OFFICIAL REPORT
AITHISG OIFIGEIL

Economy, Jobs and Fair Work Committee

Tuesday 21 February 2017

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Tuesday 21 February 2017

CONTENTS

ECONOMY, JOBS AND FAIR WORK COMMITTEE
6th Meeting 2017, Session 5

CONVENER

*Gordon Lindhurst (Lothian) (Con)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Jackie Baillie (Dumbarton) (Lab)
*Bill Bowman (North East Scotland) (Con)
*Ash Denham (Edinburgh Eastern) (SNP)
*Richard Leonard (Central Scotland) (Lab)
*Dean Lockhart (Mid Scotland and Fife) (Con)
*Gordon MacDonald (Edinburgh Pentlands) (SNP)
*Gillian Martin (Aberdeenshire East) (SNP)
*Gil Paterson (Clydebank and Milngavie) (SNP)
*Andy Wightman (Lothian) (Green)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Rod Ashley (Airdrie Savings Bank)
Wendy Dunsmore (Unite the Union)
Sue Kearns (Scottish Government)
Mike King (Scottish Government)
Professor Charles Munn
Kathie Robertson (Scottish Government)
Chris Stark (Scottish Government)
Paul Wheelhouse (Minister for Business, Innovation and Energy)

CLERK TO THE COMMITTEE

Alison Walker

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Economy, Jobs and Fair Work Committee

Tuesday 21 February 2017

[The Convener opened the meeting at 09:33]

Decisions on Taking Business in Private

The Convener (Gordon Lindhurst): Good morning and welcome to the sixth meeting in 2017 of the Economy, Jobs and Fair Work Committee. Agenda item 1 is a decision by the committee on whether to take agenda items 4 and 6 in private. Does the committee agree to take those items in private?

Members *indicated agreement.*

The Convener: Agenda item 2 is a decision by the committee on whether consideration of the draft report on the draft climate change plan, and of a European Union research paper and an approach paper on our data inquiry, should be taken in private at future meetings. Does the committee agree to take those items in private?

Members *indicated agreement.*

Airdrie Savings Bank

09:34

The Convener: We have three witnesses on our first panel this morning and I welcome them to the committee. They are Rod Ashley, chief executive of the Airdrie Savings Bank, Wendy Dunsmore, regional officer of Unite the union, and Professor Charles Munn. They are here to discuss the decision of the Airdrie Savings Bank to close.

First, I invite members of the committee to state any interests that they have in the matter of the Airdrie Savings Bank.

John Mason (Glasgow Shettleston) (SNP): I declare that I bank with the Airdrie Savings Bank and virtually all of my money is with it.

The Convener: We will proceed by committee members putting questions to the witnesses. If witnesses wish to come in on any question, they should simply indicate that by raising a hand. There is no need to work the microphones; that is dealt with by the sound desk. I ask committee members and witnesses to keep questions and answers succinct and I ask witnesses to bear in mind that they do not have to answer every question.

To start off, I have a question for Rod Ashley about the background of the decision to close the Airdrie Savings Bank. I am interested in the procedure that was followed in coming to that decision. Members of the public may not understand how it works, so it might be helpful to start with some explanation of that.

Rod Ashley (Airdrie Savings Bank): Are you familiar with the corporate structure of the bank?

The Convener: I am happy for you to give a quick summary of that.

Rod Ashley: The bank is a savings bank under the Savings Bank (Scotland) Act 1819. It has trustees, so it is not a normal corporate structure as we would expect in 21st century governance—it is a mutual. I consider that it is part of the social enterprise sector. Having said that, the bank operates with that kind of normal corporate governance structure in place, with a board, subcommittees and other governance elements as required under the various acts and banking regulations that we have.

On the background of the decision to close the bank, as a normal board we are always looking strategically at what the options are in relation to our banking structure. We undertook a strategic review of the options for the bank. That led us to conclude that the bank's medium to long-term position was sufficiently uncertain that, in order to act in the best interests of the depositors, we should take the decision to close at this point in time, which would enable us to conduct an orderly wind-down of the bank affairs so that there might be a community benefit at the end of the wind-down process.

The Convener: Can you expand on the phrase, “in the best interests of the depositors”?

Rod Ashley: Under the 1819 act, the obligation of the trustees in relation to governance is to act in the best interests of the depositors. We could have ended up with the bank continuing to make losses for a number of years to come, and there would have come a point at which the control of any wind-down would have been taken out of the hands of the local community and the trustees and handled by the regulators. The bank did not wish that to happen—it wished to retain control of what was happening, the destiny of the bank and, therefore, the best interests of the depositors.

The Convener: You said, “continued to make losses”. Was the bank making losses at that stage?

Rod Ashley: Yes.

The Convener: The decision was taken by the board of trustees—is that correct?

Rod Ashley: That is correct.

The Convener: Did the board of trustees have to run that decision by anyone? Is the board accountable to anyone in particular?

Rod Ashley: The board of trustees, internally, is not accountable to anyone, but a modern bank runs hand in hand with the regulators. Both the Prudential Regulation Authority and the Financial Conduct Authority were aware of what the board decision was going to be—they knew that it was going in that direction.

The Convener: Does Professor Munn have any comment on that?

Professor Charles Munn: One point to note is that the trustees are not remunerated. I believe that that is still the case—

Rod Ashley: It is.

Professor Munn: They are volunteers.

I should explain that I wrote the history of the Airdrie Savings Bank to celebrate its 175th anniversary seven years ago. As you know, the bank has a long tradition, as well as a history of dealing with regulators. That has not always been a happy experience, largely because for the past 40 years or so, the Airdrie Savings Bank has been unique, so it has been quite awkward for the regulators in London—whether that is the Bank of England or the Financial Services Authority—to understand what they are dealing with.

The book tells the story and I will not elaborate; I will simply say that there have been quite challenging times. For example, at one point, regulators in London asked the Airdrie Savings Bank for a full detailed statement on its international exposures. [*Laughter*.] Apart from selling the occasional travellers cheque, the bank did not have any international exposures.

The Convener: What is the full title of your book, for those who may be interested?

Professor Munn: It is simply called, “Airdrie Savings Bank: A History”, and it is available from the bank.

