



BANK OF ENGLAND

Scottish & Northern Ireland Banknote Issuance Annual Report 2018

Report on the Bank of England's work under the Scottish & Northern Ireland Banknote Regulations 2009

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Executive Summary

- Four commercial banks in Northern Ireland and three commercial banks in Scotland are authorised to issue their own banknotes (the “authorised banks”), and are required to hold ring-fenced assets that back their note issuance at all times. The aggregate backing requirement of all seven banks at end-February 2018 was £7.62bn, a decrease of 1% from £7.72bn in 2017.
- At end-February 2018, the three authorised banks in Scotland had an aggregate backing requirement of £4.87bn, comprising £4.48bn of Notes in Circulation and £0.39bn of Notes with the Potential to Enter Circulation (as defined in paragraph 11). The four authorised banks in Northern Ireland had an aggregate backing requirement of £2.76bn, comprising £2.62bn of Notes in Circulation and £0.14bn of Notes with the Potential to Enter Circulation¹.
- The Bank of England (“the Bank”) is responsible for the regulation of note issue by the seven authorised banks. The Bank undertakes a range of supervisory and compliance activity throughout the year, including compliance visits and analysis of daily regulatory reporting provided by all authorised banks. In the year to end-February 2018, this included the Bank conducting 13 compliance visits across the authorised banks’ locations to verify the value of backing assets and Excluded Notes (as defined in paragraph 11) held. Where compliance visits identified shortcomings in security or operational processes or where other regulatory requirements were not met during the period, the Bank conducted an investigation and remedial actions were agreed with the authorised banks.
- There was a satisfactory level of compliance with the regime during the year to end-February 2018. During the twelve month period, the Bank assessed one ‘Serious’ compliance failure (the categories of failures are defined in the Statement of Penalty Policy (“SPP”)²). This resulted in a penalty of £10,000 being imposed on Bank of Ireland (UK) plc. There were two ‘Notable’ compliance failures, neither of these was considered severe enough to justify referral to the Bank’s internal decision making Committees and both were laid on file for future reference without penalty³.

¹ Figures may not sum due to rounding.

² <https://www.bankofengland.co.uk/-/media/boe/files/banknotes/scottish-northern-ireland/scottish-and-northern-ireland-statement-of-penalty-policy-2017.pdf>

³ Assessed compliance failures are published in this Annual Report in accordance with Regulation 16 of the Scottish and Northern Ireland Banknote Regulations 2009. Consequently, any compliance failures in the process of being assessed at the end of the reporting period will be disclosed in the next year’s report.

Introduction

1. The Bank assumed responsibility for the regulation of note issue by the three authorised banks in Scotland and four authorised banks in Northern Ireland on 23 November 2009.
2. Regulation 18 of the Scottish and Northern Ireland Banknote Regulations 2009 (“the Regulations”) requires the Bank to publish an annual report on the discharge of its functions under the Regulations. This is the ninth such report, and covers the Bank’s activities from 1 March 2017 to 28 February 2018 (the Bank’s 2017/18 financial year).

Historical background

3. The seven authorised banks (or their predecessors) have been regulated with regard to the backing of their banknotes since 1845. Part 6 of the Banking Act 2009 (“the Act”), which came into effect on 23 November 2009, repealed the legislation under which banknote issuance was previously regulated and passed the responsibility for regulation to the Bank. Part 6 of the Act updated and modernised the framework for commercial note issuance to provide enhanced noteholder protection.

4. The authorised banks are:

- AIB Group (UK) plc (trades as First Trust Bank in Northern Ireland);
- Bank of Ireland (UK) plc;
- Bank of Scotland plc;
- Clydesdale Bank plc;
- Northern Bank Limited (trades as Danske Bank in Northern Ireland);
- The Royal Bank of Scotland plc⁴; and
- Ulster Bank Limited.

