Cabinet Secretary for Finance, Economy and Fair Work
Derek Mackay MSP

Scottish Government
Riaghaltas na h-Alba
gov.scot

T: 0300 244 4000
E: scottish.ministers@gov.scot

Gordon Lindhurst MSP
Convener
Economy, Energy and Fair Work Committee
Scottish Parliament
Edinburgh
EH99 1SP

26 August 2019

Dear Gordon,

Scottish National Investment Bank Bill - Scottish Government response to Stage 1 Report

I am writing in response to the Economy, Energy and Fair Work Committee's Stage 1 Report on the Scottish National Investment Bank Bill.

I would like to take this opportunity to thank you and the members of the Committee for your work in leading the scrutiny of this Bill. The Committee's scrutiny at Stage 1 has been thoughtful and constructive, and my officials and I look forward to working further with the Committee as the Bill continues its Parliamentary process.

The Committee has heard valuable contributions from a wide range of perspectives in its scrutiny to date and I would also like to extend my gratitude to all those who have provided evidence.

The introduction of the Bill in February marked a significant milestone in the development of our proposals for the Bank building on the Implementation Plan developed by Benny Higgins, the Parliamentary debate on 8 May 2018, and on wide-ranging engagement with stakeholders and the public including through two consultations.

I am pleased that the Committee has welcomed the introduction of the Bill in its Report. It is also clear that this ongoing parliamentary process will result in further improvements to our proposals and to the legislation. This will ensure that the Bank is equipped to the best possible extent to become the cornerstone economic institution that we believe it can. It will also pave the way for the Bank to deliver a transformative impact to Scotland's economy in a sustainable, inclusive and ethical way – an ambition for the Bank that I know the Committee will share.

With that in mind, I would like to emphasise that my door remains open to you and all members of the Committee who wish to work with me to strengthen our proposals and this legislation still further.

I have set out the Scottish Government's response to the recommendations made in the Committee's report in the attached Annex. I trust this is helpful to the Committee and I look forward to discussing these matters further during the Stage 1 debate in September.

Yours
Derek Mackay

DEREK MACKAY

St Andrew's House, Regent Road, Edinburgh EH1 3DG
www.gov.scot

SCOTTISH NATIONAL INVESTMENT BANK BILL

STAGE 1 REPORT – SCOTTISH GOVERNMENT RESPONSE

Introduction

1. The Economy, Energy and Fair Work Committee's report at Stage 1 shows that there is a clear consensus in favour of the establishment of the Scottish National Investment Bank. In particular, the Scottish Government welcomes the Committee's recommendation that the Parliament agree the general principles of the Bill at Stage 1.

2. As the Committee has noted, the proposals that the Scottish Government has brought forward for the Bank have been publically consulted on twice and were debated in the Scottish Parliament on 8 May 2018. The Implementation Plan, published in February 2018, took account of extensive stakeholder engagement and has now been built on with further engagement taking place to support that process. The Committee also issued its own call for views and has now heard evidence from a wide range of individuals and organisations.

3. The Scottish Government is grateful for the engagement it has received so far, and for the evidence provided to the Committee, which has helped with the development and refinement of our proposals. We will continue to take a collaborative and transparent approach as the planning and implementation of our proposals for the Bank continues until the establishment of the Bank in 2020, and in the Bank's subsequent operation.

4. The Committee, in its Stage 1 report, has made a number of recommendations which the Scottish Government has considered. Our response to these recommendations is set out below. The headings used follow those in the Committee's report.

Role and Status

5. We welcome the Committee's recognition of the need for statutory underpinning of the Bank and its support for the establishment of the Bank as a public limited company.

6. The Committee has requested that the Scottish Government consider how non-financial returns can be anchored in the Bill, referencing the proposed development of a 'balanced scorecard' (paragraph **80** in the Committee's report). As the Committee has noted, the Implementation Plan prepared for the Bank and published in February 2018 recommended that: "A balanced scorecard approach is required that reports on the financial performance as well as on economic impact over time, including social, environmental and ethical returns."

7. The Scottish Government accepted the Implementation Plan's recommendation and it remains our intention to implement this. The Committee has further referenced score-carding in its recommendations under Markets and Demand and we have set out in detail our proposed approach in that context at paragraphs 50-52 of this response. Our consideration of non-financial returns in the Bill is included in our consideration of the Committee' recommendation in relation to the proposed objects of the Bank at paragraph 64 of this response.

