stepchange.pdf [Accessed 09 June 2020].

63. Milligan, B. (2016). Millions have less than £100 in savings, study finds. *BBC* [online] 29 September. Available at: www.bbc.co.uk/news/business-37504449 [Accessed 24 May 2020].

64. Painter, A. (2020). Coronavirus and temporary UBI; RSA statement [press release] 18 March [online]. Available at: www.thersa.org/about-us/media/2019/coronavirus-and-a-temporary-ubi-rsa-statement [Accessed 24 May 2020].

65. Peachey, K. (2020). Coronavirus: One in nine homeowners takes mortgage holiday. *BBC*, [online] 14 April. Available at: www.bbc.co.uk/news/business-52279568 [Accessed 24 May 2020].

66. Money Expert (2020). Banks to Make £600m in Extra Interest from Coronavirus Mortgage Holidays [online] Available at: www.moneyexpert.com/news/banks-make-600-million-extra-interest-coronavirus-mortgage-holidays/ [Accessed 01 June 2020].

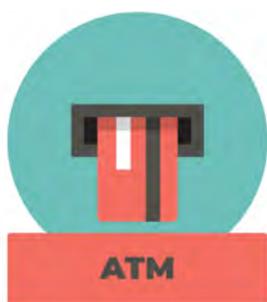
67. *Ibid.*

Britain on pause and less than 7 percent of loan payments frozen. The low take-up of these schemes could be due to the comparatively high take up of the furlough scheme and mortgage holiday freezes as well as the higher interest rates often attached to loans and credit cards. However, UK Finance have reported an increase in requests for payment holidays on loans and credit cards, rising by more than 25 percent during May.

Against a backdrop of rising unemployment and reduced wages, this scheme will likely need to be extended beyond October and as household debt increases during the crisis, longer-term measures will be needed to help people manage future repayments. Research from debt support charity StepChange estimates that 4.6 million people negatively affected by Covid-19 have accumulated £6.1bn of arrears and debt, averaging £1,076 in arrears and £997 in debt per adult affected⁶⁸.

One revenue stream for banks prior to the crisis was unauthorised overdrafts which had been making the banks over £700m per year in profits⁶⁹. When the crisis hit, one regulatory change that was already on the horizon was to curb the excessive fees and lack of transparency around unauthorised overdrafts. However, the banks used this opportunity to collectively increase interest rates on authorised overdrafts to around 40 percent, in some cases a rise of 400 percent - another example of how the banks are able to 'game the system' and circumvent legislation aimed at protecting consumers.

Plans to implement the increase in overdraft charges were essentially put on hold when the Financial Conduct Authority (FCA) brought forward emergency measures mandating all banks to offer £500 interest free overdrafts to all customers who requested it as well as enabling customers to freeze loans and credit card payments for three months. However, credit card and loan freezes have the same issue as mortgage holidays, they continue to incur interest making them more expensive in the long-term.



Access to cash and banking

What about issues around access? Prior to Covid-19 changes to our financial services infrastructure, in particular the decline of bank branches and free to use ATMs, had the biggest impact on elderly, vulnerable and marginalised citizens as well as rural communities. Covid-19 led to an almost instant super-reduction in banking services, with many branches closing and phone lines operating with reduced hours and advising customers to only call for emergencies.

This presented a different challenge to the banks from those explored earlier in this chapter. Rather than implementing schemes enforced by the government and regulators to extend credit or freeze payments, banks who spent the last few years absenting themselves from civic life would need to consider how to adapt their systems to ensure all their customers could still access essential services such as cash withdrawals, when vulnerable customers might be self-isolating. This, at a time when cash was less trusted due to public health reasons, yet basic banking services such as

68. StepChange (2020). Op cit.

69. Kollwe, J, and Collinson, P. (2018). Excessive bank fees for unarranged overdrafts to be banned *The Guardian* [online] 18 December. Available at: www.theguardian.com/money/2018/dec/18/banks-fees-unarranged-overdrafts-fca [Accessed 24 May 2020].

paying bills or transferring money for customers not familiar or able to access online banking needed to continue in some way.

Banks introduced various measures to support more vulnerable or marginalised customers, with variable success. Lloyds and RBS introduced a dedicated phone line for customers over the age of 70 and NHS workers, as well as measures such as cash deliveries and loosening restrictions on third party access to accounts so that a friend or family member can withdraw a limited amount of cash on someone's behalf⁷⁰. The fintech Starling's approach was more innovative: it launched a 'Connected card' for vulnerable customers. It can be given to a trusted person so that they can spend on the customer's behalf⁷¹. Barclays introduced virtual 'Tea and Teach' sessions to help older or vulnerable people who are not confident banking online.

These small innovations do offer vital support during the crisis. But the bigger banks especially have been plagued by issues. The legacy phone systems have been largely inaccessible for many vulnerable people. Online chats have worked well for some schemes, badly for others. In many cases, the market intelligence to offer genuinely granular personal services is not there.

Casino culture

In this chapter we have outlined how banks have provided vital support to many small businesses and individuals through the crisis as well as highlighting that many others have fallen through the net and been unable to access support through the various schemes. There is one more point to make.

We do not wish to be churlish or puritanical about banker salaries, which are a function of the market and the financialised reality created by the bankers themselves. But we note that, for those who, as we do, believe the system needs to change and who recognise a democratic and civic purpose for banks, it is concerning that just as the severity of the economic impact of the crisis was becoming clear, many of the big banks were still approving millions of pounds worth of bonuses for bank managers, and lobbying to ensure they could pay their shareholders dividends.

With the European Central Bank banning Eurozone lenders to cancel all dividend payments and the major US banks banned from increasing stock value through share buybacks, the UK banks seemed set to press ahead with £7.5bn of dividends payments. The Financial Conduct Authority acted swiftly and stopped the banks in their tracks – introducing a ban on all dividends for the rest of the year.

However, it is concerning that many of the big banks were seemingly prioritising banker bonuses and shareholder pay-outs over protecting their capital positions and ensuring extra buffers were available to support their customers through unprecedented economic crisis.

70. Finextra (2020). Lloyds Banking Group opens dedicated call line for vulnerable customers and NHS staff [online] 01 April. Available at: www.finextra.com/newsarticle/35558/lloyds-banking-group-opens-dedicated-call-line-for-vulnerable-customers-and-nhs-staff [Accessed 20 May 2020].

71. Meadows, S. (2020). What each bank is doing to help older and vulnerable people and NHS workers. *The Telegraph* [online] 08 April. Available at: www.telegraph.co.uk/personal-banking/current-accounts/bank-help-older-vulnerable-people-nhs-workers/ [Accessed 20 May 2020].

‘Like having an arsonist put out the fire’

Covid-19 has been a huge challenge for any government. Yet the evidence is clear: on the economic side, many mistakes were made and should be learned from. Not only was the policy response sluggish in respect of small businesses especially, but it is also the case that it was a crucial error to have banks triage the rescue schemes when those banks have so many internal issues around lending to small businesses and serving our most vulnerable constituencies. Delivering a rescue scheme in this way was akin to, in that well-known phrase, inviting the arsonist to put out the fire.

We need to get this right, and fast. How businesses and banks respond to government measures continues to be crucial in mitigating the economic and social impacts of crisis. SMEs employ over 13 million people in the UK and how well we continue to support small and medium sized British businesses is a major factor in how quickly we recover.

When we emerge from this crisis, the businesses that survived with the help of this scheme will have reduced income and increased debt. The government post-Covid-19 will have to raise taxes and/or cut services to pay for the emergency measures that helped us through. With the banks also recovering, it seems unlikely they will suddenly have a renewed appetite to lend to small businesses. As we have indicated in this chapter, as the conversation moves to how we bridge to the future post-Covid-19, reform, not only of banking practice but of the structure and form of the banking ecosystem, needs to be on the agenda. It is to this we now turn.

