



Treasury Committee

Oral evidence: [Treatment of Financial Services Consumers](#)

HC 631

Wednesday 4 February 2015

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Members present: Mr Andrew Tyrie (Chair); Rushanara Ali, Steve Baker, Mark Garnier, Mike Kane, Mr Andrew Love, Teresa Pearce, Alok Sharma, John Thurso

Questions 547 - 659

Witnesses: **Moray McDonald**, Managing Director of Products, Personal and Business Banking Division, Royal Bank of Scotland, and **Craig Donaldson**, Chief Executive, Metro Bank, gave evidence.

Q547 Chair: Thank you very much for coming to give evidence to us this afternoon. Perhaps I could begin with you, Mr McDonald? You will have seen the evidence of Dr Richard Clayton, who argued that gross fraud in retail banking was roughly twice the net fraud figure that is published. Do you agree with that estimate?

Moray McDonald: I would say that net fraud is a very important measure; it actually measures the proceeds of this crime. I should say we report fraud through the FFA, both on a gross and on a net basis, so those numbers exist.

Q548 Chair: But only the net figures are published. Isn't that right?

Moray McDonald: That is the case.

Q549 Chair: Why don't you publish the gross figures? Is it not the gross figure that is of most interest to a consumer who is trying to decide which bank to go to, and using information about fraud and risk as a source of differentiation between banks?

Moray McDonald: I think it is important and what would be important to customers is what the bank does about fraud, and how able is the bank in countering attempted fraud. A good way to look at the difference between gross and net is what we did about it. The fact that through our—

Q550 Chair: That is not the question I asked, though. Sorry to interrupt, but isn't the gross figure the figure that you want to know if you are a customer? It is not, "Okay, how much redress was there?" or, "How well has the bank handled it overall?" but, "What is my gross risk?"

Moray McDonald: I think you would be very encouraged as a customer if you looked at all the attempted fraud and found that the bank you had chosen took action so that the actual result of that fraud was only a fraction. I think you would be very encouraged by that. It is very important, in terms of customer expectations, that you want to know that the bank is very good at countering it. I think that is the difference between gross and net.

Q551 Chair: So you think customers should be monitoring only net fraud?

Moray McDonald: I think customers are most interested in what happens to their own account and what happens to their own account is the outcome of all the attempts and what we did as a result of that to minimise the impact on them. I think net is the more important figure by some margin.

Q552 Chair: Right. Let us just be clear what we are talking about here. Gross fraud is total money taken fraudulently from an account before any recoveries are paid back. Correct?

Moray McDonald: No.

Chair: No?

Moray McDonald: Sorry. The basis on which I am answering the question, and the basis on which I think we report, is the gross fraud was in terms of what could potentially have been at risk. The net fraud is the amount that was actually taken from the account. The difference is principally what we did to minimise the impact at risk and what the net amount was taken from all accounts.

Q553 Chair: Those are not the definitions that I think are given by Financial Fraud Action UK.

Moray McDonald: Perhaps I could check that and respond in writing, because that is my understanding?

Q554 Chair: That is very helpful.

Craig Donaldson: Could I make a suggestion? My view is very simple. If we have a disconnect, what we need is more transparency and more consistency, so why don't we agree what the definitions are? I am sure you have the power to make sure that information is fed.

Q555 Chair: That is what we have just politely agreed.

Moray McDonald: Yes.

Craig Donaldson: No, but I mean as an industry body. We need more transparency. It is the one thing we need for the public.

Q556 Chair: Do you think your customers are more clued up about this?

Craig Donaldson: Of course they are!

Chair: Do you think your customers come to you because they think you are safer than a major bank?

Craig Donaldson: I think our customers come to us because they value what we offer, which is the transparency and consistency. I don't think they think that safety is the only thing, but it is certainly part of it. What they also see with what we do is the security we offer them. We all know cyber-fraud is massive. Cyber-attacks happen: they will be happening now; everybody is being attacked. You will be being attacked yourself now and you should have malware. I think banks need to work harder to communicate with customers how they protect themselves. We offer something called Trusteer that our customers can download for free that we pay for to protect them. We have to do more of that so that we help our customers to protect themselves, and we help to protect ourselves as well.

Q557 Steve Baker: Mr Donaldson, I understand that in the first half of 2104, Metro Bank had 548 complaints.

Craig Donaldson: Yes.

Steve Baker: How does that compare to other banks? First of all, roughly how many complaints is that per 1,000 bank accounts?

Craig Donaldson: It was running then at just over one per 1,000, but at the moment it is down to less than 0.75. We take them very seriously. We are about service convenience and, by the way, it compares brilliantly well—let me just say that.

Q558 Steve Baker: Can you put some figures on that comparison?

Craig Donaldson: The latest figures will come out on 28 February. By the way, we are going to have fewer than 500, so we don't have to report, but, of course, we will report because of that transparency that I spoke about earlier, and I am certainly hopeful you will see us way at the top because it is so important to us. To me, it is about how you are using them. We do not call them complaints. The expression is "dissatisfaction". We want to capture every dissatisfaction because that is massively important. On a weekly basis we go through them all, and on a monthly basis we look at our training, IT and the root-cause analysis in a meeting we call "Voice of the Customer". We listen to the voice of the customer and we look at how we take that data and make things better.

Q559 Steve Baker: Thank you. Mr McDonald, roughly how many complaints per 1,000 accounts does RBS have?

Moray McDonald: I do not know that number, so I will not guess at it. I am happy to calculate it on that basis and give it to you. I can tell you what we're doing about complaints, though.

Q560 Steve Baker: Let me just put this to you. I understand that, excluding PPI, RBS Group banks are among the most complained about in relation to the number of accounts it has. I would be very interested in the exact figure at some point, but could you explain why you are among the most complained about?

Moray McDonald: I don't know that I know why we are the most complained about, but I can tell you what we are doing in order to reduce complaints. We are doing a number of things. We treat complaints very seriously and as an opportunity to regain the customer's trust. We do a great deal of root-cause analysis and try to go back to where the problem was caused and take action around that so that we are systematic and we learn as an organisation. If we put aside the two big bumps—PPI and, to a lesser extent, packaged accounts—and look at the underlying complaints, those have reduced for us 25% year on year. I am happy to talk about PPI and packaged separately because there are different trends going on there.

We are trying to give more control to our front-line staff, who are often the people who are first contacted by customers. Rather than immediately refer them to complaints handlers, how many more can we deal with at first point of contact? To make that real for our front-line staff, we are saying to them, "You decide. See what has happened and you make your own decision". We are empowering them, up to £500, to make the decision and then put it right so that the customer goes away happy.

Q561 Steve Baker: How many customers does the group have, just roughly?

Moray McDonald: In terms of consumer customers, we have about 16.5 million.

Q562 Steve Baker: So a huge number. You described quite a sophisticated and, I would suggest, expensive investigation process. How do you manage the threshold at which you start investigating—very seriously and expensively—a particular fraud?

Moray McDonald: Are you referring to investigations on complaints in particular?

Steve Baker: Yes. Do you have a threshold above which you take a particular set of actions, or do you always investigate? If it is a fiver, are you going to investigate in the same way as if it is £100,000?

Moray McDonald: I think it does depend on the seriousness. If we have a complaint where it is clear we have not done the right thing, and it is a relatively modest amount, we will deal with that very quickly. Hopefully we will deal with it on the spot. If it is a complex complaint dealing with a larger grievance or a larger amount of money for the customer, that is much more important and we want to take the time to work through and find out what has happened.

Q563 Steve Baker: One of the reasons I ask—I am not going to rehearse, for obvious reasons, the circumstances now—is that I had occasion to complain to an RBS Group bank and I have to say that I was most dissatisfied. It seemed like a fraud was not being taken seriously.

Moray McDonald: A fraud was not being taken seriously? If you don't mind giving me details I would be very happy to follow that up.

Steve Baker: I will, yes.

Q564 Chair: We often get that reply but what we really need, of course, is confidence as a Committee that we do not need to reach the point where an individual case is being brought to your attention.

Steve Baker: Yes, absolutely.

Chair: This is not the place to deal with it.

Steve Baker: Our main concern is the 16 million other people.

Moray McDonald: On a broader level, what I would like to let you know is that we are trying to simplify the whole bank. One of the reasons we get complaints is we have just been too complicated in the past. We have had too many products. For instance, I am ashamed to say we used to have 11 instant access products; we now have one. The impact on complaints on those products has been a dramatic reduction, and customers have trusted us with more money on that one account than the 11. That is the sort of thing we are trying to do. You may have noticed we have made radical changes in the fairness of our products. That gives rise to many fewer complaints. If you are an existing customer and see that all the good deals go to new customers, you quite rightly complain. We do not do that anymore.

Q565 Steve Baker: I am conscious of my colleagues needing to get in as well. Richard Lloyd of Which? said that larger banks had a culture of obstructing complaints. Do you recognise that culture in RBS?

Moray McDonald: No, not at all. Every complaint is one too many. The fact that it is a disturbance for the customer that they had to complain is something we take very seriously. We have not been helpful enough, quite obviously, so we take them very seriously.

Q566 Steve Baker: I am sure we will look forward to seeing Which?, putting that to them and seeing how they respond.

Moray McDonald: One measure is that we are seeing fewer of the complaints that we deal with being referred to FOS.

Q567 Steve Baker: In terms of that, then, 41% of complaints to the Financial Ombudsman Service in the first half of 2014 about RBS's banking services were resolved in favour of the consumer. What does that tell us about the quality of your complaints handling?

Moray McDonald: It is not good enough, but it is getting better. If we look at the large areas of complaint, what the FOS overturns or upholds, which is what you are referring to—

Steve Baker: 41% this is.

Moray McDonald: —is actually reducing. Our goal, when anything goes to FOS, if that if the FOS disagrees with our judgment, we look at that and say, "What could we have done differently? What should we learn?" Just this week I visited FOS and we looked at specific cases and cohorts to say, "Okay, where do we need to change our policies and approach within our complaints area to align more with the adjudicators and ombudsman within FOS?"

Q568 Steve Baker: What targets are you heading for?

Moray McDonald: I don't think you could ever get to a situation where uphold rates were very low. I would like to drive those uphold rates into the low 30s and then the high 20s, because that would mean we were aligning much more with FOS, but we have seen them drop consistently across all the major complaint areas

Q569 Steve Baker: Mr Donaldson, how do you consider Metro Bank's complaints process differs and how is it better?

Craig Donaldson: It is very, very good, and it has to be, because customers give us feedback and that is the lifeblood for our colleagues and for us to be better. We have one single platform where we hold all of our customer data. Our complaints are held within exactly the same platform. They are held against the customer and then we can look at it at a macro level. We look at that data because that is the richest source of data for how we can be better because, if the customers are telling our colleagues they are not happy with something, my job is to work with them to fix it. That is what we do on a weekly and a monthly basis.

Q570 Steve Baker: If a person complains to Metro Bank, are they handled by a single complaints handler, or do they find themselves ringing up and talking to different people at different times?

Craig Donaldson: We call it, “Log it, resolve it and close it”. That is the mantra we have around our training on complaints. The vast majority of cases are handled at a single point of contact because that is how people want it: “I want you to sort it out. Please don’t pass me off”. If we have to pass it off because it is more complex, we absolutely work to close it by the next working day.