8. The Committee has also requested that we set out further information as to who the Bank will be able to work with in the longer term (paragraph **81**). As the Cabinet Secretary set out to the Committee in his evidence session of 11 June, the initial capitalisation of the Bank

will be carried out through Financial Transactions, a form of capital budget allocated by HM Treasury to the Scottish Government which can only be deployed as loans or equity investment for activities undertaken by a non-public sector body. As a result the Bank will be able to offer finance to companies and other private sector undertakings, and to a wide range of other bodies including social enterprises, third sector bodies and cooperatives, but not to public sector bodies including Local Authorities.

9. The Bank will therefore be able to work, now and in future, with a wide range of partners to achieve its objectives. A collaborative approach on the part of Scottish Government and the Bank itself will be essential to the effectiveness of the Bank and we have set out in this response how this will be achieved in respect of the wider public sector (paragraphs 36-38 of this response) and the Advisory Group (paragraphs 25-33 of this response).

10. In the longer-term, where the Bank is capitalised by other means than Financial Transactions there is no legal impediment to the Bank lending directly to other types of body in the public sector such as Local Authorities. However, whether this is the most appropriate or efficient way for those bodies to access finance is open to question. We will continue to engage with Local Authorities, and other potential sources of public sector finance, including on this issue, and will take into consideration any proposals for financing raised with us in that regard.

11. The Scottish Government is happy to provide the Committee with an update with progress on the securing of dispensations and State Aid permissions as requested (paragraph **82**).

12. On the dispensation being sought from HM Treasury, the Scottish Government continues to engage at both official and ministerial level. The objective remains to secure early agreement with HM Treasury about the principles of a derogation arrangement, which can reflect the arrangements already in place for the British Business Bank (BBB) and Transport for London. These bodies have the capacity to carry money or budget over financial years, which recognise the long-term nature of the projects they are involved in and the potentially volatile nature of investments.

13. Discussions are ongoing with HM Treasury on the terms of the financial arrangements for the Bank. These discussions cover the aims and operations of the Bank. HM Treasury have indicated that the Scotland Reserve arrangements (which would need to be amended as part of providing the desired derogation) were put in place in 2017 and are due for review in 2021. Reaching agreement in principle now about the operation of a derogation remains our preferred option, as this would provide the Bank and the Scottish Government with certainty and inform the scheduled review.

14. If it is not possible to reach the desired understanding with HM Treasury ahead of the Review of the Fiscal Framework, the financial arrangements for the Bank would have to be managed through the existing Scotland Reserve in the short term. However, that would mean there would be have to be a closer oversight of and engagement with investment plans than is envisaged in the Implementation Plan, which would not be consistent with the degree of independence that the Government would like to put in place for the Bank and which the Committee has also heard the need for. The Scottish Government will update the Committee in respect of any significant developments in the continuing discussions with HM Treasury.

St Andrew's House, Regent Road, Edinburgh EH1 3DG
www.gov.scot

15. On State Aid approval, we have developed the State Aid case for the Bank and are preparing a full Notification for State Aid approval for capitalisation of the Bank, in line with the Commission's recommended guidance. This includes a Pre-notification process, which is underway, ahead of submitting a full Notification later in the year. We have begun discussions with the European Commission in this regard as well as continuing to work closely with colleagues in the Scottish Government State Aid Unit and the UK Government Department for Business, Energy and Industrial Strategy to ensure that we demonstrate compliance with all State Aid regulations.

16. We are working on the basis that the substantive requirements of the State Aid regulations will be similar to now, even with EU Exit and including a No-deal Brexit. The current UK Government proposals for State Aid are that, post EU Exit and following any transition period, the EU State Aid regime will be transposed into UK law and regulated UK-wide by the Competition and Marketing Authority independent from the UK and Scottish Governments. The UK Government has committed to maintain a common rulebook on State Aid in the Future Economic Partnership with the EU consistent, with Scottish Government's position of wishing to stay in the European Single Market and Customs Union.

17. However, the approval process will be different post EU Exit. At present, the notification will be considered by the European Commission until the UK has withdrawn from the EU and/or any Implementation Period is complete. After EU Exit, and in the event of a no-deal EU Exit, the Competition and Markets Authority will take on responsibility for State Aid approvals within the UK, and they will be the responsible authority post-Brexit.