Chapter 3: Alternative banking models

In the previous chapter we alighted on some alternative banking models – locally-focused and cooperative in locus and structure – that have performed particularly effectively in response to the Covid-19 crisis. In this chapter we unpick them in more detail.

First, we will explore how the banking sector – and its new post-2008 regulator the Financial Conduct Authority - has opened up to new challenger banks since 2008 and consider how well these new (and in the most part digital only) banks are serving small businesses, vulnerable people and local economies.

We will then take a brief look at new legislation, such as open banking, aims to improve financial services, and other major shifts that might be on the horizon such as digital money.

Finally, we will consider a series of alternative proposals which are designed to directly support the customers that are currently underserved by the UK banking sector.

Challenger banks

The last decade has seen the emergence of challenger banks and alternative finance providers entering the market to offer increased choice and much needed competition to the sector.

When Metro Bank launched in 2010, it became the first new bank to be granted a UK banking licence in over 150 years. After a period of rapid growth in which it opened more than 50 branches, mainly in London and the south east, and captured 2 percent of the SME market with over 100,000 accounts, Metro Bank ran into problems in early 2019 when it emerged that an error in the way they were categorising a segment of their commercial loans meant they were not holding sufficient capital against them. They were forced to raise £350m capital and their share price fell by 75 percent in just four months. Metro Bank has added much needed competition, but their shareholder focused business model is in many ways a drawback.

Two years after the launch of Metro Bank, the 2012 Financial Services Act set out a new regulatory framework for the financial system and financial services in the UK. It replaced the Financial Services Authority with two new regulators - the Financial Conduct Authority and the Prudential Regulation Authority (PRA), and created the Financial Policy Committee of the Bank of England. Twelve new banks were regulated

"With a more open market following the post-2008 reforms and the scale of technological innovation over the past decade, there has been a sharp rise in the number of new digital-only challengers".

between April 2013 and January 2016⁷² when the New Bank Start-Up Unit was set up to further reduce barriers to entry and help new banks with their authorisation and entry to the market. More than forty new banks have been licenced since 2012. Further legislation, the Cooperative and Community Benefit Societies Act in 2014 made it legally possible to establish regional mutual banks in the UK – as we will explore in chapter 4.

With a more open market following the post-2008 reforms and the scale of technological innovation over the past decade, there has been a sharp rise in the number of new digital-only challengers – often referred to as ‘neobanks’. The industry has also been adapting to new and innovative technologies such as Artificial Intelligence (AI), the Cloud and Blockchain, that are transforming how banks interact with their customers. New challengers are not being weighed down by outdated legacy technology which makes it hard for traditional banks to bring in new processes and hampers innovation.

Leading neobanks include Monzo, Starling, Coconut, Revolut, and OakNorth. All have brands and advertising campaigns targeted principally at millennials, young professionals, entrepreneurs and tech savvy businesses. What impact is this having on the banking sector as these players become more established?

This is still a very new market. Lloyds, the oldest of the big UK banks, was founded in 1765. Monzo, the leading neobank for personal current accounts, turns five this year.

Neobanks hold less than 10 percent of the personal current account market⁷³, with Monzo accounting for around half of this⁷⁴. Monzo has become the number one bank people are switching to, gaining 20,843 customers in the final quarter of 2019⁷⁵.

Consumers could have been encouraged to switch when the banks collectively hiked interest rates on overdrafts or to benefit from higher interest rates on their savings offered by digital only current accounts – lockdown also post-Covid-19 presented another opportune moment for some to consider switching to a branchless bank. In terms of preferable savings rates, useful features to track spending, and convenience for those who have at least basic digital literacy, the neobanks are revitalising a tired market in need of a shake up and their market share looks set to increase steadily and perhaps rapidly if the big banks can’t keep up with the innovation in tech.

Beyond market share, are these neobanks likely to improve financial

72. FCA, (2016). New Bank Start-up Unit launched by the financial regulators [press release] 20 January 2016 Available at: www.fca.org.uk/news/press-releases/new-bank-start-unit-launched-financial-regulators

73. For more information see: www.statista.com/statistics/912865/leading-banks-used-for-main-current-account-in-the-united-kingdom/ [Accessed 23 May 2020].

74. Nixon, G (2019). Proof that Monzo is the winner in digital bank battle for customers? Data shows it has cut into the market share of rivals Revolut and Starling. *This is Money* [online] 04 November. Available at: www.thisismoney.co.uk/money/saving/article-7647253/Monzo-accounts-half-UK-digital-challenger-bank-market-data-finds.html [Accessed 20 April 2020].

75. Nixon, G (2020). Monzo steals Nationwide’s current account crown as the building society gains its fewest number of switchers in five years. *This is Money* [online] 30 April. Available at: www.thisismoney.co.uk/money/saving/article-8269737/Nationwide-loses-current-account-switching-crown-Monzo.html [Accessed 15 May 2020].

inclusion and support more marginalised or vulnerable customers? Of the three market leaders, only Monzo has made any significant reference to financial inclusion, launching their No Barriers to Banking campaign in 2019, but it is unclear what impact this has had to date. While Monzo holds deposits of over £2bn, it recorded losses of nearly £50m in 2019⁷⁶. It's hard to see financial inclusion being a priority - it just isn't profitable. Again, we come back to the same issue – these neobanks may well live up to their strap lines. They may offer a revolutionised banking service. They will no doubt fundamentally change how we bank, in many ways for the better. But ultimately, they will be driven by what is most profitable.

Neobanks are similar to traditional banks in that they are shareholder banks, but they are operating with very different business models to the incumbents. Neobanks are building business models “less reliant on traditional lending and therefore less exposed to low interest rates. Revenues will come from recurring fees for premium services such as insurance and stock trading, or commissions for recommending products from third-party partners”⁷⁷.

The biggest opportunity for neobanks, both in terms of building sustainable businesses that also contribute towards supporting the everyday economy, could be within the SME market. As we explored in chapter 2, fintech lenders were able to respond at speed and were under-utilised in the Covid-19 response: policymakers will make note of this.

An insurgent future?

Around 30 percent of SMEs are now holding an account with a neobank. Moreover, the significant number of small businesses that were unable to access the CBILS and BBLs from the big banks, along with the major impact that Covid-19 is having in shifting people from cash to contactless payments, may lead even more business owners to look at digital alternatives.

Some indication about the future of SME lending in a world of neobanks can be drawn from the £425m Capability and Innovation Fund that was launched in 2017, as a condition of the government buy-out of RBS in 2008, to comply with EU state aid regulation. The major beneficiaries of this were Starling who are an accredited lender for both the government loan schemes. Starling have become the fastest growing bank for SMEs in Europe and now holds a 2.6 percent share of the UK's SME banking market with almost £500m of business lending on its balance sheet, with further commitments raising the total to almost £1bn⁷⁸.

Other fintechs received smaller grants, as well as more established institutions – Metro and Nationwide. However, Nationwide returned their £50m grant which had been intended to help launch their business banking in 2020, citing the impact of Covid-19 on the SME market no longer making it a viable time to enter the market. And Metro returned £50m

76. Monzo (2019). *Monzo 2019 Annual Report* [online]. Available at: monzo.com/blog/2019/06/27/monzo-2019-annual-report [Accessed 15 May 2020].

77. Megaw, N (2019). UK's bank challengers are fading in fight with big four. *Financial Times* [online] 29 September. Available at: www.ft.com/content/77ef93ec-e100-11e9-9743-d53a370481bc [Accessed 15 May 2020].