Legislative framework

5. The Act and the Regulations set out the framework for the Bank’s responsibilities for regulating the authorised banks’ note issuance. The primary objective of the legislation is noteholder protection. The provisions in the legislation are designed to ensure that holders of genuine banknotes issued by the authorised banks receive a level of protection similar to that provided to holders of Bank of England notes, through the full backing of notes at all times (see Noteholder Protection paragraphs below for more detail). The Bank is not responsible for the design of the authorised banks’ banknotes or their robustness against counterfeiting.

6. The authorised banks’ note issuance is governed by the Act, the Regulations and the related Scottish and Northern Ireland Banknotes Rules (“the Rules”). These came into force in November 2009 together

⁴ On 30 April 2018 The Royal Bank of Scotland plc transferred issuance rights to another legal entity within the RBS Group, at the same time the new entity was renamed “The Royal Bank of Scotland plc”, see paragraph 18.

with a Statement of Penalty Policy (“the SPP”). Both the Rules and SPP are revised periodically, most recently in April 2017⁵.

7. In addition, the authorised banks must comply with conditions, known as General Conditions and Specific Conditions that set out the requirements for the holding of backing assets and Excluded Notes. As the General Conditions and Specific Conditions include sensitive material such as the security standards that sites holding backing assets must meet, they are not published.

8. The Bank has the authority to impose financial penalties on the authorised banks for non-compliance with the Regulations and the Rules.

Noteholder protection

9. Under the Regulations, the authorised banks are required to hold backing assets for their notes at all times. In the event of an authorised bank entering an insolvency process as defined in the Regulations, those assets will be ring-fenced for one year or any longer period that HM Treasury may determine after consulting the Bank, for the sole purpose of reimbursing noteholders through a note exchange programme.

10. To back their note issue, authorised banks may use a combination of Bank of England notes, UK coin and funds placed on deposit in sterling in an interest bearing bank account at the Bank. Bank of England notes held as backing assets may be held at locations approved by the Bank or at the Bank. Notes held as backing assets at the Bank may include £1 million notes (Giants) and £100 million notes (Titans), which in physical terms are permanently held at the Bank.

11. For the purpose of backing requirements, notes issued by an authorised bank are always considered to be one of three mutually exclusive classes, as set out below.

- **Notes In Circulation (“NIC”):** notes that have been issued by the authorised bank and are now in general circulation, e.g. notes in wallets and purses.
- **Notes With the Potential to Enter Circulation (“NWPEC”):** notes that are held by or on behalf of the authorised banks but which are available to be issued, e.g. notes held in ATMs or in bank branches.
- **Excluded Notes:** notes which do not need to be backed. These notes are held by or on behalf of the authorised banks, which fulfil specific requirements and conditions (known as General Conditions and Specific Conditions) imposed by the Bank, e.g. are stored in a banknote cage in a secure vault. This includes notes which have been printed but which have not yet been collected from the printer.

12. NIC and NWPEC must be fully backed with backing assets. At least 60% of NIC must be backed by backing assets in the form of Bank of England notes or UK coin. The remaining 40% of NIC and 100% of

⁵For the period 1 March 2017 – 2 April 2017 the Rules and SPP dated 5 June 2015 were in effect. For the period 3 April 2017 – 28 February 2018 the Rules and SPP dated 3 April 2017 were in effect.

NWPEC must be backed by backing assets in the form of Bank of England notes, UK coin, or funds placed on deposit in sterling in an interest-bearing account at the Bank. Excluded Notes are not required to be backed.

13. At end-February 2018, the aggregate NIC and NWPEC of all seven banks was £7.10bn and £0.52bn respectively. As a consequence, the total backing requirement of all seven banks was £7.62bn, the breakdown of which is shown in Table 1, a decrease of 1% from £7.72bn in 2017. The banks' combined average NIC over the twelve month period as a whole increased from £7.12bn to £7.31bn. In comparison, the average Bank of England notes in circulation increased from £71.98bn to £74.79bn in the same period.