First of all, say, “Sorry.” It is amazing how many people sometimes forget to say sorry. My view, very simply, is that if somebody has taken the time to complain to you, you should say sorry because they feel strong enough to make it happen. You then have to listen to them and you have to fix it. My view is just fix it quickly. I don’t know about limits on what you are able to do; my view is just fix it, because it will cost you a damn sight more in paying money to the FOS or elsewhere. It is about valued customers, and also I want my colleagues to feel empowered to look after their customers. The vast majority are single point of contact and the vast majority are by close of business the next day, and that is why we probably have the best in the industry.

Q571 Steve Baker: Could I just ask Mr McDonald if RBS aims to deliver the same kind of service—next day and so forth?

Moray McDonald: We would like to resolve an ever-higher proportion of our complaints at the first point of contact and within two days, which is, as you know, the definition around reportable and non-reportable. We definitely want to grow that proportion that is resolved within two days.

Q572 Mr Love: Mr Donaldson, do Metro Bank’s retail staff have any sales-based incentives?

Craig Donaldson: No.

Q573 Mr Love: None at all, so you can categorically say to me that no aspect of either their performance assessment or their remuneration is linked in any way to products and services sold?

Craig Donaldson: Whether you walk into a store or whether you call contact centres, those people do not have sales targets. They are targeted on three things. They are targeted on net promoter score, which we do down to store level and we do that on a monthly basis, and that is all about recommendation by a customer. They are targeted on what we call magic shops and that is done to every store, every week. We call them magic shops because who wants it to be a mystery? I want it to be a magic experience for the customer. Language is very important for us. We also target them on expressions of dissatisfaction. That is not that they don't log them—it is not the number—but it is about how they resolve them that is the key. Did the customer feel as though it was owned and resolved appropriately? They are the three key metrics in performance that we look at.

Q574 Mr Love: Do you have any proxies? Some banks tell us they measure the number of interviews undertaken by staff, which works as a proxy.

Craig Donaldson: Absolutely not.

Mr Love: You can categorically say that to this Committee.

Craig Donaldson: Absolutely. We don't book appointments. We want to be able to serve you when you walk in. I want my guys out. I want them working with the communities. It is about the value they add, not about how many boxes they tick. It is about the customers. I think we have to move away from this tick-box mentality and get back to focusing on customers.

Q575 Mr Love: Mr McDonald, does RBS operate any sales-based incentive schemes?

Moray McDonald: No, we do not. If we look at what we want our front-line staff to do, we want them to get into great conversations with customers. A great conversation for us is to understand what the needs of the customer are and, if we can help, to go and do that. We do not give anybody individualised sales targets, product targets or revenue targets. No, we don't.

Q576 Chair: When did that change? That is quite a big change for RBS historically, isn't it?

Moray McDonald: I would have to confirm the date to you. I think that has been in place for a couple of years from memory, but I will be happy to give you the date.

Q577 Mr Love: The Financial Conduct Authority issued guidance in 2013. Have you followed that guidance?

Moray McDonald: The guidance with respect to incentives?

Mr Love: Incentives and the way in which you can incentivise people that produces a positive result, rather than some of the negative results we have seen. You touched upon PPI before. The FCA tells us that this is guidance to try to ensure that they are working with the grain, rather than against the grain.

Moray McDonald: Very much so. We want to feed back and reward our staff on the basis of what customers think about the experience of dealing with us. In the same way that I think Craig was beginning to describe, we measure customer satisfaction and we also measure net promoter score, which is whether customers would advocate and recommend us. We also measure the accuracy and whether we did the right thing and followed through. We are far more focused on: was the need met; was it a great experience; and was the feedback we got positive? We absolutely measure that down to the individual and to the branch level.

Q578 Mr Love: Following the guidance that the FCA brought forward, it carried out a thematic review and that showed there were up to 35 separate schemes run by the large banks where the level of sales was directly linked to incentive payments. Are you operating any of those 35 schemes that the FCA highlighted in the thematic review?

Moray McDonald: The only area of our organisation where there is any form of incentive is in specialists, and that would be in a mortgage advisor, for instance. What I can tell you is that to be eligible for any incentive related to your productivity, which, after all, is meeting mortgage needs—that is what specialist advisors do—you have to clear an absolute hurdle in terms of the feedback from the customer around the quality of what you did, and you have to meet an absolute hurdle on the quality and suitability of the advice you gave. Only those individuals are eligible, and only if they meet very stringent quality and feedback standards.

Q579 Mr Love: Rather than trying to pursue this now, perhaps we could ask RBS to respond to whether it is covered by any of these 35 schemes the FCA has highlighted and whether the answer you have just given complies with the good guidance given by the FCA. Would that be possible?

Moray McDonald: Of course. I would be happy to do that.

Mr Love: Can I then go on to basic bank accounts? Last June, RBS allowed its basic bank account holders to use all LINK machines, rather than just LINK machines in the RBS Group. Can you tell us whether that is now accessible to all basic bank account holders and what the approximate cost was of reintroducing that service to them?

Moray McDonald: I can. All our basic bank account holders can access ATMs from all banks via the LINK network. We made that change on the basis of feedback. Maybe I could tell you why we made our original decision. More than £1 in £5—22% in fact—of

all money withdrawn from ATMs in the UK is withdrawn from an RBS ATM. Our coverage alone—just the RBS network, which includes all the Tesco ATMs—was available to all our million basic bank account holders. To put it in practical terms, you would never need to walk more than a couple of hundred metres to find an RBS or Tesco ATM. We were providing, with our own network, what we thought was an appropriate level of access to cash. However, based on the feedback that was given, we were happy that we should fall into line with the smaller ATM providers and add LINK access.

In terms of the cost, that would have been millions of pounds because every transaction with another bank costs us money, despite the fact that there might be a RBS ATM 50 metres away. I don't recall the number, but I would be happy to provide it.

Q580 Mr Love: You have now signed up to this agreement with the Treasury to introduce a standardised form of service provision. Can you indicate how much additionally it is going to cost RBS to comply with that agreement?

Moray McDonald: Yes, I could. The differences there principally relate to returned item fees. Under the new basic bank account, which we will deliver this year, as we have agreed with the Treasury, there will not be any fees at all for qualifying customers under the new basic bank account criteria. I would be happy to calculate that and send it to you.

Q581 Mr Love: Finally, can you tell us, in terms of RBS, how you will pay for the additional costs? Will this be a levy on your profitable customers, if I can put it in the way that RBS used to put it, or will you absorb the additional costs into RBS's profitability?

Moray McDonald: I think this is a little bit analogous to the whole free-in-credit banking debate. We provide millions of accounts at no cost that lose us money. Therefore, since the bank is net profitable and we are growing that profitability, which is very important, everything else we do, without any doubt, cross-subsidises the provision of those free accounts. I think this is very analogous. Basic bank accounts will certainly lose us money, but we regard them as a social obligation to give access to the banking system for those people.

Q582 Mr Love: I would just comment that the Competition Commission in its last survey of the banking sector indicated that upwards of £8 billion was being made by the sector on current accounts, so whenever a bank comes before this Committee and says that they are a loss leader, we are somewhat sceptical of that from the evidence that we have been given.

I need to move on so that some of the others to contribute. Metro Bank has not signed up to this basic bank account agreement. Why not?

Craig Donaldson: We were not asked. We need a level playing field in this country for challenger banks—for banks like myself. We have over 450,000 customers now. We have £3 billion on deposit and so many things go on where we are not engaged and we are not brought to the table to discuss these things. If you want competition, we need to ensure

that we have a level playing field. This is a lovely example of where we are not engaged at the appropriate time, and then I get asked afterwards, “Why didn’t you do it?” Well, I was not asked.

Q583 Chair: Have you been put at a competitive disadvantage by not having been asked?

Craig Donaldson: To be clear, I think we fulfil everything they wanted anyway. No, I don’t believe on this one I have. On other things I have been most definitely, and it is the type of thing that we need to break.

Chair: Send us a list.

Craig Donaldson: Consider it done.

Q584 Mr Love: I am assuming that the Committee will be in agreement with this, but can I also, on behalf of the Committee, ask you to join up?

Craig Donaldson: Yes, of course.

Q585 Mr Love: Can I just ask a very final question? You already have a cash account that is different from the mainstream account. Without necessarily calling it a “basic bank account” according to the new definition, could that work in that fashion?

Craig Donaldson: To be honest, that was why we designed it; I want to bank everybody. Our job as a bank is to look after people and give them a place where they can be valued and can trust the people they are dealing with. The only people who do not get a bank account from us are the people where we can’t fulfil the Know Your Customer requirements. With a basic bank account, we do not charge for things. They have access to all the LINK statements; they have a mobile app. It is a key account and that is an account that people can move on from as well. So, yes, I am very comfortable because that was how we developed it.

Q586 Chair: Mr Donaldson, why should the cost of a transaction with another bank be so high, given that most of them will net off?

Moray McDonald: Is that for me or for Craig? Sorry, Chair.

Chair: It is for you. Sorry, Mr McDonald. It was you who said that every transaction had a cost over and above the 22%, even though it may be 50 yards down the road. Why won’t netting off greatly reduce that cost?

Moray McDonald: Well, with the net amount you end up paying, you do deduct the amount of transactions that that bank’s customers—

Q587 Chair: Yes, but the Barclays guys are using yours, you are using the Barclays guys' and there is netting off.

Moray McDonald: There is. The only flows between banks are if we happen, as we do, to have a larger network of ATMs and we have a disproportionate amount of the cash withdrawn, which we do, we are a net beneficiary of that because other banks' customers will have used more of our ATMs than our customers will of others.

Q588 Chair: The cost is going to be very small after netting off, is it not? Send us the figures, gross and net. We would be interested to have a look.

Moray McDonald: I would be happy to do that.

Q589 Rushanara Ali: Mr McDonald, I want to focus on the topic of derisking. Can you say something about the changes RBS has made in recent years to your services that you are offering to customers in the light of the anti-money laundering regulations and financial sanctions?

Moray McDonald: The changes we have made are that we must comply with those regulations. You may know this, but let me just lay out what we do. The effect of AML, anti-money laundering, and sanctions is to make us responsible for identifying at-risk customers when they are joining the bank and doing such things as looking at what their source of wealth or funds are or, in the case of a business, the source of those transactions and transfers. It is keeping an eye on their flow of transactions and doing active monitoring; having alerts if things look suspicious and then investigating them; and periodically reviewing individuals or businesses that are deemed to be high-risk or that transact with restricted countries. They are very stringent requirements that we have to apply to all customers.

Q590 Rushanara Ali: How would you describe at-risk customers? What categories would they fall under?

Moray McDonald: Individuals who are resident overseas in restricted countries. You may know that there is a list of countries where there are conflicts or problems, whether they relate to terrorism, corruption or drug trafficking, for instance.

Q591 Rushanara Ali: It would be whole countries that are on—

Moray McDonald: It typically is designations of countries. There are other ways in which individuals can be held to be at-risk. Individuals such as yourselves who are engaged in politics—

Rushanara Ali: Are risky customers?

Chair: No, politically exposed.

Moray McDonald: They are politically-exposed customers who might be the subject of attacks or approaches, given your position in terms of public policy.

Q592 Rushanara Ali: So it would be harder for us to get bank accounts at RBS?

Moray McDonald: I would not say it is harder. We want to have everybody bank with us, but we are obliged by the law, for people who are particularly at risk, to go through a process of making sure that we keep you safe.

