Northern Ireland Assembly

COMMITTEE FOR FINANCE AND PERSONNEL

OFFICIAL REPORT
(Hansard)

Banking Issues: Departmental Briefing

5 October 2011

NORTHERN IRELAND ASSEMBLY

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FINANCE AND PERSONNEL

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Members present for all or part of the proceedings:
Mr Conor Murphy (Chairperson)
Mr Leslie Cree
Mr Paul Girvan
Mr William Humphrey
Mr Ross Hussey
Mr Paul Maskey
Mr Mitchel McLaughlin
Mr Adrian McQuillan

Witnesses:

Mr Bill Pauley	)	Department of Finance and Personnel
Mr Tony Simpson	)	

The Chairperson:

Over the past number of months, there has been ongoing engagement between the Finance Minister and Department of Finance and Personnel (DFP) officials on a range of banking issues. There have also been discussions with local banks on the state of the banking sector, bank lending and a range of other issues. Mr Pauley, you can begin with an update, and that will be followed by members' questions.

Mr Bill Pauley (Department of Finance and Personnel):
Banking is not devolved; we have no powers to require our banks to do anything, but we are heavily involved because it is seen as being strategically important that we have a competitive banking sector that meets the needs of businesses and consumers. In doing so, as I think is reflected in our paper, we engage with Treasury Ministers and officials, Department of Finance Ministers and officials, the Bank of England, the banks themselves and, quite often, their representative body, the British Bankers' Association.

The current context is hugely difficult. To get a grip on the issues is enormous, in some senses. At one level, there are huge global issues: the effects of the financial crisis, which are still working their way through; sovereign debt and its impact on the banks; low growth; and the Euro crisis. There are huge banking issues ongoing. In the news, for instance, we can see that Governments, such as the UK Government and the Irish Government, want to work together as a first priority to ensure that the banks survive. One must bear in mind that, globally, they are very much inter-related. Alongside that, there is also work to ensure that banks continue to fulfil the function of being able to meet the needs of consumers and businesses here. We, perhaps, involve ourselves more in the second element than the first, which is very difficult for a small region such as ours to take forward.

The Independent Commission on Banking asked us for a response on the issue of survival and on the bigger issue. It has now made its report. We drew to its attention the fact that the structure of our banking sector was such that since two of our main banks are Irish-owned, the problems that we were facing were different to those being faced by the rest of the UK. We drew that difference to their attention. Therefore when they said they required a competitive banking sector, for us it meant the involvement of some UK banks and what were some Irish-owned banks and their operation.

The other announcement in June was by the Financial Services Authority and related to the requirement on banks to have recovery and restoration plans in place and the level of capitalisation that they were required to have. We have looked at the positive side of that in that the Chancellor is able to make a statement that UK banks are safe and that our businesses and customers here can go to banks in the knowledge that they have such plans in place. Also, as there is a different stress level of assumptions of what might happen in the economy, businesses and customers here can know that the bank that they are dealing with is safe and should be able to survive.

Therefore, there is confidence to be taken from the fact that that is in place. The downside of that argument is that having that level of capitalisation means that, potentially, the banks have less money to lend to their customers. Do you want the banks to be safe or to be able to lend? Most people agree that we do not want to go back to the way that lending took place prior to the financial crisis, but we need to find a solution in the middle. We have been corresponding with the Government about those issues.

The Minister has engaged with his past and present counterparts in the South on the restructuring of the banking sector there. We were pleased that it was announced that the Northern Ireland operations of the Irish-owned banks would be part of the two new pillars of the banking sector there and, therefore, part of the core structures. We have looked at that and are pleased to have had confirmation that investment would be made through the EU and the International Monetary Fund (IMF) to ensure that those banks have the capacity to lend in the future. Part of the EU/IMF bailout to the banks was to ensure that their liabilities were covered, and part of it was to ensure that the banks would have money to lend again.

We have been more active on the issue of lending, while taking an interest in that other structure. We have been working closely with the banks and the British Bankers' Association on the 17 task force actions it announced to improve the relationship between banks and their customers. We have attached to our briefing paper regional data on lending, which is available for the first time. It shows that nine out of 10 of the applications that are made here are being approved. It also shows that lending here has fallen, but that is closely aligned with the lending trends throughout the UK from the data that is produced by the Bank of England.

Project Merlin is another initiative by the Government that has required the banks in Britain to meet certain lending targets. The difficulty for us is that the targets in Project Merlin are applied across the UK as a whole, with no regional element to them. It would be possible for the banking sector to meet all of the Project Merlin requirements without a single additional penny of lending being made to small and medium-sized businesses in Northern Ireland. Therefore, we have been corresponding with the Treasury and the Government to ask that the basis behind Project Merlin, which is to require banks to feel some pressure from government to maintain lending given the assistance that they have had, applies here.