Capitalisation and Costs

18. The Financial Memorandum published alongside the Bill in February 2019 set out anticipated costs on the Scottish Administration for: capitalisation of the Bank; for the Scottish Government programme to establish the Bank; and the operation of the Bank until the point at which it can cover its own operating costs.

19. In relation to the costs for the establishment of the Bank, the Financial Memorandum set out estimates for costs and projections based on the information available at that time and set out that these would be refined as operational planning progressed. This continues to be the case.

20. We can confirm to the Committee that the cost estimates for the Scottish Government Bank Programme in the Financial Memorandum remain within the envelope set out. Table 2 (costs for establishment of the Bank) show £15 million for 2019-20 whilst the budget for this financial year is £10.9 million with actual spend this year anticipated to be come in between these two figures. In this context Table 3 in the Memorandum included a contingency of £4.8 million in 2019/20 which was to cover, amongst other things, costs associated with the transition of existing funding programmes into the Scottish National Investment Bank. The costs associated with the integration of the Scottish Investment Bank (SIB) portfolio into the Bank are currently being more fully identified, but remain within that estimated contingency at this stage.

21. The costs for the Bank programme, the future Sponsor Unit and Scottish Government contributions to the operation of the Bank are being further revised and developed as part of the current Spending Review process. Revised estimates of the latter costs will be supported

by further financial modelling which is under way, and on which we will update the Committee in due course (paragraph **118**). That modelling will include reflect the integration of other investment portfolios, including that of SIB, into the Bank.

22. The Committee has requested further information in relation to our proposals for the Scottish Government sponsorship unit (paragraph **119**) and we can confirm that the position set out in the Financial Memorandum remains correct, but is indicative at this stage. It includes an anticipated annual cost to the Scottish Administration of up to £1 million which would include costs associated with: supporting the Advisory Group; any external consultancy support requirement; any required research; and the staff costs associated with the unit. Overall staff numbers will be commensurate with that anticipated budget and will be finalised in due course. They will be proportionate in respect of the Bank and its relationship with the Scottish Government and not at the level of 40 staff as suggested.

23. On remuneration, as the Committee has recognised this remains a complex issue. We welcome the Committee's agreement that the broader purpose of the Bank can support recruitment of staff with the right ethos and skills to the Bank. It has always been the Scottish Government's intention that the majority of Scottish National Investment Bank staff, if not all, will be paid in line with the Public Sector Pay Policy and we are pleased that the committee has welcomed this. The Scottish Government also agrees with the Committee's recommendation that the Development Bank of Wales and the British Business Bank can provide useful examples as other commercially minded but publically accountable bodies (paragraph **120**).

24. These bodies are particularly useful exemplars as it is recognised that the Scottish National Investment Bank will operate in a very different environment from most to other public bodies and will need to recruit from a market place with fundamentally different pay and reward practice. Our approach to the development of remuneration arrangements for the Bank will have to reflect this. We are developing outline pay and reward proposals based on practice in other UK development banks, including the Development Bank of Wales and the British Business Bank, which will allow the Bank, subject to agreed exceptions and adaptions, to operate within Scottish Public Sector Pay Policy parameters for pay increases. These exceptions, which are consistent with practice in other UK development banks, are likely to include long and medium term reward plans linked to the delivery of mission based targets, for the senior team and front line investment staff respectively. Pay ranges for all roles within the Bank will be established through benchmarking against a range of private and public sector comparator organisations including other UK development banks. We are currently in the process of procuring specialist external input on the design of both the grading structure and associated pay ranges and the long and medium term reward plans.

Governance and Accountability

25. The Committee has requested that further detail on our proposals for the Advisory Group be set out and we have done this below (paragraph **149**). We have considered the evidence received by the Committee and the Committee's recommendations in the development of these proposals. The proposals set out here remain under development and we look forward to hearing the views of Committee members on these, including in the Stage 1 debate. We will continue to engage with stakeholders in this regard given its importance.

26. We propose that the remit of the Advisory Group will be to provide advice to Scottish Ministers on the operation of the Bank. This will include:

- The operation of the Shareholder Framework Document and other elements of the governance of the Bank's relationship with Scottish Ministers.
- The Bank's performance against its Investment Strategy, purpose and objects.
- The Bank's response to the Missions set for it by Scottish Ministers.
- Advice on the review of the performance of the Bank.
- Any other issue on which Scottish Ministers consider it necessary to seek advice from the Group.