Q593 Rushanara Ali: Can you say a bit about the implications on organisations within the UK or individuals? Who else would count as at-risk customers within UK organisations? For instance, we are aware of charities that have been refused banking by certain banks. Could you say a bit more about which organisations within the UK would fall into that category?

Moray McDonald: I would be happy to. Charities are a particularly difficult area. For instance, take the fact that there are many war-torn places in the Middle East. We know, of course, horrendous news around conflicts within certain countries, even in the last few days. There are charities and individuals within the UK who want to take action and take responsibility for helping folks who are maybe displaced, who are refugees, or who are impacted by those things. Those can be very localised charities. Because they are conducting money transfers with restricted countries, we have an obligation to have a look at that and say, "Is it obvious that they are undertaking humanitarian action here?" If we can establish that, we want to support that. If, unfortunately as happens, folks who are wanting to channel money and resources to support the conflict are using a charitable structure to do that, it is our responsibility to identify that and close those accounts down.

Q594 Rushanara Ali: Do you feel the banks are getting adequate guidance and support from the FCA in dealing with this challenge? It seems like you are being expected to monitor and police how organisations or individuals conduct themselves at an international level. Without sufficient support, would you say?

Moray McDonald: I think we get good support. The difficulty here is not that the policy is not clear. The difficulty is in the practical application of the policy, which we try to do through investigation and contact with the people involved. We call the trustees of charities and ask them about how they got involved, what are they trying to do and whether they know the people who are receiving the money, to try to form a view, which is very difficult, about whether this is truly a humanitarian endeavour or is, in fact, a front.

Q595 Rushanara Ali: There are reports that banks are stopping banking facilities to organisations that they would rather not bank with not because of evidence, but because of concern that they will end up with fines. Do you think there is a risk of unintended consequences when legitimate banking facilities are not being offered to organisations? That

has happened with money transfer organisations. Does that undermine efforts to prevent money laundering?

Moray McDonald: I can only speak for us. We do not take the easy way out, which is just in any blanket way to try to close accounts just because there is a small risk they might be involved in channelling funds to terrorists or drug runners. We do try to make, in every case, a judgment about whether this is a legitimate activity.

Q596 Rushanara Ali: What sort of information can customers expect when they are being refused bank accounts?

Moray McDonald: If it is an existing account that we have reviewed, we would always contact the customer and give them our reasons and concerns before we closed the account. That is a final opportunity for those customers to say, “Well, there is a whole lot more information we have not given you that will demonstrate to you that we are legitimate.” Ultimately, it has to be our call, because we are held to account by the law to make the judgment, but if we can get more information and take that into account, we absolutely do.

Q597 Rushanara Ali: Mr Donaldson, how does Metro Bank deal with the complexity of risks arising from anti-money laundering regulations and financial sanctions?

Craig Donaldson: We are all held to the same standards and I think that, as an overhead, it is a considerably increasing one, but then, when you look at the ramifications, so it should be. First of all, a lot of things that are going on are correct and my job is to do them properly, and we do. I do think we have a disconnect between expectations among the British public and possibly politically exposed people as to what may have happened in the past and how they should be treated, and now how organisations have to treat them.

I do think we are going to go through a period of time where it is going to be very uncomfortable for all of us sitting in this room when things come to happen because there is a different expectation now placed on banks. We have to ask things and we have to do things that possibly three or five years ago we did not have to. I am afraid that will mean there will be discomfort on both levels, for you and for us, at times but we have to do it. I don't know if that is understood. I don't know if that is appreciated but it does need to be. This is not a choice we have and we cannot get it wrong. The fines and the ramifications for getting it wrong are so significant now that one could say common sense has to play so far past the line because nobody may make a mistake. Zero tolerance; zero acceptability.

Does that mean commercial decisions are made for certain customers that are wrong? You know, I fear they do in certain organisations. We speak to a lot of customers who have been exited and we make commercial decisions to work with those people and to bank them because we take the time. Possibly some other organisations do not have the time—I don't know—but that is going to happen and it is going to continue.

Rushanara Ali: Because of the framework you have to operate in.

Craig Donaldson: Absolutely. I think Moray and I will disagree on one thing on this, although it is not about RBS, to be clear. What we will disagree about is that I am worried there is not enough clarity. We need more clarity. The more clarity you can have around the table here—for you and for us—the better for everybody. This is not a place for grey areas. We absolutely must demand clarity because this is an international play and if we were to be super-equivalent on our shores, we could create anti-competitive issues and significant issues for certain corridors. You and I will know corridors that have been closed down massively at the moment, which will create humanitarian issues and where we will have borders that are porous having money poured across them by people who will be taking significant cuts from what should have been legitimately transferred. We have to be very careful about that.

Q547 Rushanara Ali: In that context, what would you say the regulators could be doing to help banks to close that gap between what you are inevitably having to do in order to avoid large fines—it is human nature to be risk-averse in that context, regardless of concerns about unintended consequences? What should the FCA be doing and what should the Government be doing?

Craig Donaldson: First of all, I think this is not an FCA-Government issue; this is an international one. This is driven by the joint money laundering scheme. My view is that what we need to do in the UK is to drive for clarification and transparency. At the moment, I have concerns that you have too many organisations applying things in slightly different ways, and that creates disconnects that are dangerous for UK plc. We need to drive for transparency.

Q548 Rushanara Ali: Have either of your banks been approached by the Government's cross-border remittance advisory group on trying to improve these processes? If so, do you have any information on where that is going and if it is a genuine attempt to try to improve these points about the impact of banking and international banking?

Craig Donaldson: For me, it is a genuine attempt because nobody wants to shut countries down. It is payment gateways. It is keeping payment gateways open and ensuring that the money and the destinations are managed properly. To be honest, we have to work with people like the NCA on this. We have to work with global enforcement agencies to do this. Again, my plea is that this is not a UK issue and, because of some of the things that can be imposed on organisations, the ramifications are far broader than the UK. We need to be careful that, when we look at this, we look at this through our eyes. It needs to be tackled on a broader, grander basis, and it needs to be understood better, but that has to start with transparency and then we need to push out.

Q549 Teresa Pearce: Mr McDonald, I will just go back to the question that the Chair asked when talking about basic bank account holders and the LINK system. I have an interest: I am on the consumer board of LINK, as an independent member. You said that you have the biggest market share and that basic bank account holders could go to your ATMs, but

sometimes they went elsewhere, so then you restricted that, and now you have lifted that restriction. You mentioned that that cost millions of pounds, but if you do, as the Chair was saying, have the market share, you must take in millions of pounds from other banks' customers. Could you, not at this moment, let the Committee know the amounts involved? Clearly, if you have most of the ATMs, all other bank customers who do not bank with RBS are paying you a charge.

Moray McDonald: Absolutely. I was answering the question with respect to basic bank account holders. Clearly, all current account holders through the LINK network transact both with us and other banks.

Q550 Teresa Pearce: Yes, so as you have most of the market share, you will get quite a big cut of that amount because a lot of the people who are going to your ATMs will not be your customers. It is just that your ATMs are the nearest ones, as you said.

Moray McDonald: Yes, which I think makes absolute sense because we have invested in expanding that network over many years. We are a very popular place to take out money.

Q551 Teresa Pearce: The point I am making is it just seems to me that the amount that you lose through basic bank account holders who may be using another ATM is a drop in the ocean compared with what you get in.

Moray McDonald: I have to say that we looked at this not financially, but more through the lens that, given that we have such an extensive network, you would not have to walk very far to find one of our ATMs.

Teresa Pearce: But you have lifted that now.

Moray McDonald: Absolutely. In the request to say, "Let us have a uniform access across LINK," we made that change.

Q552 Chair: We were asking about costs because you said that there is a cost to this—

Moray McDonald: There is.

Chair: And that implied that you regretted it. Teresa Pearce and I are just examining what this cost really is.

Moray McDonald: Just to be clear, having the network we do, if customers were willing to walk 20 or 50 metres more and use our ATM, there is no cost to the bank there. If they use one that is 20 metres rather than 50 metres away, we bear an incremental cost on that account, which obviously is an account from which we gain no income. It just makes sense to us, given how good our network is, to prefer that those customers used our own network, but I would be very happy to give you the figures.

Q553 Teresa Pearce: Thank you. Mr McDonald, again, last year you dropped your customer charter pledge to stay open when RBS was the last bank in town. Why did you do that?

Moray McDonald: I think this issue around branch networks is interesting. We are seeing a revolution in how our customers want to bank and interact with us. We have been literally, candidly, taken aback. In the last three years, 300 million transactions that would have taken place in branch now take place online or on mobile. We have 6 million habitual online users and 3 million mobile users, so we have seen our customers telling us they want to do something different. We have to follow our customers and decide where we want to invest in resource in order to support them best.

As a result of that, we have decided that there are some locations where the footfall is getting so low that our customers are not using those locations. Whenever that happens, we look at those locations and say, “Let’s engage with folks locally. Let us talk to our customers,” We engage with councillors and MPs and let them know that it does not make sense to keep a branch open. We go through a period where we say, “What can we do locally to make sure that people who still want to transact here can do so?” We have an alliance with the Post Office, which has 11,000 locations—more than we ever could have. In rural areas, we have grown our fleet of mobile banks so that in areas where we have closed a bank, you still get the chance to transact. We take these things very seriously because we know it does affect customers.

Q554 Teresa Pearce: You made that pledge. Was it that you then felt there was not a demand for a branch, or was it just not economically viable?

Moray McDonald: We make that decision, though, in every single location. We try to look at where else we have neighbouring branches and where our customers sit.

Q555 Teresa Pearce: Is there a percentage? If Barclays looks and sees that 80% of people who go to one branch use another as well, that is one of the—

Moray McDonald: Yes.

Teresa Pears: Do you have a percentage like that?

Moray McDonald: Those are exactly the same things that we look at: what will be the impact on those customers and how are they dealing with us already?

Q556 Teresa Pearce: Because there are people who do come to branches. Why would you need to go to a branch and not use your mobile phone?

Moray McDonald: I think that is a very good question. We see the future of our whole branch network as evolving. Customers recognise—they are doing so in their tens and hundreds of thousands—that they prefer to deal with us electronically. When we ask them, “What would you want a branch for?” what they say is, “When I really need help, when I

want to make a big decision—perhaps a mortgage or an investment—or if I am a bit mixed up in my finances and beginning to have trouble coping.” Then, they want to come to us, and we will have the time and the interest to sit down with them and talk that through.

Q557 Teresa Pearce: The future is the future, and we are not in the future yet. There is a cohort of people for whom their local branch is important—the same as the local post office is important—and those who do not do internet banking are excluded. What happens to those people? It tends to be elderly people. You are saying that they can use the post office, but there will be services, will there not, that they need that they cannot access through the post office that they would need a branch for? What happens?

Moray McDonald: When we ask those customers, what they tend to tell us is that, for transactions, the post office is very convenient. We have expanded the range of services—not just for individuals, but also now for small businesses—that you can do through any post office, and there are many more locations that the Post Office has than we could ever have. Just to give you an idea, it has 11,500 locations where you can pay in cheques and withdraw cash, or, if you are a small business, deposit your takings. We have 1,250 branches in NatWest and 250 in RBS, so its level of service and availability is many times ours. When customers do have a need, we know they are happy to come and see us. With financial hardship, a mortgage decision or a personal loan, we will make time for them. When we look at what happens after a branch closure, the evidence is that those transactions tend to be through the post office and it works very well. Those customers want to remain within the bank, and when they want us to talk to them, they come to their neighbouring branch.