Rod Ashley: I can confirm that we still have copies available.

The Convener: Thank you. I will bring in Wendy Dunsmore when we come to questions that are relevant to her remit, but first Richard Leonard has some questions.

Richard Leonard (Central Scotland) (Lab): Professor Munn alluded to the long view. Some people would ask why, if the bank can survive two world wars and the great crash of 1929, it finds itself facing closure at this point in its history.

Professor Munn: It has not always been an easy run. Some people I have spoken to have the notion that running the Airdrie Savings Bank—especially after all the nice things that were said about it at the time of the crisis—has always been an easy ride, but it has not. There have been many challenges for the bank. In the 1970s, for example, it faced a challenge that was opposite to the one that it is facing now, because inflation and interest rates were very high. The situation now is the exact opposite. As I say in the book and as Rod Ashley has said, the margin between lending and borrowing rates is now so narrow that it is difficult for the bank to make enough of a surplus to pay its way.

Richard Leonard: I understand that the era of low interest rates is penalising not only savers but presumably the Airdrie Savings Bank’s business model. Mr Ashley, could you explain a little more about what happens when Mr Mason deposits his money in the bank? What do you do with that money and where does it go?

Rod Ashley: The Airdrie Savings Bank is entirely retail deposit funded—that is, our customers raise all the deposits and funds that we use.

The traditional model of a savings bank is that it would not lend any money to customers at all. Charles Munn will no doubt be able to correct me on the dates, but it was only around the mid-1980s that the bank started to lend money to any customers. In fact, Queen's counsel opinion had to be obtained to ascertain whether that was possible.

By the time I joined the bank, in 2013, we were in a position where, of the deposits that we had, about a third were lent to customers. That is in contrast to many high street banks, where the percentage that is lent out is closer to 75 or 80 per cent. About a third of our deposits were lent to other banks in the form of deposits with those banks. Traditionally and historically, those banks had acted fraternally towards the Airdrie Savings Bank and had perhaps given us a slightly higher rate than we might have got elsewhere. However, that does not happen any more. The final third of deposits were invested in Government bonds and gilts. In general, that was low-risk use of the funds in accordance with the bank's practice.

Since 2008 or 2009, two of those thirds have been yielding very little and the other third—the lending to the customers—has been under pressure from the low interest rate environment and the low inflationary position. Consequently, it is very difficult for us as a savings bank to make any money at that return. As Mr Mason will concur, it is certainly very difficult to give any return whatsoever to depositors in that environment.

Richard Leonard: Was any consideration given to investing Mr Mason's and other depositors' money elsewhere, as a pension fund might do? Is it possible within the terms that frame the operation of the bank—whether that is the 1819 act or subsequent legislation—to consider other forms of investment vehicles in order to try to increase the yield, instead of simply putting the deposits in another bank?

09:45

Rod Ashley: The range of investments that the bank is able to go with, certainly within its policies, is narrow. It obviously also depends on risk appetite, and the bank has first and foremost always been very prudent with investment vehicles. As I have said, the trustees' overarching duty of care is to act in the best interests of depositors. The risk profile that we were prepared to look at would have been low, in keeping with what you would expect the organisation to consider.

The Convener: I think that Gordon MacDonald wanted to come in on that point.

Gordon MacDonald (Edinburgh Pentlands) (SNP): Is the loss making due purely to the narrow margin that you have referred to, or have any additional costs been placed on the bank since the crash of 2008?

Rod Ashley: It is a combination of two factors. Because of its operating model, the bank has traditionally had a very high cost-to-income ratio compared with peers or other banks. Since 2008, we have embarked on a number of cost-cutting and income-increasing measures that our customers have worked with us on implementing. Some of the measures have been quite unpalatable, but the customer base has been loyal.

There is no question but that we have had additional costs to bear since 2008 as banking throughout Europe—indeed, throughout the world—has been reformed, and that there has been a bigger regulatory compliance burden that there might have been previously. There is no real indication of that situation reaching a plateau; indeed, it changes frequently.

Let me give you a short example. Eighteen months ago, the financial services compensation scheme limit changed to £75,000, but it has just changed back to £85,000, which is what it was previously. Such a factor is completely outwith our bank's control—and, as I understand it, outwith the UK's control—but implementing such a change, notifying customers of it and subsequently putting the limit back to where it was has been quite an onerous project for a bank of our size.

Gordon MacDonald: Presumably you had built up reserves in previous years to allow you to make up for the odd year in which you made a loss. For how many years have you been running at a loss, and how much of a reserve did you have to compensate for that loss over a number of years?

Rod Ashley: You are correct about the bank's reserves. The only way in which the bank can build up reserves is through retained profits, and over the years in which the bank has been in existence, any profits over and above the deposits that have been returned to customers have been invested in those reserves. It is exactly for the reason that you give that the board built up the reserves that it has been using over the past number of years; it felt that utilising those reserves was the way to support investment back into the community. However, the reserves had been decreasing and were forecast to continue to decrease; as I mentioned earlier, the board did not want to get to a position in which the capital requirements were not being met, because it would have lost control at that point. I believe, therefore, that the short answer is yes.

The Convener: Professor Munn, do you want to come in on any of these questions? I will then move to questions from Bill Bowman and Gillian Martin.

Professor Munn: I want to make just a small point. Following on from what Rod Ashley has just said, I think that the other element is the need for future investment in the bank's fabric and technology. That, too, can come only from accumulated reserves, and if reserves are not actually accumulating, it makes it increasingly difficult to keep the bank's fabric and technology up to date.

Bill Bowman (North East Scotland) (Con): Mr Ashley, I think that you said earlier that it was the trustees who took the decision to wind the bank down. Is that correct?

Rod Ashley: Yes. I can clarify that a little bit, if you like.

Bill Bowman: What is the background of the trustees? Are they experienced in the financial sector? What external advice did they take in making that decision?

Rod Ashley: I will clarify. The trustees, ultimately, are the decision-taking body. Because of changes to banking regulation and the fact that we come under an old act, the decision-making body in the bank is now defined as a board, which includes individuals who are also covered by the FCA and PRA senior managers regime. In addition to the trustee members, the chairman of the board, who is an independent non-executive director, the chief executive officer—who is me—and the chief financial officer sit as the board. On that basis, the three of us are considered to be part of the wider board and the decision-making process.