27. The Scottish Government intends to establish the Advisory Group early in 2020.

28. Membership of the Group will be changeable and refreshed over time to account for the different approaches that will be needed to deliver against the missions set for the Bank, and the evolution of the social and economic landscape within which the Bank will operate.

29. The Committee has recommended that STUC and COSLA should be amongst the organisations represented on the Group (paragraph **150**). This is a constructive recommendation. The Scottish Government has been engaging with these organisations to date and will consider this recommendation further when we agree membership with Ministers.

30. In relation to membership, the Scottish Government is keen that a wide range of expertise is included within the Group so that it can: speak to the issues facing communities and businesses across Scotland; represent the interests and experience of businesses and workers; and offer expert advice on the missions set for the Bank and the Bank's investment activities. It will also be important for the membership of the Group to reflect Scotland's population as far as possible, to ensure that the Bank serves and benefits the whole of Scotland.

31. The Scottish Government will also accept the Committee's recommendation that the Chair of the Advisory Group not be a member of the Bank's Board (paragraph **151**). We are considering alternative proposals with a view to ensuring a strong link between the Advisory Group and Scottish Ministers.

32. We are also happy to clarify at this point that the function of the Advisory Group will be to advise Scottish Ministers as the sole shareholder of the Bank, and not to advise the Bank itself.

33. The Committee has also requested that the Scottish Government consider how the Advisory Group may be reflected in the Bill. When the Cabinet Secretary gave evidence to the Committee on the Bill he stated the Scottish Government's view that the Advisory Group was not a matter for the legislation – this was on the basis that providing for the Advisory Group in primary legislation may prove overly prescriptive as to the mechanisms by which Scottish Ministers seek advice, and there would be a clear risk in setting out a detailed remit and membership requirements for the Group. That, on balance, remains the Scottish Government's view.

34. The Scottish Government is pleased that the Committee has welcomed the approach to engagement with the Scottish Parliament's in relation to developing the missions for the Bank as set out by the Cabinet Secretary in his evidence to the Committee. The Committee

has recommended that a process be developed by which the Parliament can formally be consulted on and inform the development of the missions for the Bank and we will give consideration to bringing forward amendments to this effect at Stage 2 (paragraph **152**).

35. Our priority when carrying out consultation in relation to the missions is gathering information, whether sectoral, technical, societal or market information etc., that will support development of an appropriate final set of missions. We will therefore aim to bring forward a process which will support the gathering of information from a wide range of sources and perspectives and will be keen to discuss with the Committee how this can best be done.

Markets and Demand

36. The Scottish Government agrees with the Committee on the importance of close working between the Bank and its key public sector partners, and on the need to deliver as simple a landscape of business support as possible (paragraph **199** and **284**). The new Bank will, wherever possible, seek to consolidate existing investment activities provided by the Scottish Government and its agencies. It will align with and complement activity by the Enterprise Agencies and Scottish Futures Trust (SFT), who will have a critical role to play in providing the advice and support that businesses and communities need to ensure that they are market ready. This will include ensuring there is a strong pipeline of viable firms and projects for investment when the Bank is operational.

37. Joint work between the Bank's Programme Team, the Scottish Government, Enterprise Agencies and the SFT is ongoing to examine the existing landscape and relationships, and how these may need to evolve in light of the creation of the Bank. This will include looking critically at the public sector landscape from the perspective of the business customer, to ensure as straightforward a customer experience as possible. This wider work will includes active consideration of the Bank's future relationship with the Enterprise and Skills Board given its pivotal role in providing strategic direction to support increased productivity and deliver inclusive and sustainable growth. It is expected that this work will continue over the coming months.

38. We recognise the need to stimulate demand, as the Committee have heard and has highlighted in its Report, for growth oriented finance in the Scottish economy as well as to increase its supply (paragraph **200**). There is clear gap in the market for patient, long-term finance that the Bank will provide. We are engaged in a number of activities to ensure there is demand for the Bank's offerings at the point at which it becomes operational. The Bank will align with and complement activity by the Enterprise Agencies, Scottish Futures Trust, and other key partners including Local Authorities who have a critical role to play in providing the advice and support that businesses and communities need to ensure that they are market ready. These partner bodies are also being encouraged to approach the Bank from the outset directly with proposed mission-related projects where the Bank can play a key role in shaping and funding. This will help to ensure there is a strong pipeline of viable firms and projects for investment when the Bank is operational. The Bank's Programme Team is cognisant of the potential resource requirements associated with this type of activity, which is being considered as part of the wider work that is being progressed as part of the design of the operating model and structure of the Bank.