Q558 Teresa Pearce: Surely rebuilding trust in banking is about relationships and you cannot have a relationship with your mobile phone. Individuals trust the people in their branch. They might not trust the bank, but they trust the branch.

Moray McDonald: I could not agree more.

Q559 Teresa Pearce: So how many more branches do you plan to close this year?

Moray McDonald: We have identified 99 branches that we think we would close this year. I have to say that this is a rolling process for us. I do not want you to take that as the hard number and the most we would do. We are looking on with an enormous change in behaviour of our customers, and I think what customers want us to do is to move with them.

Q560 Teresa Pearce: It is interesting you say that because, Mr Donaldson, Metro Bank has moved with customers in a way, given the fact that you can go to a Metro Bank on a Sunday. You can take your dog in.

Craig Donaldson: Or your kids; both are welcome.

Teresa Pearce: I do not want to take my kids in. Branches are important to you. You are a newish business, yet you see this as the future. Why?

Craig Donaldson: I see the store as central to what we do. The store is in the communities. What we are there for is to serve the communities. The communities are our consumers, but they are the SMEs or the charities—they are the whole part of it—which is why we are open seven days a week. It is interesting, because when we open a store for the first time it takes time for customers to come in outside core banking hours, because they are conditioned. We are institutionalised to go into a bank between nine and five. You find people come in and you go, “Why didn’t you come in this morning when you walked past?” They go, “Oh, God, you’re open”. We have managed to get into the minds of customers, “We are there for banks. It is our job to queue for a bank.” We are a service provider.

Q561 Teresa Pearce: Why don’t you use the post office then?

Craig Donaldson: Because at the moment what I am trying to do is to grow my network and my infrastructure, so what I am trying to do is serve the communities where I am. I only open accounts in store at the moment because I want to be able to make sure I deliver service convenience to every customer, and to do that I have to grow properly. It is really important that I do.

For me also, I offer things in my stores. In the nicest possible way—I am going to be rude a little bit—I would not want to go into an RBS store. What can I do? I can buy something, but I do not want to buy something. What if I have lost my card? It is my money. It is my access. We are the first people globally to print contactless chip and PIN cards at point of sale. Why? Because customers told us that that is what they want; they say, “I need my card. I cannot afford to wait seven days.” Pop into any of our stores, seven days a week, and it takes about two and a half minutes to print you a new one off. You set your own PIN, because you are the customer. If you want a chequebook, pop in and we’ll print you one out. Do you want cash or coins? Do you want us to count your coin for free? Why will banks not count your coins? We are banks; you know, that is what we do. I just get a sense that we have forgotten that we are there to serve the communities in which we are. That is what Metro Bank wants to do. That is why we are open seven days a week and that is why we are open early and late, because other people’s lives have moved on and it is about time we, as an industry, moved on with that. That is what we are doing.

Q562 Teresa Pearce: I heard someone senior from your bank once say that you do not want customers; you want fans.

Craig Donaldson: That is what I want. Fans are happy people; you want them in your stores.

Teresa Pearce: Like Apple. Okay, thank you.

Q563 Alok Sharma: Mr Donaldson, I think Metro Bank describes itself as the UK's most revolutionary bank. You have done a good sales pitch telling us a few of the extra things that you offer but, basically, you have the same provision as everybody else. You do some traditional free-in-credit banking services and you do it through a branch network. Okay, your hours are slightly longer, but that is it. Where is the revolution?

Craig Donaldson: The revolution is about culture. It is about focusing on customers. We are about being transparent and simple. We do not do wealth management; we do not do investments; we do not do insurance. We do banking really well and that is what we need more of: proper banks doing banking.

Q564 Alok Sharma: Mr McDonald will probably say the same thing. In fact, he has said it—he is focused on customers. That is what all banks do. I used to work for a bank. You have always focused on customers. What do you do? Apart from the mantra of, “We are focused on customers,” what is revolutionary about your offering?

Craig Donaldson: Our revolution is how we are surprising our customers, and how we go out of our way to work with our customers and communities to deliver long-term, traditional banking where we build relationships with our customers so that we know them and they know us. The revolution is how we get great people in great locations with great technology. We have forgotten to do that. There is nothing wrong with a smile. You are right; what we need is more diversity. What we do not need is more of the same, but we should not underestimate the fact of simplicity.

Alok Sharma: Let us test that. You guys have been open for four and a half years. In response to Mr Love, you talked about the fact that it is not a level playing field. Give me a couple of examples. I know you are going to write to the Committee and our Chairman, but just give me a couple of really big examples of where you do not think there is a level playing field.

Craig Donaldson: Let me give you three, if I may. Point one would be capital. I am sitting next to Moray from RBS. If I was lending money to you—the same customer, with the same affordability and credit score, on the same property with the same loan value—I would have to hold 10 times more capital than my competitor. Why? That is not a level playing field. If I have to hold 10 times the cost of resource, that makes it so much more expensive for me to compete. That is true for every new bank.

Alok Sharma: Okay, so capital is one.

Craig Donaldson: The second one is payments. I have to go into the payments infrastructure through a big bank. It is crazy, if you want a level playing field, that you force new entrants and banks building like mine to go through big banks into the infrastructure that is owned by the big banks. That is not regulated as of April, but is overseen by the schemes, and all the board seats are held by the big banks. I cannot believe any other industry would be allowed to do this.

The third one would be what is going on around savings. We need to look at what has been happening on savings rates. I find it shocking that we can cut rates on customers without telling them. We want loyal customers and we want customers to trust us, yet I see, day in and day out—if you want, I will share some independent research I have had given to me—that banks are cutting rates, and not rates that you will expect. They are just cut and cut, and it is not communicated to people, but then we expect customers to trust banks. It must stop. What we are also finding is the banks that cut the rates say, “We will let you know if we have a better one.” Just move the customer on to the better one.

Q565 Alok Sharma: Okay, so there are three key areas. Do you think these are the three key areas that have held back other potential challenger banks?

Craig Donaldson: I do not know where they are on their cycles. I think that things did hold people back originally when dealing with the regulators. To be fair to the regulators, obviously we went through something was quite intrusive. It is still intrusive, and so it should be, but we have learned.

Q566 Alok Sharma: Let us focus. What do you think the regulator could do to make it easier for challenger banks?

Craig Donaldson: I go back to those three things: sort capital regimes out and create a level playing field; sort payment systems out and create a level playing field; and sort out the misconduct that is occurring on customers at the moment and create a level playing field on front-book pricing.

Q567 Alok Sharma: Okay. Mr McDonald, your turn. Has RBS lost any market share in the personal current account market as a result of challenger banks like Metro?

Moray McDonald: I do not think that we have been a significant loser to Metro.

Q568 Alok Sharma: Okay, but overall, what was your percentage five years ago, if you can tell us, and what is it now? Maybe five years is not the right figure but—

Moray McDonald: If we are talking about customers being able to move bank accounts, the current account switcher scheme I think has been extremely important in allowing customers to make a choice and not to have any worries about switching.

Q569 Alok Sharma: Instead of looking at the past, let us look at the future. In the next five years, what do you expect will happen in terms of RBS’s market share when it comes to current accounts? Is it going up, is it going down, and by how much percentage wise?

Moray McDonald: I would say we intend to grow it. Let me link my answer to your first question.

Alok Sharma: Of course you intend to grow it. I am asking you, as a percentage of the total market, what will happen. What I am trying to understand is whether challenger banks are having an impact on large banks such as you.

Moray McDonald: We hold about 17% of the stock of current accounts in the UK. I think the impact of challengers will inevitably be that we are held to account. It does not just happen in terms of share. If challengers grew significantly, yes, I think we would be at risk because we have so many current account holders.

Q570 Alok Sharma: In five years from now, from 17%, what do you think your figure will be?

Moray McDonald: I think our figure will grow because I think we need to become better for customers in many ways, and I intend that to be successful.

Q571 Alok Sharma: I suspect all the other big banks sitting there would say the same thing. What you are saying is that the market is going to consolidate even more, despite challenger banks coming in?

Moray McDonald: No, I am not. I would not predict that.

Alok Sharma: Someone is going to lose market share if you have more challenger banks, and you are saying it is not going to be you.

Moray McDonald: I intend it not to be me.

Q572 Alok Sharma: Can we talk a little bit about competition in retail and SME banking particularly? Perhaps Mr McDonald first. In terms of where the competition is coming from in this, where do you see the competition coming from for your bank?

Moray McDonald: Are you talking about across all banking services, or simply around current accounts?

Alok Sharma: Let us focus on SME banking.

Moray McDonald: We hold a significant market share in SME banking. I think it is a market where there is quite significant competition. That is a market where you do tend to pay for your transaction accounts and I think there has been quite a lot of innovation in our competitors in terms of price-led challengers.

Alok Sharma: What I am trying to understand is where your competition is coming from. One of the analysts from Jefferies, the banking group, has estimated that the big

banks will cede around 4% of the lending market share in the next five years. Who are they going to lose that 4% market share to? Will it be to these challenger banks? Will it be peer-to-peer lending? Who will that be lost to?

Moray McDonald: I think that peer-to-peer lending potentially could be a challenger for the larger banks, but I would say again—

Q573 Alok Sharma: What about internet-only banks? What do you think the scope is for them to pick up some of this business?

Moray McDonald: I think there absolutely is scope. Whether it is Metro, with a community and branch-based strategy, or whether it is internet banks, the effect they have is not just in taking share, but showing up the rest of us, holding us to account, and being customer-focused and demonstrating that we could do a better job for customers.

Q574 Alok Sharma: A final question to you, Mr McDonald. There are these challenger banks—people like Metro—and you are talking about increasing your share of the pie and all the rest of it. Give me three concrete examples of what you are doing in response to the challenge from people like Metro that is then having a positive impact on your customers and making them stay with you, or more people coming to you.

Moray McDonald: I am happy to do that. We are an organisation of which a lot is expected. We lost our trust with some of our customers and we are dedicated. In fact, we want to be the leader in trust and service by 2020.

Alok Sharma: Just give me three concrete examples. I know we need to move on.

Moray McDonald: I will give you three examples. I will be very happy to. Three actions we are taking rather than just saying. First, we are making ourselves easier to deal with. We are simplifying our product range—I gave you the example of instant access—so that we are very transparent. We are reducing the charges we have. In fact, we are trying to get all the charges in the bank on one piece of paper, and not in tiny type either. We are trying to be fairer and, in fact, to set new standards of fairness. Nowhere in RBS will a new customer get a better deal than an existing customer.

Alok Sharma: Okay, thank you.

Q575 Chair: Is it correct, Mr Donaldson, that you cost more on average than the four major clearers?

Craig Donaldson: Not that I have ever seen, no. I would say quite the opposite, actually.

Chair: Okay. Send us those figures because that—

Craig Donaldson: I do not know what you want—

Chair: —contradicts some of the material that was put before the Parliamentary Commission on Banking Standards.

Q576 Mark Garnier: Mr McDonald, I think you said earlier that you have 16 million customers. How much does it cost you to run those current accounts?

Moray McDonald: I do not know the figure in total.

Mark Garnier: You must do. You are a bank. You must know how much the cost of running your services is.

Moray McDonald: I could find the number and send it to you. I honestly do not know. The total of all operating costs for those accounts, I am afraid I do not know.

Q577 Mark Garnier: It is a pretty important number, though, isn't it? You are running a sensible business. You must know what your cost base is. What I am getting at is: what is the cost per account of delivering a current account?

