Funding the Future

The Quick Guide to the new Scottish Currency

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Tim Rideout has asked me to publish this guide created by the Scottish Currency Group and I am happy to do so:

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1. ***When will the Scottish Pound come into use?***

As soon as possible after Independence Day, which means as soon as the Scottish Reserve Bank, the central bank of Scotland, is ready and Parliament authorises it to proceed. The aim is that this should be of the order of a few months, but that depends on how long there is between a vote for Independence and Independence Day.

2. How long does it take to create the Scottish Reserve Bank and be ready to release the new currency?

The Scottish Currency Group plan shows this to be about 4 years, of which 18 months or so of preparations can be done now before IndyRef 2.

3. Why is it called the Scottish Pound?

This seems to be the most popular choice, but there are other options from Scottish history such as the Merk, Noble and Lyon.

4. Will I be forced to convert my money?

No, everyone is free to choose how much of their savings they wish to exchange into the S£. If you prefer to keep your savings in Sterling you are free to do so.

5. Do I need to do anything?

Yes, as the default position is that your bank accounts, cards, etc will all stay exactly as they are. Your bank will contact you some months in advance and ask you if you would like to have an account(s) in the new currency. You will need to instruct them to set up the account(s) if that is what you want.

6. Will my new S£ account and cards be the same as my existing ones?

No. Your existing Sterling account has a UK sort code, contains Sterling and is ultimately under the control of the Bank of England. That can't be changed so you will need a completely new account with a new Scottish sort code that can contain the S£ and which is ultimately under the control of the Scottish Reserve Bank.

7. Can I keep my Sterling account(s) and have new S£ accounts?

Yes of course. If you travel to rUK or place orders with rUK shops often then it would be quite sensible to keep your existing Sterling account and debit card. That will save you foreign exchange fees in the future.

8. Isn't this even more complicated than Decimalisation in 1971 or bringing in the Euro?

No, it is actually much easier for us and businesses. That is because £1 will equal S£1, so there is no need for any shop or restaurant to change any prices, get menus reprinted, buy new cash registers, etc. All you will notice are a new design for the bank notes and coins, and a new debit card for making payments.

9. ***Can I just carry on using Sterling for all my purchases?***

Yes, but after the initial Exchange Period this will start to cost you foreign exchange fees that will be the same as when you use Sterling in Spain or other foreign countries. The Exchange Period is the first month or two when the Scottish Reserve Bank will keep the two currencies fixed at one to one and with no charges for changing between them. After that the S£ will start to float on the currency market and the banks will charge a foreign currency fee on Sterling transactions. Shops may decide to stop accepting Sterling bank notes and coins.

10. Isn't this all very difficult for businesses that buy or sell in rUK?

Not really. We will do what happens in Canada. Most businesses will probably keep their Sterling accounts, credit card machines and the like and use those when buying or selling in rUK. They will use their new Scottish accounts and credit card machines for their dealings within Scotland.

11. What about my mortgage, credit card and personal loan?

All loans will stay exactly as they are in Sterling until you instruct your bank to change them. There will be no automatic conversion into S£. Your bank will contact you near the time and ask if you would like to re-mortgage into the S£, or take out new S£ credit cards and loans. The banks, Scottish Government and the Scottish Reserve Bank will run an information campaign to explain to you the risks and benefits of changing loans into the S£ compared to leaving them in Sterling. It is likely that the Reserve Bank will assist / require the banks to provide the same interest rates and terms on replacement S£ mortgages and loans as you had on your old Sterling ones.

There are about 900,000 mortgages with a total outstanding debt of £75 billion, making the average mortgage £83,000. That is about 30% of Scottish households meaning that 70% of households do not have a mortgage to worry about.

12. If I re-mortgage how does this work?

You are best to ask your bank to do this during the Exchange Period, the first two months or so. That will avoid you having any currency fees to pay or any risk from exchange rate changes. After you instruct your bank to arrange an S£ mortgage you will complete the standard process of selecting a mortgage (fixed term, tracker, etc), an updated valuation if required and the legal paperwork. On the date agreed with your bank they will release the S£ funds, exchange those into Sterling and use that Sterling to repay your Sterling mortgage. Your Sterling mortgage account will be closed and you will be left with just your new S£ mortgage account. You can do this at any time, but the longer you delay the more likely that the S£ and Sterling values will diverge, in which case it might cost you either more or less in S£ to repay the Sterling loan.