39. The Scottish Government recognises and welcomes the intention behind the Committee's recommendation that a Target Rate of Return not be set or applied for the Bank

in the short term (paragraph **202**). In his evidence to the Committee the Cabinet Secretary stated that, while setting a target rate of return was considered to be appropriate for the Bank, "I do not want it to be overly restrictive or to give the impression that that is the matter of primacy."

40. The Scottish Government considers the Committee's recommendation to be insightful and is consequently exploring potential implementation with a view to accepting the recommendation. One option for implementation may be for the Scottish Government to wait until the first review of the Bank's performance (as provided for in section 13 of the Bill) has been carried out and a Target Rate of Return could be set at that point.

41. In case it may be of use to the Committee, set out below are some of the considerations that will impact upon the final decision to be reached.

42. First, we recognise that within the Bank there will be, from its earliest stages, an awareness and acceptance of the need to achieve a positive overall rate of return on its investments. This is essential to enable the Bank to act in line with the recommendations in the Implementation Plan.

43. In particular, to deliver this vision, the Bank will:

- Over time, need to accrue sufficient revenues to cover its operating costs so that it is not reliant on revenue support provided by the Scottish Government. The Financial Memorandum included an estimate based on indicative financial modelling that this would be achieved in 2023/24 but this will depend on the performance of the Bank's initial investments, and the investments to be transferred to the Bank. The point in time at which this is expected to occur is subject to some uncertainty at this stage.
- In the longer term, as noted in the Financial Memorandum, have to make sufficient financial returns to support the repayment of the Financial Transactions provided to the Bank, by the Scottish Government to HM Treasury.
- Over the course of its life, have to make sufficient returns to grow its asset base; safeguarding its long term financial sustainability and enabling future rounds of investment in Scottish companies and communities to achieve the desired economic, environmental and social impact on an ongoing basis.

44. Second, as the Cabinet Secretary set out the Committee, any prospective Target Rate of Return must be determined and subsequently viewed alongside the social and environmental impact that the Bank will be asked to deliver; the Bank's focus on delivering patient capital; and the development of its mission-oriented activities.

45. In that context, a sole focus on a Target Rate of Return, particularly in the Bank's first few years of operation, is unlikely to accurately account for the full range of the Bank's activity and could, if handled insensitively and in the Committee's words, see the Bank judged "harshly" in that time. Indeed, a blunt Target Rate of Return could risk distracting the Bank and others from some of the more complex medium- to longer-term financial performance issues – such as securing an appropriately balanced portfolio and targeting and supporting the right businesses - especially in its early years of operation. It would be hugely undesirable if the unintended consequence of such a Target was to drive short-term decision making that detracted from those more patient considerations.

46. The Scottish Government is therefore sympathetic to the Committee's recommendation with two potential caveats at this point. First, in its prospective implementation it will have to be considered whether not setting a Target Rate of Return will impede the Bank's ability to determine that certain types of investment are not appropriate for it to undertake. For example, as the Committee heard the Bank is not envisioned to act as a lender of last resort for distressed companies (a function which should remain with the Scottish Government); but not having a Target Rate of Return agreed with Scottish Ministers may not provide sufficient support for the Bank in its resistance to any political pressure in this regard.

47. Second, a decision not to set a Target Rate of Return for the Bank would have to be reached in line with any requirements in this regard set by the European Commission in its consideration of State Aid permissions for the Bank.

48. Nevertheless, the Bank's Board will, as is normal industry practice, need to develop and hold a view about the desired level of financial return required from the investments it makes and holds (i.e. set its own internal rate of return as part of its investment criteria). The Board and the Scottish Government will also need to hold a joint understanding about the financial milestones that lead to the Bank being able to cover its operating costs from the returns it makes on its investments – both those it inherits and the new investments it makes as it grows its portfolio and supports the Scottish economy. Not only is this helping to shape current spending review considerations, it will be an important part of the assurance for Parliament and the Scottish Government, as principal investor, that the Bank is suitably stewarding the money provided to it and is ensuring its own long-term viability. The required understanding about the Bank's internal rate of return and its financial milestones are expected to inform the Shareholder Framework Document which will govern the relationship between the Bank and Scottish Ministers, and the review of the Bank's performance provided for in section 13 the Bill.