Table 1 Breakdown of backing requirement and comparison with previous year

	28 February 2018	28 February 2017
Scotland authorised banks	£4.87 bn	£5.10 bn
<i>NIC</i>	£4.48 bn	£4.56 bn
<i>NWPEC</i>	£0.39 bn	£0.52 bn
Northern Ireland authorised banks	£2.76 bn	£2.64 bn
<i>NIC</i>	£2.62 bn	£2.51 bn
<i>NWPEC</i>	£0.14 bn	£0.13 bn
Aggregate backing requirement	£7.62 bn	£7.72 bn

Note: Figures may not sum due to rounding.

Compliance framework

14. The Bank has a small team of staff within its Notes Directorate to monitor compliance with the regime. The team analyses the daily and weekly data reported by the authorised banks to ensure that both the total value and the composition of backing assets held are at all times in accordance with the legislation. The Bank undertakes a range of other supervisory and compliance activity throughout the year, including compliance visits to the locations used by each of the authorised banks for the storage of their notes and backing assets. The compliance visits enable the Bank to verify the value of backing assets and Excluded Notes held, and to confirm that the necessary conditions (e.g. security standards of sites storing backing assets and/or Excluded Notes) are met. In the year to end-February 2018, the Bank conducted 13 such compliance visits. The Bank regularly re-evaluates its supervisory activity to ensure that risks to noteholders are adequately mitigated.

Compliance failures and penalties

15. The Bank has set out in its Statement of Penalty Policy its approach to assessing compliance failures and the imposition of penalties. During the year to end-February 2018, the Bank imposed one financial penalty on Bank of Ireland (UK) plc for a Serious compliance failure and assessed two Notable compliance failures.

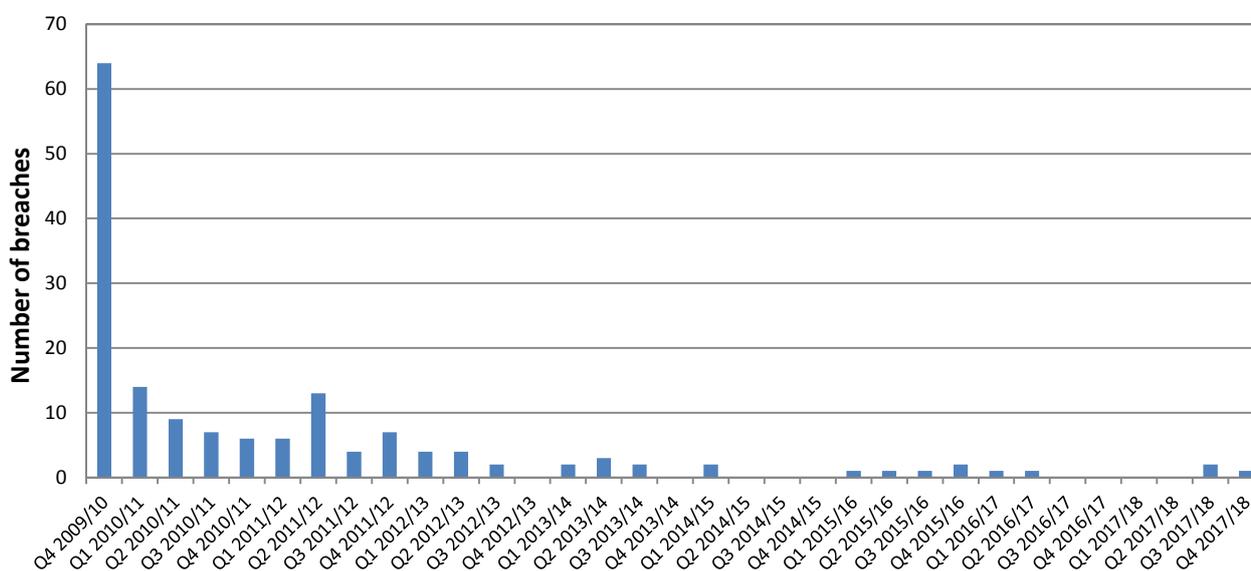
16. Neither of the Notable compliance failures was considered severe enough to justify referral to the Bank's internal decision making Committees and both were laid on file for future reference without penalty. By comparison, in the year to end-February 2017⁶ there were no compliance failures investigated by the Bank's committees and two compliance failures were laid on file for future reference without penalty. As shown in **Table 2** and **Chart 1**, the number of assessed compliance failures has decreased significantly since the start of the regime.

