



BANK OF ENGLAND

# Scottish & Northern Ireland Banknote Issuance Annual Report 2019

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 2019 was £7.49bn, a decrease of 2% from £7.62bn in 2018.
- At end-February 2019, the three authorised banks in Scotland had an aggregate backing requirement of £4.63bn, comprising £4.36bn of Notes in Circulation and £0.26bn 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 £2.86bn, comprising £2.67bn of Notes in Circulation and £0.20bn of Notes with the Potential to Enter Circulation.<sup>1</sup>
- 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 2019, this included the Bank conducting 11 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 2019. 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”).<sup>2</sup> This resulted in a penalty of £5,000 being imposed on Bank of Ireland (UK) plc. There was one ‘Notable’ compliance failure, however this was not considered severe enough to justify referral to the Bank’s internal decision making Committees and was laid on file for future reference without penalty.<sup>3</sup>

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<sup>1</sup> Figures may not sum due to rounding.

<sup>2</sup> <https://www.bankofengland.co.uk/-/media/boe/files/banknotes/scottish-northern-ireland/scottish-and-northern-ireland-statement-of-penalty-policy-2018.pdf>

<sup>3</sup> 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 tenth such report, and covers the Bank’s activities from 1 March 2018 to 28 February 2019 (the Bank’s 2018/19 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 plc;<sup>4</sup> 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 with a Statement of Penalty Policy (“the SPP”). Both the Rules and SPP are revised periodically; the

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<sup>4</sup> 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”.

current Rules have been in effect since April 2017. The current SPP has been in effect since August 2018 following the implementation of the new Enforcement Decision Making Committee (see paragraph 18).<sup>5</sup>

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

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<sup>5</sup> For the period 1 March 2018 to 2 August 2018, the SPP dated 5 June 2015 was in effect. For the period 3 August 2018 to 27 August 2019, the SPP dated 3 August 2018 was in effect. For the period 28 August 2018 to 28 February 2019, the SPP dated 28 August 2018 was 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 2019, the aggregate NIC and NWPEC of all seven banks was £7.03bn and £0.46bn respectively. As a consequence, the total backing requirement of all seven banks was £7.49bn, the breakdown of which is shown in Table 1, a decrease of 2% from £7.62bn in 2018. The banks' combined average NIC over the twelve month period as a whole decreased from £7.31bn to £7.21bn. In comparison, the average Bank of England notes in circulation increased from £74.79bn to £74.80bn in the same period.

**Table 1** Breakdown of backing requirement and comparison with previous year

	28 February 2019	28 February 2018
Scotland authorised banks	£4.63 bn	£4.87 bn
<i>NIC</i>	£4.36 bn	£4.48 bn
<i>NWPEC</i>	£0.26 bn	£0.39 bn
Northern Ireland authorised banks	£2.86 bn	£2.76 bn
<i>NIC</i>	£2.67 bn	£2.62 bn
<i>NWPEC</i>	£0.20 bn	£0.14 bn
Aggregate backing requirement	£7.49 bn	£7.62 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 2019, the Bank conducted 11 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. During the year to end-February 2019, the Bank imposed one financial penalty on Bank of Ireland (UK) plc for a Serious compliance failure and assessed one Notable compliance failure. The Bank can also issue a Private Warning for a Minor or in exceptional circumstances a Notable compliance failure; however these are not included in the Annual Report. The Notable compliance failure was not considered severe

enough to justify referral to the Bank’s internal decision making Committees and was laid on file for future reference without penalty.