Ethics and Equalities

49. As set out above, it remains our intention that the Bank deliver financial, economic, social and environmental impacts and that these be fully evaluated (paragraphs **203** and **204**). As a publically owned organisation the Bank will be expected to report in a way that is aligned to the National Performance Framework and hence the UN Strategic Development Goals.

50. Scottish Government officials and analysts are working on a potential approach designed to be adopted by the Bank. This approach, which is still in development, combines a short-term ex-ante assessment of the each of the activities of the Bank against the "6 P'S" – Productivity, Participation, People, Population, Place and Planet – that form the Scottish Government Inclusive Growth monitoring framework with a follow up, ex-post, evaluation of impact that also aligns to the National Performance Framework. Officials are engaging with a variety of external stakeholders to ensure that the approach is developed to be in line with best practice. The approach will be aligned to HMT Green Book[1] (which was updated in early 2018) in a manner consistent with the rest of the Scottish public sector. From an examination of what is currently undertaken in similar institutions, this is a challenging area and it is expected that the approach will develop over time. There is huge potential to develop innovative metrics for evaluation and it will be crucial that the Bank (and its sponsorship team within the Scottish Government) allocate significant resource to the area.

[1] https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent

51. Work is underway to make the first links between the reporting and evaluation framework workstream and that on remuneration (see paragraphs 23 and 24 of this response) to ensure that any medium and long term reward plans are linked to appropriate performance metrics. Likewise, the approach taken by the Bank to comply with the reporting requirements set for it by Scottish Ministers via the Shareholder Framework Document can be expected to evolve over time, as can the reporting requirements themselves, as alternative and innovative metrics for evaluating impact are developed.

52. The Scottish Government published an Equality Impact Assessment in February 2019 which set out that it will be updated as policy development for the Bank continued. The Scottish Government has continued to engage with stakeholders in this regard, and has considered closely the evidence the Committee has received, to further develop our ideas and to learn from our partners and stakeholders, including Engender and Close the Gap to ensure that the Bank does act in the ethical and inclusive way envisioned.

53. The Equality Impact Assessment previously published set out a number of commitments for the Bank, and outlines key areas of focus for the Bank's activities. In particular it sets out that:

- Secondary legislation will be brought forward to make the Bank subject to the Public Sector Equality Duty and Fairer Scotland Duty.
- The Bank will align its activities with the UN Guiding Principles on Business and Human Rights and the UN Global Compact.
- The Bank will be a signatory to the Women in Finance Charter which focusses on gender representation in the financial services industry.
- The Bank can act to improve access to finance for women-led businesses and female entrepreneurs who are currently not receiving finance at comparable levels to male entrepreneurs.
- The Bank can also improve access to finance for business owners and entrepreneurs from minority ethnic communities and can address structural issues in doing so.

54. The Scottish Government will publish a revised Equality Impact Assessment that will build on these findings and recommendations (paragraph **228**).

55. The Scottish Government will include its consideration of the Fair Work Action Plan, and the IPPR report '*Delivering Inclusive Growth in Scotland'*, as recommended by the Committee, in the revised Equality Impact Assessment and in the Fairer Scotland Duty Assessment as necessary (paragraphs **231** and **282**).

56. The Committee also recommended that the Bank adhere to the UN-supported Principles for Responsible Investment (PRI). We are aware of the PRI initiative and welcome its intentions. It is, however, principally directed at asset owners (such as pension funds, sovereign wealth funds, and foundations) and persons who manage or control investment funds. The Principles therefore focus upon investment of a different category to that which the Bank will make such as investing in listed equity or in index-tracking funds rather than, for example, investing directly in SMEs.

57. The PRI are nonetheless being considered in relation to the operation of the Bank. In particular, the PRI's emphasis on the incorporation of environmental, social and governance information into decision making is a welcome example of the industry best practice that can be drawn on to support, for example, development of the evaluation framework as outlined above.