Moray McDonald: That very much depends on how the customer uses the account, but I would be very happy to—

Q578 Mark Garnier: If you were to take the overall cost of delivering a banking service and divide it by, in your case, 16 million—Mr Donaldson will have the same question, but he divides by 450,000—you will get a cost per account of what it costs to deliver per customer.

Moray McDonald: Correct.

Mark Garnier: Yet we have this free-in-credit banking model.

Moray McDonald: Yes, we do.

Mark Garnier: So this is misleading, isn't it? It is not free-in-credit. There is a cost to somebody, so you have to recover that cost. You did say a bit earlier that you make money on the 16 million current account customers, so that basically means that what you are charging is for the cost of running the entire business of delivering the current account, which is a cost you apparently do not know, and then you add on to that the various other bits and pieces, and end up with a profit. Where are you deriving the profit from?

Moray McDonald: There is a cross-subsidy inherent in the UK banking system and it is a distortion that is very significant and far reaching.

Mark Garnier: Expand on that.

Moray McDonald: When it costs you quite a lot to provide something—and it very much does. As we said, a current account holder expects to be able to visit a branch or to call us

if they have a problem, and perhaps to use a mobile app. That costs a lot of money. When you do not charge for that, that clearly is a distortion and I think that—

Mark Garnier: You have to recover that cost elsewhere.

Moray McDonald: You do, so it gives rise to a cross-subsidy.

Chair: By selling other products?

Moray McDonald: By selling other products, yes.

Q579 Mark Garnier: Look, we know this, so I am slightly drawing you towards something. We know that you will charge for a letter, for example, for an overdraft. You will charge obviously overdraft rates. You will be charging foregone interest, effectively, so there is the interest on all that money that is deposited in those 16 million accounts that is not being charged for, but when they are overdrawn, you will be charging a higher rate of the cost of funding that. That is the basic stuff that you are charging and then on top of that you are selling other products, aren't you?

Moray McDonald: Yes.

Mark Garnier: Products like PPI insurance, perhaps?

Moray McDonald: At a high level, if the community want banks to be sustainable, they have to be profitable.

Q580 Mark Garnier: Of course they do, but do you not think it is very misleading—this whole idea of presenting a free-in-credit banking model—when, in fact, it is incredibly expensive? There is a charge that is not transparent and that is perhaps core to some of the problems. The reason I brought up the PPI insurance thing is because, of course, clearly—I can never remember what the name of this model is—if you have existing customers and an existing product, you can either sell those existing customers different products, or you can sell the same product—

Moray McDonald: Cross-selling.

Mark Garnier: You can sell the same product to more customers or sell a new product to new customers. If you are trying to expand, that is absolutely the right thing to do, but if you are trying to find ways to cover up undisclosed costs, you start entering into a rather peculiar and unpleasant grey area. I mentioned PPI insurance because, inevitably, there is a pressure on an institution such as yours—and indeed all banks that run free-in-credit banking models—to make up that money somehow.

As I said before, you get it from foregone interest, from punitive charges on things like unauthorised overdrafts and from higher rates of interest on authorised overdrafts, but then, on top of that, there is an incentive for you to go out and sell other products. We have seen that the selling of other products attached to loans, such as PPI, leads to

mis-selling, and that leads to massive mistrust in banks. Do you think we are getting close to the time when the free-in-credit banking model should be drawn to a close?

Moray McDonald: If I could answer both those questions, I do not think the fact that there is an inherent cross-subsidy in UK banking gives rise, in any inevitable way, to real misjudgments like PPI. I think that has much more to do with culture and incentives.

Q581 Mark Garnier: This is the point I am trying to make. Is this opacity around charges and cost driving a poor culture?

Moray McDonald: No, I think the answer here is that we have to have a real focus on customer need. If the need is not there, don't sell inappropriate products.

Q582 Chair: Isn't the first thing that a customer wants to know how much he is being charged and isn't that a reasonable thing for him to want to know?

Moray McDonald: What is being charged?

Chair: What it is really costing.

Q583 Mark Garnier: It is so misleading this whole business about free-in-credit. Mr Donaldson, I noticed you were slightly shaking your head when I was proposing that we should be coming to an end of this. One of the big problems is that you cannot have a truly competitive model because, as a challenger bank, it is costing you. You have 450,000 customers. There is a cost to you. I suspect that in your case it is much easier to derive how much it costs you. I would be interested; do you have that number?

Craig Donaldson: I know by account, but I do not do down to customer level, because I do not—

Mark Garnier: What is it by account?

Craig Donaldson: It costs me about £12 a year to run an account on my IT systems.

Mark Garnier: £12 a year, so £1 a month.

Craig Donaldson: For me, it is important that I do not want to work out customer profitabilities because I do not want to focus on that part of the customer. That would lead you down a horribly wrong avenue as a culture.

Q584 Mark Garnier: That is absolutely fine. None the less, if you are looking at competition between banks, surely at the end of the day we need to have transparency. One of the big problems is you need to have transparency between what the accounts are. We have these packaged bank accounts where you get all sorts of holiday insurance and all sorts of

free dental care and God knows what else being thrown in, which is even more confusing, and then you have the free-in-credit model. Go on, you are trying to get in.

Craig Donaldson: Going back to what was being asked by Alok, we need more diversity in banking. We need more competition, but what we do not need is more of the same. We need more diversity: peer lenders, internet banks, things we have not even thought of yet. I think Fidor is doing some very interesting things in social networks. We just need diversity. We are too concentrated in the UK and that is not good, when a country goes through shocks, as to how it recovers. We have to have diversity; we just have to get it. Peer lending is brilliant. Challenger banks are brilliant. We need more models and more diversity.

For me, what you are driving for—and I worry about this—is a charge on free banking, and it is about this charge or that charge. I do not know where you go with that. The key is transparency and clarity. I think that banks have over-engineered what is going on with overdrafts now to make the money back that the OFT court case several years ago tried to drive out. I think it is beholden on the banking industry, and I think the CMA will force this as part of its review, to look seriously at it. It is just too convoluted and we, as an industry, have to change that. We are looking at what we are going to do, and please can we talk about that in a few months' time, because banks have to change. Transparency is needed, not price setting by regulators or Governments.

Q585 Mark Garnier: No, I agree entirely with you and there is no question whatsoever that price setting by regulators is absolutely to be avoided. In terms of getting transparency, for all banks—all people providing this service of a current account or, indeed, any account—there is a cost that is associated with that. In your case, it is £1 per month per account.

Craig Donaldson: For the IT, and then it depends on how many transactions, which is variable.

Q586 Mark Garnier: Absolutely, but you can charge on a transactional basis and all the rest of it. You have now come out and told us that is how much it is, but you have to recover that from somewhere. The problem is that recovering that is where you lack the clarity and where you lack the transparency that tells you what is coming out of your account. There is an alternative way of doing this. You could publish what the foregone interest is on your account that you have not received. Of course, many of the banks do sweetener offers: come along and put your money with us, and we will give you 10% or whatever it is.

Craig Donaldson: We do not do any of those.

Mark Garnier: No, I am sure you do not, but banks do, so you end up with this rather confusing position in the marketplace, but underneath all this is the fundamental basic cost. That is what—

Craig Donaldson: But, Mark, how would you add value? What value would you put? This is where it gets interesting for customers. Customer needs are value. What do you value as a customer? With one bank you may have to wait seven to 14 days to get a card; with

another bank you can get it within two and a half minutes. How much do you value that, Mark?

Q587 Mark Garnier: Mr Donaldson, that is a great thing about what people like you are doing. You are getting into the market and you had this fantastic, very exciting opening of the Cambridge branch with festivities, stilt walkers, face painting, performing dogs, and live music.

Craig Donaldson: And popcorn.

Mark Garnier: And popcorn; we all love that. We all know that Metro Bank employs staff by their—

Craig Donaldson: Attitude.

Mark Garnier: If you take somebody who has a nice attitude, that is a different way of doing it, and that's great, but there is a hard-nosed end of all this. You will go out and compete on the basis of trying to be different by doing all that stuff—that is fantastic—but none the less, the bottom line is that there is very simple mathematics that goes with this. What I am trying to put to you is that, notwithstanding all that stuff and notwithstanding the stilt walkers, dogs and popcorn, behind all this is the cost of the current account. None of you are prepared to—actually, that is not true; some banks are. Some people like Handelsbanken and some of the private banks are coming in and saying, “This is how much it costs and we will provide a service. It is pretty simple, it is pretty straightforward. You pay for what you get and the service is a different type of service, more customer-friendly”.

However, the big banks and some of the challenger banks are saying, “We have no choice but to try to compete on the basis of a free-in-credit banking model because that is what it is, so we have to recover the cost of running these accounts from elsewhere.” Then, once you have done all that, you are competing on the service on top of that. I am putting it to you: would it not be much, much better if everybody finally turned around and said, “This is ridiculous. We have been duping customers for years and years and years. We have been having to rip them off. Let us go back to where we should be, which is tell people how much it costs, charge them for that, give a better service, and stop trying to sell them things like PPI insurance, which ends up with a bad culture in the bank because you are trying to recover your costs”?

Moray McDonald: Could I respond to the question because I am conscious I did not answer it when you asked it the first time? Would we be in a better place if we did not have free-in-credit banking? Yes, we would. That inherent cross-subsidy would disappear. There would be more incentive to innovate because you would gain from doing so and be able to differentiate more. That makes a lot of sense to me.

In terms of overdrafts, which you have referenced a number of times and which you characterise as being inherently unfair—

Mark Garnier: Not inherently unfair, but it is a way of recovering your costs back.

Moray McDonald: There are just a few things that I think are worth mentioning. When we look at customers who go into overdraft and have not arranged an overdraft, those are the people who tend to get those unexpected charges. Just a few things that we are doing, which I think are very firmly rooted in doing the right things for customers: we are giving more and more customers small overdraft amounts so that they do not pay those daily charges.

Chair: I think Mark is really concentrating on this big point, rather than all these little things that are quite—

Moray McDonald: Yes, I just wanted to make the point about the unfairness.

Q588 Mark Garnier: You do raise an interesting point. You are addressing a very specific point: at a cost. That cost now has to be recovered somewhere else, and that is the problem. I completely understand that you are trying to help people. If people bounce £25 overdrawn, should that be worth a £20 letter? The cost of a small overdraft with you is far greater than the most horrific payday lender.

Moray McDonald: We have just given half a million people an overdraft of £250 so that won't happen.

Q589 Mark Garnier: How are you recovering that money? Where are you getting that money back from? That is a cost to you, which now everybody has to pay a share of, and we do not know what it is.

Moray McDonald: We believe it is the right thing to do for those customers in that situation. They should not pay those charges.

Q590 Mark Garnier: That is 250,000 customers. Are you telling the other 15.75 million customers that they are paying for a little bit of that?

Moray McDonald: Across all our activities, without any doubt, for the bank to be profitable, all of our activities across loans, mortgages and investments have to generate enough profitability to offset the cost of not charging for current accounts. That is absolutely correct.

Q591 Chair: We have just rehearsed there the thought processes that led both the Parliamentary Commission on Banking Standards and, before that, the Treasury Committee, in its report on retail banking, to conclude that we had to unravel this complex cross-subsidy, but we were not getting any co-operation from banks in doing so. You have said today, and I wrote it down, that this “makes a lot of sense to me”. That, at least, is some comfort to us. Thank you very much, both of you, for giving evidence to us this afternoon.

