Briefing for the Backbench Business Committee debate: Royal Bank of Scotland and the future of British banking

1.1 RBS: government shareholding

A list of the government market holdings in RBS (pre disposal programme) is shown below:

Government shareholding in Royal Bank of Scotland

		Shares	Total investment	Investment per share	Value at 31 March 2015
		millions	*£millions*	*pence*	*£millions*
Initial recapitalisation	Dec-08	**2,285**	**14,969**	**655**	**7,770**
Preference share conversion	Apr-09	**1,679**	**5,058**	**318**	**5,709**
APS B shares	Dec-09	**5,100**	**25,500**	**500**	**17,340**
Total investment		**9,064**	**45,527**	**502 (avg)**	**28,191**
Fees received			***305***		
Total net investment		**9,064**	**45,222**	**499 (avg)**	
APS exit fee			***2,504***		
Initial DAS Retirement Dividend			***320***		
Final DAS Retirement Dividend			***1,280***		
Total investment net of all fees & dividend:		**9,064**	**39,938**	**441 (avg)**	

Source: UKFI Annual Report 2014/15; Library calculations

UKFI press release 17 September 2013

UKFI press release 26 March 2014

At the Mansion House Speech in June 2015 the Chancellor announced the Government's intention to dispose of its shareholding in RBS, even if it produced a loss in regards of the value of shares sold:

> I was not responsible for the bailout of RBS or the price paid then for shares bought by the taxpayer: but I am responsible for getting the best deal now for the taxpayer and doing whatever I can to support the British economy.
>
> There is no doubt that starting to sell the government's stake in RBS is the right thing to do on both counts.
>
> That is not just my judgement – it is the judgement of the Governor of the Bank of England, whose views I sought and whose letter to me on the issue we publish today.
>
> In the Governor's words: "it is in the public interest for the government to begin now to return RBS to private ownership".[1]

RBS's share price rose by six pence in the morning following the announcement and stood at £3.52. In line with the FTSE Index as a whole the share price has declined since then and stands at £3.17 at the end of October 2015. This would make the government shareholding worth about £27 billion (after the first share disposal – see below).

On 3 August 2015 UKFI announced the intention to start the sale of government owned RBS shares:

> The Placing is expected to comprise of approximately 600m of the Company's ordinary shares, representing approximately 5.2% of the economic ownership of the

[1] Mansion House speech 10 June 2015

> Company. As a result of the Placing, the overall size of HM Treasury's economic interest in the capital of the Company (which includes its holding of ordinary shares and B shares in the Company) will be reduced from approximately 78.3% to approximately 73.2% and its holding of ordinary shares in the Company will be reduced from approximately 61.3% to approximately 52.0%.[2]

The exact details of the sale are shown below, note the details relate only to the initial RBS shares:

Government shareholding in RBS, August 2015 -

	Shares (millions)	
	Remaining Share holding	Implied share sale
Holding b/fwd August 2015	3,964	
Notified sale 4 August 2015	3,334	630

Source: London Stock Exchange press release; 4 August 2015

The shares were sold at £3.30 per share; proceeds were £2.1 billion.

1.2 The Future of British Banking

The UK banking system has been in a state of change ever since the financial crisis:

- Established banks have had to address prudential issues such as the need for greater capital.
- Successive scandals have forced new ways of working in some markets and activities such as their benchmarking work.
- The proposals enacted in recent financial services legislation have had to be addressed, none of which is bigger than the requirement for 'ring fencing' between investment and retail activity, however, work on the resolution and recovery of institutions is significant too.
- Outside of regulation the preliminary findings of the review of competition in banking have just been published: (*Retail Banking market investigation: summary of provisional findings report*) by the Competition and Markets Authority on 22 October 2015.

These changes however are to what might be called the existing structure of British banking. The motion for the debate relates to a new, changed structure – "in the context of a wider review of the UK's financial sector and that such a review should consider the case for establishing new models of banking, including regional banks".

Past ideas for or suggested innovations for new models of banking, or new types of bank, include:

- Industrial investment banks
- Community Re-investment type banks
- Regional banks

Industrial Investment banks

3i

An early manifestation of 'banks' dedicated to providing investment for industrial activity was the **Industrial and Commercial Financial Corporation** and the **Finance**

[2] Stock Exchange; Regulatory announcement; 3 August 2015

Corporation for Industry established by the post war Attlee government in 1945. These vehicles were funded by groups of bank, insurance companies and investment houses and backed by the Bank of England. In the mid 1980's the groups merged under the Investors for Industry name and when they floated on the Stock Exchange in 1994 it adopted its current name of **3i**. It now has three main business streams – private equity, infrastructure investment and debt management. A fact sheet outlining its activity can be downloaded here.

British Business Bank

The BBB is a part new and part re-package of previous schemes set up by the Coalition Government in 2003. Its work is aimed at the SME sector and encompasses the whole start up to mature expansion business life cycle. It works though 80 partners and does not make direct investments itself other than start up loans. It currently support over 40,000 smaller businesses with over £2.3bn of finance.

The BBB website is the best place to access information about its activities.

Community Re-investment Act (banking)

There are repeated calls for the introduction, in some form of the United States' Community Re-investment Act (CRA) in the UK. The Act, passed in 1977 states that "regulated financial institutions have continuing and affirmative obligations to help meet the credit needs of the local communities in which they are chartered." The Act has a monitoring side to it, measuring the banks level of lending, investments and services in low- and moderate-income neighbourhoods. Banks are graded on their performance. Further information about background to the CRA can be found in a Library Standard Note (SN/BT/400).

Regional banks

One of the attractions of the regional bank model is its role within what is seen as a successful, advanced industrial economy, Germany. Two, publicly owned, regionally focused, but heavily interlinked through ownership and mutual protection guarantees exist in Germany: Landesbanken and the Sparkassen.

The Landesbanken are state owned, regionally organised, banks with responsibility for smaller Sparkassen banks in their own region.

Information about the Sparkassen can be found on its (English) website. One of its introductory pages outlines the ethos behind it:

> Savings Banks are profit-oriented businesses. Their aim, however, is not to maximise short-term profits: net income generated is set aside as reserves to protect their business and used to promote public welfare. Through their business policy, they clearly demonstrate that a commitment to the common good is a foundation for sustainable action – which is not inconsistent with achieving success in business

A Deutsche Bundesbank article in April 2015 outlined the structural changes taking place in the German banking sector. It pointed out that regional banks are to an extent protected from full competition for funding and assets, but the pressures for cost reductions and the digitisation of banking services has put the traditional model of a large number of narrowly focused institutions under pressure:

> More than three-quarters of credit institutions in Germany are savings banks or credit cooperatives, but their combined total assets make up less than a quarter of aggregate total assets in the German banking system. The process of consolidation which had been evident for some time gained traction in the 1990s, notably in the cooperative bank sector with its very large branch network, as credit institutions set

out to streamline costs. Momentum waned after the turn of the millennium, however. Networked institutions, which did not want to risk watering down their customer-centric approach by further downsizing their regional footprint, sought to spin off and merge certain business units as specialised entities as noiselessly as possible. But the fact remains that the aggregate number of institutions across all categories of banks shrank by more than half between 1990 and 2015.

Advancing digitalisation has further eroded the importance of branches as a sales channel, while the pressure to reduce the cost base through economies of scale has fostered the spread of direct banking.