13. What is the big picture on our debts?

By far the biggest component of personal debt is mortgages. Exact data for Scotland is hard to find, but personal loans, credit cards, and overdrafts probably total less than £20 billion. As there is no change to Sterling debts until such time as people and business ask for their banks to exchange them into the S£, then it is expected that the exchange of debts into S£ will lag significantly behind the exchange of deposits and cash. As we have seen with mortgages then exchanging a debt into the new currency involves paying off the old Sterling loan. This means that settling these debts requires an outflow from the S£ and into Sterling. For example, I take out a new S£500 overdraft and ask my bank to pay off my old £500 Sterling overdraft. That means my bank will sell S£500 and buy £500. That is most likely to be via the Foreign Exchange market, but may be assisted by the SRB. This will depend on whether the transaction is before or after the initial Exchange Period ends, and what the conditions are in the FX market. If there is a large or sudden outflow of S£ to redeem Sterling debts then the SRB can intervene in the market to buy up (and thus cancel) an surplus S£. It can do that using part of the Sterling reserve it acquired selling us the new S£. It should be kept in mind that there is also a long tail of people who held on to Sterling who will exchange it gradually over many months. That inflow will to a large extent mop up the outflow that is clearing old Sterling debts.

14. What about my ISA?

If you have a cash ISA then it is up to you to decide whether to keep the money in Sterling or to exchange it into the S£. There is no guarantee that the Scottish Government will continue the ISA scheme after Independence so there might be tax changes. If you keep your cash ISA in Sterling then it may become a foreign investment rather than a domestic Scottish one but it would still fall under the jurisdiction of Scottish tax law. If you want to avoid exchange rate risks you will be safer to exchange your Sterling cash ISA into S£. Until such time as there is a Stock Exchange in Scotland then a stocks and shares ISA would remain in Sterling as the shares would be held in the London market.

15. What about my wages?

This depends on your employer. If you work for the Scottish Government, Scottish Health Service, a Council or any other public sector body then from the first month your wages will be paid in S£. You will not have a choice about that. The amount you get paid will be exactly the same as before. If you work for somebody else then it is up to you and your employer to agree whether they continue to pay you in Sterling or switch to S£. Most employers are likely to switch to the S£ within a month or two, simply because using Sterling will become inconvenient.

16. What about my pension?

It is likely that as part of the Independence Negotiations the Scottish Government will agree to take over the UK State Pension for anyone resident in Scotland on Independence Day. If that happens then the new Scottish State Pension will be paid in S£ only. Any Scottish public sector pension (Council, SHS, Fire, etc) will be paid in S£ only. For the declining number of people lucky enough to have a private sector company pension then it is up to the pension scheme to decide. Where it is a Scottish company scheme then they are likely to change to pay in the S£ within a short period. Where it is an rUK scheme (e.g. British Airways), then it will continue to be paid in Sterling. Annuities, personal pensions and similar from rUK providers (e.g. Aviva) will be paid in Sterling. Scottish providers (e.g. Scottish Widows) will probably offer the option to convert to receiving S£ if you wish to do so. Some large pension schemes (e.g. the Universities USS) may choose to allow Scottish pensioners to be paid in S£ rather than Sterling. If you use an rUK pension provider you may wish to move your pension fund to a Scottish provider if you want to avoid any exchange rate risk.

17. Don’t we need to save up Foreign Exchange reserves before we can introduce the S£?

No – this is a much repeated and common fallacy. The new S£ is not given out free of charge. Every new S£ is sold to us in exchange for us paying £1 Sterling. So if the Scottish Reserve Bank issues S£40 billion in the first week, it will also receive £40 billion of Sterling as payment. That becomes our Foreign Exchange reserves. You should note that the UK net reserves are US$88 billion (BoE data for August 2020), so pro-rata

Scotland would need $8 billion. As there are around £160 billion that belong to us and which will be gradually exchanged then the Scottish Reserve Bank will end up with very large reserves. If we allow the Scottish Banks to carry on issuing their own design of bank notes then the £4.5 billion they hold on deposit at the Bank of England would also move to the SRB, while the SRB will get the £3 billion Bank of England notes and coins that currently circulate in Scotland when they are replaced by the new SRB ones.

18. What happens to the Banks?

Commercial banks and building societies that wish to continue to do business in Scotland will need a Scottish subsidiary company that is registered in Scotland and obtains a banking licence from the Scottish Reserve Bank. It is standard practice that foreign banks, which would after Independence include rUK banks such as NatWest, would not be allowed to offer services in Scotland if they do not comply with the requirements of the Scottish Reserve Bank.

