

Agenda item: 

**Title of meeting:** Governance & Audit & Standards Committee

**Date of meeting:** 14 September 2018

**Subject:** Hampshire Community Bank - Update

**Report by:** Director of Finance and IT (Section 151 Officer)

**Wards affected:** All wards

**Key decision:** No

**Full Council decision:** No

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## 1. Purpose of report

1.1 To update the G&A&S Committee on progress for the Hampshire Community Bank project.

## 2. Recommendations

2.1 That the G&A&S Committee note the information contained in this report.

## 3. Background

3.1 A [report](#) on the Hampshire Community Bank was approved by Cabinet on 10 July 2014 and City Council on 14 July 2014 ([minute 72/2014](#)). The report included the following recommendation:

*3) Authority to approve a Capital Investment of up to £5 million in in the creation of Hampshire Community Bank and incur any necessary costs relating to the Due Diligence process is delegated to the Head of Financial Services and Section 151 Officer in consultation with the Strategic Director Regeneration.*

3.2 The key benefits of investing in a Community Bank along the lines of the German Sparkassen community banks were set out in the report and included the following:

3.2.1 Creation of a new "not for profit" bank which cannot be taken over or sold and which will exist in perpetuity to benefit the County of Hampshire.

3.2.2 Distribution of half of the banks surpluses by a Grants Board including the investor's representatives to support charitable or other deserving causes in Hampshire. Over 5 years it was estimated that over £6.5m would be distributed, rising to over £20m over a 10 year period.

3.2.3 Over 5 years support to around 480 small and medium enterprises in Hampshire to grow through provision of key investment capital.

3.2.4 Provide funding to support £375m of investment in the Hampshire economy.

3.2.5 Create between 2,600 and 4,100 new jobs over the first five years.

3.2.6 6% return for investors over 10 years.

## 4. Corporate Structure

4.1 Hampshire Community Bank has a three level corporate structure as follows:

### 4.1.1 HCB Foundation

- Company Limited by Guarantee registered as a [Charity](#) with the Charity Commission and governed by Trustees.
- Charitable Objects include "*To promote any charitable purposes (according to the law of England and Wales) that benefit the public primarily in Hampshire*" and "*To promote any purposes that benefit the public primarily in Hampshire; to promote any charitable purpose (according to the law of England and Wales) in the United Kingdom, if the public in Hampshire will also benefit indirectly*".
- Will be responsible for establishing a "Grants Board" which will "*allocate for charitable grants, donations and disbursements half of the funds contributed to the Charity by both the Community Bank and HCB Holding*".
- HCB Foundation holds 50% voting rights in HCB Holding Limited (see below).
- [Trustees](#) currently are Anne Harrison (formerly of Hampshire County Council, now retired), Sarah King (Eastleigh BC Chief Financial Officer), Shamsheer Dandha (entrepreneur), Andrew Walsh (Finance Director) and [Dr Richard Werner](#) (Professor of International Banking at the University of Southampton).

### 4.1.2 HCB Holding Limited

- Private Company Limited by Shares. This is the company in which PCC and other public sector investors have purchased shares. The shareholders have signed up to purchase 8,000 shares at £1,000 per share as set out below.

To date shareholders have released half of these funds and payment of the remaining half is conditional on further Due Diligence reports from BDO. PCC have therefore paid £2.5m of the total £5m due:

- 5,000 - Portsmouth City Council
  - 500 - Eastleigh Borough Council
  - 250 - Winchester City Council
  - 500 - Test Valley Borough Council
  - 200 - The University of Portsmouth
  - 100 - The University of Winchester
  - 400 - The University of Southampton
  - 100 - Southampton Solent University
  - 950 - [Local First Community Interest Company](#)
- Shareholders have 50% of the voting rights in HCB Holding Limited (see below), the other 50% being held by HCB Foundation.
  - Prior to Hampshire Community Bnk Limited (see below) being authorised the Board of Directors for HCB Holding Limited is taking all of the decisions in relation to the establishment of the Bank.
  - HCB Holding Limited effectively controls Hampshire Community Bnk Limited (see below) as it holds all the share capital for and can appoint and remove Directors of Hampshire Community Bnk Limited.
  - [Directors](#) currently are Chris Ward (Chair of the HCB Holding Limited Board of Directors and PCC Director of Finance and IT), [Johannes Haas](#) (General Manager, DZ Bank AG London Branch), Charles Haswell (Previously Global Head of Financial Sector Policy, HSBC) and Dr Richard Werner (Professor of International Banking at the University of Southampton, previously Senior Managing Director, Bear Stearns Asset Management now JP Morgan).