We conducted an extensive strategic review over 12 months. We were supported in various phases of that with views from outside consultancy agencies on what we were looking for before we arrived at the conclusion that we reached.

The Convener: What outside consultancy agencies did you rely on?

Rod Ashley: We worked quite closely with the big four accountancy firms. The bank's audit firm is Deloitte, but we also have relationships with the other accountancy consultancies.

The Convener: Did you take advice from banking experts of any sort apart from the accountants to which you refer?

Rod Ashley: The answer to that is yes because, through me and other members, the bank is involved in various forums and groups to which we took discussion about a number of the strategic options that we were considering. We have also discussed the position with the Scottish Government, which has been sighted on what we have been doing for the past couple of years, so we have had meetings with it in Edinburgh.

I will jump back to Mr Bowman's question—I just remembered that I did not fully answer the second part of it, which was about the skills and qualifications of the other board members. There are a number of bankers on the board. Traditionally, the local townspeople would have been the trustees but, increasingly, we have people with a banking background sitting on the board of trustees. For example, we have a couple of lawyers and accountants with banking knowledge. We have a chief risk officer as well. Therefore, there is now quite a strong level of banking and financial services awareness on the board and among the trustees.

Gillian Martin (Aberdeenshire East) (SNP): I cannot have been alone in feeling disappointed when I heard the news that the bank was going to close. Many people in Scotland who looked to the Airdrie Savings Bank as an alternative to mainstream banking will have shared my thoughts on that.

I will pick up on something that Professor Munn said about modernisation. What impact did the inability to modernise to the extent of introducing internet banking and providing a more cashless service have on your decision? What did you do to get assistance in modernising from agencies such as Scottish Enterprise, the Scottish Government and your local authority? Why did that not come to fruition—or did it?

Rod Ashley: The bank's traditional offering has been and remains branch based. In around 2010, it implemented an internet banking offering. That was particularly useful for the business banking customers, who were looking for it. Since 2010, everything has moved on: the digital age has arrived with even more force and our offering is behind that curve. The investigations that were done into the investment levels that would be required to move us forward with that showed that they would be outwith the bank's capabilities, given its retained reserves.

In terms of the discussions that we have had, we are an account managed firm with Scottish Enterprise, with which we worked closely—we had a number of introductory contacts following our meetings here at Holyrood. One of the strategic areas that we looked into was diversification of product offering, to try to spread the bank's products. Scottish Enterprise was able to offer us some support on that in terms of capacity, through a contribution towards specific project employment costs in order to get two specific projects that we undertook with it under way.

Gillian Martin: I know that people turned to the Airdrie Savings Bank when they lost faith in the commercial banking sector—for example, around the crash—and that after the Scottish independence referendum you again had a surge in people wanting to bank with you. Did you feel that you were limiting the number of people who could come to you because you were unable to modernise? Was that a factor? Were you unable to grow, or did you not particularly want to grow?

Rod Ashley: I did not get a sense that anyone who wanted to join us was unable to. For some of the customers who were coming to us, there was potentially a slight mismatch between their expectations of what banking services might exist and the reality of the situation: at the time, we had eight branches, which we then decreased to three; we did not have mobile banking apps; and our current account service cost £5 a month, unlike a number of other banks. However, anyone who wanted to join us—certainly, anyone who spoke to me about coming to join us—for such reasons was welcomed in and able to open accounts with us.

Gillian Martin: Okay. Thank you.

Jackie Baillie (Dumbarton) (Lab): I am curious to know the extent of your contact with the Scottish Government. Who did you meet, what was discussed, and what was your ask of them?

Rod Ashley: It is nice to see you again, Jackie. I do not have my notes of the meeting with me, but we met Mr Swinney, while the matter was within his brief. Our local MSP is Alex Neil, and Richard Leonard is also one of our local MSPs. We had two or three committee meetings at which they were able to push us in the direction of a number of contacts, which I then followed up through various meetings through Scottish Enterprise. The Scottish Investment Bank and the UK Green Investment Bank were the kinds of contact that we were put in touch with, principally to see whether there were other areas that we could lend into.

Jackie Baillie: Did that achieve any outcome?

Rod Ashley: I would say that it was moderately successful. One of the challenges that we came up against was that, for a lot of the small and medium-sized enterprise lending, we are really very small. Our maximum lend was potentially smaller than a number of projects that we were looking at in that area. We were being taken into areas that were very interesting and important, but not ones in which we had a particular skill set.

We were looking at developing and at who we might work with. We launched a social enterprises project and established a relationship with the Scottish Community Re:Investment Trust, which is supported through the Scottish Government. We were trying to make Airdrie Savings Bank at least one of the main banks that social enterprise would think of when looking at banking facilities.

Jackie Baillie: How much increased lending did that result in?

Rod Ashley: It resulted in some increased lending, but, as you know, the wheels turn more slowly in that kind of sector, as everybody gets together and decides what is going to happen, and a lot of projects do not come to fruition. We did quite a lot of work, we were moving in the area and we did some additional lending, but it was not going to be a bank-changing amount of lending.

Jackie Baillie: Okay. That is helpful to know.

I move on to staff and to questions for Wendy Dunsmore. The bank has, I think, 70 members of staff, and the partnership action for continuing employment team has been in. I am keen to know how easy it is going to be to relocate people who have very particular skills, given that job numbers in the banking sector overall appear to be contracting.

10:00

Wendy Dunsmore (Unite the Union): Airdrie Savings Bank staff would be an absolute catch for any other bank. I say that because I have worked in the finance sector as a Unite officer, and the Airdrie Savings Bank’s commitment to staff training is exceptional when compared with that of any other bank. The proportion of people who have banking degrees or are chartered accountants is far higher than in any other bank. If I were TSB or Lloyds I would be hanging about Airdrie Savings Bank to snap those people up because of their incredible talent. The staff have the banking qualifications that other banks do not even explore.

Jackie Baillie: How many people is the bank losing just now?

