

Decision Pathway – Report Template



PURPOSE: Key decision

MEETING: Cabinet

DATE: 02 July 2019

TITLE	Avon Mutual Regional Community Bank		
Ward(s)	City Wide		
Author: Denise Murray	Job title: Director of Finance		
Cabinet lead: Councillor Craig Cheney	Executive Director lead: Mike Jackson		
Proposal origin: <i>Other</i>			
Decision maker: Cabinet Member Decision forum: <i>Cabinet</i>			
Purpose of Report: The report sets out the proposal being explored to create a regional local bank with an inclusive finance ethos that supports the local community and economy, and seeks approval for Bristol City Council (BCC) to make an initial investment that will support its establishment.			
Evidence Base: What is the proposition? The Community Savings Bank Association, registered with the Financial Conduct Authority is seeking to develop 19 regional community banking models across the UK, with London and the South West already in the pipeline and Wales and some other regions following close behind. Avon Mutual was established to create a regional community bank for the West of England covering Bristol, South Gloucestershire, Bath, Gloucestershire, Wiltshire and North Somerset. Avon Mutual have approached potential social investors and regional anchor institutions (including BCC), that share the social and economic ethos of the mutual, to invest circa £20m of the share capital required. In April 2019, Avon Mutual opened their first offices at SETsquared Bristol and is part of the Business Acceleration mentoring programme. Avon Mutual will have a social mission focused on the following: <ul style="list-style-type: none"> • the creation of a bank to serve the everyday financial needs of ordinary people, local community groups and small and medium sized companies; • help redress regional inequalities, make financial inclusion the norm, build and store community wealth; • significantly increase the proportion of bank lending going to the ‘real’ (non-financialised) economy and SME’s instead of the financial economy; • build regional economic resilience; and • bring about a renaissance of customer service, relationship banking and mutual trust. In addition to the above, this investment could complement the local investment that has been made in support of the Bristol Pound (B£) and the Bristol Credit Union and via collaboration of these parties, help build the region’s evolving alternative finance ecosystem. Local banks supporting local businesses have been successful in Germany with around 70% of banking carried out by some 1,700 local co-operative banks. With a change in the bank licensing rules, less onerous / capital intensive process and support from anchor organisations, not only in the set up but in utilisation, this model could be			

sustainable in the UK.

Avon mutual anticipates a timeframe from concept to trading from 2018 – 2021 and is seeking total investment of £20.5m in 3 rounds.

- Round 1 - 2018 - £500,000 - initial investment to build initial team and start licensing process - Investment in this round will result in two free shares for every share purchased which AM estimate equates to circa 20% IRR.
- Round 2 - 2019 - £2.0m - Investment to finalise licensing, test systems, build bank team and first branches and HQ – Investment in this round will result in one free share for every share purchased which AM estimate equates to circa 15% IRR.
- Round 3 – 2020/21 - Investment drawn down day after license gained to capitalize the bank. Operations go live with branches fitted out and systems integrated and trading commence £18m - Investment in this round will result in one share and circa 7.5% dividend.

The initial assessment of the financial return is that annual dividends of 7.5% could be achieved by year 5, with future increases related to share of profits. It is expected that a high and growing dividend yield, moderate share price growth is likely over the medium term and impact investors (such as local authorities) can choose to extract the additional return or recycle financial returns into further social impact in debt, poverty alleviation or financial capability and training. In further developing the proposition for the region, the Avon Mutual will need to complete detailed market research, operational planning and systems implementation. BCC would need to undertake our own due diligence and sensitivity analysis on the business plan assumptions prior to any further investment and to this effect £50,000 is being requested.

Why does Bristol need a regional mutual bank?

Access to financial services and financial inclusion are of fundamental importance to achieving an inclusive economy where no one is left behind. The impacts of exclusion are not just financial but also affect education, employment, health, housing and overall well-being.

The UK bank landscape and investment institutions currently do not provide a diverse and resilient financial system that has enough variety and choice to serve the needs of all our community. Groups of individuals and businesses are excluded from obtaining a basic level of service from financial services providers; bank branches closure in the region and Bristol specifically are significant and often in the poorest areas at a time, when there are still large sections of our community who rely on bank branches to carry out their banking needs, both business and personal. ATM charges are becoming the norm and the poverty premiums mean that those that are the most vulnerable pay more for financial services products.

According to Bristol University, individuals on low incomes suffer an average of £490 p.a. additional costs due to being prevented from accessing preferential deals due to their income levels and history. The impact of this 'poverty premium' can be severe - for 10% of these households the cost rises to £780 p.a. and for those in severe hardship this premium rises to as much as £2,250 p.a. These costs are attributed with lack of access to a full current account, a necessity to use high-cost credit, living in perpetual overdraft debt, households using high cost "rent-to-own" for essential household goods.

