

Treasury Select Committee

Oral evidence: [Access to basic retail banking services](#), HC 808

Monday 19 December 2016

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Members present: Mr Andrew Tyrie (Chair); Helen Goodman; Kit Malthouse

Questions 168 - 274

Witnesses

I: Moray McDonald, Managing Director, Personal and Business Banking Division, Royal Bank of Scotland; and Steven Noakes, Managing Director, Retail Customer Products, Lloyds Bank.

II: Stu McInroy, Chief Executive, National Pawnbrokers Association; Dominic Thorncroft, Chairman, Association of UK Payment Institutions; and Dr John Low CBE, Chief Executive, Charities Aid Foundation.

Examination of witnesses

Moray McDonald, Managing Director, Personal and Business Banking Division, Royal Bank of Scotland; and Steven Noakes, Managing Director, Retail Customer Products, Lloyds Bank.

Q168 **Chair:** Thank you very much for coming to give evidence to us this afternoon. I would like to go straight to the core question, really, which is how much this is costing your respective banks. We are discussing basic banking. What does it cost your bank, Mr Noakes, to provide basic bank accounts?

Steven Noakes: I am sure you are going to get different numbers from the two providers here, but I will give you the data for Lloyds.

Q169 **Chair:** I think you are the two biggest, are you not?

Steven Noakes: We would be, yes. If you look at the proportion of costs in terms of the branch network, the ATMs and the customer service centres, our view of the cost of provision for our just shy of 4 million basic bank account customers is about £230 million.



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Chair: Net?

Steven Noakes: That is the cost of the provision. Then there is some income that we get from those customers. However, recognising that for these types of services the level of income you get is relatively small, we would assess that the income covers less than half of that cost. We are probably left with £130 to £140 million net cost of provision for those services.

Q170 **Chair:** How many people are provided for?

Steven Noakes: That is for just shy of 4 million customers.

Q171 **Chair:** What is the cost per customer, therefore?

Steven Noakes: The cost per customer is around the £50 mark. That is on a gross cost basis.

Q172 **Chair:** What are those figures for your bank, Mr McDonald?

Moray McDonald: They are very similar. We would place the cost per person slightly higher than £50.

Chair: Just give us the figure.

Moray McDonald: We would estimate it is between £60 and £70.

Chair: That is quite a lot more, actually.

Moray McDonald: The difficulty with these sorts of estimations is that, in allocating very large costs, as Steven referred to, such as the cost of the branch network, the cost of contact centres and those sorts of things across millions of customers, if you change that allocation by a relatively small amount or take a slightly differing view, as we might, between organisations, you can easily explain those differences.

Q173 **Chair:** Just give me the equivalent numbers: the number of people involved and the overall cost.

Moray McDonald: Our overall number of people involved today is about 780,000 that we have on basic bank accounts, and our estimate of the individual cost is £60 to £70 per head. Like Steven, the important part of this to understand is that the cost of providing a basic bank account does not really vary very significantly from any other bank account. What differs is that there is very little income associated with those accounts to offset the cost of carrying the accounts.

Q174 **Chair:** You have been saying it is very difficult to estimate, but the banks themselves would not be providing these accounts were it not for the requirement to do basic banking. Is that correct?

Moray McDonald: Certainly, speaking for my own organisation, we provided significant basic bank accounts prior to the 2014 agreements.

Q175 **Chair:** The question I am asking you is: before you were asked to make



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this specific provision, which was initially resisted by the banks when it was first discussed with them, you presumably concluded that these would be loss-making, and that is why they were not already being provided.

Moray McDonald: If you call these ones new basic accounts, post-2014, the old basic accounts were also loss-making, just speaking for our own organisation.

Q176 **Chair:** How long has this project been in place? It is a lot more than two years. I cannot remember how many years this has been going on for, but it has been a long time.

Moray McDonald: The memorandum of understanding came into force on 1 January 2016.

Q177 **Chair:** That has superseded another arrangement.

Steven Noakes: There was a prior arrangement, which dates back to 2002.

Chair: That is the one I am thinking of.

Steven Noakes: In fairness, the industry was providing elements of basic bank accounts prior to that.

Q178 **Chair:** I do not want to prolong this, but I want to get to the very simple number. There is a number over and above the amount that you would in any case have been prepared to bear as a cost, which is a consequence of Government intervention: the memorandum of understanding and now further formalisation of these arrangements, which have brought a cost to your banks. I want to know what that number is.

Steven Noakes: From our perspective, as Moray has touched on previously, these have always been loss-making. The key thing for us is making sure that the industry—

Q179 **Chair:** I want to know what that number is. I am just asking you a very simple question. You are doing things you would not otherwise do had you not been directly asked by the Government to do them. How much has it cost you to do what the Government asked you to do in 2002 and since? Are the numbers you have just given me the right numbers to answer that question?

Steven Noakes: From a cost perspective, yes. There may be differences in terms of income, but they would not materially change the fact that these would still be loss-making.

Q180 **Chair:** We are going round in circles here. If the income was huge, the cost would be neither here nor there. You would say, "These are very good accounts; they have twice the income of the cost base, so that we must keep these accounts." However, that is not what you are saying. You are saying that the benefits are nugatory. The returns are nugatory.



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Steven Noakes: I am saying that, from our perspective, we have always had the view that, given our position in the UK market, we need to support social banking. That is a cost to us as a business but we think it is the right cost to us as a business.

Q181 **Chair:** I am asking what that cost is. What is it?

Steven Noakes: That goes back to the numbers that I have talked about. The fact is, at the moment, we have more than our normal market share. From a back book perspective, we have 50% of the market. From a new business origination perspective, we have 36% of the market. That is well in excess of the 25% of full facility accounts that we currently provide.

Q182 **Chair:** Who picks up the bill for this?

Steven Noakes: This is one of the things that we were open about in the consultation with the CMA. This is probably the one element of cross-subsidisation that exists in banking account provision.

Q183 **Chair:** Many would dispute that and say there are many other cross-subsidies involved in retail banking. That is a very controversial remark that you have made. However, you are saying that this is one element that you would agree is a cross-subsidy. You are saying other account holders are paying for this.

Steven Noakes: Ultimately, although through the work that you do on full facility accounts you would always make sure that those are competitive and provide value for money. Inevitably, it probably also has a cost in terms of absolute profit that an organisation will make.

Q184 **Chair:** Exactly. Isn't the bank is going to split the cost of this three ways? First, there will be a lower return to the shareholder in dividends or share value, ultimately. Secondly, there will be a somewhat smaller remuneration pot to share out among employees. Thirdly, customers may, depending on the shape of the demand curve, also end up paying slightly more.

Steven Noakes: That is a fair assessment.

Q185 **Chair:** All three are picking up the tab. Mr McDonald, what about your bank?