Moray McDonald: Thank you very much.

Craig Donaldson: Thank you.

Chair: We will go straight on to the next session because we will be having a vote in the House, almost certainly, at 4.30 pm.

Examination of Witnesses

Witnesses: **Lakshman Chandrasekera**, Chief Executive, London Mutual Credit Union Ltd, and **Andy Caton**, Chief Officer for Treasury and Corporate Affairs, Yorkshire Building Society, gave evidence.

Q592 Chair: We will begin because there will be a vote and a number of colleagues want to get in. Let us begin with you, Mr Caton. The coalition agreement contains a commitment to promote mutuals and foster diversity. What has become of that commitment? Has anything happened on it?

Andy Caton: I think probably there is more evidence of protection of the mutual sector over the life of the coalition Government, but probably less evidence of promotion. The sorts of things that would come to mind are the consultation we had on the leverage ratio through the FPC. At one stage, that looked like that could have quite a draconian outcome for lower-risk lenders such as building societies. The end result of that is something that is a lot more palatable where we have a base leverage ratio around the 3% level. I think that was a major point of industry concern. Capital is obviously a very important area for mutual organisations as the requirement for better-quality capital has clearly come about. We have had the development in the building society sector of core capital deferred shares, which has now been issued by Nationwide.

Q593 Chair: That generates balance sheet risk, though, doesn't it?

Andy Caton: I think that depends how you interpret balance sheet risk. It clearly provides extra capital.

Chair: Enough to make the regulators consider whether you need more capital to support you.

Andy Caton: Generally speaking, the regulator is pleased to see more capital come on to the balance sheet. That is meant to make the balance sheet more secure. Other external stakeholders such as wholesale investors and rating agencies want to see that institutions have access to external means of capital. Clearly, the conundrum for a mutual organisation, and in many ways the benefit, is that we are largely driven by retained earnings. The benefit of that is that our business planning is done on a very long-term basis. It is very aligned to customer needs but, on the other hand, we are often perceived as not having access to wholesale markets in the way that other share-based banks would do.

Q594 Chair: And therefore more vulnerable to both liquidity and solvency risk.

Andy Caton: Potentially. That could be the interpretation. We are very alive—

Chair: Because if you have all your eggs in one basket, you are vulnerable just on liquidity grounds because if you have mismanaged the shape of your main portfolio, you may find yourself running out of cash.

Andy Caton: To be honest, I think that that is common across a bank balance sheet structure as well as a building society structure. The perception would be more in terms of access to external capital rather than liquidity per se.

Q595 Chair: Anyway, have the Government really done much to help the mutuals or not?

Andy Caton: As I say, it has probably not actively promoted mutuals. The debate seems to have been much more centred around promotion of public sector mutuals, which I thoroughly understand. Perhaps going forwards in the development of new regulation there could be a call for explicit consideration that new regulation that is coming in does promote additional diversity, whether that is the challenger banks or existing challenger institutions, such as 150 year-old building societies, and that it is in line with the objective of promotion of mutual interests.

Q596 Chair: Mr Chandrasekera, you are offering similar services to those of banks and building societies. Are you actively trying directly to compete with them?

Lakshman Chandrasekera: Yes, we are. We are working with the local communities, so it is very different to any other business model. We are trying to be transparent from day one. We have a current account and we charge 95p a week, because we know what it costs to run the current account, and our members know exactly what they are getting from day one.

Q597 Chair: Were you listening to the discussion that took place at the latter stages of this last hearing?

Lakshman Chandrasekera: Yes.

Chair: You then went out of the room just at the moment we would have liked to ask you follow-up questions to that.

Lakshman Chandrasekera: I am sorry.

Chair: Perhaps you can say what you might want to say in response to that. Are you saying that you are finding that by telling people how much they are being charged, you are getting more custom?

Lakshman Chandrasekera: Yes.

Chair: People welcome the truth is what you are saying.

Lakshman Chandrasekera: That is exactly what it is. We are transparent from day one. There are other products and services that they are getting from the credit union. Yes, they pay 95p a week, but they have access to cheaper loans, advisory services and so on. That is one of the reasons why so many members are joining.

Chair: Very interesting.

Q598 Teresa Pearce: Is it correct that London Mutual's cash ISA is market-leading?

Lakshman Chandrasekera: It was last year. We were offering 3%, but it was too demanding, so we reduced the interest to 2%.

Q599 Teresa Pearce: Have you now ceased taking applications for it?

Lakshman Chandrasekera: That is right, yes.

Q600 Teresa Pearce: Was it too popular?

Lakshman Chandrasekera: It was too popular and we did not need that much liquidity in our balance sheet, so we had to stop that.

Q601 Teresa Pearce: Do you think that credit unions are better equipped to compete in the savings market than the ordinary personal current account market?

Lakshman Chandrasekera: We are specialised in the loans market—it is our forte. A larger number of members are borrowing a small amount of loans. In order to lend money we need to raise capital, so we found ways of raising capital. One thing that came from the 2010 legislation was allowing the credit unions to have interest-bearing accounts, so we introduced the cash ISA, and if we are running out of cash, we increase the interest.

Q602 Teresa Pearce: You say that the cash ISA was very popular—or a bit too popular. Are there any risks posed by attracting too much ISA savings?

Lakshman Chandrasekera: Yes. We were monitoring very closely and we took action last year to reduce it. We knew our liquidity was going up and we could not lend that money to the members. It is risky, but we need to monitor it.

Teresa Pearce: You reduced the rate and then you closed it altogether.

Lakshman Chandrasekera: Yes.

Q603 Teresa Pearce: Right, okay. Mr Caton, the Yorkshire Building Society offers 19 different savings products to the over-18s. Many of them look very similar to me. Why does it have so many?

Andy Caton: It probably reflects the fact we operate under different brands. Through the financial crisis we went through a number of mergers. We merged with Norwich & Peterborough Building Society, Chelsea Building Society and Barnsley Building Society, for example, and we tend to have very similar products, but we like to keep those local identities. Those original building societies are very well known in their own locality, hence we have quite a replication of products.

Q604 Teresa Pearce: Are you saying that most of these 19 different savings products are pretty much the same product with a different stamp on it?

Andy Caton: Yes, more or less. I am sure there will be some differences between them. I am not familiar with every single one of them.

Q605 Teresa Pearce: Do you think that would make it difficult for savers to try to look through and see whether they are the same or different? Is there any way you could make it simpler for a saver to identify the best deal for them?

Andy Caton: We certainly try to do that. One thing we are keen to emphasise is disclosure of interest rates, and making sure that is very prominent in statements, on our website and on the investor page, and keeping the range itself fairly simple as well.

Q606 Teresa Pearce: Clearly you want new customers. Do you offer better rates of interest to new customers than to existing savers—old savers?

Andy Caton: No. We are slightly the other way round. One of the rather painful experiences, to be honest, over the past couple of years has obviously been the impact of low base rates and the impact of the Funding for Lending Scheme, and we have gone through three broad waves of adjustments downwards in administered savings rates—the rates that we manage as a society. In each of those cases, we have tried to protect existing members as much as we can. We have a number of off-sale accounts that offer higher rates than on-sale accounts. Part of that is the fact we are a member-owned organisation, so it is logical that we benefit existing members, and partly we are in an environment where we are trying to protect ourselves against too much retail savings inflow as well.

Q607 Teresa Pearce: You would never offer teaser rates?

Andy Caton: No. We have a long-term agenda to try to maximise customer benefits over the long term. We will be actively in best buy tables, for example. I think over the first six months of last year we had over 700 savings best buys, but we try to maintain those price positions over the long term, rather than being in and out of the marketplace.

Q608 Alok Sharma: Mr Chandrasekera, can I turn to you? I think London Mutual was the first credit union to offer payday-style loans. What motivated you as an organisation to get into this market?

Lakshman Chandrasekera: There were two reasons. It was to protect ourselves and our business to begin with, because we found that some of our members were getting into trouble with payday lenders and not paying our loans. When it comes to collecting money at the end of the month, they do not have money in the bank.

Q609 Alok Sharma: That is interesting. When you do the application test, I assume your potential customers are required to tell you whether they have outstanding payday loans already?

Lakshman Chandrasekera: They will tell, but most of them do not tell. They do not lie. They do not give the whole picture. We use the credit reference agencies to find exactly what amounts are outstanding, but with the credit reference agencies, there are so many things missing in there as well. Someone can take a loan from one lender last week and it is not updated.

Q610 Alok Sharma: Right now, what percentage of your balance sheet is payday loans?

Lakshman Chandrasekera: Very small. I would say 5%, if anything.

Q611 Alok Sharma: Do you have a limit in percentage terms that you will allow for payday loans, so there comes a point where you just say, "That is it, we have reached 10%, 15%"?

Lakshman Chandrasekera: No, because through the payday loans we are attracting a new breed of customers or members who are working and who earn good money, but have some small problems in the short term. Once we start to attract them and give the first loan, they start to take long-term loans from us and then stay with us borrowing money. That is how we make money from them.

Q612 Alok Sharma: Okay, but your payday loan business is still making a loss?

Lakshman Chandrasekera: Not now, no. Last year the interest rate increased from 2% to 3%, so we have started at least to break even now.

Alok Sharma: Okay, you are now breaking even, because I think you were making a loss of £1 per payday loan at the time.

Lakshman Chandrasekera: At that time, yes.

Q613 Alok Sharma: Has the PRA, the Prudential Regulation Authority, expressed a view on your payday loan operations?

Lakshman Chandrasekera: No.

Alok Sharma: Nothing at all?

Lakshman Chandrasekera: Nothing at all, because I think we are not breaking any laws and we are upfront, and we do not have any hidden charges or anything like that.

Q614 Alok Sharma: Can I talk to you about your default rates? The figures that we have in front of us suggest that your default rates are higher than those of payday lenders such as Wonga, for instance. Does that suggest that your checks are not as tight as they could be?

Lakshman Chandrasekera: I do not know what the Wonga payday default rate is.

Alok Sharma: As I understand it, the comparators are that you have a 10% default rate and Wonga, as an example, has just over 7%.

Lakshman Chandrasekera: Yes, we do have 10%, but 80% of our applications are going through non-automatically. Someone has to decide on the loan application.

Q615 Alok Sharma: Obviously, when you go through and work out who basically to lend money to, there is quite a large attrition rate. There are a lot of people you reject. Could it be argued that what you are doing is effectively taking the best payday loan customers and the rest are being shoved out on to the high street lenders?

Lakshman Chandrasekera: No, I think most of the people who get rejected are people who are probably unemployed and not earning enough money. We have a threshold of a minimum earning of £12,000 per annum, so if they do not fulfil that, they get rejected. At the same time, we have other loan products for them. We reject the payday loans, yes, but we offer them other loans—open the account and save with us.

Q616 Alok Sharma: How many other credit unions that you are aware of are offering the same style of payday loan as you?

Lakshman Chandrasekera: None in the UK.

Q617 Alok Sharma: Why is that?

Lakshman Chandrasekera: I do not know. I think some of them—

Alok Sharma: That must be a discussion that you must have with your credit union peers. If you are telling us that you have a model that is now break-even and the

reason for having this model is that you get additional business that is profitable, why is not everybody else doing this?

Lakshman Chandrasekera: We are talking to a number of other credit unions and the Welsh Government are interested. They are coming to see our systems. One credit union is trying to use our system, because we are sharing our system free of charge. It is going on right now, but then the interest rate cap came up, so a little bit of demand—

Q618 Alok Sharma: You said you are sharing your systems. What does that mean? Are you providing the backbone infrastructure and saying to other credit unions, “You can use this for free”?