78. Clymo, R (2020). Starling Bank boosts its support for small and medium-sized businesses. *TechRadar* [online] 28 May. Available at: www.techradar.com/uk/news/starling-bank-boosts-its-support-for-small-and-medium-sized-businesses [Accessed 03 June 2020].

that was granted to develop a more advanced business current account offerings and ancillary products for SMEs. The more specialised fintechs have clearly been able to make better use of these funds to enhance the SME market and this raises some questions about the ability of national branch-based models to grow their SME offering in the current climate.

Prior to coronavirus, the big banks had been investing billions of pounds in new or refreshed digital services to meet growing customer demand and competition from challengers. While they are playing catch-up to the likes of Monzo and Starling, partnership with fintechs enable them to keep to the pace more than their traditional banking set up. HSBCs Kinetic is currently in beta phase with plans to launch in 2020, while RBS' plans to launch a digital only bank. Both have been scrapped due to the impact of Covid-19.

Open banking and digital currencies

Innovation to support financial inclusion could be more likely to come from outside the banking sector, which is heavily regulated and costly to enter. Following a review of retail banking from the Competition and Markets Authority in 2016, a series of measures were introduced to help smaller banks overcome some of the challenges of competing with the big banks. This included Open Banking which came in to affect in January 2018 and required the biggest banks and building societies to make it possible for their customers to share their current account data with third parties. This opens up two major opportunities, it could help “customers to have more control over their financial data and potentially lead to new and better products and services for customers”⁷⁹.



Open banking is still in its infancy, but hundreds of businesses are now regulated to provide services and over one million customers have consented to share their data to use them. The Finance Innovation Lab has supported innovators such as NestEgg, who work with credit unions to improve their loan approval processes enabling more people to access affordable credit, to ensure that the benefits of open banking are realised. As well as enhancing financial inclusion, open banking will open up new opportunities for SMEs, enabling close to real-time payments with better visibility, more accurate cashflow data that can be compared against forecasts and better analytics⁸⁰. Research from PwC suggests that 64 percent of adults and 71 percent of SMEs are expected to adopt Open Banking by 2022⁸¹. While this creates new opportunities there are also significant risks to opening up financial data and enhanced government and regulatory oversight will be essential if Open Banking is to have a positive impact.

It is not just the big banks that are having to respond to innovation and competition in the market. The UK's central bank, the Bank of England,

79. The Finance Innovation Lab (2018). Briefing: Open Banking and Financial Health [online]. Available at: financeinnovationlab.org/wp-content/uploads/2018/03/Briefing-Open-Banking-and-Financial-Health.pdf [Accessed 21 May 2020].

80. Conroy, M. (2019). The benefits of Open Banking for SMEs *UK Finance* [online]. Available at: www.ukfinance.org.uk/news-and-insight/blogs/benefits-open-banking-smes [Accessed 21 May 2020].

81. PwC (2018). The future of banking is open: how to seize the Open Banking opportunity [online] PwC Available at: www.pwc.co.uk/industries/financial-services/insights/seize-open-banking-opportunity.html [Accessed 21 May 2020].

is having to consider the future of money itself. With private tech giant Facebook planning to launch their own digital currency in November 2020, central banks across the world have become concerned about the impact this could have on issues from privacy to maintaining monetary and financial stability.

In March 2020 the Bank of England published a discussion paper on Central Bank Digital Currencies (CBDC) which says:

“CBDC could provide households and businesses with a new form of central bank money and a new way to make payments. It could ensure that the public has continued access to a risk-free form of money issued by the central bank, which may be especially important in the future as cash use declines and new forms of privately issued money become more widely used in payments. CBDC could also be designed in a way that contributes to a more resilient, innovative and competitive payment system for UK households and businesses”⁸².

The design of CBDCs is something that is being considered by central banks across the world. The Bank of England’s preferred method at this stage is a platform model that ensures people can access ‘safe money’, fulfilling the central bank’s purpose of maintaining financial and monetary stability, while not hampering innovation from the private sector. CBDC could also provide a more effective system of getting money directly to people, if schemes such as UBI are considered by government in the future, or during a future crisis where a direct stimulus is required as we have seen during the Covid-19.

Stakeholder banks

There are at least four distinct models of stakeholder bank that have both social and financial objectives, and make a major contribution to financial stability, local economic development, business lending, and financial inclusion⁸³. They are:

- Cooperative banks
- Credit unions
- Community development finance institutions (CDFIs)
- Public banks

As we have seen in our research, the UK banking sector is unusual in that it is dominated by shareholder banks that prioritise profit maximisation. This is not the case in most other countries which have a much higher proportion of stakeholder banks – for example Germany has a blend of commercial, cooperative and state-owned banks while in France the cooperative banking sector is larger than the commercial sector. Similar

82. Bank of England (2020). Discussion Paper: Central Bank Digital Currencies. Opportunities, Challenges and Design [online]. Available at: www.bankofengland.co.uk/-/media/boe/files/paper/2020/central-bank-digital-currency-opportunities-challenges-and-design.pdf [Accessed 20 May 2020].

83. See also Prieg, L. Greenham, T. (2013). Op cit.

comparisons can be drawn from many countries across the world⁸⁴ and in the previous chapter we outlined the positive role these models were having in supporting businesses through Covid-19 alongside the commercial banks.

The UK has a history of stakeholder alternatives such as credit unions and CDFIs and they have played an important role in supporting some businesses through Covid-19 at the local level. But investment in such communities at scale has been limited. The industry body for responsible finance providers reported that their members had lent £16.7m to 315 small businesses and microenterprises through CBILS⁸⁵ with credit unions across the UK also offering vital support to their members outside of the government schemes.

The UK, unlike other advanced economies, currently has no public or cooperative banks in the strict sense - though there has been increasing debate in recent years about whether that needs to change and what that change might look like.

Going mutual?

Consider, the government became a major shareholder in RBS, buying a 70 percent stake as part of its bailout during the financial crisis in 2008. The government's stake has since fluctuated and now sits at 62.4 percent with the last tranche sold for £2.6bn at a significant loss to the taxpayer of over £2.1bn⁸⁶. While successive Chancellors have been keen to return RBS completely to the private sector, as has been the case with Lloyds, organisations such as the New Economics Foundation (NEF) and Positive Money have argued for major reform of RBS – taking it in to full public ownership and effectively turning it into a stakeholder bank with a regional branch network⁸⁷.

With RBS having reportedly been responsible for around a third of lending via CBILS this proposal seems attractive. The IPPR thinktank suggests that the Treasury could take advantage of a significant drop in its share price, costing around £5bn – “a drop in the ocean of the government's crisis spending”⁸⁸.

84. Ibid.

85. Responsible Finance, (2020). CBILS Update – 11th May [press release] 11 May. Available at: responsiblefinance.org.uk/2020/05/cbils-update-11th-may/ [Accessed 21 May 2020].

86. Partington, R. (2018). UK government to sell 7.7 percent stake in RBS worth almost £2.6bn. *The Guardian* [online] 04 July. Available at: www.theguardian.com/business/2018/jun/04/uk-government-to-sell-stake-in-rbs-worth-almost-26bn [Accessed 21 May 2020].

87. For more information see: neweconomics.org/uploads/files/141039750996d1298f_5km6y1s1p.pdf and positivemoney.org/2019/02/making-rbs-work-in-public-interest/

88. Berry, C. Macfarlane, L. and Nanda, S. (2020). Who Pays and Who Wins? Rentier power and the Covid crisis [online]. Available at: www.ippr.org/files/2020-05/1589291707_who-wins-and-who-pays-may20.pdf [Accessed 01 June 2020].