Rod Ashley: I can support what Wendy Dunsmore has said. A handful of our staff have been successful recently in obtaining other jobs in financial services. However, we have begun the first consultation—28 April is the key date for that.

Wendy Dunsmore: The bank is doing a properly structured wind down, which is far better than the position in 2009, when everyone was chasing their tails trying to deal with 40,000 job losses because of mismanagement. That is the shame of the big banks. Airdrie Savings Bank has become a bit of victim of its own success because it was not touched in 2009—there was not the same impact as there was with HBOS, Lloyds, the Royal Bank of Scotland or any of the others. However, now there is an impact on its talented workforce. That is the tragedy—it is not just that it is the last trustee bank in the United Kingdom, but that there will be such an impact on the workforce.

We are now going through a consultation process and some staff will be made redundant in the second half of the second quarter of the year. However, it is being done in a very organised way. In addition, Airdrie Savings Bank is properly committed to good industrial relations. If you look at what happened in 2000 onwards, and probably before then, other banks did away with paying staff for their skills and instead paid staff for what they could sell—and miss-sell. Airdrie Savings Bank never went down that road and instead rewarded staff every year for the skills that they learned—they were never targeted on sales.

Airdrie Savings Bank carried on the proper banking stuff from the 1970s and 1980s, when all the banks were really successful and steady, and it never lost its ethos. It is now a victim because of that, yet the other banks are still able to meet customers' needs by selling—however you want to wrap that up. Airdrie Savings Bank does not have the products and has never forced itself on its customers. If I go to the Bank of Scotland, it will not make any money on my deposits, but it will make money on my insurance, my credit card and all the rest of it. Airdrie Savings Bank could not offer that suite of products in order to make money out of me. It can only offer the basic service, which does not make any money. That is where the impact has been.

Jackie Baillie: I am happy to continue, convener, if there is time.

The Convener: You may ask another brief question. I should tell the witnesses that the committee would welcome further information in writing. If you feel that you have not had an opportunity to clarify your answers as you might like, you may come back on a question in writing to add to or clarify what you have said. Please bear that in mind.

Jackie Baillie has a short question and then we will come to John Mason, who has already been mentioned.

Jackie Baillie: I want to ask about the bank's customers. Wendy Dunsmore touched on the point that the expectation of customers was that they would get services that were different from those offered by the other high street banks but vastly better than those offered by credit unions. Was any consideration given to going back to more of a credit union model, for which there is a lighter touch in terms of regulation?

Rod Ashley: That was one of the strategic options that we considered. Aspirationally, it was appealing in a number of ways, although it would have proved quite complicated to carry out. In effect, it would be easier to set up a new credit union with elements of the bank than it would be to carry out a conversion process. Working with the local credit unions might well be something that happens in the course of the wind-down. We are very open to that.

Jackie Baillie: Do the local credit unions bank with you, or do they bank elsewhere?

Rod Ashley: A number of my colleagues in other banks have made active plays to attract business from the credit unions. We enjoy good relations with several of the local credit unions.

Professor Munn: May I just add a thought on Jackie Baillie's first question about skills and employability?

The Convener: Certainly.

Professor Munn: For many years I was chief executive of the Institute of Bankers in Scotland. In the 1990s, when banks started deciding that they no longer wanted to employ bankers but wanted to employ salespeople, a lot of the traditional bankers we have been talking about left the service. My colleagues and I were able to help quite a number of people to find employment. We were pleased and surprised to discover that their skills were transferable not just into other financial services companies but into a wide range of enterprises and public service. I am sure that that is still the case.

Jackie Baillie: That is good to hear.

John Mason: We have covered quite a lot of ground, including the impact of regulation and modernisation, which Gillian Martin talked about. It seems to me that there are two issues. I should say that I am one of the people who deliberately moved to Airdrie Savings Bank because I was fed up with the bigger banks, and I am incredibly disappointed that you are not going to be there any more. However, that is the way it is going.

Even if we had not had all the other banking problems and all the extra regulation, was it almost inevitable that the modernisation process—I do not have a contactless card, for example—was going to squeeze you anyway, whatever happened?

Rod Ashley: Contactless payment is a good example of an additional burden that one would not necessarily call a regulatory burden. We are a member of Visa, and pushing contactless cards has been quite a strong agenda item for Visa over the past couple of years—not much longer than that. Visa has basically mandated that all its members have to make their cards contactless by a particular date. Making the cards contactless would have been another quite major project that we, as a card issuer, would have had to deal with. Beyond that, contactless payment brings in an additional level of risk—cyber-crime and fraud risk—which we are not exposed to at the moment because we just have a chip and PIN card process. There is no question but that, as the cost base shifted and needed to be redressed, even if we had not gone through that to the extent that we have, fundamental changes in strategy would still have been required in the bank.

John Mason: I am an accountant by background, not a banker, so I do not know all the details of banking, but if you were to introduce something like the contactless payments, is there a lump sum that you would have to pay as a one-off cost for new equipment and things and also an extra cost per card? How does that all work out?

Rod Ashley: Every time a customer uses their card for anything, be it to take money out of an ATM or to buy something using contactless or chip and PIN payment, the bank gets charged for that. There has to be a way of recouping those funds. We would have to set up an internal project, probably involve external information technology, require testing by a third party and pay Visa to set up a project team in order to run it, and then purchase a whole new stock of cards for all the customers before sending them out to them. That is quite a major project.

John Mason: Leaving aside regulation, you are a small player in the banking system and you are struggling to compete and work with all that. It has been suggested that you could join up with another bank at some point, which would overcome some of those problems. Was that ever seriously considered?

Rod Ashley: Yes, absolutely. I might bring Charles Munn in to say a wee bit specifically on the structure, but that was a strategic objective that we looked at. For various reasons, again relating to the corporate structure, a merger or a takeover is not possible.

Professor Munn: There are plenty of examples—historical and more recent—of small organisations going into partnership arrangements with other, sometimes larger, organisations, to share resource, develop a product or pursue a project. Indeed, when Airdrie Savings Bank first got into lending, it did so through the Bank of Scotland, in the 1970s and 1980s.