Sterling can't be held in a bank in Scotland and S£ can't be held in a bank in rUK other than as cash notes and coins. That is because holding the currency in an account requires that the account and the bank are connected to the relevant central bank payment system and account ledgers. So for a bank such as Tesco Bank it will divide into Tesco Bank (rUK) Plc and Tesco Bank (Scotland) Plc, with both companies being owned by Tesco Banking Group Plc. Prior to Independence our sterling accounts (and loans, etc) will become part of the rUK part of the relevant bank. In the case of Tesco Bank (rUK) Plc it would carry on being a Bank of England regulated bank that works in Sterling. Tesco Bank (Scotland) Plc would initially have no accounts or funds and thus a zero balance sheet. When the currency is created the new S£ accounts will be opened in the relevant Scottish bank company. If you ask to exchange £500 into the S£, then the rUK bank holding your Sterling account will sell that £500 to the Scottish Reserve Bank. The SRB will deposit S£500 to the Scottish Bank company Reserve Account at the SRB (of the same banking group, e.g. Tesco Bank) for onward deposit to your new S£ bank account.

The SRB works in S£ so the Sterling it buys from us can't be held in the SRB accounting ledger. The way banks work this is to hold the foreign currency in a correspondent bank that works in that currency. It is likely the SRB would use the Bank of England, but it could use Barclays or another Sterling bank. In the above example the £500 would be paid into the SRB correspondent bank.

19. I have been told the banks will have unmatched assets and liabilities and that this will cause a big problem?

No they won't. It is a bit complicated as it is all double entry accounting but here goes. The first thing to note is that every bank has a Reserve Account at its central bank. The reserve account is where the bank keeps its money. So just as my company has an account at Santander, so the Bank of Scotland has an account at the Bank of England. If I ask Santander to pay a supplier who banks at Barclays £500 then £500 is debited to my Santander account and it is also debited from the Santander reserve account. The Bank of England credit the £500 to the Barclays reserve account for onward credit to my supplier.

When I ask for £1000 from my Santander account to be exchanged into S£ this is what happens. Santander (rUK) debits my account by £1000 and credits the Scottish Reserve Bank sterling correspondent bank £1000. Lets say that is the Bank of England for simplicity. So £1000 is debited from the Santander Reserve Account and credited to the SRB Reserve Account. Deposits in a bank are a liability of the bank, so Santander (rUK) has a fall in liabilities of £1000. The Reserve Account is the bank’s own money and thus an asset. That has also fallen by £1000. Thus Santander (rUK) has seen the assets and liabilities fall by the same £1000 and all that has happened is the balance sheet has fallen by £1000. The exact opposite happens at Santander (Scotland) as the customer deposits increase by S£1000, and the assets in the Reserve Account increase by S£1000, so both match and the balance sheet has increased by S£1000. There is no mismatch and nothing is owed between Santander (rUK) and Santander (Scotland).

20. It has been claimed that the commercial banks will face huge foreign exchange risks?

This is not true. We have already seen that the banks will have to divide into a Scottish Bank and an rUK Bank. The S£ customer deposits and new loans and mortgages in the S£ will be entirely in the Scottish Bank. The old Sterling deposits and old Sterling mortgages and loans will be entirely in the rUK Bank. As we already saw the balance sheets in the rUK banks will fall with no mismatch between assets and liabilities. The balance sheets in the Scottish banks will rise, again with no mismatch between assets and liabilities. There is nothing owed from the Scottish Bank to the rUK Bank, or vice versa. If there is nothing owed, then there is no foreign exchange risk.

What risks there are, are taken by the Scottish Reserve Bank. Those are any risks during the short fixed rate of the official Exchange Period when banks and the public are indemnified against FX movements / costs, and later as the SRB will have a large holding of foreign currency that might rise or fall in value. Equally we (individuals and companies) will have a currency risk to the extent that we retain Sterling deposits in our old bank accounts (now located in the rUK part of our bank), leave our mortgages and loans in Sterling, or remain in receipt of a pension paid in Sterling. The public information campaign will educate us about those risks and ensure we can take suitable action in good time if we wish to do so. Many people may choose to leave their arrangements as they are, perhaps keeping a Sterling loan because they also have a Sterling income (e.g. a pension or share dividends). The more adventurous might choose to speculate that the S£ could rise against Sterling, but that is not recommended for anyone without a clear understanding of the risks and a willingness to accept that could cause a loss just as easily as a gain.

For more information see www.reservebank.scot, or email info@reservebank.scot