EIS Committee: Access to Banking Inquiry

Note of visit to Principality Building Society – 5 June 2019

Attending: Russell George AM (Chair), Hefin David AM, Vikki Howells AM, Bethan Sayed AM, Joyce Watson AM, Lara Date/Amy Knox (clerking team).

Principality Building Society Headquarters

Meeting with: Steve Hughes (CEO), Julie-Ann Haines (Chief Customer Officer), Tom Denman (Chief Financial Officer), David Critcher (Head of Regional branches), Jamie Pike (Corporate Affairs Manager)

Principality operates a mutual model answerable to the members who own it rather than to shareholders – it has one of the largest turnouts for its AGMs in the UK, and also holds 5 talk-back sessions around Wales which are well attended. Commitment by customers may be partly down to its unique Welshness' and because members feel they have a voice.

Principality has a fund of £75 million for social housing, runs a schools partnership programme and financial inclusion work. Its strategy for the increase in digital banking services is 'how do we bring the best of branch to digital?'

Financial institutions have been impacted across the board by the squeeze on margins, e.g. a 30% reduction in margins on mortgages in the past year – this is driving the price down on lending, therefore there is a big focus on driving down the cost:income ratio, and high street presence is costly. For banks it is easier to direct traffic to a low cost digital model rather than high cost branch model. The ringfencing of retail and investment banking following the Vickers Commission report has had an unintended consequence as banks can no longer cross-subsidise.

Principality's CEO visited all 71 branches in his first 90 days in post and has seen the impact of bank closures, for example, in Fishguard where there are no bank branches a builder uses his Principality savings account to pay his workers.

There has been a massive change in how customers transact. The drive towards digital is a push-pull issue with customers wanting to do more digitally as well as it being promoted by financial institutions. It means bank footfall has decreased, but Principality doesn't see that as it offers savings rather than bank accounts.

The pace of change with digital technology has been exponential, but cash is still there and people need to access it - Principality branches are there to stay. Some rural communities have problems of lack of broadband, and people also value the face-to-face contact with people in branch. Some members need assistance.

60% of Principality branches have 4 members of staff who are encouraged to embed themselves in the local community. The customer base tends to be an older demographic for savings - the average age is 58 - and older people are using branches more. 500,000 savings customers drives the incentive to have branches.

Principality is not a current account provider at present - when asked if it was exploring that, as it was well set up to move into that area, Members were told the cost of entering that market with the technology required is prohibitive, and requires selling of lots of financial products. Principality staff are not incentivised to sell a range of products and it is not right for their business and members right now, although could not be ruled out in the very long term.

The costs of the branch network were discussed - £10m is spent on this as it is what members say they want - they want face-to-face contact to trust people with their life savings.

If Principality were to take on people switching to current account banking it would cost £3.5m due to the cost of providing the services people expect in banking.

The First Minister's commitment to a community banking model was discussed - Principality identified the challenges as building up from scratch - aside from Metro bank opening in Cardiff, new banks coming in are all digital only, no bricks. It was described as a "major mountain". "not a walk in the park", and the challenges should not be under-estimated: in terms of: capital; equity; liquidity; product sales; operational resilience; regulatory requirements; Financial Services Compensation Scheme compliance.

Of the 71-72 new banking licences issued this year only 10% are making a profit. There are FinTech companies coming in who don't see themselves as banks. Just to get the banking licence is a multi-year project.

The cost for Principality to run a branch was in the region of £250,000 per year, with up to £800,000 up front to invest the capital to set up a branch. There were also the back-office, treasury and risk management capability functions to consider, so the cost could amount to about £1m per branch if you include all the costs. Another factor would be the products offered - if you offer savings there is the FSCS compensation regulation - this means a step change in terms of financial oversight. If lending money then you have to have a credit risk management function. It takes 7-10 years for an individual branch to break even and you need to attract people in and get customer flow. Footfall is very important. Trust is vital - would customers engage with a new brand? Principality has been going for 159 years and still has to invest in events etc to get the trust of Welsh customers. After 159 years and with 71 branches it has achieved a 14-15% market share in savings. If the goal is to fill gaps in services it's important to ask why the gaps are there in the first place. State Aid issues would need to be resolved, but there were considerations there for example with the goal of creating job opportunities.

Members asked what changes to regulations could help? Financial education was discussed - some education was delivered to schools at key stage 2 through business in the community - but it was noted financial education won't be part of the Welsh curriculum. Principality tries to bridge the gap in reaching teens with the importance of saving - people like the passbook and the discipline of coming into branch to make a deposit, and people like having to make that extra effort to withdraw from their savings. Principality is also introducing a new product that links parents and children's savings and encourages them to save more.

Regulation in the industry is all about managing systemic risk – the top 5-6 banks' priority is ensuring that the banking system works.

Members asked what should Welsh Government's role be in maintaining access to banking? Principality's CEO saw government's role in terms of policy to ensure ease of doing business and supporting investment in infrastructure. He pointed to work on the housing agenda and education for young people. It was about *having the right partnerships*. A partnership model was the way to go, and to make sure communities don't feel isolated and unloved.

A key issue for Wales is access to technology and wifi – policy on broadband and mobile connectivity is really, really important and will only become more so.

Access to cash and the ATM debate was also important. Principality has 12 ATMS and would be looking at whether it can extend that network and fit more in – in some smaller branches it's not physically possible. It was also looking at providing an ATM in locations where there is only one bank branch.

Members were interested in the agency model, where Principality has a presence in partnership with another business such as an estate agency or auctioneer, filling a gap in a particular area. However agencies cannot provide the same range of services as a branch. Principality would provide more information on its agency model and what it can do that a Post Office branch can't.

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