The mapping of deprivation within Bristol indicates 42 areas are in the most deprived 10% in England, including 6 in the most deprived 1%. It is estimated that over 72,000 (17%) Bristolians suffer income deprivation and in some areas of Bristol this is likely to be as high as 49%. With figures on this scale of the spectrum the poverty premium is likely to have a major impact in Bristol.

Micro, small and medium size enterprises (SMEs) are the engine of job creation but are increasingly overlooked by the large lenders. For many SMEs, access to cash can be a critical success factor for the survival of the business. The issue of retail banking disappearing from local communities across the region is one that has been highlighted and currently attracting much media interest. 25 bank branches have closed in Bristol 2015 - 2019; South West region seeing 374 branches disappear for the same period. SME loans in the BS postcode area have fallen by 19% in 5 years

– almost double the national average of 11% and the Big four banks only allocated 1%-4% of assets to SME lending (Source: UK Finance Post Code Lending Data).

There is a strong view that these factors disproportionately hit communities and businesses in areas of deprivation or rurality and have a significant impact on the most vulnerable that need easy, inexpensive access to banking / cash facilities. It is important that consumers continue to have the freedom to pay for goods and services however they choose and access to cash must be maintained for those that need it. The rate at which free to-use ATMs have been closing indicate that these closures will have unintended consequences and be symptomatic of a wider issue. We recognise that as cash usage falls, it is important to consider how this infrastructure can be redesigned to better reflect cash's declining popularity but this needs to be considered from both a social, economic and financial ethos.

What are the costs / benefit for the customer?

Avon Mutual are committed in achieving financial inclusion, the same service for all regardless of income and will charge a simple and transparent upfront membership fee of £5/month for personal accounts, £10/month for business accounts to all customers. In return for this fee, there are a range of benefits that current account providers will receive such as:

- The provision of staffed branch services, which many SMEs rely on for cash banking facilities.
- “Softer” analogue human factors and local knowledge.
- A current account without requiring a minimum income or a credit check, which means that customers currently excluded and seen as a greater risk can bank, improve financial management and receive the wider benefits from direct debit discounts.
- Interest will be paid on whole combined balance across accounts including current account balances.
- No complex additional charges (for example SME's paying in cash).
- Access to cash via ATM's will be free - bank branches are closing and independently operated machines usually charge around £1.50 to £2 per transaction.
- The main credit product for Individuals and SME's is an overdraft, which can only be provided directly by banks (and not by credit unions or post office accounts).
- Access to residential mortgages as well as business and personal loans at reasonable rates.

The management fee is outweighed by these benefits and the significantly reduced 'poverty premium' for low income families.

What are the options available?

The Mutual has successfully raised £450,000 towards the first round investment from Stroud Council, two local foundations and local individual impact investors. Should BCC and other Council propositions in the pipeline be approved, this would take the Mutual's total investment to date to £600,000 by end July, following which Round 1 will close. The Round 2 process will then commence to finalise the regulatory business plan and seek authorisation from the Bank of England and Financial Conduct Authority to become a bank and commence trading.

The following options are available to BCC:

- Do nothing - No investment from BCC, risk that the target fund is not achieved - markets will determine the outcome and as such it is anticipated that without public intervention the current trend would continue to deteriorate.
- Invest in Round 1 – to July 2019 – investment as a higher risk / reward. It reinforces to other public and private sector investors, BCC's commitment and confidence in this proposition and provides the opportunity to work with the Board utilising our due diligence and area specific USP, to shape the long term proposition.
- Invest in Round 2 - 2019 investment. The wider benefits are as above but with a high risk / but lower reward. The timing difference between Round 1 & 2 is minimal however the share conversion results in one free share for every share purchased as opposed to two in the earlier round
- Invest in Round 3 – 2020 investment. This round delays the decision until 2020 where it would then be possible to invest this value or a larger amount at lower risk.

- Invest in all Rounds 1, 2 & 3 - as above

Conclusion

If BCC believe in the ethos behind the community bank and the benefits this could bring to the local economy, it is recommended that BCC invest up to £100,005 in Round 1 and a further £50,000 is earmarked for BCC to undertake [the necessary due diligence on the developing business / financial model, growth assumptions and the Bristol market for financial services, and help to shape the wider proposition for the region.

Members will recognise that in option 2 the investment may not necessarily be returned to the Council as there is a risk that there will be no financial return and the entire investment could be lost, if the plan to launch the mutual is unsuccessful, a banking license is not granted, or if the mutual turns out not to be profitable. Hence, at this stage, officers do not recommend investing in the mutual explicitly to derive a financial return as this is deemed too much of a financial risk.

It is envisaged that other authorities within the region who support inclusive financial and economic growth, would also consider investment to make this proposition a reality and potentially shorten the timetable to opening branches and commencing trading within the wider West of England region. At the time of writing the Council would be within the first group of authorities who have made a firm commitment to provide support to the mutual and we would seek to promote the wider benefits of financial inclusion to, other local authorities, Combined Authority and anchor organisations within the region.