Moray McDonald: We take the view that this is one example, but not the only one, of cross-subsidies that happen in UK banking. However, given how moderate the income is, there is a loss on pretty much every basic bank account. Therefore, that loss is paid for by, most obviously, anyone else who pays for their banking, be that a current account, a loan, an investment or a mortgage. They are certainly paying for the basic bank account holders. I would say that we are enthusiastic to allow people to participate in the financial system. We have all accepted that that is a good thing to do.



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Q186 **Chair:** I am listening to what you are saying. You have said that several times already. I want to clarify one other point. Are you clear that these are not accounts that you might want to hold for the long term because they become profitable at a later stage? I worked in the financial services industry for a while and there were things we did that sometimes ran at a loss for many years because they would become profitable later.

Moray McDonald: Maybe I can give our own example, because we recently—

Q187 **Chair:** Sorry, was that a “yes” or a “no”?

Moray McDonald: It is a “yes”. Our own example is that, prior to the new accounts—these ones that are post the MOU—we had a little over 1 million different types of existing basic accounts. When we came to introduce the new basic account, we moved 600,000 of those million customers into the new basic account and we upgraded 400,000 of the million to a regular current account. That was because they no longer met the criteria for the new basic account, which is a real positive. As you imply, they had migrated out of being in a disadvantaged situation, so we were able to give them a regular account.

Q188 **Chair:** We will come on to that in a moment. The social implications are a very important aspect of this, which colleagues will comment on. Mr McDonald, I have one more point of clarification about the numbers. You were saying you get some income from these accounts. What is the average income you get from these accounts?

Moray McDonald: I do not have that number in front of me.

Q189 **Chair:** Could you send that to the Committee?

Steven Noakes: Yes.

Q190 **Chair:** Do you know what that number is?

Steven Noakes: It is about £20 or £25.

Q191 **Chair:** What was the cost?

Steven Noakes: My gross cost was £50.

Q192 **Chair:** So we are talking about—

Steven Noakes: A £25 to £30 net loss.

Q193 **Chair:** Yes, but you are talking about nearly half the cost being met by income.

Steven Noakes: Yes.

Chair: There are lots of questions that that throws up, but I am not going to open it just now.

Q194 **Helen Goodman:** Mr Noakes, just to pursue this a little further, the latest data show that over 3.5 million pre-2016 basic bank accounts were still open at Lloyds, while fewer than 200,000 new basic accounts were



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open. The other banks have closed pretty much all their pre-2016 accounts. Why did Lloyds not do that?

Steven Noakes: The key reason for that is that our historic basic bank account proposition was quite rich, by which I mean that there were a number of benefits that basic bank account customers enjoyed as well as the full facility accounts, such as cashback rewards. If someone is spending on their debit card, they could get up to 15% cashback on that spending. When looking at the possibility of forced migration—

Q195 **Helen Goodman:** Do you mean that if I had a basic bank account in the old scheme with Lloyds and I went to the supermarket and the bill came to 100 quid, you would put 15 quid into my account?

Steven Noakes: It is dependent on the offers that were available. This is the type of service that many of us offer in the market today.

Q196 **Helen Goodman:** Do you?

Steven Noakes: Yes.

Q197 **Helen Goodman:** Why do I not get 15 quid back every Friday, then, when I go to the supermarket?

Steven Noakes: One good example would be working with a supermarket chain, where we have data that says, "Here is a regular Asda customer, but they may occasionally shop at Morrisons." Morrisons would provide an incentive, which we then offer to that customer to say, "If you shop at Morrisons, you will get the 15% discount on your purchases for that instance."

Q198 **Helen Goodman:** It is not every week.

Steven Noakes: It is not every week.

Helen Goodman: I was going to say, it would be pretty phenomenal.

Steven Noakes: There is value in that for those customers.

Q199 **Helen Goodman:** Are you saying that the loyalty schemes the supermarkets run are not paid for by the supermarkets but are paid for by the banks?

Steven Noakes: No, they are paid for by the supermarkets. Indeed, all the other providers that enter into those types of schemes pay. The key issue is that the new basic account, which we have offered since the beginning of January, does not confer those benefits. In considering moving the back book of customers from that proposition to the new one, you have to be careful in terms of whether or not they are seeing more benefit, rather than the potential risk of paying fees. The approach we therefore took was, rather than doing a forced migration, to write to all those customers to explain the options they had available, and the costs and benefits of those different options, for them to make their own decision.



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Q200 **Helen Goodman:** Sorry, I am a bit confused now. I thought that you told the Chairman that the old basic bank accounts were more costly to you than the new ones. Is that right?

Steven Noakes: No.

Helen Goodman: That is not right. Were the old ones more expensive to you or less expensive to you?

Steven Noakes: Both the old and the new continue to lose money.

Q201 **Helen Goodman:** Which loses more from the point of view of the bank?

Steven Noakes: It depends on the individual customer and the profile that you have there. That is the reality, and that is why we have not been able to force migrate. This is not a commercial consideration. It is primarily a customer consideration. If we force migrated 3.6 million customers, and some of those lost out on a benefit rather than the potential risk of getting a returned item fee from time to time, we would then have a very serious conversation with the conduct regulator. The approach we have taken is to write out to each of those customers and give them the option.

The one thing I should say, however, in terms of response to this question, is that we are clearly conscious that, if you write out, you only get a certain number of customers either looking at or acting on that communication and we are not comfortable with that, moving on an extended period of time. Therefore, we have a firm plan to ensure that all those customers move away from a fee-paying, risk situation in the second half of 2017.

Q202 **Helen Goodman:** Can we just come back to this: do you make bigger losses on the new basic bank accounts or on the old basic bank accounts?

Steven Noakes: The one area of income that you are not permitted to see in the new structure, as of the beginning of January, is anything like returned item fees. Those do get charged to the back book customers. However, it depends on their individual behaviour.

Q203 **Chair:** What was the answer to Helen's question?

Steven Noakes: Marginally, yes, you lose more money on the provision of the new account versus the old.

Chair: Net?

Steven Noakes: Net. However, it is marginal and, as I said, the key consideration in terms of migration was not a commercial one. It was a customer one.

Q204 **Helen Goodman:** You lose more on the new than the old.

Steven Noakes: Yes, marginally.

Q205 **Helen Goodman:** However, they gain more on the old than on the new,



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like the £15.

Steven Noakes: That is right: the 15% off.

Q206 **Helen Goodman:** That does not make sense. How can they gain more on something that you lose less on?

Steven Noakes: There was a lot of work done across the industry in coming to an agreed standard under the memorandum of understanding with Her Majesty's Treasury. As part of that, we did not think about including an ongoing spending rewards programme for the new acquisition activity from January 2016. There are differences in the way that the propositions operate.

Q207 **Helen Goodman:** It would be a good idea if we could have this set out in writing.

Steven Noakes: I am very happy to do that. The key consideration and difference to impress on you, and one of the reasons why we were driving 50% market share historically, is that we had a very rich proposition. The basic account that we have operated for a number of years looked very similar to a full facility account, including things like spending rewards. Therefore, in moving to a proposition that, for us, potentially offers lower value to those customers, we have to manage that transition very carefully.

