Economic Perspective 2

FULL BANKING STATUS FOR THE TSB?

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The Trustee Savings Banks Group is preparing to change the structure of its component trustee savings banks from that of unincorporated societies managed by boards of trustees to public limited companies managed by boards of directors. This metamorphosis is part of its progress towards full banking status under the Banking Act of 1979, a process which has been under way since the Page Committee reported in 1973. The former narrow concentration on personal savings offering a high degree of security, with assets invested in safe but low earning government securities through the national debt commissioners, is to evolve into a full fledged bank offering competitive rates of return and a comprehensive range of financial services.

The change in status to a public limited company is necessary because the present TSB structure does not meet the requirements of the First EEC Council Directive on Credit Institutions of December 1977. Exemption was permitted from this directive for eight years, hence the need for legislation, or an extension of the exemption, by 1985. Though the TSB was given exempt status under the 1979 Banking Act the Bank of England appears to be unwilling to extend this beyond the period provided by the First Directive, despite the fact that the extensive savings bank network in other EEC member countries does not appear to be under the same pressure. The attainment of full banking status will bring the TSB within the control of the Bank of England for supervisory purposes in addition to present controls for monetary policy purposes.

Legislation will be required to enable the restructuring to take place. Amongst the problems to be resolved are those of identifying the present owners of the trustee savings banks and deciding how they should be compensated when the trustee savings banks transform themselves into public limited companies. These are not trivial questions. With an operating profit of £154.9 million in 1983 before allowing for exceptional items, and applying a less than generous average price/earnings ratio of six, the trustee savings banks would be capitalised at well over £900m. A larger figure could readily be justified on the basis both of higher expected future earnings as the range of services provided by the TSB is extended and the lower than average degree of risk associated with their operations compared to other commercial banks because of the TSB's negligible exposure to foreign lending and small exposure to the corporate sector.

The interesting question arises as to how the underlying worth will be capitalised. There are no legal owners of the TSB at present, but existing depositers and staff would appear to have a strong claim on the assets. This is recognised by the TSB when the 1983 Group Report talks of "..... the offer for sale of shares in TSB Group plc preferentially to customers and staff .....". What this means in practice will will only be known when the draft legislation is published. Present government thinking on the issue may be gauged from the Green Paper on Building Societies (Cmnd 9316, para. 5.31) where, commenting on any move to confer company status on a building society, it says that this "would generally involve

(a) a scrip issue of company shares to existing shareholders with holdings above a certain threshold, with conversion of their existing shares into deposits; and

(b) the issue of further shares, by a rights issue or otherwise, to secure additional capital.

An identical option is not available for the trustee savings banks as there are at present no recognised shareholders.

The Green paper also points out that after conversion to limited company status the words "building society" could no longer be used in the corporate title. The same proposition would presumably apply to the Trustee Savings Banks, where after incorporation the word "trustee" would no longer be accurate and could indeed be argued to be misleading implying as it does some additional form of security.

The change to company status will also have the desirable result from the Bank of England's point of view of identifying a group, the board of directors, which is legally answerable for the activities of the TSB, while also providing a mechanism to permit access to the capital market to supplement the equity base of the then incorporated TSB should that prove necessary. Under the present mutual structure the latter can only be achieved through the earning of a surplus on current activities.

Pressure for the change to corporate status comes not just from the supervisory authority but also from the present executive management who believe the change will provide "an effective operational and commercial structure to meet the demanding needs of the changing financial services market" (TSB Group Report 1983). The activities of the TSB plc will certainly be regularly exposed to the market through the standard reporting requirements of the Companies Act and the Stock Exchange with the result that its performance could then be compared with that of other banking companies. If adequate performance was not forthcoming TSB plc. would be exposed to the possibility of a takeover bid, something which is not possible under the present mutual structure. It is likely however that the legislation changing the structure of the TSBs will place some restrictions on takeovers, at least for some minimum period.