Cabinet Member / Officer Recommendations:

That Cabinet

1. Approve an investment of £100,005 (at risk) on the basis of the Council being a Founder Member to support the formation of Avon Mutual; a Regional Community Bank for inclusive growth, funded from 2018/19 Additional Business Rates s31 Grants.
2. Delegate authority to the Director of Finance in consultation with the Director Legal and Democratic Services and Deputy Mayor and Cabinet Member for Finance, Governance and Performance to conclude the subscription by the Council for 6,667 Founder Shares for a sum of £100,005 in Avon Mutual, and all matters and documentation required in connection with the Council's application to be a Founder Member.
3. Approve up to £50,000 to be used by the Council to undertake further independent due diligence, which will include where applicable, the costs of consultancy support to inform the wider business model for this proposition and any further investment from the Council.

Corporate Strategy alignment:

The proposal supports the goal outlined in the Council's Corporate Strategy and the One City Plan of "building a city of hope and aspiration, where everyone can share in its success" and in working towards this goal, the following Corporate Strategy priorities apply:

- **Empowering and Caring** - empowering communities and individuals, increase independence and support those who need it.
- **Fair and Inclusive** - Improve economic and social equality, pursuing economic growth which includes everyone and making sure people have access to homes they can afford.

Our principles:

- Build city resilience, improving ability to cope with environmental, economic or social 'shocks and stresses'.
- Use our assets wisely, generating a social and/or financial return.

City Benefits:

A community bank can assist in developing balanced communities which are inclusive. They can play a key role in

establishing a resilient city financing structure, with investment strategies that recognise the long-term challenges and vision for the region, the long-term resilience value shaped by investments, rather than just short-term financial returns. This proposition could assist the council deliver target outcomes around a prosperous and inclusive economy, as well as helping the city to be innovative, prosperous, resilient, and attractive to business.

Consultation Details:

- In conjunction with the RSA (Royal Society for the encouragement of Arts, Manufactures and Commerce), Avon Mutual have run a series of public events across the region to engage stakeholders, explain the plans and to hear what investors would want from the regions bank
- They have also had hundreds of one-to-one meetings with people and organisations and spoken at over thirty events.
- Avon Mutual Community Bank Round Table was hosted by BCC – with attendees from many of the regions with propositions in development.
- Movement building is ongoing and will involve further stakeholder engagement as the proposition is shaped to reflect the region and key milestones are delivered.

Background Documents:

None

Revenue Cost	£150,005	Source of Revenue Funding	2018/19 Additional Business Rates s31 Grants
Capital Cost	£	Source of Capital Funding	
One off cost <input checked="" type="checkbox"/>	Ongoing cost <input type="checkbox"/>	Saving Proposal <input type="checkbox"/>	Income generation proposal <input checked="" type="checkbox"/>

Required information to be completed by Financial/Legal/ICT/ HR partners:

1. Finance Advice:

This proposition seeks investment of £150,005 to support the next stage in the setting up (£100,005) of the Avon Mutual Regional community bank and further due diligence by BCC (£50,000) to inform the developing business model and support any decisions with regional partners for future investment.

The Mutual has successfully raised £450,000 towards the first round investment from Stroud Council, two local foundations and local individual impact investors. Should BCC and other Council propositions in the pipeline be approved, this would take the Mutual’s total investment to date to £600,000 by end July, following which Round 1 will close.

If approved, this investment will be made in 2019 and it is proposed that the Council uses funds from the unallocated additional Business Rates s31 Grants received from government in 2018/19, to invest in the Mutual. In return for the investment of £100,005, the Council will receive 6,667 Founder Shares, which will subsequently be converted into 20,001 ordinary shares. These shares are expected to receive a dividend of 7.5% if the new bank becomes profitable and the dividend return may rise over time if the bank is successful and the surplus is returned.

Growth expectations in the business model for the Region are as follows:

Customer:	Year 1	Year 2	Year 3	Year 4	Year 5
Personal	4,745	17,745	37,375	61,750	78,261
% Increase		274%	111%	65%	27%
Business	1,876	3,275	6,900	11,400	14,449
% Increase		75%	111%	65%	27%

As the Council will receive ordinary shares which we expect to have a right to receive a dividend attached to them if the society generates a surplus, this initiative could be considered as an investment. However, any dividend would be subject to Avon Mutual receiving the relevant approvals and future funding to enable it to operate and, once it commences operation, being profitable. Given the risks that this may not be achieved this should not be viewed as an investment made for purely financial return but one which supports the local economy and at least in the short term akin to an economic grant. The current business model proposes a small monthly charge (£5/£10: personal / business) for each customer and further consideration will need to be given as to how this can be mitigated for vulnerable customers.