We are even beginning to see that kind of approach in the credit union movement. I think that it is the Department for Work and Pensions that has put up quite a bit of money to provide a common platform for credit unions, so that a lot of the overheads can be shared and the banking systems—the simple ledger stuff—can be operated on a common basis over a number of credit unions. That means that each credit union does not have to set up its own facility and incur all the costs. As Rod Ashley said, it is some of the start-up costs that really do the damage.

John Mason: Some of the regulation is at EU level, as has been mentioned. I understand that in Germany, Spain—I happened to be in Spain last week—and other countries there are more small banks. Are such banks coping? Are they facing the same problems? I do not know whether that is outside your field.

Professor Munn: They are facing the same sort of problems not just in Europe but in the United States. I spent a year in the States recently and I still have a joint account with my American wife in a little bank in a little town in Massachusetts, in the hills. It is wonderful, and it reminds me of Airdrie Savings Bank every time I think about it, because the parallels are so strong. However, all the other local banks around that bank have merged; it is the only survivor out of a raft of little banks that existed for a very long time in those local towns—it is real small-town America.

Similar things are happening in Europe, although it is not possible to generalise across Europe, because of its diversity. There has been a lot of merger activity of small banks, particularly for banks of the size of Airdrie Savings Bank. When I heard the news that Airdrie Savings Bank was to close, I was hugely disappointed, but I cannot say that I was entirely surprised.

John Mason: Was the union surprised, or did staff accept that closure was inevitable?

Wendy Dunsmore: There are a couple of points to make on that. Were we surprised? Of course we were, because we had been working with the bank. As Rod Ashley said, at one point the bank had nine or 10 branches, and it was doing another strategic review every year to reduce the branch network, because footfall was falling and banking was changing for everyone. We live in a reality-television world now, in which everything has to happen immediately, and Airdrie Savings Bank cannot cope with that kind of demand. We had gone from nine or 10 branches to three branches.

However, when the announcement was made, it came as a shock to us and to the staff. Although I think that the staff can be snapped up, a lot of people have been loyal to Airdrie Savings Bank for many years. A lot of people have worked there for 40 years, and there are families who work in the bank, so the closure is a community hit. It is a shock. I am confident that the staff will be able to get other jobs, given their skills, but there is a confidence issue and people are quite institutionalised—I do not mean in a bad way; the point is that when someone has been in a job with a company for a long time, leaving is a difficult prospect. There will be challenges.

The closure was sort of expected, though, because of the low interest rate, the increase in regulation and the demands of the digital age. We could see that the bank was struggling.

John Mason: Do Unite and the staff basically agree with the board's decision—

Wendy Dunsmore: Unite will never agree to job losses.

John Mason: I did not mean the job losses. Did you agree with the decision to close the bank rather than to struggle on or do something else?

Wendy Dunsmore: Would I like to see the bank try to struggle on? I am not a banker—I never have been and would not want to be—but I understand that the bank has explored every avenue and I have never heard anyone come up with an alternative.

John Mason: A few years ago, a number of people thought that Airdrie Savings Bank was the model for the future, so there was an injection of money, I think, and a new branch was opened in Falkirk or somewhere—I cannot remember.

Wendy Dunsmore: That would be the international branch. [*Laughter*.]

10:15

John Mason: Was that overly optimistic? What happened to that branch?

Rod Ashley: That is a good example. Back in 2010, it was widely reported that a number of Scottish businesspeople were supporting the bank and I think that the media probably reported it as their having invested in the bank. However, as we have discussed, there is no mechanism to invest funds in Airdrie Savings Bank, which is one of the strategic challenges that we have had. Retained reserves and capital are built up by retained profits. In essence, we worked closely with those businesspeople to establish the branch out in Falkirk.

In 1997, Airdrie Savings Bank closed a branch in Whifflet, but it kept the expertise in the bank and redeployed it to Falkirk in a new launch. The Falkirk branch started off buoyantly. We were pleased with the results and the way it was heading. However, not long after we moved in, things changed structurally around Falkirk: a new retail park opened further out of the town, the footfall in the town centre appeared to get even less and the business that we had coming through the door fairly quickly tailed off. When the lease came up for renewal, we decided not to renew it.

We thought at the time that putting ourselves out there had been a successful escapade to an extent but we had not established a model that could be replicated and on which the bank could build.

Andy Wightman (Lothian) (Green): Wendy Dunsmore mentioned that recklessness and criminality in the financial sector ultimately led to the regulatory regime that is now having an impact on your sector, although it was never designed for your sector because your sector did not cause any of the problems.

I will reflect on John Mason's point about other European banks. In Germany, for example, there are 431 banks in the Sparkasse network. They have €1 trillion of assets and 15,000 branches and they employ more than 250,000 people. The Sparkassen are a key support of German industry. It is not that the savings bank model cannot work; it works extremely well in countries such as Germany. What wider lessons are there for our banking and savings culture in the UK? Is there something fundamentally wrong with the way in which the UK approaches the organisation and structuring of banks?

The Convener: Professor Munn, do you have a comment on that?

Professor Munn: Thank you—I think.

We do not have a savings culture. There is good logic in that because, with a very low interest rate environment such as we have and easy and cheap accessibility of credit, the savings culture that we once had has evaporated and no longer exists. There was once a strong savings culture and Airdrie Savings Bank did a lot to encourage it, especially through the work that it did in schools. We had a national savings system in the UK but that was abandoned in, I think, the 1970s, when the other problem that we talked about earlier—high inflation—did a lot of damage to the savings culture. We now have a spend-before-you-earn culture. That is not conducive to the running of banks such as Airdrie Savings Bank.

Andy Wightman: The wider culture in countries such as Germany is that people save in savings banks.

Professor Munn: It is a very different culture.

Andy Wightman: They invest in local industry to create jobs that generate wages that they save in the bank that finances the industry. The broader question is about the ecology of banking and how it is connected to the country's industrial, manufacturing and economic base as much as it is to do with the financial sector itself.

Professor Munn: The Germans do not buy houses, and bank cards are very moderately used there. That is a serious difference with Scotland and it is hard to make the connections.