That said, we are uncomfortable about that prolonged position. Our firm intent is to ensure that none of those customers have the risk of paying fees in the second half of 2017, but it is still a complex process for us to manage because we need to ensure that there is no conduct risk as we manage that transition.

Q208 **Chair:** Just before we move off, what is the cost of providing your full proposition, as you have called it, which is very similar to that for a non-basic bank account holder?

Steven Noakes: It is less the cost; it is more the fact that there is less opportunity for income because you do not have the fee from time to time.

Q209 **Chair:** That person is getting a lower service, are they not? They are getting less than they otherwise would have.

Steven Noakes: They are not getting a lower service. The way that you service those customers is actually pretty similar.

Q210 **Chair:** The cost per head basis—

Steven Noakes: The cost per head, the £50 I talked about earlier on, is pretty consistent in terms of legacy book versus the front book.

Q211 **Helen Goodman:** What about the difference in the costs and the incomes on the old and the new at RBS?



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Moray McDonald: We did not have anything like the spend programmes on our old, so it is much simpler for us. It is more costly to RBS to offer the new accounts, but despite that we moved them anyway.

Q212 **Helen Goodman:** How long do you think you will carry on running the old ones for?

Moray McDonald: We do not have any old ones. As at the reporting date in June, we had a little less than 7% of old customers still to move. They have now moved, so we have moved everyone.

Q213 **Helen Goodman:** You have obviously done it in a more aggressive way than Lloyds. Did you secure the consent of all these people in the way that it is doing or did you go about it in a different way?

Moray McDonald: No. We did not have the considerations that Steven is referring to in terms of complexity and in terms of what was in the customers' interest. By the way, the MOU did not oblige us to do this. No part of it obliged us to move the customers. It was clear to us they were better off in the new basic account and therefore we moved them.

Q214 **Helen Goodman:** When your colleagues from the BBA and Barclays came to the Select Committee a couple of years ago, they said that they wanted to make the basic standard and premier accounts sit alongside everything else and equally visible. However, we have looked at your websites, both RBS and Lloyds. On Lloyds, there is a great big screen on Club Lloyds: up to 40%. Then there is a great big screen on the classic account. Then we moved down to private banking, and right at the bottom there is a tiny-weeny, incy little footnote with basic bank accounts, which quite honestly I cannot read. You are not really offering these to people on the same basis as the other accounts, are you?

Steven Noakes: I have a couple of things on that. Interestingly, of the 150,000 that we have opened since 1 January, for which we have 36% market share, 45% have been opened through the digital channels. We see some difference across the brands. You will be aware that we operate in a multi-brand situation. I am not sure whether you went on to the Halifax website, but if you did, you would probably have seen greater prominence in terms of the basic bank account. Halifax has more of a heritage of serving this particular customer group, so we are looking at it on a cross-brand basis as well.

One important part of the memorandum of understanding is that you need to understand whether or not the customer is, first, eligible for a full facility account, and the basic account should only be offered if that is not the case. The reason is that a full facility confers additional benefits to the customer. They clearly have the opportunity of access to credit. Through access to credit, they can get themselves set up where they could get lending on an unsecured basis or ultimately on a secured basis. You need to check that they are ineligible for full facility first. I can assure you, in terms of the journeys either in the digital channel or indeed in the branch environment, if that customer proves to be



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ineligible, then they will have very clearly flashed that they are able to take a basic bank account with us.

Q215 Helen Goodman: The situation with the way that RBS appears to be displaying this to customers is exactly the same: great big advertisements for everything and then a tiny-weeny, incy little notice of the basic bank account.

Moray McDonald: Our basic bank account is called "Foundation", and wherever we show our current account range we show Foundation with equal prominence. The landing page for current accounts on our website shows the Foundation account and the student account with an equal sized block. It is there on the landing page. Our current account brochures mention the Foundation account alongside the other accounts.

In the same way that Steven mentioned, we guarantee that if you are in this area of economic disadvantage by credit score, you will get a basic account. In addition, we train all our frontline staff that when they are talking to a customer, even if the person scores higher than the cut-off that guarantees a basic account, they can at their discretion, if they think there is an indication of prior bad debt, if the person looks confused or unclear, if they have any other marker of homelessness, disability or vulnerability, also give the customer a basic account. We use science but also judgment, and try to give indications to our frontline staff about putting customers in who would also benefit.

Q216 Helen Goodman: That is interesting. You said a minute ago that, of 1 million people, you had moved 400,000 into having regular current accounts. Obviously that raises the question as to whether or not some of those people were moved on perhaps because they had a good six months but then fell back, and moving them to the current account was not helpful to them because they took on debts that they otherwise could not afford. That would not be helpful to somebody. Rather than ask if it did or did not happen, I would be interested to know if, of those 400,000 people you moved on to the current account, you have measured whether any had had to be moved back to the basic account subsequently.

Moray McDonald: We have. I cannot tell you that at the moment, but I am happy to provide it.

Q217 Helen Goodman: Do you have some sense of whether it was a lot, half or a tiny number?

Moray McDonald: It is small, but some of the numbers I can give you. We were terribly cautious about putting those 400,000 into a regular account, the main reason being that, were they to go into overdraft, they would pay charges, and they would not have paid charges had they exhibited that same behaviour on the new basic account. That was what we were most worried about.



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There is a feature of our standard current account called overdraft control, and it allows you to have a regular account but not risk going into overdraft. Of the 400,000, we put 350,000, which is nearly all of them, on to this overdraft control to prevent them paying fees. Our hope with those folks, which is beginning to happen, is they will get comfortable having a regular account; as Steven indicated, they will take an arranged overdraft; and, if they successfully use that overdraft within the limits, they will build a credit profile, which for this group is terribly important because they may then look to apply for a credit card, a personal loan or down the road a mortgage. It is very helpful to have a credit history.

Q218 **Chair:** Why do we not do that for all accounts?

Moray McDonald: We do. Anybody who holds a current account with NatWest or RBS can choose to have overdraft control and completely prevent the risk that they will pay fees. We make customers aware of that. We write to them every year and say, "If that is what you would like to be sure to avoid it, we can do that for you."

Three-hundred and fifty thousand went on overdraft control; 50,000 went on a regular account—with no trainer wheels, if you like. Those customers have much stronger credit scores, and when we looked at their behaviour while they had a new basic, they showed no indication of going into a negative balance on their account. So far, the performance of the 50,000 who could pay fees is that they had fewer payment problems than everyone else who holds that account. It could be that we have been too conservative, and that many of the 350,000 might have benefited had we not put that control mechanism on them.

Q219 **Helen Goodman:** That suggests that there might be something wrong with the scoring mechanism that you are using when you are assessing people.

Moray McDonald: This was the first time that we had moved such a large group of people into a situation where they might pay fees and would not historically have done so. We deliberately chose very conservative criteria, and not just the credit score. We used the credit score and then we said, "In the last six months, has this customer had any form of payment issue that would have taken them overdrawn?" If they did, we ruled them out. We also looked at their broader credit history and said, "If there is any history of bad debt going even further back, we will not move them into this".