We have raised similar issues with the Irish Government. When, in August 2010, they gave some additional resources to their banks, they required each of them to lend £3 billion per annum to small businesses. The Irish Credit Review Office monitors that, but that does not apply to the Northern Ireland operations of the Irish-owned banks. We have been discussing with counterparts there how that pressure on banks to maintain lending to small and medium-sized businesses can be felt. If it cannot be made a legal requirement, it should at least be felt by the operations here that lending to small businesses is important.

At the Conservative Party conference, the Government announced the credit easing measure, of which we will hear more in the autumn statement. Under that measure, the Government will act as a guarantor for some of the lending that will take place. Precise details are not available, and, in line with the approach that we have been taking to keep the pressure on the Governments and enforce their initiatives, we will write to the Government to indicate that we would like that to be in operation. The Minister of Finance and Personnel also has a meeting coming up in November with Sir Mervyn King, the governor of the Bank of England, which will be operating the credit easing report. The Bank of England will also put in place the arrangements for the recovery and restoration plans that I mentioned earlier, and, as part of our continuing approach, we will outline to the governor that that needs to happen.

The Minister has met representatives of local banks. Towards the end of August, they discussed some of the issues around the financial crisis, rather than the ongoing work on how we might communicate to our business sector that the banks have money to lend here and that they want to lend. The data that I have quoted shows that nine out of 10 applications received are approved. There is a perception that there is no money available for lending, but banks here are giving us the different message that there is money available to lend for viable and sustainable projects. We want to build confidence among them and encourage them to take the step of coming forward.

The Chairperson:

I refer to the data on bank lending. That is the nub of the argument, because local businesses are saying that banks are not lending. However, the banks are saying that there is not a full uptake of the lending available. Local businesses are saying that it is too complicated and convoluted and that there are too many string attached to encourage them to avail themselves of it. Therefore, people are not coming forward to seek the loans. That is a dispute that you would think the data that you are trying to gather through the Northern Ireland Statistics and Research Agency (NISRA) might address and be able to provide clarity on. If Project Merlin is not providing the regionalised data, and if you are not getting data from the South regarding their banking interests here, how does NISRA get to the nub of the problem regarding the difference in opinion as to what is available and what people are taking up?

Mr Pauley:

I think that we suffer from the problem that you outline: there is that difference of opinion. It is exactly the same nationally. That may not be any comfort, but it was hugely difficult to get even the data that we received from the banking sector. We now have the British Bankers' Association report. That work started with the cross-sector advisory forum. Some of you will know when that work started. We got it in June of this year, so it has taken a huge length of time to get this data.

The national position is the same. I mentioned the credit easing measure. The Government have had Project Merlin, but they have still felt the need to introduce a further measure of credit easing. There is no doubt that lending is still happening. The banks' data show that. Banks will be very clear that they do not make any money unless they lend some money. They need to lend it; that is their business. I believe that to be true. All of the Bank of England data shows that some lending has taken place, although it is less than previously.

The Chairperson:

It is not measurable here; that is the problem. The targets that are being applied under Project Merlin are not measurable in terms of their achievement here.

Mr Pauley:

Those targets for increases do not apply here. We now have a measure of the new term lending, and one quarter is included in the statistics. We only have data on three quarters now, but we will have new data every quarter, and we will start to see whether that is happening and understand whether our banks are increasing or decreasing their lending.

Part of the problem is that lending is falling everywhere. It takes us back to some of those global issues that we talked about and the question of whether you require banks to increase their levels of capitalisation or require them to lend. It is about finding the balance. There is no point in their being perfectly capitalised if they do not lend and perform their functions. It is a huge dilemma, and it is very difficult to get a precise picture of how we can do that. Hence, we have written lots of letters about the targets being applied. We have also met many people to talk about the need to apply them here. Those people have included individuals at political and official level in Departments. We have also met representatives from the banks and their representative organisations.

The Chairperson:
That would be fine if it were the banks' own money that they were being coy about. It is, in fact, our money, which is the difficulty for us.

Mr McLaughlin:
Thank you for the presentation. You referred to a lending approval rate of 90%. Particularly in the context of the trend of a reduction in the number of applications, that could be interpreted as being down to the fact that people have to accept more stringent conditions because they are in such financial difficulties. Both the complaints that we have received and those that you have received could be true, in that there are people who felt that there is no point going to the banks, so they do not appear in the figures. That goes back to the Chair's point that we are operating with incomplete data, and it is difficult to make effective interventions in those circumstances.

You will be aware of the credit review process that has been developed in Dublin.