Something that has always been said about banking in the United Kingdom is that it does not serve industry particularly well. However, nearly all the academic studies that have looked at that have countered that argument and said that it is not true. A lot of the things that I have written in banking histories have also confirmed that. Whether we look back to the Macmillan committee in 1931 or beyond that to other criticisms that have been made, there has been no great evidence to show that industry has been starved of funds.

I have had lots of arguments about it over the years as, given my background, people look for an argument and say, “You banks are not doing your job properly and you are not helping local industry.” However, when I was running the Committee of Scottish Clearing Bankers for a time, we asked the banks every few months how many accounts for new businesses they had open—that could have included hobby businesses, which are certainly not registered for VAT like businesses with a turnover of £60,000—and we came up with very substantial numbers. Those numbers gave the lie to what was often reported in the press, which was that new business generation numbers in Scotland were poor compared with other countries. They were not; it was what was being counted and how it was being counted that made the difference.

If we are trying to suggest that there is a major cultural or structural difference between Germany and the UK, I would say that there might be, but I do not think that that includes any deficit on the part of the banking fraternity.

The Convener: Professor Munn said that the culture in Germany is very different. You commented—if I understood correctly—that people there tend to use cash, rather than cards, more than do people in this country. Rod Ashley made a comment about the opening of a bank branch in Falkirk being followed by a new shopping centre being built elsewhere and footfall for the bank falling away. Apart from the cultural differences in how people approach money, are there other factors that might support the model that Andy Wightman is talking about? Perhaps in this country there is no joined-up thinking, but in Germany there is.

Professor Munn: It is certainly the case that the way in which people approach money is changing quite dramatically. We have talked in the UK about the cashless society for quite a long time; now it seems to be arriving, although it has taken some time to get here. The point is that it is almost unheard of for people to go into their bank branch. They do not use cheques to make payments any more; it is all done online and through telephone banking. The level of need for a branch network, compared with what it was when I was a young bank clerk in the 1960s, is incredibly different. Large organisations have to deal with those changes.

I am not an expert on Germany—far from it—but we should not think of it as having some wonderful model for us all to follow. Its big commercial banks—in particular, Deutsche Bank—have had great difficulties, too. However, Deutsche Bank in Germany is not a behemoth such as the likes of Barclays are in the United Kingdom—Deutsche Bank has only 5 or 10 per cent of deposits. Where Germany has had an advantage is in that it has a lot of regional banks, but they are not small organisations the size of Airdrie Savings Bank. The Sparkasse savings bank model might to some extent have had its origins in Ruthwell, as the rest of the savings bank movement did, but it moved in a different direction in the 19th century. The Sparkassen became, to all intents and purposes, commercial lending banks at a very early stage in their history. They are considerably larger than the likes of Airdrie Savings Bank, with something in the order of £150 million of deposits.

Wendy Dunsmore: I would like to say something about footfall in branches and the wider context. In my view, the big banks have deliberately looked for branch closures and have staff with targets to get people to do internet and telephone banking. Staff who do not hit their targets are put through a performance management process, which can end up in dismissal. The big banks have determined that they want call centres or internet banking centres, which has an impact on footfall.

Another thing that has stopped people—including me—going into branches is staff having to try to sell us something every time we go in. Rather than having to keep saying, “No, I don’t want anything”, people decide to do internet banking instead. That is having an impact on and creating problems for rural communities, in particular.

The banks have deliberately taken that approach. Their strategy has not been as visible to our communities as it should have been.

The Convener: Do you accept that there might be strategies that have unintended consequences?

Wendy Dunsmore: I absolutely do. Let us consider what the banks are doing just now. I will pick a recent example. Inverary used to have a Bank of Scotland and a Royal Bank of Scotland. The Bank of Scotland closed in November or December and the Royal Bank closed, I think, in January. People were told, “You’ve got digital banking”, but people in that rural community do not have good internet access, so they will be cut off from banking. In addition, buses are being cut back. The nearest towns are Dumbarton and Lochgilphead, so the vulnerable people who might use banks—older people, younger people and disabled people—cannot get to banking facilities and cannot access banking without good internet access, which Inverary does not have.

There are unintended consequences, but I am not convinced that they are really “unintended”. Branches are expensive to run and banks exist to make money for their shareholders—although not Airdrie Savings Bank, which is a true bank.

The Convener: Professor Munn mentioned cheques. If I recall correctly, in the recent past there was a move to get rid of cheques, but that did not happen—I think, because people pointed out that loss of the service would present difficulties to elderly people and others who have to pay by cheque. Will you comment on that?

We have been asking about lessons for the future. What can we learn from experience about how to ensure that elderly, disabled and other vulnerable people, and people who do not have good internet access, can continue to access banking services?

Professor Munn: From the last time that I caught up on the issue, I understand that it is still the banks' ambition to end the use of cheques. There are plenty of other ways to make payments. As we know, we can make a payment over the telephone or on the internet—assuming that there is a good internet service, which is clearly not always the case. It is still possible to send a cheque through the post.

As to what the future holds—I wish I knew. We are clearly at the point of a serious change in how people deal with money and run their financial affairs. I wish that I could see clearly what will happen. Historians like me are supposed to be able to do that, because history is supposed to teach us what the future holds. All I can say is that there will be more of the type of change that we have been talking about.

It is clear, too, that the entry of all sorts of other bodies—for example, Apple—to the payments arena will bring further change and will make inroads into the business of the commercial banks. If we allow that to continue as it is already happening, and to expand, we will get to the point—we might actually be in this situation already—at which the commercial banks experience the same pressures as the Airdrie Savings Bank experienced, for the simple reason that it is virtually impossible for a commercial bank to make money from running current accounts nowadays. That is why they have become sales organisations—they are trying to make their money by doing other things.

10:30

Gil Paterson (Clydebank and Milngavie) (SNP): Having stood for the Airdrie and Shotts constituency twice in Scottish Parliament elections and having been elected in 1999—although I did not get elected in Airdrie and Shotts, but was elected on the regional list—I find this a very sad occasion. I know that the bank is very well respected and trusted by the local community. The responsible way that you are carrying out the bank closure shows why, Mr Ashley. I commend you for the way in which you are going about your business; it is absolutely correct.