58. The Committee will also be aware of the United Nations Environment Programme Finance Initiative Principles for Responsible Banking. The Principles are due to be launched in September 2019 having been consulted on earlier in 2019. The Scottish Government will also take into consideration these examples of best practice in the further development of our proposals for the Bank, recognising the common ground between this initiative and our commitment, set out previously in the February 2019 Equality Impact Assessment, that the Bank will align its activities with the UN Guiding Principles on Business and Human Rights and the UN Global Compact.

59. On the Committee's recommendation concerning the governance structure of the Bank and committees to be formed (paragraph **230**), the Scottish Government considers that, on balance, there is an overall need for flexibility in this regard. Currently section 9 of the Scottish National Investment Bank Bill provides that the Bank's directors shall establish an Audit Committee and a Risk Committee, and sets out the key aspects of the remit of each. This approach was taken to provide assurance that these two particular issues would be handled robustly, given their importance to an institution of this type.

60. The UK Corporate Governance Code[2] sets out best practice for the remit and function of an institution's Audit and Risk Committees. The Code further sets out best practice for the establishment in particular of a Remuneration Committee and a Nomination Committee in a corporate institution. Given that the Scottish National Investment Bank will be a public body as well as a public limited company, and that the rules arising from that dual status will act as a constraint on the institution, we are considering whether it might be appropriate for the Bank to merge those two committees, in part to avoid disproportionately committing the time of board members since the Bank's Board will be relatively small. Setting out all the required committees in legislation would remove this flexibility.

61. On the Ethics Committee in particular, the Scottish Government considers that the ethical stance of the Bank will be vitally important, and is currently considering the best means by which ethical and equalities considerations can most effectively be embedded in the Bank's governance. Specifically, the Scottish Government is reflecting on whether it might be better for the formal responsibility for ethics and equalities to be seen as a main Board duty – in line with the Board's duty under the Corporate Governance Code to establish the Bank's values and strategy and assess and monitor its culture. The Board will also need to ensure that the remit of any Investment Committee that is created reflects the need for the Bank's investment criteria and their application to give sufficient practical weight to the ethical dimension.

62. With these considerations in mind, the Scottish Government continues to examine potential models for the Bank; and will want to discuss them with the incoming Chair, once s/he has been recruited, before the detailed arrangements are confirmed. We will keep the Committee updated on our considerations and will be keen to discuss this issue and to hear further from the Committee in this regard in due course.

---

[2] https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code

Vision and Mission

63. The Implementation Plan set out a vision for the Scottish National Investment Bank and that is being realised across the programme to establish the Bank. However, the Scottish Government will consider further, as per the Committee's recommendation, the wording of the proposed objects of the Scottish National Investment Bank, set out at Section 2 of the Bill. This will be done with a view to making amendments at Stage 2 that will ensure alignment between the objects of the Bank, the vision set out in the Implementation Plan and the ambition being demonstrated across the programme to establish the Bank, and the anchoring of non-financial returns in the Bill (paragraph **80** and **280**).

64. The Scottish Government is pleased that the Committee was encouraged by the proposed approach set out by the Cabinet Secretary for the Bank to speak to the whole of Scotland in its investment activities. As the Committee has heard the investment decisions of the Bank will be merit based, but due attention will be paid to stimulating the right kind of demand across the country. We agree with the recommendation of the Committee on the importance of the Scottish Government and the Bank engaging collaboratively with local authorities, and other key partners, to ensure that this takes place.

65. The Committee also requested that further drafts, and final drafts where available, of the governance documentation for the Bank be shared. The Scottish Government remains committed to a transparent approach to the development and establishment of the Bank. At the Committee's request we previously shared a draft of the Shareholder Framework Document and have also shared the draft Articles of Association and further material in relation those.

66. The draft Shareholder Framework Document provided to the Committee on 24 May 2019 noted that decisions remained to be reached in several areas before it could be finalised. These included a number of issues highlighted in the Committee's Stage 1 report including: a prospective Group Financial Target (or Target Rate of Return), a prospective investment threshold, the Committee structure, and a remuneration policy for the Bank. We have set out the current position on each of these issues in this response and the need for further work, which will include further engagement with relevant stakeholders and with the Committee, and which are likely to benefit from discussion with the incoming Chair, before a final position can be reached on these evolving matters.

67. The Scottish Government looks forward to continuing to engage with the Committee on these important and complex issues.

St Andrew's House, Regent Road, Edinburgh EH1 3DG
www.gov.scot