Mr Pauley:
Yes.

Mr McLaughlin:
An appeal mechanism has been developed, which is done in the bank and involves a bank official reviewing the work of a fellow bank official. The credit review process is external. I do not know enough about it to testify that it is independent, but, on a number of occasions, the original decision has been challenged. However, I also know that the banks' decision-making process and conclusions have been upheld. There is a benefit both to the sector and to businesses that are looking for facilities from the bank. We have had consistent and credible evidence that the change in the credit facilities is compounding the difficulties that companies here were facing

already.

Paul referred to the fact that we do not have devolved authority. If we can do anything that is modelled on that credit review process, it will almost need to be a voluntary compact between all of the banks operating in this region. The banks would have to allow their decision-making process on credit applications to be examined externally. Have you considered doing that?

We are getting data at a UK level that is only indicative of what is happening here, because some of the banks here are not inputting to that data. In any event, regional extrapolations are always possible to misread. A regional facility would help. The banks are arguing, with some force, that they are back in business and that they are anxious to do business, but the industry representatives have told us that they cannot afford to do business with the banks and take on the revised conditions that are being attached. We are in a self-defeating circle, and we need to break out of it.

Can some consideration be given to assisting the banks and the businesses that are looking for facilities to be sure that lending is taking place? There is a lack of credibility, because businesses are telling us straight up that that is not what is happening. They are saying that the banks are looking for hair and teeth and driving them out of business. One man who had been in business for 30-odd years was in tears when he told me that the banks' conditions were driving him out of business. He presented to them a plan that would have allowed him to survive the downturn.

Mr Pauley:
We have looked at the Credit Review Office in the South. Its latest report shows that, of the 98 cases that it reviewed, the banks' original decision was upheld 27 times. Subsequently, banks provided credit in 30 cases, and 13 cases were withdrawn. There were further categories; for example, that more work was required.

One of the actions that the British Bankers' Association has proposed is that there will be a review facility, but, as you rightly say, the first stage of that is for the bank to carry out an internal review by someone who was not involved in the previous lending decision. However, the last aspect of it is that an independent person would be appointed to oversee that. That person has been appointed; he is Russel Griggs. Each year, he will review the performance of each bank with regard to how they have reviewed their own operations, and see whether there are any discrepancies. That is a stage further from full independence, but there is that element to what has been proposed, which we understand will operate here and throughout the UK. It was originally to have been in operation by the end of October. However, the last time that I met the British Bankers' Association, which was about three weeks ago, we were told that it may now be mid- to late-October.

Mr McLaughlin:
Russel Griggs is looking at the appeals process, not the outcomes; "process" is the important word.

Mr Pauley:
The other feature that he is looking at relates to new lending applications. A lot of those who are discussing issues with the Department are, quite often, those who are having their existing arrangements reviewed. That is proving very difficult for them as customers, and they are finding it to be onerous. We have written to a number of banks about that issue and asked them for their comments on it. That is about as much as we are able to do.

Mr McLaughlin:
Is that the second element of Russel Griggs's remit? Is it covered in the report?

Mr Pauley:
He will lead the review team, and he will be supported by the consultancy firm.

Mr McLaughlin:
Yes, but that is into the appeal process only.

Mr Pauley:
Yes, but he will look at the appeals that have operated, their outcomes and how they have been carried out. It remains to be seen how it will work.

Mr McLaughlin:
I want to go back to the 90% approval rating that was quoted. There are a number of ways in which that can be achieved. It could be that the banks are proactively looking for customers to lend money to, or there could be a reduced number of people who are prepared to go through that

process and accept the new conditions. You could have 90% approval of people who are in such a circumstance that they cannot afford not to do business with the banks, and you will get a very high percentage approval rating, but the overall amount of money that is lent and the pool of people who are making applications is, actually, declining. That seems to be what is happening. I, therefore, dispute the conclusion that is presented here.

Mr Tony Simpson (Department of Finance and Personnel):
I want to make another couple of points. The Chair has already referred to the NISRA work. One of the key things that we are trying to explore in that work is finding out from businesses whether the terms and costs have changed. You are right: there is a lack of information on this, and this will help inform the discussions that we have with the banks to assess how much this is an issue.

Within the past couple of weeks, junior Ministers met folk who are involved in the Credit Review Office to explore what lessons we might be able to learn for what we are doing here. The key element that they acknowledged when they met the junior Ministers was that it is a voluntary arrangement with the banks, and the banks have already progressed what we are proposing here in relation to the independent appeals process and the work of Professor Griggs. At that meeting, the junior Ministers reached the conclusion that it is worth seeing how this system works at this stage, given that we are quite close to conclusion and getting this in place, because we do not have the legislative cover to put in place something like the Credit Review Office in the South.