#### 4.1.3 Hampshire Community Bnk Limited

- This is the company which is seeking authorisation from the Bank of England to operate as a bank. The name includes the word "Bnk" because a company name cannot include the word "Bank" until it is authorised to operate as a bank by the Bank of England.
- As described above HCB Holding Limited Board has the power to appoint or remove Hampshire Community Bnk Limited directors.
- Directors currently are Johannes Haas (General Manager, DZ Bank AG London Branch) and Dr Richard Werner

(Professor of International Banking at the University of Southampton). The Articles of the company place no limit to the number of Directors, but there must be a minimum of two.

## 5. Contractual Position and Due Diligence

- 5.1 The eight public sector shareholders have signed up to an 'Application to Subscribe' for shares in HCB Holding Limited and a 'Subscription Agreement'. PCC has committed to purchase £5m of shares with payments being made in four instalments linked to key parts of the bank authorisation process. Release of each instalment is conditional on a Due Diligence report from banking experts BDO LLP which assesses whether, in BDO's expert opinion, HCB are capable of achieving authorisation. To date BDO's reports have satisfactorily concluded that the bank is capable of achieving authorisation and therefore all eight investors have paid the first two instalments.
- 5.2 The agreement includes a "longstop date" of 31 December 2018. It is likely that investors will need to agree to extend that date in order to be able to proceed through the bank authorisation process.
- 5.3 The latest BDO report was prepared for investors in March 2018 on progress to date showing key milestones achieved, an assessment of the key milestones still to be met, the estimated timescale to obtain authorisation, a Risk Register and an assessment of Hampshire Community Bnk Limited's ability to obtain authorisation to operate as a bank. That report concluded:  
*"Overall, we conclude that HCB has the ability to be authorised as a bank although we have identified several risks that may cause delays to the process. These risks relate predominantly to the hiring of key senior management staff and the implementation of IT systems. We therefore recommend that HCB includes a contingency buffer in its planned timelines for "authorisation with restrictions" and in respect of the lifting of restrictions at the end of the mobilisation phase".*

## 6. Operations

- 6.1 Planning to provide the key resources and facilities needed for Hampshire Community Bank Limited to satisfy the regulator and start operations is well advanced. Set out below are details of progress on some of the key items.
- 6.2 **Core Banking System** - HCB will identify a preferred core banking IT business partner prior to the "challenge session" (see section 7.1 below). To reduce risk and facilitate procurement, an external IT consulting company has been engaged.
- 6.3 **Liquidity, asset and liability management and regulatory reporting tools** - Software to carry out this analysis has been purchased and the implementation process has commenced.

- 6.4 **Agency Banking Arrangements** - A pre-contract agreement has been signed with a major bank offering correspondent banking services. The preferred vendor for the Community Bank's core banking system is scheduled to be selected by the end of September 2018.
- 6.5 **Premises** - Property in Winchester has been purchased which would partially meet HCB's accommodation and banking requirements, however a better opportunity has arisen which would fully meet HCB's needs and negotiations to purchase that property are underway. If that purchase goes ahead successfully the current property will be sold.
- 6.6 **Additional investors** - another local authority in Hampshire is considering investment of circa £1m in HCB.
- 6.7 **Staffing** - hiring of key senior management positions has begun. The CEO has been selected, interviews for the Chief Risk Officer took place in July 2018 and interviews for the Chief Operating Officer are scheduled. Starting dates for all appointments are likely to be late Quarter 3 to Quarter 4 2018.
- 6.8 **Commercial loans** - In the UK lending to businesses does not require authorisation as a bank. HCB already has a loan portfolio for lending to small and medium sized entities (SME's) of over £1m. That loan portfolio was originally funded by a Regional Growth Fund (RGF) grant of £950,000 and administered by Local First Community Interest Company with Eastleigh Borough Council as Accountable Body. At the end of March 2017 loans ranging from £20,000 to £250,000 and totalling £1,145,000 had been given to 13 different companies largely in the Winchester and Eastleigh areas. Loan terms have been complied with by all but one debtor who unfortunately went into administration resulting in a loss for Local First CIC of £46,000. The remaining loans are transferring from Local First Community Interest Company to Hampshire Community Bank Limited.
- 6.9 **New PCC Commercial Loans initiative** - PCC and HCB are currently finalising the legal documentation (no loans will be made until that documentation is satisfactorily completed) to allow further commercial loans to SMEs secured on property which, if successful, could result in further lending of the order of £10 million. Unlike the City Council's existing £5m commitment to purchase HCB Holding Limited shares (£2.5m invested so far, remaining £2.5m conditional on further Due Diligence reports from BDO as described in 4.1 above) this is not an equity investment for the purposes of setting up and capitalising the bank. Rather it is a loan facility approved by the City Council under its Treasury Management powers specifically for commercial loans to SMEs secured on property and at interest rates in excess of those that can be obtained through our normal treasury management investments.