There have been other proposals. In the 2019 General Election the Labour Party made the case developing a Post Bank, utilising the strong brand and branch network of the Post Office to enable local economies to maintain a physical branch network across the UK⁸⁹. While there is certainly a strong case for utilising the Post Office's existing branch network to enhance banking access, particularly in communities that no longer have a bank branch presence – we argue that there are some major concerns with these proposals. Post Office branches are not well designed to deal with all banking transactions. While proposals include enhancing facilities for small businesses, they would not offer business banking accounts. Finally, the proposals would require a £2.5bn of capitalisation from HM Treasury⁹⁰ – in the post-Covid-19 climate it will be hard to build consensus for an expensive project that does little to support small businesses growth.

At the outset of this programme of work in 2017, the RSA's Inclusive Growth Commission led by economist Stephanie Flanders suggested another idea. It submitted the case that regional banks adapted to the UK market could be both commercially viable as well as drive inclusive growth⁹¹. Of these three models – full public ownership of RBS, Post Bank, and local cooperative banks, it argued that the latter would deliver the most bang for buck. Rather than investing further in a large state-owned bank, a network of locally rooted and independent stakeholder banks would be better placed to support individuals and businesses whose needs are not currently being met by traditional banks and emerging neobanks.

That idea – and that alternative – formed the seed of what emerged next: a genuine movement for stakeholder, regional community banking in the UK whose birth is recounted in the next chapter.

89. Berry, C. and Macfarlane, L. (2019). A New Public Banking Ecosystem [online]. Available at: labour.org.uk/wp-content/uploads/2019/03/Building-a-new-public-banking-ecosystem.pdf [Accessed 01 June 2020].

90. Ibid.

91. RSA (2020). Inclusive Growth Commission: Making our economy work for everyone [online]. Available at: www.thersa.org/discover/publications-and-articles/reports/final-report-of-the-inclusive-growth-commission [Accessed 10 June 2020].

Chapter 4: Birthing community banks

To recap: throughout Europe, regional or community stakeholder banks – whether publicly owned such as Sparkassen in Germany or cooperative models including JAK Medlemsbank in Sweden - provide an alternative that make up a significant proportion of the banking sector.

Box 10: Characteristics of regional stakeholder banks

Regional banks **serve a specific geographic area**, focusing on retail banking. Models that most effectively support the everyday economy generally have three additional defining characteristics:

1. **Mission led:** they will have a dual social and financial mission either written into the constitution of the bank, as with German savings banks, or by virtue of being customer-owned, as with cooperative banks and credit unions worldwide.
2. **Commercially rigorous:** whether classified as mission-led businesses or social enterprises, regional banks lend on a commercial basis. However, with the benefit of additional 'soft information' they can successfully lend to a wider range of businesses that might otherwise lose out on the basis of centralised credit scoring adopted by the major banks.
3. **Network collaboration:** they collaborate to share costs where possible to achieve economies of scale while retaining their regional autonomy in order to protect their mission⁹².

These regional or community stakeholder banks complement the presence of large national and global shareholder banks by pursuing a different business model and brings social and economic benefits, regionally and nationally, in four main ways:

1. The **resilience of the overall financial system** is improved by the diversity provided by regional mission-led banks. After the financial crisis large banks in many countries shrunk credit provision to repair their balance sheets. In contrast, regional banks steadily increased credit to households and SMEs providing a cushioning effect for regional economies in those countries compared with the UK, which lacks any significant local banking sector. Building societies do not play this role because they are restricted to residential mortgages.

92. Ibid.

"There are several strategies that can be pursued in the UK to improve regional financial systems, many of which are complementary to each other. However, regional community or stakeholder banks are the only vehicle that can provide payment services as well as the ability to recycle local savings deposits to fund credit in the regional economy".

2. The **quality of credit allocation** improves as a result of superior access to the soft information required for more marginal lending decisions. The breadth, depth and quality of hard data – which can be quantified in a consistent, comparable and accurate manner – is improving all the time with the use of big data and artificial intelligence. However, it cannot replace the soft information from knowledge of local economies that is captured by good relationship managers based close to the customer. SMEs and social enterprises are affected the most because they are more difficult to collect hard information on at a distance, and often have poorer collateral, requiring credit officers to place greater reliance on judgements on future cash flows.
3. Regional banks usually have a commitment to **financial inclusion**, often specifically guaranteeing universal access to banking facilities on equal terms to all citizens in the region. Over one million adults in the UK still lack a full bank account and around 3.2 million people are in severe problem debt⁹³. This creates barriers to participation in the economy as we are increasing the harm caused by high cost credit and problem debt, which have been exacerbated during Covid-19.
4. The presence of a head office with all the attendant functions of C-suite executives, non-executive directors, and highly qualified professional staff across all business functions from IT to marketing adds an **important route for local career progression** as an alternative to migrating to London.

There are several strategies that can be pursued in the UK to improve regional financial systems, many of which are complementary to each other. However, regional community or stakeholder banks are the only vehicle that can provide payment services as well as the ability to recycle local savings deposits to fund credit in the regional economy⁹⁴.

That, more or less, was the proposition. Regional or community stakeholder banks, in theory, offer vehicles that speak positively to the consumer, business and also the democratic functions of banks – and that helps to mitigate the structural and systemic problems identified in our research, roundtables and system analysis to date.

But how to test a proposition about an untried layer of financial services designed to compete with some of the biggest institutions in the world for real, on the ground? As we progressed through this process we realised that this project could not be theoretical, or a manifesto for new businesses - there are plenty of those. Rather, we needed to think and act entrepreneurially – and stress-test the theory through convening, influence and action.

So, we did. The rest of this chapter tells the story of how we are doing this, and how the RSA and our 30,000-strong global Fellowship has played a crucial role in setting the foundations for a new layer of local banks in the UK.

93. For more information see: www.stepchange.org/policy-and-research/debt-research/post-covid-personal-debt.aspx

94. RSA (2020). Op cit.

Please note that at the time of writing, the organisations we discuss in this report are at varying stages of the process of attaining regulatory approval, and so we offer this work, not as financial advice but as reflections on social change.

Before we explore the progress in the UK let's first look at a more in-depth case study of the well-established community banking sector in the US.

Box 11: The US community banking experience

The 5,000 community banks present in the US are higher in number than banks of any size in any country in the world⁹⁵. While the number of US community banks has declined in recent years, due in part to bank mergers and the increased regulatory costs for smaller banks, they represent 97 percent of the banks operating in the US and are a key part of the US economy. This is because community banks, along with credit unions, still perform incredibly important functions in the many underserved parts of the US. This is specifically the case in terms of rural areas and underserved urban areas. Community banks are also primarily headquartered in counties with a population of under 50,000, “where they play a critical role in providing credit, liquidity and investments to these communities”⁹⁶.

While community banks outnumber commercial banks, it should be noted that the big banks still hold the vast majority of all banking industry assets (85 percent), with the top four banks holding 50 percent of those large bank assets⁹⁷.

Community banks and credit unions play a particular role in times of crisis. While after the 2008 financial crisis loans to small businesses declined steeply at big banks, small business lending grew relatively faster in community banks. Counties with a higher market share of community banks also faced fewer negative impacts following the crisis “on aggregate flow of small business credit; and the impacts on interest rates, business expansion, employment, and wages were more muted and rebounded more quickly during the recovery”⁹⁸.