Mr McLaughlin:
I think you have answered as much as you can. Some of the evidence we have heard is that the risk has been shifted substantially on to the people who were looking to do business with the banks, and the banks were looking for assurances, particularly personal assets. So the whole relationship has changed for the worse, in circumstances in which the banks lack a considerable amount of their former authority and credibility. It appears that they are putting the knife into the very people they should be helping, so this process does not give me any assurance that we will reassert the original relationship. People who have been doing business with the same bank for 30-odd years have more or less been told to put up or get out. You have probably taken me as far as you can on this, and, despite the good work that people are doing, I am not reassured.

Mr Girvan:

Thank you for the paper. One of the problems that I have encountered with banks is that they were converting what were overdrafts into loans. Therefore, they were not making any additional loans available but were putting through overdrafts as approvals for loans. They were simply changing the terms that they had with existing borrowers.

The independent commissioner's report indicated that banks need to increase their cover. It was recommended that small banks need to increase their cover to 10% and that large banks need to increase it to between 17% and 20%. A certain amount of protectionism has been going on in banks, in that they have been covering themselves with additional cash and investing in areas that they felt safe with. Therefore, they were removing a revenue stream from borrowing. I know of a number of businesspeople who had to go to their bank to renegotiate their overdraft, which they had had at a reasonable rate. When they did so, the bank offered them a new loan that was less than what their overdraft was and at a higher rate of interest. The bank told them that it was trying to recover losses, but it was doing so by converting overdrafts into loans.

You talked about a 90% approval rate. That is, probably in a high percentage of cases, money that the banks have already committed. Has any work been done to investigate how much that practice has gone on? The banks would probably not be too keen to volunteer that information, but that is the message that is coming from the general public.

Mr Pauley:

That might come out from the work on the supply of and demand for credit, to which Tony referred. It takes us back to the huge dilemma that the Government are requiring banks to take action to ensure that they are safe, but that has an impact on the banks' ability to lend and the amount that they have to lend. As we look at individual instances or hypothetical circumstances, I feel poorly qualified to say whether such changes are right or wrong. Generally, people believe that we cannot have the lending environment that used to exist. The banks' processes of examining to whom they are lending and the requirements that they make of people perhaps need to be different than they were some years ago. Without having teams of people looking at the performances of the banks, it is hugely difficult to say where we should find that balance in the future.

Mr Girvan:

I do not necessarily see a lot of new borrowing going on. I see conversion of existing borrowing to a different form of borrowing. Is that what the banks are using to get those figures?

Mr Pauley:

The data shows a decline in the amount of borrowing. We have only three graphs, and although that is three more than we used to have, it is limited information. Undoubtedly, the total amount of borrowing is going down. Between quarter 3 of 2010 and quarter 1 of 2011, it reduced by around one third. That is a significant decline. Banks tell us that people are not coming forward to ask for loans. Some of the people who would have applied for loans are afraid to do so because of the circumstances that you described. We now have some data that we can at least discuss with the banks. Perhaps some people will have a different interpretation of what that means, but we now have something where we had nothing. As we go forward, we intend to continue the discussion and the pressure, particularly about whether lending targets or other arrangements apply and are seen to apply in this region as well as elsewhere.

Mr McQuillan:

Unless the data is regionalised, we will not have a proper picture. The current picture is too broad to make anything out of it. It is important that we try to get that work done.

I agree with what Paul said. We have all had people coming to us who have never defaulted on repayments for their overdrafts or anything else, yet they have been offered loans at extortionate rates, which they have no choice but to take. The people who stuck with the banks through thick and thin are being screwed by them because of other people's defaults. What the banks are doing is wrong.

The Chairperson:

It strikes me that the essence of the issue is that, despite the fact that the state has bailed out the banks, the power relationship in terms of the information flow has not changed that much.

Mr McLaughlin:

It has; for the worse.

The Chairperson:

Through this Committee, we are trying to get a sense, at a small regional level, of how taxpayers' money, which was used to shore up the banks, is being used to stimulate economic activity and to support businesses in tough economic times. However, we are still at a deficit with the information. There does not seem to be any sense of responsibility among the banks that, despite having received vast amounts of state aid, they have a responsibility to display, in an earnest way, how they are using that money to assist with the coalition British Government, the Executive and the Dublin Government's goal of stimulating economic activity. That is the difficultly.

You referred to two reports in your submission: the NISRA report, which is trying to burrow into the more regional aspect from the perspective of borrowers if not that of the banks; and the Griggs report. To assist the Committee, can we have early sight of those reports as soon as they are available?

Mr Pauley:

OK.

The Chairperson:

Thank you very much.