Q220 **Helen Goodman:** There is this perverse thing, isn't there? If you are a person who does not have a credit card and never borrows any money, you end up with an abysmal credit score because there is no data on you. I do not know how many people fall into that category.

Moray McDonald: I do not know how many people in the market fall into that category.



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Q221 Helen Goodman: Mr Noakes, in answer to the Chairman, you said that the gross cost of these 4 million people who have basic bank accounts is £230 million. You said the cost of the people on the basic bank account is pretty much the same as the cost of people with an ordinary current account or any other current account. Is that because you are looking at the average costs of running accounts across the bank, and is that a fair way of assessing what the cost of these basic bank accounts is? Should you not be looking at the marginal cost and not the average cost?

Steven Noakes: This comes back to Moray's earlier response and the fact that you will get some differences. As you look at the cost allocation, there are clearly different approaches that you could take. The allocation and the costs that I provided to the Chair are looking at a proportionate cost in terms of the use of ATMs and the use of branches.

The one thing we see is that basic bank account customers tend to use ATMs more frequently. You will quite often see a larger number of withdrawals but on smaller amounts, because essentially they are more tightly managing their cash flow. You could say, "Should we be charging them a greater number for ATM usage rather than the share of the accounts?"

Q222 Helen Goodman: As to the cost of the headquarters, the cost of the computer systems or the cost of compliance, you would have to have all these things whether you had these 4 million basic bank account people or not, for the more profitable business. It is not right to load that set of costs on to those people, is it?

Steven Noakes: The cost numbers that I have given you look at the cost that is more about the cost of the channels and the servicing structure. It does not include head office costs. It is essentially branches, ATMs, customer service—the things that customers would use on a regular basis.

Q223 Helen Goodman: You have mentioned branches, so we will come on to branch closures, which as you may know is something that I am particularly interested in. At Lloyds, what is your cut-off for the profit from a branch before you close it?

Steven Noakes: We do not have a cut off in terms of profit. We look at customer behaviour. The branch closures we have announced to date, and regrettably there will be branch closures in the future, are based on what we see in terms of transaction levels. The reality is that transactions continue to move progressively towards digital.

Q224 Helen Goodman: You are not interested in transaction levels, are you? You are interested in making money. That is what banks do, isn't it?

Steven Noakes: The way that you make money is by satisfying customer need. You need to look at where the customers want to engage with you.



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Q225 **Helen Goodman:** Is transaction level a proxy for what the costs and the income are?

Steven Noakes: Not necessarily, because you have fixed costs in terms of running a branch.

Helen Goodman: Exactly, so the cost is a feature.

Steven Noakes: Let me give you one example of a branch that was closed relatively recently, and one that I personally got quite close to, which was in Glastonbury. The reality is that we had 28 customers who used that branch on a regular basis. That was the level of regular custom.

Helen Goodman: And 200,000 for a week in June.

Steven Noakes: They may have used the ATM service in that period of time. One key consideration that you make when you go to a branch closure is: what are the alternate facilities? We have an arrangement as an industry with the Post Office. A number of the basic bank account services, such as cheque deposits and cash withdrawal, you can make in a Post Office. There are 11,500 of those around the country. The other thing that we are looking at, where there is less ability for provision, is to mitigate some of those closures with a mobile banking system, which would provide a guaranteed service for x hours per week.

Q226 **Helen Goodman:** Let us come back to this thing about transaction levels. As a matter of fact, Lloyds has not closed any branches in my constituency in the last three years. Some other banks have, but Lloyds has not. If you were looking at transaction levels in a small town like Spennymoor, and you were comparing them to transaction levels on Oxford High Street, of course transaction levels would count, but they are not the only thing that would count. The rent is also different. The cost of the property is also different. It would be absurd to allow the same low level of transactions at Knightsbridge that would be completely reasonable in a place like Spennymoor.

Steven Noakes: The key thing on transaction level is that it is more around the customer—what customer population are you serving, and to what extent are they looking to use the branch to satisfy those banking needs? The reality is that we have big chunks of the population that are now doing pretty much all their banking online. We need to understand the particular footprint and the particular cohort of customers that branch is servicing and where those needs are.

Essentially, the closures that we are making and the closures that we have announced are in response to those customer trends. The cost that we need to deal with in terms of what is happening at the back of that is our issue. The key thing is that, if you are looking to provide a full banking offer to a large part of the UK, which essentially is our mission, then you need to deal with those changing trends.



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Q227 **Helen Goodman:** Are you telling me that the places where you close branches are the places where people are using more online banking?

Steven Noakes: Correct.

Q228 **Helen Goodman:** I don't believe that; I'm sorry. What is the evidence for that? If that were the case, you would be closing all the branches in the big inner cities and leaving all the rural branches and the branches in small towns open.

Steven Noakes: That is not strictly true. If you look at the level of digital adoption across the country, it is not just urban areas where you see that.

Helen Goodman: No, it is not just urban areas.

Steven Noakes: One of the key things is that a lot of the counter transactions these days are less from personal customers and are from small business customers. You tend to see more small business customers in those branches, and that would be true in some of the urban environments. We have a mix of customers that we are looking to serve, both personal and business, and we need to understand how those trends are moving in terms of determining the distribution strategy.

Q229 **Chair:** Do you have any regional data for your bank that you could supply us with, which would not be commercially confidential? I do not want you to supply commercially confidential information, and I respect the fact that it may need to remain so. There is understandable scepticism on this point, and it would be helpful to have that data.

Steven Noakes: We would be very happy to provide that.

Q230 **Helen Goodman:** Mr McDonald, from the point of view of RBS, do you also look at the level of transactions or do you have a different system for deciding which branches to close?

Moray McDonald: There are a number of factors, but the number of transactions is a very important one. We are witnessing a huge change in customer behaviour. In our own case, we have seen transactions across the network decline by 43% in the last five years, while the number of digital transactions has gone up 400%. Therefore, we feel that we are quite naturally flexing the balance between different channels that are available. If you include the branch closures we have announced, we will still have a network of over 1,200 locations, which we think is extremely important to serve customers.

Q231 **Helen Goodman:** What counts as a digital transaction? For example, if I buy some theatre tickets, I can do it in one of four ways. I can go to the theatre and pay cash; I can phone up and do it over the phone with my credit card; I can phone up and send a cheque; or I can do it online. Does that count as digital banking?

Moray McDonald: Yes.



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Q232 **Helen Goodman:** I do not quite see how the fact that my doing it online rather than phoning the theatre and reading out my cheque card number is any indication whatsoever of my desire to have a local branch. Neither of those has been going through the bank branch for 30 years.

Moray McDonald: I see what you mean. We are able, down to the individual customer level, to see what the mix is, not of the whole customer base but for an individual customer, such as yourself. We know how many people, as Steven was implying, are completely digital, how many combine digital habits, such as those you described, with still valuing contacting us in a call centre or in a branch. It is that mix of behaviours that we are trying to manage so that you feel very engaged with the bank. Rather than being a "or", it is an "and", if that makes sense.