Community banks and credit unions have proved to be a fundamental source of stability for small businesses and individuals early on in the Covid-19 crisis. A good example of this has been the administration of the Paycheck Protection Program (PPP) from the Small Business Administration (SBA). At the end of the first round of funding, 1.66 million loans, for the value of \$300bn, had been approved. Approximately 60 percent of these were made by community banks⁹⁹; 74 percent of these loans were for under \$150,000, seemingly cementing the beneficial relationship between small banks and small businesses. The relationship banking model has been credited as the central feature that made community banks particularly well positioned to service these clients in the crisis¹⁰⁰.



95. For more information see: www.americanbanker.com/opinion/how-to-keep-community-banks-thriving

96. For more information see: www.bankingstrategist.com/community-banks-number-by-state-and-asset-size

97. *ibid*

98. For more information see: ssti.org/blog/community-banks-driving-small-business-formation-growth

99. For more information see: www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/statement-secretary-steven-t-mnuchin-and-administrator-jovita-carranza-success-paycheck-protection

100. For more information see: www.forbes.com/sites/franksorrentino/2020/04/24/community-banks-play-critical-role-in-helping-americas-small-businesses-get-back-to-business/#6ed2a51d14af

Think like a system, act like an entrepreneur: community banks as local investment platforms

"For some time, the RSA's overarching concern has been impact. Our core idea of thinking like a system and acting like an entrepreneur emphasises the contingent nature of change and encourages policymakers (and practitioners) to ask not only what they think needs to be done, but what might be possible in any specific context".

– Matthew Taylor, CEO, the RSA

How to turn a compelling case into practical action? Today's social challenges, such as the failure of our banking sector to adequately serve the everyday economy are complex and interconnected. The injunction, think like a system, compelled us to see the bigger picture; unpack the banking challenge through an understanding of its systemic conditions – and it also laid the foundations for solutions that have real-world impact.

Pivoting to act entrepreneurially and so achieve impact at scale, is the next move in the sequence. We aimed to create iterative responses to the power dynamics at play in the system, understanding where there was resistance to change, and where there was energy for it. Following and harnessing that energy, acting like an entrepreneur, requires an agile approach that encourages testing and learning to develop solutions.

This means we need perspectives. There are three perspectives mentioned at the top of this report, that of consumer, business and democratic/civic in terms of the purposes of banks. We also leaned into international perspectives and ideas, informed our colleagues in RSA US and RSA Oceania that sought to surface differing community perspectives on ways to overcome regional inequalities and level-up localities, such as promoting financial inclusion and inclusive growth.

All over the world, the RSA engages Fellows and other members of local communities in the question of what an inclusive economy actually looks and feels like for real. It was important to understand how this work meshes with perspectives from other organisations and praxis traditions. In pivoting from making a theoretical case to a practical case for a new layer of banks, we wanted to incorporate all of the various paradigms currently in play. The following schematic captures some of those reflections:

Paradigm	Mission statement The way to achieve an inclusive economy is...	Policy Example	Role of Financial Services	Political nuance
'New Big Bang'	... by lowering taxes and encouraging the benefits to trickle down to - and raise - all	Freeports, tax free zones	Invest in high growth enterprises and lobby for facilitative tax regimes	Right-laissez faire
Financial Inclusion	...by targetting marginalised, underserved groups and bring them into the mainstream	Microfinance	Bring marginalised groups into the banking, asset building system	Centre-social democratic
Inclusive Growth	...by co-creating growth strategies that reflect the perspectives of the whole community and share proceeds according to a similarly broad range of social concerns	Deliberative budgeting	To provide capital for growth; to mitigate negative externalities; to facilitate economic expansion	Centre-left-social democratic
Community Wealth	...by redistributing power, taking economic agency away from multinationals and other extractive forces and creating a locally-owned and people-powered economic model	Anchor institutions supporting co-operative development; local wealth funds	To provide communities with additional base of power through mutual banking institutions – and to provide risk capital for locally-focussed initiatives	Centre-left – democratic socialist
Just Transition	...by directing all institutions in society to the end	Wide-ranging Green New Deal	Support overarching vision in pursuit of green and clean economic aims	Left-centre

Figure 7: Five parts of an inclusive economy (RSA summary), duplicate of Figure 2

Applying these ideas to community banking in more detail in order to pivot into practice:

- **A truly free market/‘new big bang’:** community banks are businesses and they compete for business in local communities. At a base level, they diversify and make the market ‘freer’. If you are pro-choice in financial services, you are for community banks.
- **Financially inclusive:** community banks have a financially inclusive heart. Where larger banks flee from local communities, community banks bringing the unbanked and those underserved back into financial services. Those who are marginalised and those groups who are excluded find a provider hungry to serve them in community banks.
- **Inclusive growth:** community banks can act as local catalysts for change. Their managers are specifically armed with local knowledge of the community, they are hungry to learn more about their customers and eschew one-size-fits all legacy bank systems. Thus, they are potentially able to mitigate the small business lending bottleneck and the further marginalisation of the most vulnerable.
- **Community wealth-building:** community banks, mutually owned, focusing on local, sustainable economies, are creatures of a bottom-up, generative vision of local economies that resists extractive practices. They are a key tenet of the community wealth building approach expounded by our friends Ted Howard and his organisation The Democracy Collaborative in the US, and others. Community banks can reach out to key asset and anchor institutions, community foundations and others, support cooperatives, be an anchor for change themselves. Financing community wealth building and genuinely transferring power from the centre means supporting the local asset building and investment platform that is created by the presence of community banks.
- **Just Transition:** in the fight against climate change and transitioning to clean, green jobs, locally owned community banks can support projects and purposes and be enjoined in great movements for change as part of a local community, not simply as a player in those communities, but as part of local, sustainable movements for change.



The overall takeaway of this outreach and development work could be summarised as follows:

If you wish to build inclusive economies, you need community banks.

Push what moves, working with our connections: the Community Savings Bank Association

Acting entrepreneurially is not just about abstract design: it means working with the field. There are many others making the case for local stakeholder banks. Part of the entrepreneurial approach to system change is to work with the grain and ‘push what moves.’ The pivot from making the policy case for regional stakeholder banks to practical implementation necessarily involved partnership; in this case a cornerstone partnership with a body called the Community Savings Bank Association.

The CSBA was established in 2015 by **James Moore FRSA**. Their model aimed to make it easier, simpler, less risky, quicker and cheaper for each region to setup its own independent, customer owned bank. This included:

- The legal form and constitutional documents for establishing a customer owned bank
- The development of a template banking license application pack
- Initial design of products, branches, online portals, payment systems infrastructure and IT systems of a low-cost retail bank
- Building a pilot bank to test, prove and refine all the elements of these banks before going live with customers

Partnership agreements with key technology suppliers, financial and legal advisors were part of the offer.¹⁰¹ Ideas for new banks emerged through vibrant design and ideas sessions.

Box 12: Potential form and functions of community banks

Community banks can offer a full range of retail banking products and services and part of the design process saw considerable debate about this. Some of the features of a community bank in the UK might include:

- Local branch network with combination of main bank branches and smaller satellite branches, including innovative use of public space to provide services, ATMs etc (eg old phone booths).
- Branch director with local knowledge and lending authority to seek out ‘difficult but deserving’ customers.
- Smaller and longer-term loans for small businesses than those offered by incumbent banks.
- Mortgages, including guarantor-backed mortgages for first-time buyers.
- Real time accounting which means that payments will not be authorised if the account has insufficient funds, no unauthorised overdrafts will be levied, and balance inquiries will always be accurate.
- Jam-jar accounting which is specially designed to enable customers to divide money into different ‘jars’ within a single account. This enables an agreed amount to be set aside for essential bills as soon as it becomes available in the account and help with budgeting.