By making this “investment”, the Council will be forgoing potential return on the business rate pilot gain monies. The current investment return achieved by the Council is c.0.9% per annum. This equates to forgoing £900 per annum, if interest rates and returns were to remain the same.

While community banks would tap into localism, they would still have a challenge in attracting customers as bank switching is not a common occurrence and the competition could perceive a threat and respond accordingly. Some depositors would act out of philanthropic motives, however community banks would still have to offer an attractive commercial proposition to lenders and borrowers if they are to be viable and remain sustainable in the long term.

Finance Business Partner: Chris Holme - Interim Head of Corporate Finance – 12/06/2019

2. Legal Advice:

There are two primary powers which would enable the Council to invest in Avon Mutual – Section 12 Local Government Act 2003 and section 1 Localism Act 2011. Under section 12 (a) Local Government Act 2003 a local authority may invest for any purpose relevant to its functions. There is no limit on the nature of the investment, provided it is relevant to the authority’s functions. One function of the authority is to deliver the One City Plan, and investment in Avon Mutual is consistent with that function. Section 12 (b) Local Government Act 2003 allows a local authority to invest for the purposes of the prudent management of its financial affairs. Investment under (b) is aimed at general prudential management of finances, which would mean any investment would need to comply with the authority’s investment strategy etc. Section 1 Localism Act 2011 gives a general power of competence. As the investment in Avon Mutual may be characterized as an activity for a commercial purpose, then the local authority can undertake the activity through a permitted structure as set out in s4 Localism Act 2011. The proposed Avon Mutual structure as Avon Mutual is a registered society within the meaning of the Co-operative and Community Benefit Societies Act 2014, which is permitted under section 4.

Avon Mutual is a co-operative society registered with the Financial Conduct Authority, but yet to commence trading. It requires further regulatory consents before it can commence trading, and if these are not forthcoming the Council will lose its investment.

As a limited liability entity, if Avon Mutual is wound up, the Council will have no liability beyond the value of its initial investment. The shares are non-withdrawable – this means that the Council cannot withdraw its share capital from the Mutual; it can only cease to be a member if the directors of Avon Mutual agree to that being the case.

A shareholder is not automatically a member of the Mutual – an application has to be made. It is envisaged that the application to become a member will take place at the same time as the application to subscribe for shares. If the application to become a member is not accepted, Avon Mutual is under no obligation to repay the subscription monies for the shares.

Shares being issued are ordinary shares (convert from Founder Member shares). There is no guarantee that any dividend will be paid on those shares, and so there is no guarantee that the Council will receive any return on its investment. The copy of the rules which relating to Avon Mutual which is filed on the Mutual Societies register suggests that the board can determine the rights attaching to the shares by resolution prior to the first issue of shares of that class. We have not seen a copy of any such resolution or other confirmation of the rights (such as a right to receive a dividend if a surplus is generated) attaching to the shares. As such, before entering into any

arrangements with Avon Mutual, the Council should clarify the terms attaching to the shares and Membership, including confirmation that no further membership fees will be payable.

The Council is being offered the opportunity to invest on the same terms as other investors (who include private sector individuals). The share price is fixed in the rules of Avon Mutual. As such any risk of state aid to Avon Mutual would be considered low, on the basis of the normal market investor principle.

There are no regulated procurement implications in connection with the subscription for shares, as this is a financial investment and the amounts are below the thresholds set out in the public procurement regulations in any event.

Legal Team Leader: Eric Andrews, Team Leader, Legal Services - 21/06/2019

3. Implications on IT: As a funding only initiative, there are no identifiable IT implications in this proposal.

IT Team Leader: Ian Gale - Service Manager, Service Delivery and Integration – 11/06/2019

4. HR Advice: No HR implications evident because Avon Mutual is a separately constituted organisation.”
James Brereton (People & Culture Manager), 12th June 2019

HR Partner: James Brereton - People & Culture Manager, 12/06/2019

EDM Sign-off	Mike Jackson	29/05/2019
Cabinet Member sign-off	Cllr Cheney	21/06/2019
For Key Decisions - Mayor's Office sign-off	Mayor's Office	24/06/2019

Appendix A – Further essential background / detail on the proposal	YES
Appendix A - Avon Mutual Regional banking for inclusive growth	
Appendix B – Details of consultation carried out - internal and external	NO
Appendix C – Summary of any engagement with scrutiny	NO
Appendix D – Risk assessment	NO
Appendix E – Equalities screening / impact assessment of proposal	YES
Appendix F – Eco-impact screening/ impact assessment of proposal	NO
Appendix G – Financial Advice	NO
Appendix H – Legal Advice	NO
Appendix I – Exempt Information	NO
Appendix J – HR advice	NO
Appendix K – ICT	NO