Helen Goodman: I have one final question.

Chair: You can ask one last quick question, and then we really must move on.

Q233 **Helen Goodman:** Obviously, bank branch closures are extremely unpopular with the public. I do not need to tell you that. Why do you not explore sharing premises so that we avoid these closures of the last bank in town?

Steven Noakes: I guess our industry response to that is the work with the Post Office. That service is available for personal customers. At the moment, the Post Office provides business services only for two or three of the players in the industry, but there is a desire for that to be provided universally. That is essentially trying to provide the same solution.

Q234 **Helen Goodman:** I know it is, but would it not be better to do it the way that I am suggesting?

Chair: That really is the last question.

Steven Noakes: There are challenges in terms of that construct. You can think about all the compliance activity that you would go through with an individual adviser population. For instance, if, let us say, Moray had a branch on a Monday and I had it on a Tuesday, we would have to be rotating in colleagues and compliance individuals. It is quite challenging to operate that. The alternate model, which is to use the Post Office to provide a holistic solution to the industry, is much more attractive and practical in terms of delivery.

Q235 **Kit Malthouse:** First off, can I draw the Committee's attention to the fact that I have personal and commercial dealings in my business with both of the banks that these gentlemen represent? I wanted to ask you, if I may, some questions about technology, and to take the digital conversation further on. The 2014 agreement included access to card payments, including online. Can the basic bank account holders of your banks still access all the online apps and payment facilities that ordinary



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account holders do?

Moray McDonald: Absolutely.

Steven Noakes: They get full access to those, yes.

Q236 **Kit Malthouse:** Is there a different pattern of use and take-up between standard bank account users and basic bank account users?

Moray McDonald: Do you mean in their use of digital services?

Kit Malthouse: Yes.

Moray McDonald: No, there are pretty high transaction levels on debit and on digital services among basic bank account users.

Steven Noakes: To build on an earlier point, 45% of the new basic accounts that we have opened since January 2016 have been through the digital channel. If I gave you the answer for a full facility, it would be pretty similar, probably slightly more in favour of digital. It would be more like 55% of full facility opened through digital. In terms of initial account opening, it is broadly comparable in terms of what you are seeing on basic bank accounts versus full facility.

Q237 **Kit Malthouse:** Presumably the digital route is cheaper for you guys to run. The marginal cost of running an account that is done completely digitally must be much less.

Steven Noakes: It is, but clearly, as large players in the market, you still have the cost of the branch network. The important thing, which is where you may lead in terms of your question, is whether this is an opportunity for new entrants. It potentially is. The challenge for that is with the business model that has been set up. It is not obvious that a new entrant would target this particular group if they cannot get a higher level of income from them.

Q238 **Kit Malthouse:** Essentially, what I was trying to push at—you are exactly right—is whether there is scope for more competition in this market.

Moray McDonald: Specifically in basic bank accounts?

Kit Malthouse: Yes. Presumably, of the basic bank accounts that you have, while your income opportunity is low, my presumption is that, because of the nature of the accounts, you are running an average cash balance across all those accounts. You are effectively taking deposits from these people on an average basis. I forget, Mr Noakes, how many accounts you have.

Steven Noakes: Nearly 4 million.

Q239 **Kit Malthouse:** Even if they only have a tenner in them on average, you have a 40 million deposit there, on which you are not paying any interest.

Steven Noakes: No, that is right. That is the income opportunity.



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Q240 Kit Malthouse: If I were a competitor looking at the accounts, I would be saying, "I can take a £40 million deposit or I can effectively get free deposits, and if I do this digitally, I can manage it at very low cost."

Steven Noakes: Where you may get more interest is if there is the opportunity to charge a small fee for added value services. You are now seeing some new entrants in the FinTech area offering greater advice and service in terms of: "Here is the way to best optimise your account." Another thing we see in basic bank account customers is nervousness about direct debits. They are not sure of the level of cash that they might have in their account at one time, so they tend to have a lower adoption of direct debits.

If they had advance services that regularly communicated to them to say, "This direct debit is going to come through in x days' time; you need to make sure you have x amount of cash in your account," you might see a greater level of adoption. Those are the types of services that some of the new entrants are definitely keen to offer. However, the fact that you cannot charge any fees for those types of services will reduce the level of competition that you might see. It is not to say that you will not see some new entrants, but the attraction that the sector offers will be diminished to a certain extent by that issue.

Moray McDonald: The equation economically for a new entrant under the new basic regime is whether you can get the operating cost per account below the interest income on the balance. That would be difficult. One thing I would say, which is separate to digital or open banking, is it would be a great idea if competitors beyond the nine within the memorandum of understanding had the opportunity to offer basic bank account services to these customers. A potential basic bank account holder who likes the Metro brand and perhaps lives close to a Metro branch currently cannot request a basic bank account from Metro, and they might benefit from doing so.

Q241 Chair: You could pay Metro to provide it for you.

Steven Noakes: You could do, and in fact there was one option being discussed at one stage, which was whether you should have a surcharge on every account. There are similar models. If you go to the insurance industry on flood, the way that the industry provisions for properties in a flood region is to put a £10 surcharge on every account. There are other constructs in terms of the way that it could operate.

Q242 Kit Malthouse: We have heard in the past, in other hearings, about the marked improvement in people's behaviour or the advantages of these text alerts, as you alluded to, Mr Noakes. Are overdraft alerts not available to basic banking customers?

Moray McDonald: They absolutely are. I do not know about Lloyds, but we like to draw all of our customers' attention to the fact that they are at risk of going into a negative balance. We do that to every account, because we think it is a good thing for people to know. If they can



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intervene between 10 in the morning and 3.30 in the afternoon and fund their account, in the case of a regular account they avoid any unauthorised overdraft charges or unpaid item fees. We do not charge those on basic accounts, but it is good to let customers know.

Steven Noakes: We have a similar facility.

Q243 **Kit Malthouse:** Finally, I wanted to ask a related question about the future of cash. Cash is diminishing as a means of exchange. There is more and more online. We are paying with our mobile phones and all the rest of it. That will necessitate more and more people being driven into having a bank account, which is a good thing, as they come into the real economy.

Do you see, though, that ultimately the solution to this issue might be the creation of an electronic version of cash? I know that we have Bitcoin out there doing its thing, unregulated and unsupervised. If the Bank of England were to create some form of electronic cash that I could store as an individual, then I would not need a bank account; I could manage my affairs from my own phone or laptop. It may not happen in the next five or 10 years, but beyond that do you see that being a pattern of behaviour?

Steven Noakes: Yes, and it is probably your comment there in terms of the next five to 10 years. Is cash reducing? Yes. Is it reducing very quickly? The answer to that is no. We see that in terms of ATM usage. While things like contactless and having contactless cards on Apple Pay, for example, are being taken up, you are seeing a very small change in terms of ATM transactions. Cash is here for a long period of time. If you fast-forward beyond your five to 10-year time window, could you envisage different models in existence? Yes, but for the short term and foreseeable future cash is going to be a key part of the way that we need to operate banking.