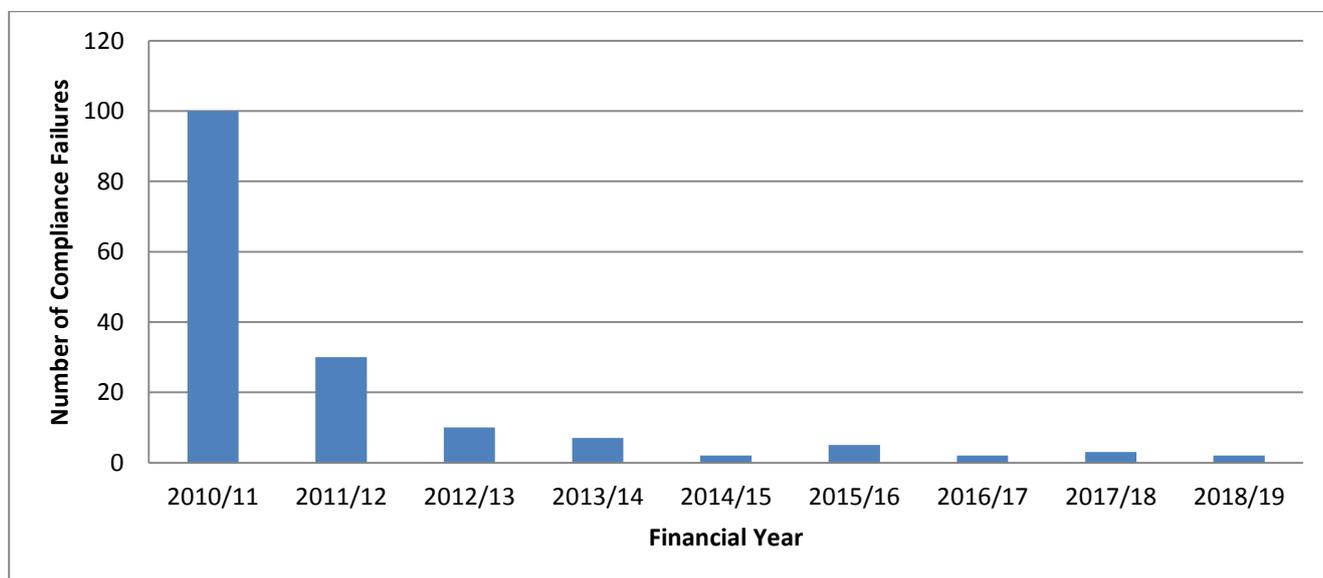
16. By comparison, in the year to end-February 2018 there was one financial penalty imposed for a Serious compliance failure and two Notable compliance failures were laid on file for future reference without penalty. As shown in **Table 2** and **Chart 1**, the number of assessed compliance failures has decreased significantly since the start of the regime.

17. Between the commencement of the regime and end-February 2019, 28 compliance failures have been penalised, and penalties amounting to £119,700 have been issued and paid.<sup>6</sup> 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	2018/19	Total
Investigated by the Bank’s Committees	79	4	3	2	0	1	0	1	1	91
<i>(of which penalised)</i>	<i>(20)</i>	<i>(2)</i>	<i>(1)</i>	<i>(2)</i>	<i>(0)</i>	<i>(1)</i>	<i>(0)</i>	<i>(1)</i>	<i>(1)</i>	<i>(28)</i>
Laid on file	21	26	7	5	2	4	2	2	1	70
Total	100	30	10	7	2	5	2	3	2	161

**Chart 1** Assessed compliance failures by date: November 2009 – February 2019



Note: Figures for 2010/11 are based on the date that the new regime came into force (23 November 2009) until the end of the Bank’s financial year (28 February 2011). Subsequent reporting periods 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.

<sup>6</sup> 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 3 August 2018 the Bank strengthened the independence and robustness of the decision-making process by implementing the new Enforcement Decision Making Committee (EDMC) to take decisions in respect of contested enforcement cases across all regulatory areas of the Bank, including the S&NI Regime. This followed a consultation seeking the authorised banks' views on the proposed amendments to the SPP where no objections were raised. The EDMC replaced the S&NI Appeal Panel, which previously would have taken decisions in respect of contested penalties within the S&NI Regime.

19. As detailed in last year's report, 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 plc with effect on and from the 30 April 2018.<sup>7</sup> At the same time 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 that came into effect on 1 January 2019.<sup>8</sup>

20. On 13 February 2019 AIB Group (UK) plc announced its intention to cease issuing its own banknotes in Northern Ireland from 30 June 2020, and instead to dispense Bank of England banknotes through its Branch and ATM Network from this date onwards. AIB Group (UK) plc must continue to hold Backing Assets (as defined in the Rules) covering their NIC and NWPEC until 30 June 2022, after which point any remaining Backing Assets will be returned to AIB Group (UK).

21. As part of wider contingency preparations in 2018/19, the Bank participated in joint regional business continuity exercises in Northern Ireland and in Scotland, which were focused on a scenario involving banks having to unexpectedly deal with a payment systems outage.

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<sup>7</sup> Pursuant to the Scottish Banknote (Designation of Authorised Bank) Regulations 2018.

<sup>8</sup> <https://www.bankofengland.co.uk/prudential-regulation/key-initiatives/structural-reform>

## 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](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](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 28 August 2018  
(<https://www.bankofengland.co.uk/-/media/boe/files/banknotes/scottish-northern-ireland/scottish-and-northern-ireland-statement-of-penalty-policy-2018.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>).