17. Between the commencement of the regime and end-February 2018, 27 compliance failures have been penalised, and penalties amounting to £114,700 have been issued and paid⁷. Once received, penalties are passed to HM Treasury.

Table 2 Number of compliance failures assessed

Number of compliance failures	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	Total
Investigated by the Bank's Committees (of which penalised)	79 (20)	4 (2)	3 (1)	2 (2)	0 (0)	1 (1)	0 (0)	1 (1)	90 (27)
Laid on file	21	26	7	5	2	4	2	2	69
Total	100	30	10	7	2	5	2	3	159

Chart 1 Assessed compliance failures by date: November 2009 – February 2018



Note: The four quarters to Q3 2010/11 are based on the date that the new regime came into force (23 November 2009). Q4 2010/11 was extended by 6 days in order that it and subsequent quarters align with the Bank's financial year, which runs from 1 March. Any compliance failures in the process of being assessed at the end of the reporting period are shown as occurring in Q1 of the subsequent financial year.

⁶During this period the Rules and SPP dated 5 June 2015 were in effect: <https://www.bankofengland.co.uk/-/media/boe/files/banknotes/scottish-northern-ireland/rules-2015.pdf>

⁷ Penalties are published in this Annual Report in accordance with Regulation 16 of the Scottish and Northern Ireland Banknote Regulations 2009.

Other developments

18. On 5 April 2018 the Bank issued a consultation document to the seven authorised banks seeking views on its proposed amendments to the SPP. The amendments would replace the existing Appeal Panel with the Enforcement Decision Making Committee (EDMC) that will also make decisions for Prudential Regulation, Financial Market Infrastructure and Resolution. The proposal aims to strengthen the independence and robustness of the decision-making process. The Bank's intention is to publish and implement the revised SPP once the EDMC becomes operational (expected to be later in 2018).

19. With effect on and from the 30 April 2018 The Royal Bank of Scotland plc transferred its authority to issue commercial banknotes in Scotland to another legal entity within The Royal Bank of Scotland Group plc⁸, at the same time as the new legal entity was renamed "The Royal Bank of Scotland plc". This transfer was necessary to enable commercial banknotes to be issued from the banking group's ring fenced bank following structural changes to comply with ring-fencing legislation whereby from 1 January 2019, the largest UK banks must separate core retail banking from investment banking.

20. As part of wider contingency preparations in 2017/18, the Bank facilitated joint regional business continuity exercises in Northern Ireland and in Scotland, which were focused on a scenario involving banks having to unexpectedly deal with an IT systems outage.

⁸ Pursuant to the Scottish Banknote (Designation of Authorised Bank) Regulations 2018.

Appendix 1: Legislative Documents

- The Banking Act 2009, Part 6 (“the Act”), which received Royal Assent in February 2009 and came into force on 23 November 2009.
(http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/2009/cukpga_20090001_en_1).
- The Scottish and Northern Ireland Banknote Regulations 2009 (“the Regulations”), which were made by Parliament on 18 November 2009 and came into force on 23 November 2009.
(http://www.opsi.gov.uk/si/si2009/pdf/uksi_20093056_en.pdf).
- The Scottish and Northern Ireland Banknote Rules (“the Rules”) 3 April 2017
(<https://www.bankofengland.co.uk/-/media/boe/files/banknotes/scottish-northern-ireland/scottish-and-northern-ireland-banknote-rules-2017.pdf>).
- The Scottish and Northern Ireland Banknote SPP 3 April 2017
(<https://www.bankofengland.co.uk/-/media/boe/files/banknotes/scottish-northern-ireland/scottish-and-northern-ireland-statement-of-penalty-policy-2017.pdf>).
- The Scottish and Northern Ireland Banknote Approach Document March 2017
(<https://www.bankofengland.co.uk/-/media/boe/files/banknotes/scottish-northern-ireland/scottish-and-northern-ireland-regime-approach.pdf>).