Moray McDonald: If you think about the way most of us make small payments, many people barely touch cash, not just because of contactless but because of something. We have a thing called "Pay Your Contacts".

Kit Malthouse: I know you do. I use it.

Moray McDonald: Provided you have somebody's mobile phone, you can send them money. Settling up between mates after a night out and those sorts of things, which would have been previously deferred until you all saw one another, you can sort out in the morning. The popularity of those services is extraordinary. We have a very strong trend—I do not know about Lloyds—that the more digitally engaged customers are in those sorts of things, the higher their satisfaction. It is extremely marked. Folks really enjoy being in control of those convenient, small payments.

Q244 **Kit Malthouse:** As to the pattern of use, I appreciate you say that the



trend at the moment looks to be very slow. If you look at the history of those means of exchange, like cheques for instance, I can remember when Marks & Spencer stopped taking cheques. It went through a stage where it tried to make it easy. It would print the cheque for you, if you remember, which was a slightly Heath Robinson way of dealing with it, and then decided, "That's it. We won't take the cheque."

Large retailers might start to say, "Handling all this bullion and cash is a real pain. It's dirty and horrible. It's hard to record and it always goes missing". If a large retailer said that they were stopping taking cash—and lots of retailers do not take cash, including Amazon—could you see a sudden drop off in the use and an explosion in the use of contactless?

Steven Noakes: There is no doubt that retail and retailers are a big part of that future model, but interestingly there is some incentive for retailers to still have cash. To the extent that Tesco and Sainsbury's have ATMs sitting outside of their buildings, with the way that the interchange arrangement works across the LINK network, that is a profit driver for them. While they will be thoughtful in terms of the operation costs of dealing with cash, there are also some negatives that they would need to work through.

Q245 **Kit Malthouse:** Finally, I asked the question at the start about the evolution of cash and the creation of electronic cash at the Bank of England. In the end, as I say, that would mean I did not even need a bank account. I could have my own store of cash, stored electronically in the cloud, certifiable by me as a means of exchange. Is that a likely development?

Steven Noakes: The area that the industry is more focused on is the potential changes from the Payment Services Directive to where you could see greater competition beyond traditional banks. In the future, sitting on this panel answering these questions, you might see Facebook or Google, if they want to enter into the financial services market. Going beyond that, a situation where bank accounts do not exist at all is definitely much further out there at the moment.

Moray McDonald: We want to make regular bank accounts with regular money so compelling, easy and intuitive that you would not want another currency. That is well within our grasp; I am quite sure of that.

Chair: Thank you both very much for coming to give evidence to us this afternoon. I expect we have not covered a range of things that you prepared for and thought we ought to find out about. If there are issues of that type, please put them in writing to us. We are very receptive to receiving the supportive written evidence.

Steven Noakes: We would be pleased to.



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Stu McInroy, Chief Executive, National Pawnbrokers Association; Dominic Thorncroft, Chairman, Association of UK Payment Institutions; and Dr John Low CBE, Chief Executive, Charities Aid Foundation.

Q246 **Chair:** We should get this session underway. As you can see, we are competing with the Prime Minister's statement of the Floor of the House, and I think she is winning. Can I begin by asking you, Mr McInroy, what you think the scale of derisking is? How big a problem is this? Do you have any numbers to give us?

Stu McInroy: Yes. The simple fact is that 91% of my members have now had bank accounts closed to the point at which they exist with their business on one single bank account. Since 2013, 41% of my membership have had at least one bank account closed, which has led to that 91% position.

Q247 **Chair:** What has that done to the industry?

Stu McInroy: It has made it very cautious. It has reduced it.

Q248 **Chair:** That is the first question. By how much has it reduced it?

Stu McInroy: We believe that there has been a natural reduction in the size of the estate from about 2,000 shops down to 1,350 at the moment. That has mirrored a reduction in membership from about 200 members down to 160. Six per cent is equated to nine members and approximately 13 shops, but they have been single shop businesses, so nine businesses have stopped trading.

Q249 **Chair:** This is wiping out quite a bit of your trade.

Stu McInroy: It is not necessarily wiping out the trade. The trade is there, but the ability to service that trade through a pawnbroker is a declining trend.

Q250 **Chair:** What about the customers? What is happening to them? What are they doing, because they still have needs and demands?

Stu McInroy: Indeed, and we believe that those needs are exacerbated, in that the believed 8 million people who either choose not to have or do not have access to a bank account have partially used pawnbrokers as access to credit within their local community. Given the fact that branches are closing—I believe it is 1,100 in the last 18 months or so—pawnbroking ability or capability is an option. Banking is not necessarily something that everybody chooses. They might want the cash quickly, readily and available. However, it is another limitation on the customer's access to consume credit.

Q251 **Chair:** I will ask another question. Clearly, banks are derisking because they are concerned that they might be fined for inadvertently involving themselves in illicit activity. Rather than going through the very hard work of identifying the account, they are closing classes of account, and



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this is resulting in a lot of perfectly respectable people getting hit. The next question has to be: what is the scale of the illegal activity? Is there anybody here who can make some rough estimate of the scale of illegal activity that might be being curtailed, against what is being lost that was perfectly legitimate?

Stu McInroy: The short answer from my perspective is no, because the banks do not tell us anything. The individuals receive a short, sharp and entirely non-personal letter that tells them. There was a transition away from affecting the sector. It was flagged by the Treasury that a prejudicial approach could not be taken to any one sector as an entity. All that we saw happen was a couple of words change in the letter to make it reflect the fact that the review had taken place of an individual's operation, and the decision had been made to close the account. No further information is given, and when the pawnbroker approaches the bank for further clarification none is forthcoming.

Chair: Mr Thorncroft, what would you like to add?

Dominic Thorncroft: We are not in a position to know what the level of financial crime is. In terms of the level of derisking, I will point you to two bits of data. The PSR report into access confirmed that 450 bank accounts had been closed for PIs or PSPs in the last couple of years. Our estimate is that, of the authorised payment institutions, of which there are about 370, about 60% have lost at least one bank account. The money remittance sector has lost most bank accounts.

Q252 **Chair:** This is very serious indeed, because these people are going into the black economy to secure those transactions, are they not?

Dominic Thorncroft: Precisely, yes.

Chair: We are hearing anecdotally that these people are now being forced back into cash, carrying it illicitly or arranging for couriers to carry it illicitly on aeroplanes, in order to get money back to families in difficult countries. Is this correct?

Dominic Thorncroft: Yes, absolutely.

Q253 **Chair:** What kind of evidence can you supply to give substance to the anecdotal points I have just made?

Dominic Thorncroft: Anecdotally, my understanding is that there is a particular issue on Somalia. There is a great use of cash couriers.

Q254 **Chair:** We are allegedly suppressing one kind of illegality, but we are generating another type, and one potentially much more serious.