Lakshman Chandrasekera: Yes.

Q619 Alok Sharma: How many have expressed interest?

Lakshman Chandrasekera: Only one so far, and then there are a number of others talking.

Q620 Alok Sharma: A very final question. Is it right that you use psychometric tests to determine eligibility for payday loans?

Lakshman Chandrasekera: Yes, we did up until last year. We stopped that one because we wanted to see whether that theory is working or not. We stopped it.

Alok Sharma: It did not work.

Lakshman Chandrasekera: It did not work.

Chair: Was it the Reverend Flowers who was appointed on psychometric testing? I think he was partly.

Q621 Mike Kane: Mr Chandrasekera, you just mentioned that the Government introduced a cap, but the problem with the cap, speaking as someone who campaigned for the cap before I came to this place 10 months ago, is that you can take out a payday loan with a credit union, which I think is at generally much more preferable rates—there are other credit unions in Southampton and Manchester, of which I am a member, that do some payday loans—and then, unlike in the United States, you can go ahead and take out a payday loan from the commercial sector at the same time. Is that a big problem?

Lakshman Chandrasekera: Yes, it is. Right now, one of the problems we are having with the credit referencing agencies is we cannot get the true picture of a member. That is why we are talking to them to see if we can get things updated on a daily basis—someone can take a loan from one payday lender yesterday, but we will not know if that person came to us today what the existing balance is and so on—so that we can make a better decision based on that.

Q622 Mike Kane: You do not have real-time market information on that customer, do you?

Lakshman Chandrasekera: No, we do not right now.

Q623 Mike Kane: Do you think that is the next stage of what the next Government should be thinking about in terms of tackling this industry?

Lakshman Chandrasekera: Definitely. To add to that as well, it is for the credit referencing systems to include the rent and council tax aliases so that we can get a better picture of someone by having all that information in one place.

Q624 Mike Kane: Is it a lonely place being the chief executive of a credit union? Do you feel you get much political support?

Lakshman Chandrasekera: I think Governments are supporting. The current Government have spent nearly £33 million on the development project and the previous Government spent something like £80 million on the growth fund. Governments are supporting the credit unions a lot, yes.

Q625 Mike Kane: Good. Are any senior party members customers of yours?

Chair: You are not obliged to answer that question.

Lakshman Chandrasekera: Okay, maybe I won't then. We have quite a lot, yes. I do not want to name names.

Q626 Mike Kane: I want to ask both of you a question. I am a Co-operative Bank customer back home in Manchester. Should I keep this card or should I not?

Andy Caton: I cannot answer that question. I think that is probably down to your own personal choice. I would like to see Co-operative Bank getting over its current troubles and being a thriving mutual.

Mike Kane: That is very nice of you.

Andy Caton: It is part and parcel of the diversity of UK financial services.

Chair: It adds to diversity, yes.

Q627 Mike Kane: You are expanding into more diverse products, but that is what the Co-operative Bank got into trouble for. How do you think you will do it better than perhaps it did?

Andy Caton: If that is a debit card, I am not sure whether debit cards were at the centre of the Co-op Bank's woes. I think it had more to do with commercial lending, but I do take the point about diversification. Ultimately, that has to be driven by customer need and by the competence of the organisation to deliver that. We currently are very much a bit player in the current account market. We have 100,000 customers through our Norwich & Peterborough brand, but in the fullness of time, we would like to see that developing into a group current account proposition. We are looking with great interest, obviously, at the review of the market, barriers to entry and the need for some quite determined structural reform there.

Q628 Mike Kane: Mr Chandrasekera, critical to your business is having a bank of affluent customers. A credit union cannot be seen as a repository just for poor people because it therefore cannot raise capital to lend. Key to that is payroll deduction at source, is it not?

Lakshman Chandrasekera: Yes, it is. We need the balanced membership. Most of the credit unions have one or two either local authority or hospitals doing the payroll deductions. It is nice to expand that idea to all employers who are taking part in pay-as-you-save schemes or something like that. The money deducted from the salary goes to the credit union, so people will start to save money as well as borrowing.

Q629 Mike Kane: What is your view in this time of austerity with multiple Government Departments? The Cabinet Secretary writes to tell me that there are multiple HR departments across Government, yet it is up to them whether they introduce payroll deduction at source for members of the civil service to become members of a local credit union?

Lakshman Chandrasekera: Yes. Right now we are talking to the Ministry of Defence and DWP on the payroll deduction facilities, and we have been told that the personnel departments are consolidating and becoming one, so it could be in the future.

Q630 Mike Kane: But at a stroke of the pen the Government could make a real contribution to credit unions by allowing payroll deduction at source.

Lakshman Chandrasekera: They could do, yes. We are talking to the Government Ministers and so on about payroll deduction schemes, especially for the DWP.

Q631 Mike Kane: Do you think the credit union movement needs to be better at lobbying across not only central Government, but local government as well?

Lakshman Chandrasekera: Yes. We could do a bit more lobbying and get the message across, especially on payroll deductions and on having some level playing field, and access to the payment system in the UK and the Bank of England settlement accounts. I heard that some larger credit unions are putting their money on 10 or 15 different banks just in case one falls down. We do not have anywhere to put all our money in one place, and it is a risk.

Mike Kane: Just to finish, I will declare my interest as a member of the Manchester Credit Union.

Chair: Some personal information coming into the Committee this afternoon.

Mike Kane: I like to liven it up.

Chair: Absolutely, I agree. I call Mark Garnier—I am sure it will be livened up now.

Q632 Mark Garnier: I will keep all my personal information to myself, if I may.

Mr Caton, you and Mr Kane were chatting about Co-operative Bank. I was very interested in your views on Co-operative Bank because, probably by any traditional judgment, it would no longer be a co-operative bank. It is, of course, now owned by—

Andy Caton: Just a change in its ownership structure.

Mark Garnier: Absolutely right, and there is an interesting question: how significantly do you think it has changed, and its culture has changed, as a result of the change of the management and the ownership structure?

Andy Caton: It is very difficult for me to make comments about another organisation. Obviously I do not sit within the Co-op, so I do not feel that change in culture. I see from the outside that it has done a review of their ethical stance and reiterated how it stands as an organisation. I also appreciate the point that, as you increasingly get external stakeholders taking a stake in a mutual organisation, that must imply some sort of change in direction or diversion of financial benefits. Within our own business we are 100% customer owned, so all our profits are going to retained earnings, and that drives the capital of the organisation and how we drive the business. We do not have that compromise.

Q633 Mark Garnier: No, exactly right. This is perhaps why I am driving at this because, of course, the co-operative model is a different model anyway from the mutual model, but none the less, in some respects, broadly similar. But certainly with the Project Verde report that we did on the Treasury Committee and then also looking at the various different models of the Parliamentary Commission on Banking Standards, there were some pros and cons of both. The interesting one about the co-operative model was that one of the failings that we found was that, while it is very well intentioned that you have members who are running these organisations, when you get into the extraordinarily complex world of financial services, particularly when you have complex things like banks, balance sheets, reserves and all that kind of stuff, it becomes slightly too difficult for what ostensibly is a layman, as a non-executive director in the Government, to be able to handle it.

The conclusion we broadly came to was they made an awful lot of terrible decisions. Trying to increase the size of that bank tenfold in the space of a few short years at the time of incredible stress on the banking industry, which is still there, of course, was a very bad corporate decision, supported by laymen. Whereas in your model, while it is not that similar, you do none the less have a one member, one vote, type of system, and you do of

course also have the fact that you have a more family-type feeling about your organisation than you would in a purely commercial, traditional publicly listed company. However, do you find that sometimes you get unhelpful outcomes in members' meetings when a well-intentioned group of members might vote for something that is commercially idiotic?

Andy Caton: No, because we do not have that direct linkage into the active decision making of the organisation, in reality. All directors are members, but they are appointed in accordance with their expertise in overseeing the governance of the organisation. We do not have that committee-based, co-operative-style, layman-driven governance structure. Every member of the board is there due to their own expertise and what they bring round the table. We have more non-executive directors than executive directors so that, as an executive director, we have the right level of challenge across the board table, and feedback from members is very direct. I go to probably every one of our member question times, where the dialogue is very much around products, benefits and services, and what we are doing in their local communities, but we are not looking to members to drive the business on the day-to-day basis.

Q634 Mark Garnier: How many non-executives and executive directors do you have?

Andy Caton: We have five executive directors and eight non-executive directors.

Q635 Mark Garnier: So 13 on the board?

Andy Caton: Yes, and that can vary.

Mark Garnier: Sure, but again it is a manageable size board; it is not unworkable.

Andy Caton: Yes.

Q636 Mark Garnier: You said all the non-executives are members. Are they members first or are they required to be members—

Andy Caton: It can be either.

Q637 Mark Garnier: But they are chosen and put forward because of their expertise in what they do?

Andy Caton: Yes, we will go through a recruitment process just like you would do for any other senior management.

Q638 Mark Garnier: It would be a very familiar process that you would see with, for example, Metro Bank which is a small bank?

Andy Caton: Yes.

Q639 Mark Garnier: That is very reassuring. With the expansion, one mutual has done extraordinarily well in terms of expanding and then had to deal with its balance sheet. Nationwide tackled that through its capital deferred shares, which of course is now moving quite markedly away from the purist mutual model. How do you see the mutual model progressing in the future in terms of expansion? Again, you are challengers to the banks. Your success is good. It provides diversity of opportunity, diversity of product, diversity of model and, one would hope, choice of service. If you are restricted by the capital and purely by the fact that you have to get the positives to be able to expand, that will limit your ability to grow. Would you see yourselves as being restricted in order to maintain your model, or would you be prepared to go to things like capital deferred shares and move away slightly from the mutual model in order to expand?

Andy Caton: There are quite a number of points in there and it is a very interesting question. First of all, there is a question of balance in terms of how you mix 150 years of retained earnings, the best kind of capital you can have, with the amount of CCDS issues you might do in the marketplace. If you look at the nominal amount that Nationwide has issued, it is relatively small compared with that underlying capital base. I do not think that is polluting the balance of benefits of the organisation.

Q640 Mark Garnier: It could be the thin end of the wedge.

Andy Caton: It could, but I think that other things would come in as self-limiters on that, if only the cost of the capital that you were raising, which is relatively high. In Yorkshire Building Society's case, we have no immediate need to issue co-capital deferred shares. We have very high core equity ratios—13.5% or so—and our leverage ratio is about 4.5%. We do not have those kind of immediate “still more capital” needs, but we are very mindful of things that might be coming down the path that could limit that. Maybe at that point the argument goes in two directions. First, is CCDS uniformly applicable to all building societies? Certainly in the form that Nationwide has issued it, it does have to be of a certain size to be liquid, to be publicly quoted and to be tradable—that is not applicable to probably two thirds of the rest of the sector—and yet it is providing a valuable addition to the overall industry. Hopefully there is the development opportunity for another investor base for co-capital deferred shares for smaller societies within the retail sphere.

The recent consultation of the FCA on the retail distribution of mutual shares moves in the right direction, with identification of a restricted class of investor as well as sophisticated and high net worth, but maybe there is a further to go in the amount that those individuals could invest in those shares in the appropriate sales framework. Currently the discussions are around 5% of net investable assets, but investment in a crowd-funder can be 10%. There are probably very good arguments why the risk profile of a small mutual building society is stronger than a crowd-funder investing in starter businesses, although that is very worth while.