Some of these ideas would fall away over time and others would emerge to meet the local requirements or to respond to market needs. This experimentation continues to be an exciting part of the realisation process.

¹⁰¹. CSBA (2020). About Us [online]. Available at: www.csba.co.uk/about-us/ [Accessed 10 June 2020].

As well as depth, the movement acquired breadth. RSA Fellows and others in many parts of the UK joined the call to co-create. Bankers, economists, movement builders, project managers, researchers and many more from the RSA's networks and beyond, have been involved.

The skills and experience needed to build new banks are diverse. Here are some of the stories.



Mark Hooper FRSA is one of the founders of Banc Cambria – which aims to be a mutually owned community bank for Wales. Mark joined the RSA in 2016 and his work with indycube, a cooperative co-working space that supports freelancers to reduce vulnerability and insecurity, is an RSA Future of Work Award Winner and participant in the RSA Economic Security Accelerator in 2019.

Mark helped build an initial team to drive Banc Cambria forward and they are in regular contact with Welsh government who committed to supporting a public bank in their 2019 manifesto. Wales has been one of the places hardest hit by branch closures in the UK and Mark has been busy travelling around the country meeting with communities such as Buckley, a border town in the north east, that has lost their last bank branch. They have been using their Twitter platform to communicate with potential members and have gathered nearly 1,000 responses to help shape the bank's vision and values. The challenge for Banc Cambria is to get to a licenced operation as soon as they can; the need in communities such as Buckley is pressing. Banc Cambria hope to share an outline timetable to launch during the summer.

Gemma Bone Dodds FRSA joined the RSA as a Fellow in 2019 and has been working to kick-start the process for a community bank for the north east. The RSA co-published her report, *A bank for the north east*, that calls on public bodies in the north east to fund initial research needed to build a comprehensive picture of the north east banking landscape¹⁰². The report was launched at an event in Newcastle and Gemma also delivered a workshop at the People's Powerhouse Convention in Sunderland in 2019.

Proposals for a community bank for the north east have gained interest from Jamie Driscoll, Mayor of the north of Tyne, who committed to setting up a bank for the region in his 2019 election manifesto¹⁰³.

Jules Peck FRSA is the founder of Avon Mutual which is currently applying for a banking licence to build a community bank covering Bristol, Bath, Gloucestershire, Wiltshire, and North Somerset. Having established Avon Mutual in 2017 following an event convened by NEF and the RSA in Bristol, the first priority for Jules was to get out across the region and start to build a movement.

102. Bone Dodds, G. (2019). *A Bank for the North East* [online]. Available at: allin.agency/resources/ABankForTheNorthEast.pdf [Accessed 10 June 2020].

103. For more information see: www.jd4mayor.com/blog/a-peoples-bank-explained/

"The RSA has, in concert with Fellows, convened countless events across the UK to explore the idea of community banking, utilising the RSA's Fellowship networks and pooling the community's knowledge, expertise, and resources to take the movement forward at a local level".

In partnership with the RSA, Avon Mutual ran a series of events covering every corner of their region, it attracted a broad range of stakeholders with key representatives from local authorities, including Marvin Rees, the Mayor of Bristol, who has gone on to be an invaluable partner of Avon Mutual. Other attendees included Local Enterprise Partnerships, other incumbent and challenger banks and building societies, credit unions, local community groups and foundations.

Avon now has a team of 14 including a board with significant banking experience. Many of the local authorities that first heard about Avon through the initial round of events have become investors, supporters, co-operators and other key partnerships have been developed. Avon Mutual sees itself very much as part of the community wealth building movement, Jules explains:

"We aim to become a key anchor institution supporting the growth of other community wealth building institutions and focused on promoting sustainable and inclusive prosperity for our region".

Avon have now raised over £1m in capital and are working with their funders on due diligence for the subsequent rounds of investment. They have submitted their regulatory business plan to the regulators and hope to secure a provisional licence in 2021 and a full public launch in 2022.

Opening the debate

Advocacy, lobbying and debate were crucial to making change possible. After the 2008 financial crisis came the introduction of the Cooperative and Community Benefit Societies Act 2014¹⁰⁴ which made it legally possible to establish local cooperative banks in the UK. In a sense this piece of advocacy was the root of the work that followed, and the advocacy did not end there.

The RSA has, in concert with Fellows, convened countless events across the UK to explore the idea of community banking, utilising the RSA's Fellowship networks and pooling the community's knowledge, expertise, and resources to take the movement forward at a local level – including with The Rt Hon Baroness Kramer, the legislation's early sponsor. At an event the RSA hosted with Bristol Council in January 2019, Conrad Hall (at that time, Chief Finance Officer at Brent Council), highlighted research showing "that residents without a bank account pay a 'poverty premium' of £500 on average, simply because they cannot access the best deals for ordinary services like utilities, as they are unable to pay by direct debit". In more extreme cases he explained "residents may also be forced to rely on expensive payday loans, or worse, due to lack of access to affordable credit."¹⁰⁵ Following rich debate and discussion, Deputy Mayor of Bristol, Cllr Craig Cheney, concluded:

"This is a huge and exciting opportunity to bring a whole new model of banking to the UK".

104. Co-operative and Community Benefit Societies Act 2014 c. 14. London: HMSO. Available at: www.legislation.gov.uk/ukpga/2014/14/contents

105. Hall, C. (2019). Could local banks help tackle financial inclusion and support small businesses [online]. Available at: www.thersa.org/discover/publications-and-articles/rsa-blogs/2019/06/could-local-banks-help-tackle-financial-exclusion-and-support-small-business [Accessed 03 June 2020].

The RSA also platformed a wide-ranging series of thought leadership interventions to raise the profile of this work. Jules Peck explained in a 2018 article:

“As the investment function in national and local economies is so key and influences the character of the rest of the economy, one crucial player in the institutional landscape of all successful examples of community wealth building is a community bank, which along with other Community Development Finance Institutions, plays an important role in shifting power away from capital, to citizens”¹⁰⁶.

As well as adding to the debate on the future of cash and bank branches, our previous report in this series, *Cashing Out*¹⁰⁷, was influential in spreading the case for stakeholder banks on the ground.

Shortly after the RSA presented the findings of this report to the Financial Conduct Authority, Chairman, Charles Randell, remarked that alternative models such as community banks might help ease the impact of the reduction in bank branches at a speech to the Retail Banking Conference¹⁰⁸.

“If the banking sector is currently providing a service to a community through branches that we want to maintain, who should pay for this when the last bank in town wants to close its branch?... Are there other models, such as shared branches, community banks, credit unions or local authority supported banking centres which can help to ease the impact of the reduction in bank branches?”

The report was also referenced in the Treasury Committee’s Consumers’ Access to Financial Services inquiry in May 2019¹⁰⁹. Over the summer we met with the Archbishop of Canterbury’s advisors and the Just Finance Foundation at Lambeth Palace which led to them calling on the government to invest in community banks in their report, *More than Just Credit*¹¹⁰.

106. Peck, J. (2018). Building Community Wealth in the Banking Sector [online]. Available at: www.thersa.org/discover/publications-and-articles/rsa-blogs/2017/10/building-community-wealth-in-the-banking-sector [Accessed 03 June 2020].

107. Greenham, T. and Travers-Smith, F. (2019). Op cit.

108. Randall, C. (2019). Is it a Wonderful Life? [online]. Available at: www.fca.org.uk/news/speeches/is-it-a-wonderful-life [Accessed 03 June 2020].

109. HM Treasury (2019). Consumers’ Access to Financial Services inquiry [online]. Available at: www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries/parliament-2017/consumers-access-to-financial-services-17-19/ [Accessed 03 June 2020].