Dominic Thorncroft: Absolutely, because we do not know anything about the genesis.

Q255 **Chair:** What we need as a Committee is the evidence to support that view, if indeed it is correct.



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Dominic Thorncroft: We do not have the evidence because there is no way for us to get the evidence. We believe it anecdotally to be the case. We know, for example, that customers will go to retail shops. I was hearing on one corridor that some carpet shops and import/export firms—this is obviously not MSB—were dealing in cash and processing transactions in a Hawala style. We understand that is growing.

Q256 **Chair:** What could be done realistically by Government or by regulators to enable better data to be collected on this?

Dominic Thorncroft: On illegality?

Chair: On the consequences of derisking for the creation of this grey or black economy.

Dominic Thorncroft: More surveys of consumers, to find out how they are sending money back to wherever they are sending money, would perhaps be useful.

Q257 **Chair:** Perhaps all three of you could give thought to how this could reasonably be collected, at reasonable cost, and who might best do the collection, and come back to us in writing. I do not think we can carry on with the state of affairs we are in now, with possibly a very serious problem growing. Most people who have looked at derisking have concluded that this is not a minor problem, but a very serious problem, which to some degree is driven by regulation and large fines in the United States, but also driven perhaps by banks being overcautious. Again, that is an anecdotal point that I am making there. We need to see a lot more information before we can come to firm views as a Committee, but we certainly need to try to collect it.

I was not going to neglect you, Dr Low. I was going to bring you in right now and ask you to comment on any aspect of what we have heard so far.

Dr Low: The Financial Conduct Authority has undertaken a review of the off-boarding of charities. One bank reported to the FCA that it had closed the bank accounts of 2,500 charities, but only 57 of those were for compliance reasons. The number of charities that are losing bank accounts is very difficult to measure because the banks will not disclose the information. They will not communicate the reasons with the charity.

Chair: We are going to come on to the charitable sector in a moment, but carry on. Do finish your sentence.

Dr Low: You were asking about what could be done to collect more data. Much of it sits, I believe, with the FCA, because they have the ability to demand data from the banks. There is a major problem of not allowing accounts to be open, of obstructing the movement of funds or of creating compliance barriers and transaction costs that prevent the movement of funds. None of that is available publicly. That is all commercially confidential, and the FCA could collect that information and make it



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anonymised and publicly available, which would inform the Committee in some depth.

Q258 **Chair:** That is a very interesting set of suggestions. Would you be prepared to write down on a piece of paper, in a little more detail, the set of three questions that you have outlined to us there? You gave us three main headings that they might want to look at.

Dr Low: I would be happy to do that.

Chair: Bear in mind always the test of reasonableness for this. Every time the FCA goes to the banks and asks for information, we are adding business cost. We need to make sure that we are asking these questions in a way that should reasonably be answered and that does not generate unnecessary burden.

Q259 **Helen Goodman:** I want to ask a few questions about the impact on the charitable and voluntary sector. Would I be right in thinking that there are basically two problems? One is the bureaucratic problem that people have nowadays in opening accounts, changing who the voluntary treasurer is or changing who the trustees are. Do you have any sense, Dr Low, of what impact the changes are having at that end on the charitable and voluntary sector?

Dr Low: Different approaches are taken by different banks, as far as we can see. Some will acquire the identification of every trustee, so they will all have to queue up with their passports and utility bills at a branch to open a new bank account. There is great reluctance to opening another account or moving an account, because of the inertia in the system. Some of it is justified and some of it feels excessively bureaucratic.

The Charity Commission encourages charities to have more than one bank account, to give them some protection against an account being closed. Curiously, having two accounts creates problems because the bank cannot trace activity on the secondary account right through to the end beneficiary of the payment. Therefore, it gets blocked. That creates a risk rating on the account and could often lead to the account being closed. The secondary accounts are quite often the ones that are targeted, rather than the primary account. In a way, the charities cannot win because they end up having to face a lot of administrative and bureaucratic problems. If they open a secondary account, that can end up creating problems for them.

Chair: That is what I am hearing.

Q260 **Helen Goodman:** Me too. You have given quite a lot of evidence to this Committee in the past as well. Have you or the Charity Commission made representations to the FCA about the way this thing is operating at the moment?

Dr Low: Yes, we have. We worked together on a whole range of areas. We worked, for example, in changing proposition 8 in the FATF arrangements, which has a presumption that charities are high risk. We



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have now had that changed to a risk-based approach to the risk rating of charities, which has created terrible distortions in the assessment of charities.

Helen Goodman: I can imagine.

Dr Low: The best example that I could give you is in Egypt, which is scored very highly by FATF because it follows explicit rules in the treatment of charities. Yet all we have seen is a closing of civil society space in Egypt, where charities are simply closed down. That produces the best result, as far as FATF is concerned, because there is then no risk, since they are inherently high risk. Many of these charities are the ones that criticise the Government, so there is a real adverse effect coming through from some of these actions. We have worked constructively and positively with the Charity Commission and achieved change in the FATF regulations and advice.

Q261 **Helen Goodman:** On the domestic front for a minute, before we go into the international area, you said you think 2,500 charities have been closed down.

Dr Low: That was one bank's evidence to the FCA.

Q262 **Helen Goodman:** You may not know the answer to this. One of the Charity Commission's responsibilities is to close down charities that should not be operating because they are fronts for something else. In that case, everyone would be absolutely delighted by that happening. Do you know the extent to which there is an overlap between what the Charity Commission would have question marks about and what the banks have question marks about?

Dr Low: The Charity Commission data are in a different league. In 2014-15, which is the latest data that is available, they had undertaken 20 in-depth investigations of charities. They had had 11 serious incident reports. The numbers are very small compared to those figures.

Q263 **Helen Goodman:** Fine. We are seeing a real problem for the operation of real charities. You talked about the international aspect of this, and I think your message has got through because the Financial Conduct Authority looked at this in February this year. We are about to have a statement on the Yemen. One of the things said in the FCA report is, "One famous name charity required £40k of advice on sanctions regimes in order to maintain operations in a number of jurisdictions." I guess the British public will be underwhelmed when they are writing their cheques for the Yemen and Aleppo to hear that some of it is going into administration, in order to satisfy British banks. What is the extent of this problem? How widespread is this for people operating in the international development field?

Dr Low: The large international NGOs are spending significant amounts of money on compliance, to be able to operate in warzones and in challenging countries. DFID's own recommendations in terms of the



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funding that it provides is that 7% of the cost of any grant that it gives may be used on compliance costs. Anecdotally, charities will tell us that the real cost is usually twice that. DFID allows 7% from the grants for compliance.

Q264 Helen Goodman: That is pretty spectacular: 7% to 14%. Is that compliance with the banking regime or all different kinds of compliance, including the banking?

Dr Low: It is compliance to ensure the safe application of the funds in the country to which the project is targeted.

Q265 Helen Goodman: How do you think that this system could be streamlined? When people send £100 to the Red Cross, only £93 gets there. What can we do to get it back up to £100?