In many respects the TSB plc would be an attractive acquisition for possible bidders as it will comprise in essence a large national bank with deposits in excess of £8 billion, 1641 branches and over 19,000 staff. But while the TSB has more than 6 million account holders representing over 14% of the adults in the UK it is, however, heavily dependent on the older age and lower income groups. Nonetheless, the TSB's strong retail deposit base with its latent opportunities for the cross selling of a range of financial services, the as yet relatively small penetration of the company lending market and little exposure to foreign business provide ample scope for expansion, either in the hands of existing management or under the auspices of a successful bidder. The task of revitalising the TSB will not however be an easy one, given the likelihood of intensified competition in banking services from the building societies and the more active role for national savings being pursued by the present government.

Some doubts have been raised regarding the desirability of the proposed evolution of the TSBs. These stem in part from the process of creating shareholders from the present mutual organisation. It is feared in some quarters that the whole process will deprive the TSB of its distinctive character, which arises from its mutual organisation and history as a thrift institution based on voluntary work, and cause it to become instead simply another commercial bank shorn of its present close links with the local and regional areas in which it operates. The centralisation imposed by the company structure may result in the TSB losing its ability to respond to local needs and preferences. The process of competition may force the new bank to concentrate its resources on an already over-populated and increasingly competitive company sector at the expense of its traditional personal customer. The loyality of existing depositors may well be strained while the development of new financial activities will make the whole undertaking a riskier enterprise than hitherto.

Furthermore, any surplus which is earned by TSB plc will have to be partly distributed to shareholders instead of automatically ploughed back into the business. This suggests that sustaining the existing organisation will require either a large increase in business, higher charges or a substantial reduction in costs. These doubts notwithstanding, even with its present trustee structure the TSB movement has moved so far along the road to full banking status with incorporation that it would be a difficult process to stop without cogent arguments at this advanced stage. The Trustee Savings Bank Act 1976 established the TSB Central Board with certain supervisory and regulatory functions for the group as a whole. Since then four regional TSBs have been formed plus other public limited liability subsidiaries - Central Trustee Savings Bank Ltd, TSB Trustcard Ltd, TSB Trust Company Ltd and United Dominion Trust Ltd, which provide services for the group as a whole. One of the regional organisations is TSB Scotland which will become one of the fully owned subsidiaries of the TSB Group plc.

At present the TSB Scotland accounts for 18% of the total number of TSB branches. It enjoys a significantly greater presence in its market area than the other TSBs with well over 20% of the adult Scottish population holding accounts with it. It accounts for assets of £1.3 billion out of the TSB group total of £9.6 billion. In common with other regional TSBs it has in recent years placed considerable emphasis on extending its range of services thereby attracting a wider range of customers, including business customers. In this regard the TSB Scotland has a significantly lower ratio of advances to customers to total assets than exists for the group as a whole, though significant progress has been made in recent years in changing the portfolio of assets by developing other outlets.

TSB Scotland hope that their provision of a full range of financial services will maintain the present strong depositor loyalty, and that such loyalty will in turn be encouraged by membership of an effective national TSB group providing both marketing and financial economies. Nonetheless there are undoubtedly fears that the pull of the central TSB organisation coupled with the natural advantage of London as a financial centre will result in some key decision-making processes and their associated jobs gravitating south away from Scotland.

Once the changes have taken place the TSB will be well on the way to becoming the force in banking which the Page Committee predicted, but as part of the private banking sector which that committee saw as being neither practicable nor desirable in principle. The issue of principle has apparently been decided by the decision takers in the TSB, the practicability will be determined when the legislation to permit the change is published in due course. The desirability of the move is more difficult to determine since the TSBs are not unique in having a mutual form of organisation in the financial sector - mutual assurance companies and building societies being the obvious examples. Savings bank organisations on the continent do not seem to be intent on adopting a corporate structure but this may reflect a more sympathetic approach by their supervisory authorities.

Progress to corporate status appears to be expedient in the move towards full banking status and desired by those determining the future of the TSB who see the corporate structure as necessary to produce a flexible and efficient organisation capable of meeting the needs of the fast moving financial services industry. Any lingering doubts about the loss of mutual status seem to have been swept aside by these pressures.