Q641 Mark Garnier: That is very interesting; thank you very much. Does Yorkshire Building Society limit itself to Yorkshire? There is great debate going on about regional banks and products. One of the questions that has not been answered by those who are advocating it is that if you want to do a mutual in the south-east or a bank in the south-east, you have a huge depositor base with lots of spare cash. There are other parts of the country that do not quite have the same amount. The north is not as wealthy as the south. That is not to suggest for a moment that it is poor, but do you think the regional mutual model is one that is ultimately completely competitive, because if you are just restricting your depositor base to one area, you are merely reflecting liquidity in that area, rather than necessarily adding something to that area?

Andy Caton: Regional building societies, to use them as an example, have a very viable business model and there are advantages that they are embedded and well known in their communities, fundamentally. From Yorkshire's perspective, we are the second largest society in the UK, so we are much more nationally based, although we do have regional brands within our group. We are touching all parts of the UK in reality. Over the past two years we have been accounting for around about 18% of total UK net lending, so we are very much punching above our natural weight, where we would have a natural share of probably just under 4%, for example.

Q642 Chair: There has been a lot of regulatory misconduct in the financial sphere, particularly with respect to banks and their customers. Do you think customers are more or less likely, or neither more nor less likely, to be protected or—let us put it the other way round—vulnerable to that type of misconduct at a mutual?

Andy Caton: Sorry, that they would be more protected as a mutual.

Chair: You can look at it either way. Do you think that the mutual model is a predictor of whether you will get better service or less regulatory misconduct?

Andy Caton: That should certainly be the case.

Chair: Why is that?

Andy Caton: Ultimately, of course, you do have to look at governance and compliance monitoring systems.

Q643 Chair: Why will mutuals behave better than retail banks?

Andy Caton: I think fundamentally because they are customer-owned. If you take yourselves back to pre-crisis and you perhaps compare an organisation such as the one I work for, Yorkshire Building Society, with a Northern Rock, which obviously was an ex-building society—curiously the same size as Yorkshire when it demutualised—with its strategy of growth and some of the things it was doing with products such as the Together mortgage, it was running on a different rule book to the one that we were. Our business

strategy meant that we were constrained, even if we had wanted to grow at those levels and make some of those short-term business decisions.

Q644 Chair: You are linking the misconduct and the mis-selling to fast growth and to a bid for fast growth, but is it not the case that the Co-op, for example, had a much higher mis-selling record and a much more serious misconduct record than the major banks?

Andy Caton: Yes, and I am sure you can always find those examples. On the other hand, if you look at some of the industry statistics—

Chair: So it was an exception?

Andy Caton: Yes, I think so.

Q645 Chair: The reason you gave was because you are mutually owned by members. Do you think it is realistic for your members to exercise that kind of influence and do they, in practice, exercise that influence? Imperfect though it is, don't you think that the absence of shareholder pressure, which would subject a limited company to the disciplines of the market, might provide more pressure than members of a mutual?

Andy Caton: I think we are kept honest by the fact we are customer-owned and we have to—

Chair: Only in a very notional sense.

Andy Caton: We have to plan over the long term, though. The business model has to be geared around sustainability and a lot of our financial—

Q646 Chair: Is not the history of mutuals one of self-perpetuating boards?

Andy Caton: No. If that was the case at one stage, those days are very much gone. We all comply with the same regulatory framework. I think mutual building societies are fundamentally closer to their customers, either by virtue of their constitution—one member, one vote makes us uber-democratic—or the way we behave in terms of how we keep in touch with our members.

Q647 Chair: Mr Chandrasekera, on the same thing, you are offering payday loans at competitive rates of interest. Do those who take those loans out automatically become members?

Lakshman Chandrasekera: Yes, they do. They need to be a member; yes of course.

Q648 Chair: Do you think that customers who might come to you for only a very short period of time are likely to become meaningfully engaged in the running of your firm?

Lakshman Chandrasekera: They have that opportunity. For anyone who wants to become a director of the credit union, there is a process to follow and they could do that. We are attracting directors through those channels.

Q649 Chair: The Archbishop of Canterbury suggested that credit unions might be capable of putting payday lenders out of business. I am paraphrasing what he said slightly, but do you think that can be done?

Lakshman Chandrasekera: We have succeeded so far in trying to bring the cap to 1,500% APR, so that has consolidated the market quite a lot right now. It probably may be a big question, but there is some room for manoeuvring there.

Chair: Sorry, I did not hear the substance of the answer. It sounded as if it was in that last sentence. Could you say that again?

Lakshman Chandrasekera: No, there is a long way to go for us to take out all the payday lenders from the market, but the cap that we were arguing with the PRA and FCA came, so we were happy on that.

Q650 Chair: But the cap would not be a competitive driving out but a regulatory driving out. What I am trying to get at is whether it is through regulation or competition that we ought to look best to deal with misconduct. There is a lot of good lending going on in the payday lending market, but there is a lot of misconduct as well, and it is the misconduct we want to drive out.

Lakshman Chandrasekera: Even with the credit unions, everyone knows it is a mutual and we have a cap on interest rates. I do not see any problem with regulators coming and saying that you cannot charge more than 8% per month or something for the loans. In that sense, we are having some kind of level playing field in there.

Q651 Mr Love: Mr Caton, do the regulators understand the mutual sector?

Andy Caton: Yes, I think they do. We have a good dialogue with the PRA and the FCA. In the development of regulation, we are mindful of proportionality both for ourselves and for smaller players. That is where I feel the vision is largely focused at the moment. I will give you one example. There is consultation around proposals through the Basel Committee for new standardised risk weights, so that obviously goes fundamentally to our lending profile. The detail of those early proposals look like they would be quite punitive for higher LTV mortgage lending. We obviously are very focused on first-time buyers and helping people to get on the housing ladder early on.

At the moment, that looks potentially quite worrying, and there are a number of different aspects to that in terms of the classification not being indexed. We could see that

potentially that could create artificial churn in the marketplace. It might mean that first-time buyers do not get longer-term deals because they have been incentivised to take shorter-term deals. Those sorts of developments do not seem to be very in sync with what we are trying to achieve as a mutual or, indeed, the interest of the wider housing market in the UK.

Q652 Mr Love: Let me take two other examples. You mentioned the leverage ratio where the building society sector was unhappy with the decision of the regulator. The Financial Services Compensation Scheme is not weighted to low-risk organisations, so the building societies pay a lot more than they believe they should. How come the regulator got those so badly wrong as far as you are concerned?

Andy Caton: Those are just situations that we have to live with. We pay more than our fair share to the compensation scheme because building societies are major players in holding the UK's national savings. The rules of the game are that you pay in line with your market share. Even though there have been very limited examples of failure within the sector, we end up paying a larger bill and, until those rules are changed, I think that will remain the case.

Mr Love: You did not mention why the regulator had structured the Financial Services Compensation Scheme in such a way, but let me carry on.

Andy Caton: We obviously lobbied hard for those rules to be changed.

Q653 Mr Love: You mentioned Basel. Basel decided that permanent interest bearing shares, which everybody thought was tier 1 capital, was not anymore. Nationwide has come up with this new capital, which we understand will be designated as tier 1, but we hit the problem you elaborated a few moments ago that you will not be able to sell this to retail investors, which is against the principles of the mutual movement. How come they are getting it so wrong on so many fronts?

Andy Caton: Perhaps this is because these instruments are new and, in fairness to the FCA, they have engaged in that debate in distribution to retail investors. We have gone from a situation where there was effectively a minimum £25,000 investment for CCDS. That was obviously a very high figure, which stands somewhat illogically against the fact that CCDS would be eligible for ISAs, and are now looking at a better set of rules for that, but it has taken time to do that.

Q654 Mr Love: The regulator is hung up on this idea of sophisticated investors and retail investors and has come along with this compromise, if I can call it that.

Andy Caton: Yes, absolutely.

Mr Love: But that does not address the issue for the mutual movement.

Andy Caton: No, I would agree with that and also, of course, any investor could invest in a share in a bank, so why not invest in a CCDS building society? We do have those anomalies as well. This is a process of dialogue with the regulator and that has evolved. I think we have ended up in a more satisfactory place than perhaps it looked when we started.

Q655 Mr Love: Mr Chandrasekera, let me ask you the same question. Do the regulators understand the credit union movement?

Lakshman Chandrasekera: I think they do. We have close dialogue with them. A group of credit unions like ABCUL contacted them individually as well. We are talking to them on applying proportionate responsible legal regulations and so on to the credit unions. Right now, yes, we have a good dialogue, and I think they also understand our needs and where we are coming from.

Q656 Mr Love: You are having a dialogue, but is the prudential regulation proportionate to the issues that you are trying to get across?

Lakshman Chandrasekera: Right now, we think it is, but there are some new things coming up, like the senior managers regime and so on, where we do not know where we are going. Again, the FCA is talking to us and we are trying to be one of the first credit unions to take part in a pilot project with it so that it can understand what credit unions' requirements are for the new regime.

Q657 Mr Love: Credit unions go from fairly large sophisticated organisations to relatively small—and, some would say, rather risky—credit unions at the lower end of the marketplace. Do you think that the regulator fully understands that while regulation might be appropriate for the large and sophisticated, it may well be disproportionate in terms of the smaller organisations and make life even more difficult for them on the daily grind?

Lakshman Chandrasekera: Yes, some smaller credit unions are finding that the regulation is tough and they might not be able to meet certain requirements but, at the same time, we need to understand that we are looking after someone else's money. It is getting that balance, and I think that both the PRA and FCA are trying to understand the credit union sector and apply the rules accordingly.

Q658 Mr Love: Do you think there is a pecunious streak in the regulator? I mean this in the sense that there are significant legal constraints over what you can do, and they occasionally deregulate legally, although that is very occasionally. For example, you can charge 1% interest and then they move it to 2% interest and then to 3% interest a month, yet other financial organisations can charge according to whatever the risk they are facing in terms of an interest rate. You have the legal constraints and you also have on that heavy prudential

regulation. Is that appropriate for credit unions? Do they not need to be freed up so that they can challenge in the way that the Irish or American credit unions do?

Lakshman Chandrasekera: That is a fair point. On the interest rate cap, we could not understand what the reasons were behind it, so we are talking to ABCUL and our trading organisation about that. We could not understand why we are capped for 3%, but any payday lender can charge anything they want. Those are the things that we happily wait for and, within reason, we have to change going forward.

Q659 Mr Love: Let me ask you an unfair question, because it is about other credit unions. My own local credit union, the Edmonton Credit Union, went out of business some time ago. Because you are members of the Financial Services Compensation Scheme, everyone is guaranteed their own resources up to £85,000, but they continue to go on. Is it not bad news for the credit union sector that so many of the small credit unions are going out of business? What do you think we need to do to address that issue?

Lakshman Chandrasekera: We need to have a better dialogue with the regulators and the trading organisations to understand the credit unions that are struggling, for example, and then try to come up with some solutions before they go under. One of the probabilities is merging with the credit union next door.

Chair: I think we will have to adjourn there. In fact, it might be best to bring the hearing to an end. Thank you very much for coming to give evidence. If you have further thoughts that you feel have been curtailed, do put them in writing and we will be very glad to have them. We are grateful to you for your patience this afternoon in waiting so long in order to give evidence.