110. Just Finance Foundation (2019). More than Just Credit? [online]. Available at: www.justfinancefoundation.org.uk/credit-union-report [Accessed 15 May 2020].

This research was cited from the Scottish Highlands to south west England. In December 2019 First Minister of Wales, Mark Drakeford, announced his intention to support the Banc Cambria during First Minister's Questions at the Welsh Assembly¹¹¹, where the RSA's work is regularly referenced in discussion and debate. Indeed, we support and welcome calls made at the 2019 General Election, for the British Business Bank in to become national development bank with a remit to support the development of a cooperative banking sector¹¹².

Building banks: progress at the time of writing

The above is a series of snapshots of long-ranging activity, still in progress. It begins to articulate how a case for change became a movement for change, on the ground. We have high hopes for the banks' future but at the same time we must recognise that these banks are businesses. As with all start-ups, these aspiring banks will have to adapt to the challenges presented by Covid-19 and the new world which lies ahead.

Here is where we are now. As of June 2020, there have been six organisations registered with the FCA that have started the process of establishing an independent regional community bank. They are located in London¹¹³, Greater Manchester, the west, south west, north west of England and in Wales.

We are proud of the progress made in developing this nascent layer of one of our most entrenched and important industries. RSA Fellows have been at the heart of this movement, establishing these new organisations, building skilled and experienced teams, developing business plans, building relationships with local authorities and other key stakeholders across their regions.

There is still much work to be done before each of these organisations can open their doors as a licenced bank. But, as with many important innovations of the past 260 years, the RSA will continue to nurture in debate and in practice their birth in line with our values, and we encourage others to step into this space and engage. In line with this, we turn next to our final chapter, recommendations for the future that flow from this work, and from the story of regional or community stakeholder banks to date.

111. For more information see: www.bbc.co.uk/iplayer/episode/m000c25t/welsh-first-ministers-questions-03122019 [Accessed 15 May 2020. Expires November 2020.]

112. Berry, C. and Macfarlane, L. (2019). Op cit.

113. Note: Greater London Mutual has withdrawn its application for a banking licence and ceased operations.

Chapter 5: Levelling-up through community banking - recommendations

What does it mean to reform financial services? How do we build local inclusive economies in practice? How do we level-up and overcome our regional inequalities? This paper has explored these issues. It has explained some of the fundamental issues caused by the lack of diversity in the UK's banking sector. It has explored how stakeholder institutions, such as our emerging network of regional community banks may be better designed to support small businesses and marginalised individuals. And it has considered in part how the growing fintech sector and new regulation such as open banking will alter the future landscape of the UK banking industry, and how we might support more functional and inclusive local economies thereby. It has, we hope, also told a story of changing, happening for real on the ground.

In this final chapter, then, we alight on some recommendations to take this work forward.

Purpose

We started with purpose – the purpose of financial services and their systems; why purpose affects practice. We agree with RSA Fellows David Pitt-Watson and Dr Harinder Mann who argue that we require a **purpose-driven transformation** of financial services, from the bottom up. We need to be explicit about the role of financial services in society and surface the tensions that exist within the system.

Financial purpose is not widely understood. In line with our vision for a more democratic and civic minded financial industry we contend that the conversation about purpose must begin with people. We need to surface stories of where financial services are failing ordinary people and businesses. We need to co-create the financial services architecture of our localities, together.

The RSA previously held the Citizens' Economic Council, a national roadshow on what a good economy looks that surfaced post-crash tensions in our economy. We propose a follow up: a **Citizens' Council on Financial Purpose** – a series of deliberative events aimed at developing a new shared vision of what a productive and purposeful financial sector that serves people and places might look like. This would also enable the performance of the industry as a whole and individual institutions (such

as banks) to be measured by civil society against deliberately agreed purposes. This council should form the starting point for a broader action-research agenda in this space¹¹⁴.

There are further touchpoints that we should lever in aid of this aim. For example, we should **review how business schools teach finance**, so that they explicitly cover financial purpose and lean further into their civic and democratic responsibilities, as well as review codes of conduct and practice for financial services operatives such as asset managers. The goal is to imbue purpose at every level of the value chain and legislative review may also be part of this. Corporate social responsibility and shared value networks – often maligned - should be enjoined as part of this industry wide effort. Further action-research to unlock more touchpoints and bring key players together to make practical change happen should flow from this work.

Small businesses and community banking: LIFT funds

Community stakeholder banking is an exciting tool for local economic development. We urge further support for this nascent movement. This begins with a recognition of the potential systemic importance of community banks from the Bank of England itself.

We urge the Bank of England to consider creating an endowment fund to capitalise the community stakeholder banking layer: we call it the Local or Levelling-up Investment and Finance Trust (LIFT). Communities face devastation in any U- or L- shaped recovery and there needs to be radical thinking if many areas aren't to become finance deserts.

The LIFT Fund is an endowment fund from the Bank of England for community banks that supports the long-term resilience of the financial system. It could be organised in the form of bond purchases or deposits. Further capitalisation from dormant account assets and from the proceeds various banking infarctions, could assist the flow of capital. Local authorities would be encouraged to apply for and hold local LIFT funds to support burgeoning community banks and banking driven by social entrepreneurs and movements in their area; ultimately they, and also key institutions such as public 'ed and med' anchors, would be encouraged to do business with these local institutions and build the market for their offer.

Already this gives the levelling up agenda teeth and offers a genuine, institutional legacy solution to turbo-charge the agenda.

Part of the purpose of community banking is to act as an anchor, to enable new kinds of conversation to take place in the local economy. Local government should seek to host conversations on their investment needs with Local Enterprise Partnerships (LEPs), commercial banks, CDFIs, credit unions, charitable funds (including philanthropic grant-giving), major funders and impact investors in order to agree principles of investment for community financial support and to share best practice – as well as to nurture the development of their stakeholder banking infrastructure. Such meetings might take the form of LIFT boards that also offer some oversight of flow of public and private money, with responsibilities to account, release appropriate data and report.

¹¹⁴. For more information see: www.pensioncorporation.com/media/100020/the-purpose-of-finance-report-2017.pdf

Immediate actions

There are also things that councils can do right now. Local government has an interest in supporting the development of local community banking initiatives such as South West Mutual, Avon Mutual and Banc Cambria and consider their role in creating **genuinely local investment and asset platforms**. Councils might consider immediately:

- Investing in shares in their regional bank
- Partnerships to jointly serve vulnerable communities
- Co-location of branch facilities

Central government should also consider other ways, aside from the local LIFT schemes that they **might support the development of a local banking sector across the UK** in support of its levelling up strategy including:

- Providing match-funding for local authority investors mutual banks
- Allowing shares in mutual banks to be eligible for Enterprise Investment Scheme allowance and/or other tax reliefs that are designed to stimulate enterprise and social impact investment
- Aligning accounting and treasury guidance to local authorities to unlock investment, including preferential rates from the PWLB used for that purpose

Central government, the FCA and other relevant stakeholders should review and look to **remove the current barriers to regional banks co-operating in networks** created by UK competition law, as is the case in Germany (and elsewhere throughout Europe) where regional banks are able to collaborate and benefit from economies of scale.

Even without community banks we can begin this work now. At an RSA roundtable of key finance experts in May 2020 it was recommended that we need an independent **review into diversifying local investment and lending models** and an entrepreneurial approach to making this happen. Commercial banks should be part of this work. As we have seen, too often investments are soaked up by ‘oven ready’ ideas; local money is sent out of the door, triaged by the ‘usual’ client providers. A review into more collaborative approaches and further research into what works is a good idea, and we would urge this review to have prototyping and practical action at its heart. Let us build relationships between local councils, foundations and business networks: genuine platforms for locally granular investment, and make the case for further such structures where necessary.