## **7. Regulatory Process and timetable**

7.1 The Banking Authorisation process is administered by the Bank of England via the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The key stages include:

- Legal structure set up
- Funding secured
- Pre application meeting
- Feedback meeting(s)
- "Challenge Session"
- Submission of Application for authorisation
- Assessment and Authorisation process (led by PFA/FCA)
- "Authorisation with restriction" achieved
- Mobilisation phase (led by PFA/FCA)
- Restrictions are lifted and Full Authorisation achieved.

7.2 The delay to achieving authorisation has arisen for a number of reasons. The original timetable anticipated a start of operations in 2016 however that reflected a £7m injection by Central Government which, following the General Election in 2015, did not materialise. That delayed progress whilst funding was raised from a range of public sector investors. To attract those investors and finalise the complex legal documentation required to create a new "not for profit" bank which will exist in perpetuity and cannot be taken over or sold took over a year, being finalised in February 2016.

7.3 Since that point the pace at which the process can proceed has been largely determined by the regulator (the Bank of England via the Prudential Regulation Authority and the Financial Conduct Authority) and delays have arisen through a combination of HCB being an entirely new concept requiring closer scrutiny and the advent of Brexit which has generated a significant extra regulatory workload for the regulators.

7.4 HCB has currently prepared the majority of the documentation needed for the Application for authorisation. The HCB timetable currently indicates that the Challenge Session should take place in Quarter 4 of 2018 with "Authorisation with restriction" achieved in Quarter 2 of 2019 and full Authorisation in early 2020. Note that BDO LLP has recommended that the timetable should include a 3 month contingency for obtaining the authorisation with restriction and a further 2 months contingency in the mobilisation period to allow for delays relating to senior management hire and IT systems implementation.

## **8. Reasons for recommendations**

8.1 To keep the G&A&S Committee apprised of progress on the Hampshire Community Bank project

## 9. Financial implications

9.1 Hampshire Community Bnk Limited, subject to actual financial performance, aims to pay the City Council a return equivalent to an Internal Rate of Return over 10 years of 6% on the Council's £5m investment. The level of return beyond that 10 year period will be a matter for Hampshire Community Bnk Limited directors and HCB Holding Limited directors and shareholders to determine.

9.2 The benefits the bank will bring to the local Solent economy and the distribution of 50% of the Bank's profits for charitable purposes, mainly in Hampshire, both have the potential to reduce the level of demand on City Council (and other Government) services, though it is not possible to quantify that potential benefit.

9.3 The proposed SME lending secured on property (see para 6.7 above) is compliant with the City's Treasury Management Policy.

## 10. Equality Impact Assessment (EIA)

10.1 The preliminary EIA carried out prior to the report to Cabinet and Council in 2014 indicated that the requirement for a full EIA was low. To date no changes have arisen that would materially effect that conclusion.

## 11. Legal implications

11.1 The City Solicitor confirms that it is within the powers of the Committee to approve the recommendations to this report

Signed by:

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**Christopher Ward - Director of Finance and IT (Section 151 Officer)**

### Appendices:

### Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

<b>Title of document</b>	<b>Location</b>
1 Report on Hampshire Community Bank to Cabinet and Council 10th and 14th July 2014.	PCC External website
2 Report by BDO LLP Hampshire Community Bank - Review of Banking Application Preparedness - 13 March 2018	Financial Services - contact Chris Ward, Director of Finance and IS