Dr Low: The system is inherently designed to achieve the right outcome from each part of the process. The banks are required to ensure that the funds that their clients are processing are used legally and are not used to finance terrorism, corruption or any other illegal activity. They face very large fines. They have no guidance in terms of what is an acceptable level of risk. They do for other areas, but they do not have it for charities.

You could have Treasury-approved guidance, developed along the lines of the guidance that is available from the Joint Money Laundering Intelligence Taskforce for other areas of activity. The banks would know that, if they operated within that framework, then they would be taking an acceptable level of risk.

Q266 Helen Goodman: Would it be possible to have some general clearance? One hears about very well intentioned people who set up tiny, small-scale projects. They fill lorries with stuff and drive through the Sahara desert. Obviously the banks will want to look at things like that, but, when we are talking about large organisations like the Red Cross and UNICEF, could there not be a system where these organisations are cleared and audited once a year, rather than auditing every single episode?

Dr Low: That is possible, but it would require the acceptance of the risk that it is possible that some of that funding would end up in the hands of terrorists.

Q267 Helen Goodman: Why is it more likely that this money would go to terrorists because the banks have not gone through their bureaucratic processes? Presumably, UN agencies and large professional charities are not interested in funding terrorism. They have their own systems for assuring that that will not happen, haven't they?

Dr Low: There is always some leakage. If you buy a tent and give it to someone in a country where terrorists are operating, they can get access to that tent. You can buy food. You can buy medicine. The medicine can end up treating soldiers or terrorists who have been injured. That is



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seen as funding that is flowing through an aid organisation to benefit those who are considered to be terrorists in the eyes of the system that is monitoring it.

The big challenge is that charities are helping to deal with the cause of terrorism. They are dealing with the deprivation and the underlying issues that feed terrorism, where people are not listened to, their voice is not heard and they do not have basic facilities for living. That drives the effect of terrorism. That terrorism does not stay in that country. It comes across borders; it comes here.

By putting serious constraints on the charity's ability to operate in country, and these are difficult countries, you are stopping terrorism, in theory, through the banking system, but allowing it to breed and fester without dealing with the underlying cause, because the charities are not able to operate. You end up with serious unintended consequences in this system.

Q268 Helen Goodman: This is not your responsibility, but have you heard of people in the arms trade complaining of similar problems? We host a very large arms fair every year in London. They have not sent any evidence into the Committee, I do not think, about this concern. Have you heard any concern from them?

Dr Low: It is not an area of particular specialisation, but no, I have not.

Q269 Kit Malthouse: The only question I have for you is about whether Brexit and us leaving the European Union might have any impact on our ability to reassess the regulations as they are.

Dominic Thorncroft: All we know at the moment is that the UK Government are going to implement PSD2 and 4 AMLD in their entirety. We know that that is happening. We understand that there are going to be new money-laundering regulations drawn up this year, for the fourth Money Laundering Directive, for the UK. The problem is that so much of the regulation is driven by the principles of FATF and the risk-based approach, which goes above anything that Europe is talking about.

We find that the risk-based approach has been a bit of a black hole and has caused a lot of trouble for SME business, because we assess our risk, but the assessments that our firms make of their risk does not match with where the banks see their risk. There is no forum to discuss these issues and we have a lot of trouble. In fact, we failed to create a forum where the banks will talk to us about the financial crime issues. The legislation is one thing, but if the parties do not want to talk to you and they cannot be forced to come to the table, then we are not going to make any progress, I am afraid.

Dr Low: It is an interesting question, but of course the banking system is international. It is driven by international trends. Certainly, if Britain could throw off some of the anti-money laundering and CTL regulation from Europe, theoretically that would allow a greater freedom to



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determine our own future. Frankly, much of what we do hangs on US law. The impact of US law right through the banking system is the issue, more than anything. A bank that operates in the US will want to comply with US regulation, even if dollars are not involved and even if the US is not part of the transaction. It will go to great lengths to ensure that it complies with US legislation, even outside of the US territories.

Q270 Kit Malthouse: Notwithstanding the zealous approach of the UK Government to try to deal with these issues, you think that the extraterritorial reach of the United States will mean that, whatever the British Government decide, it will not make much difference.

Dr Low: Yes, because it drives the behaviour of the banks.

Q271 Kit Malthouse: We are in effect being run by the Americans.

Stu McInroy: Yes.

Dr Low: It is something that I would suggest the Government may wish to investigate and to characterise properly, so that the implications of US extraterritorial influence on the UK are fully understood.

Q272 Kit Malthouse: Over the last 10, 15, 20 years or longer, there has been a slow ratcheting up of the anti-money laundering regulations, starting with us all producing our passports and a utility bill—as though criminals do not have passports or utility bills, which of course they do. Yet my sense is that it has not had much impact on the amount of money laundering or criminality that takes place in the financial services industry. Is that your experience as well? As the Chairman said, are we not driving the crime elsewhere?

Stu McInroy: The short answer is yes. It goes back to a Home Office Treasury report in 2015 when the concern was that, if we lose the ability to legitimately and legally employ money transfer business within, for instance, my sector, it will have the domino effect and the unintended consequence of pushing it underground to cash and create a completely different monster to the one that you thought you were addressing but probably did not exist in the first place.

Q273 Kit Malthouse: The sum total product of all this regulation is inconvenience to the legal and legitimate users of these services, and it has little or no impact on the criminal element of the transaction.

Dominic Thorncroft: We would agree, and the cost of it cannot be underestimated. For our members to keep an account open, they were told by the bank that they had to get expensive software systems in. Where they had been paying £50,000 a year on compliance, they ended up paying £300,000 on compliance. They are spending a lot of money, and they still lost their account. The bank still took their account away in the end.

Dr Low: It would be unreasonable to say that all this anti-money laundering and corruption and funding of terrorism legislation has had no



effect. It is more difficult. You have to be more sophisticated to be successful in money laundering, but of course it just drives up the level of sophistication. Where is the end point?

Q274 Kit Malthouse: The point I am making is that this is not a battle that is being won. You are saying that these effects are not designed in this country and this is not a battle that is being won. The only product thus far is more sophisticated terrorists and money laundering, and more inconvenienced consumers.

Stu McInroy: And the cessation of business for some of my members. The innocent, low-hanging fruit is the victim in all of this.

Dr Low: No one wants to see, in my case, charity funds ending up in the hands of terrorism. We do not want to see the proceeds of crime being laundered through the work of charities, and we would stand against corruption. I would not advocate sweeping away all these provisions. They could be made to work more effectively and more efficiently.

Chair: What we need is advice from organisations like yours on how that can be accomplished. We have only scratched the surface of this extremely concerning subject and one of growing concern. We will leave it there for today, but if you have further points you would like to make in writing, as with your predecessor panel, we would be delighted to receive them. We will persist with our investigation into this. We secured a report, as you know, from the FCA on derisking a little while ago. Perhaps the time has come to revisit this with more vigour. Thank you very much indeed for coming in.