Post-crisis

We note also that there will need to be immediate action in relation to outlining the process of deciding which companies to back and which to let go when it comes to repaying government endorsed loans. The question of who decides what and when repayment is due is considerable: local knowledge of a kind that generally eludes the major banks will be key.

We urge this work be conducted in conjunction with new community banking institutions as they emerge and surface – and in concert with movements on the ground developing these structures where they do not yet exist.

The British Business Bank

We also need to review the British Business Bank. In terms of assessing the work of the British Business Bank and other triaging structures for the purpose of this review, we agree with welcome calls made at the 2019 General Election for the British Business Bank to become a major player with a remit to support the development of community stakeholder banking - a central strategic function in concert with the Bank of England - and we would add strategically overseeing the financing of community wealth building approaches more broadly to this remit¹¹⁵.

In the meantime, we urge the highest standards of open data and transparency in releasing economic data in this area, especially in the take up of post-Covid-19 schemes, which alas has not always been the case until now.

Marginalised, elderly, vulnerable

Community banks should be **anchor institutions of the future**: governments central and local could work with them and, together, leverage their potential to support not only businesses but also individuals and drive real change. Yet while they surface, in order to meet urgent need, there is still much that localities and central government can do.

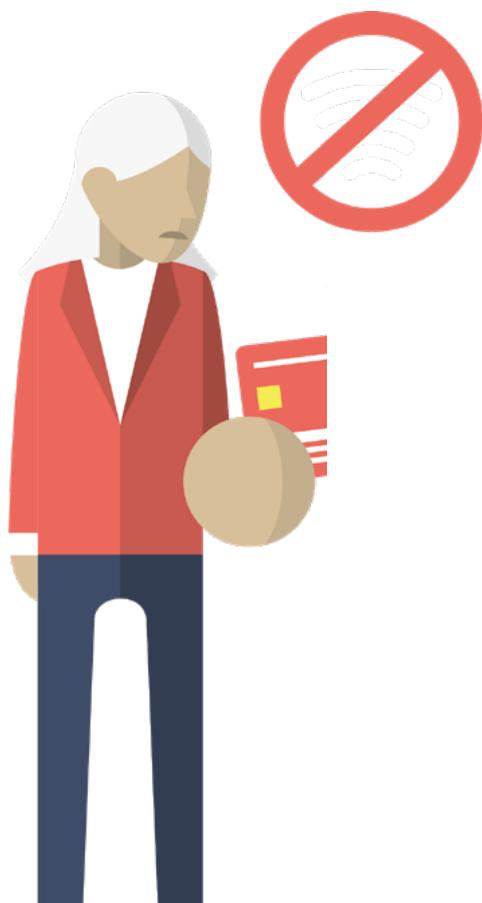
We need to recognise the growing problems of the unbanked and underserved and bring them back into financial services. As such, we urge the government to introduce already-announced legislation to protect free access to cash. This will ensure that all consumers are able to access the cash that they need to pay for goods and services for as long as it is needed, reducing the risk of financial exclusion for those with no option to go online.

The government must also take all necessary steps to ensure people can continue to pay with cash for essential goods and services during the coronavirus pandemic. This includes providing support to businesses to be able to accept cash, offering clear guidance on how to handle banknotes and coins safely. This will ensure that no one is left unable to pay for the essential items they need throughout the duration of the pandemic.

The FCA should collect and publish information about emergency measures that individual banks have put in place, including an assessment of their long-term viability and effectiveness. The FCA should work with consumer groups and industry to ensure that people are aware of the options currently available to them. This will support development of durable industry-wide initiatives to ensure a consistent level of support for customers who risk being left behind.

Many of these proposals are championed also by UK consumer group Which? who have unparalleled insight into the issues facing consumers on the ground.

115. Berry, C. and Macfarlane, L. (2019). Op cit.





Longer-term, the government should also maintain their budget 2020 commitment to **protect access to cash so that phasing out, where appropriate, is done in a socially just way.** To make this viable the government should work with the industry and communities to **reduce the cost of circulating cash in our economy (currently approx. £5bn per annum) by at least 50 percent.** Crucial to this will be finding ways to recirculate cash within local economies, such as **legislating to enable more local businesses to offer cash-back services.** Other ideas surfaced through the Community Access to Cash Pilots initiative should be considered for adoption at scale with consultation and support from the banks, regulators, and central and local government.

There is no point protecting access to cash if retailers stop accepting it and so the government should **work closely with the retail sector, bringing in key stakeholders such as the Industrial Strategy Council, to ensure cash is withdrawn in a way that leaves no one behind.**

Finally, in terms of protecting branches, banks outside the stakeholder regional community banking network might consider working together with local authorities to offer **shared banking hubs** to ensure communities maintain bank branch provision. This could be underpinned by LINK technology which is already a fundamental part of the UK's payments infrastructure.

The future beyond

We need to get serious about futureproofing our financial services and moving beyond frustrating legacy systems of banks. There should be **clear guidance to banks on supporting customers set up online and telephone banking** and ensuring the necessary support is available for this, building on schemes brought in during the Covid-19 crisis.

In the short-term, **more fintech banks should become approved lenders of CBILS / BBLS** and the level of capital allocated to them from the government guarantee should be increased so they can increase lending to small and micro businesses.

The government must, furthermore, **protect the innovation in fintech that will be vital for the UK's recovery efforts.**

Longer-term, the government should work with the FCA and the banking sector to **ensure a digital transition strategy** is developed alongside the measures to protect cash that were announced in the budget.

A plank of this should be a **Central Bank Digital Currency**, which will remove the private monopoly from digital money¹¹⁶.

As the use of cash declines it is essential that one dominant digital currency does not emerge as a monopoly, eroding competition and privacy. The Bank of England should develop a Central Bank Digital Currency. The design of CBDCs is vital, something that is being considered by central banks across the world. The Bank of England's preferred method at this stage is a platform model that ensures people can access 'safe money', fulfilling the central bank's purpose of maintaining financial and monetary stability, while not hampering innovation from the private sector. Yet the possibilities are endless. CBDC could also provide a more effective system of getting money directly to people, if schemes such as UBI are considered by government in the future, or during a future crisis where a direct stimulus is required as we have seen during the Covid-19.

¹¹⁶. Bank of England (2020). Op cit.

This is precisely the sort of issue that should be put to **public deliberation events on central bank digital currencies**.

Open Banking and Open Finance presents a huge opportunity to give people more control over their financial data and drive digital innovation, so products work better for customers. However, more innovation is needed to maximise the opportunity. **A social investment fund should be introduced** to support the development of new products that benefit citizens and should be seeded by a wholesale institution such as Big Society Capital with a line into government. Government should encourage a widespread conversation about this, compelling Big Society Capital, thinktanks and other policy bodies to make recommendations on how open banking/finance regulation can best support society.

Finally, we need to get serious on bridging the digital divide that risks becoming mass disenfranchisement when applied to digital money. The government will need to deliver on their pledge to **ensure all homes and businesses can access full fibre broadband by 2025**, prioritising the 20 percent of rural premises that are hardest to reach. And work should start now with broadband providers' and local authorities' help to connect those who have no online access.

The RSA (Royal Society for the encouragement of Arts, Manufactures and Commerce) believes in a world where everyone is able to participate in creating a better future. Through our ideas, research and a 30,000 strong Fellowship we are a global community of proactive problem solvers. Uniting people and ideas to resolve the challenges of our time.



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