Your submission makes it clear that quite a number of issues put pressure on the bank. Would one or two items being avoided or not happening have made a difference? Was there a killer blow?

Rod Ashley: The one overarching factor that has influenced the business model of the bank and which has been outwith the bank's control has been the "lower for longer" interest rate position that we find ourselves in.

I think that the board of trustees took the right actions when the rates dropped to 0.5 per cent back in 2008-09. As we discussed earlier, they had built up reserves that were used to provide the service in the community, but we looked to see what we might be able to change. I do not know about Professor Munn, but since 2009 I have been attending presentations at which economists have been telling me that a rise in the rate is just around the corner. We are still hearing that in 2017.That is partly influenced by the central Government policy of keeping interest rates low and providing support behind the scenes such that the larger banks can take money from the Government at low cost and pump it out in the form of low interest rates. That manifests itself in interbank lending rates being low for the bank. We all know that the retail deposit rates, which determine what we receive in interest, are very low. In the mortgage market as well, deals can be offered with very low rates of interest, which makes it even more difficult for organisations such as ours to enter that arena.

In summary, the one item that has affected the model most is the interest rate environment.

Gil Paterson: The interest rate is also the item that you have the least influence over, is it not?

Rod Ashley: Yes.

Gil Paterson: I suppose that only the Government has the power to influence that and, in the climate that has existed, changing it would have been an impossible ask, even to save your bank.

Rod Ashley: Yes. The low-interest environment is a challenge that is appreciated by other banks, as well. However, their business models are—Wendy Dunsmore alluded to this—structured completely differently from ours, in that they have other ways to raise income.

The Convener: I would like to clarify one thing. I understand your point about the Government supporting certain schemes—for example, lending schemes for first-time buyers—but is it not the case that interest rates worldwide are low at this time? Also, it is the Bank of England that sets the interest rate, independent of Government.

Rod Ashley: Yes.

However, I do not think that interest rates are universally low worldwide—for example, in Australia they have not dropped to as low a level as they did in this country. They did across Europe and in America, although they have crept up a smidgen from where we were.

The Bank of England's independence to control inflationary pressure is right. I am thinking not necessarily of the first-time-buyer type of schemes, but of Government schemes such as the funding for lending scheme and its successors. The bigger banks could access that scheme through the Government to obtain funds at low cost.

The Convener: Was the Airdrie Savings Bank able to do that, or did that scheme not fit with your product?

Rod Ashley: Technically, we could have applied for the funding, but it was a question of scale and cost: we were not big enough to take advantage of it.

Bill Bowman: I have a quick question for Mr Ashley. What happens to a surplus at the end of a winding up?

Rod Ashley: The governing structure for the bank is the Savings Bank (Scotland) Act 1819. There is also a set of rules, orders and regulations that are subject to the jurisdiction of the sheriff principal—who in our case is close by, in Airdrie. Under those rules, if there is, in the final winding up of the bank, a surplus of assets over liabilities—at the moment, we do not know whether there will be, but we anticipate that there may be—those assets must be returned to depositors in such proportion as they had deposited in the bank, at a date to be established by the board of trustees.

To be honest, we have not given a lot of thought to exactly when that date would be. It is likely that it would be a date in the past rather than a future date. We also suspect that if there is a surplus—we hope that there will be—payments would be small because of the large number of low-level depositors that we have. The board is, consequently, considering various options, among which is the question whether there is a way of approaching the court to establish whether the funds could be used for the community or charitably. However, I have no definitive answer for you at this point.

Ash Denham (Edinburgh Eastern) (SNP): What was your relationship with the PRA like? Was it easy or difficult to deal with?

Rod Ashley: I would describe the relationship with the PRA since I have been at the bank—I joined in 2013—as very encouraging. We have had key managers appointed to the bank who have remained with us over that period and with whom I continue to work on a week-to-week basis. They have taken quite a lot of time and effort to understand our business model and have listened to our proposals for various strategic options. They have been supportive and challenging, as they have needed to be, in relation to that. As we know from the papers, their objective is to ensure a strong and secure financial sector; I used the word "encouraging" because that is what they would like the entities to become. I have been encouraged by the relationship that we have had with the PRA, and we continue to work with it.

Dean Lockhart (Mid Scotland and Fife) (Con): I want clarification on a couple of points. You mentioned that you consider the bank to be a social enterprise. Did the bank, as a social enterprise, receive any funding or other help from any Government agency—for example, Scottish Enterprise or Social Enterprise Scotland?

Rod Ashley: I am not sure which bracket the support would fall under. For the two projects that helped us to move into the intermediary mortgage market and to establish ourselves in the social enterprise sector, as I mentioned earlier, we obtained funding and support from Scottish Enterprise, including staffing costs to get the projects established. That was the support that we obtained. I would not describe it specifically as social enterprise support, but it was certainly helpful and appreciated.

Dean Lockhart: My other question is on the winding-up process. What will happen to any outstanding loans or mortgages that you have? Loans and mortgages tend to be longer-term assets. What plan do you have in place to wind down those longer-term assets?

Rod Ashley: We have been working with the TSB, which has been our partner in the process, and the secured lending book has been sold to it. Mortgages are currently in the process of moving across to the TSB.

We have contacted customers who have unsecured lending to explain the situation and work with them to find how they might be able to repay us. Much of that lending was not profiled over a large outlying number of years—the vast majority of it will be due for repayment in the normal course over the next 12 to 18 months, and a lot of it will be able to remain on normal repayment terms. Some customers have said that they will move elsewhere, but we are committed to working with each of our customers to find a solution that works for them.

The Convener: Richard Leonard has a final question.

Richard Leonard: I do not want to raise false hope or put words into your mouth, Mr Ashley. However, in answer to a question that Jackie Baillie posed, you hinted that there may be the possibility of a phoenix rising from the ashes of the Airdrie Savings Bank. Given the great reputation that the bank has established over 180 years, is there any possibility of anything being rescued, maybe through a different model of ownership?

Rod Ashley: My hesitation is due to uncertainty about what the future might hold rather than reluctance to say anything definitive. The position at the moment is that the bank will wind down. The current accounts in the branches will close at the end of April. We will then have a residual set of deposits left, and the trustees will need to find another deposit taker to which to move that book of residual assets.

The project has been scoped out to that point, and we are looking at the options in relation to that. I do not want to give any hope that there is something there, but how it will all end up being settled has yet to be established. In a practical sense, we have to work on the basis that we are winding down and that there will be some sort of community legacy from the bank, rather than a banking legacy.

Richard Leonard: That legacy might take the form of a credit union.

Rod Ashley: That is the specific point that Jackie Baillie and I were talking about. Nothing in that vein has been discussed, but I can see the similarities between the bank and a credit union. As Charles Munn said, if we were based in America or Canada, the Airdrie Savings Bank would be a credit union, because that is the model that it follows. The two are closely related.

Richard Leonard: Banks and credit unions operate under quite different regulatory regimes, though.

Rod Ashley: Yes. To an extent, the credit unions benefit from having a specialist sourcebook with regard to regulation, where everything is kept condensed. I have been out of that sector for a number of years, so I cannot comment on the current position, but the regime was quite different from that under which the banks operate.

The Convener: Andy Wightman has a final, final question.

Andy Wightman: Assuming that winding up is completed, what will you do with the artefacts and archives that the bank's long history must have generated? Are you planning to deposit them with the National Archives of Scotland? What arrangements have been made?

Rod Ashley: I have been contacted by a number of organisations including the Business Archives Council of Scotland. I have also spoken to the Savings Banks Museum in Ruthwell, regarding the archives there, and to CultureNL, which operates within the local authority in which we are based—North Lanarkshire—and which has a heritage museum at Summerlee. I am confident that the archives and legacy will end up in the most appropriate place for them, where they can be seen and shared with the community.

The Convener: That concludes our questions for today. I thank all three of you for coming. The circumstances in which we have invited you here are regrettable, if I may put it that way, so I am sure that committee members would like to send their best wishes to all those who are involved—in particular, the workers at Airdrie Savings Bank—and wish you all the best for the future.

We will return to public session at 11.30 am.

10:45

Meeting continued in private.

11:37

Meeting continued in public.

Draft Climate Change Plan and Energy Strategy

The Convener: Welcome back to the meeting. We have with us Paul Wheelhouse, the Minister for Business, Innovation and Energy, who is here with officials from the Scottish Government: Chris Stark, who is director of energy and climate change; Mike King, who is an economic adviser; Sue Kearns, who is head of electricity; and Kathie Robertson, who is head of the heat, energy efficiency and low-carbon investment unit. I welcome all our guests.

I will start by asking about emissions reductions. The emissions reduction that is planned for the transport sector is 31 per cent to 2032. Emissions are a big issue for our country's health, especially in certain areas. For example, St John's Road in Corstorphine here in Edinburgh is one of the most polluted roads in the country. Has a realistic target been set? How will it be achieved?

The Minister for Business, Innovation and Energy (Paul Wheelhouse): I thank you for the invitation to appear before the committee. Transport is an important area, in which we acknowledge that we have to make more progress. We are working to deliver effective solutions. Through using the TIMES model, on which my colleagues can provide technical background, we have looked at cost-effective pathways to deliver our emissions reduction targets to 2032 and beyond to 2050.

In the past, there has been a great challenge in the transport sector. Vehicle emissions have reduced and vehicle emission standards have improved dramatically in the motor vehicle manufacturing trade, but that has to some extent been offset by an increase in the use of vehicles. People have cars with more efficient engines, but they are driving further than they did previously, which has to some extent cancelled out the efficiencies that technology has generated.

We have to look at alternatives for delivering transport emission savings. One of the key ways in which we can do that is by decarbonising the vehicle fleet so that, if people continue to drive, that does not add significantly to emissions in the way that vehicles do at present. The strategy places a lot of emphasis on electrification of the vehicle fleet.

That is not to ignore the important work that we are doing to promote the use of hydrogen. We are doing excellent work at Fife energy park and in Orkney as part of a project that involves working in partnership with the European Marine Energy Centre and local interests to develop the use of hydrogen for storage and in vehicles. The project in Orkney is looking at the ferry fleet, and the work in Fife is focusing on council vehicles such as Kangoos, Transits and refuse collection vehicles.

We are doing a lot of work to pioneer new technologies and alternatives to diesel and petrol. Equally, we are keen to advance the uptake of electric vehicles in the Scottish fleet. Our ambition is that, by 2030, just over 40 per cent of new vehicles that are bought will be electric or hybrid. That is consistent with the pathway to which you referred, which sets out an emissions reduction target of more than 30 per cent for the transport sector.

The Convener: Is that target achievable?

Paul Wheelhouse: We are working in the current context, in which there is a balance of devolved and reserved powers. Some powers over transport are reserved, so we are making assumptions about what is achievable at a UK level and about what more we can do to increase the use of electric vehicles—for example, through the extensive roll-out of electric vehicle charging points. Scotland is doing really good work on that; we have a well-developed network of rapid charging points for electric vehicles.

Through car clubs and other means, we can do work on the infrastructure side to support people to change behaviours and to increase the use of electric vehicles. However, we must bear it in mind that we do not at present have all the tools in our box to influence those things.

We have been realistic about what we can achieve, and the target will be challenging. I know that Humza Yousaf and his colleagues in the transport team would say that the figures that we have set out are challenging, as they are, but we have to be ambitious if we are to achieve the scale of emissions reduction that we need across the economy. We should bear it in mind that, if we do not make progress in transport, some other part of the economy will have to pick up the additional emissions reductions that are required.

The Convener: You talked about moving people to electric vehicles, but the energy has to be produced somehow. Will it come from sources that do not produce carbon emissions?

Paul Wheelhouse: In the draft energy strategy that supports the climate change plan, we have taken a whole-system approach. We are looking at the supply and use of energy. You are right to highlight that, as we electrify transport and heat—some aspects of our heat supply will have to be electrified when other solutions are not appropriate—demand for electricity will grow. That is why the strategy looks at supply and at the need to invest further in renewable sources of electricity and in supporting technologies such as pumped storage hydro, to ensure that we have the capability to deliver the electricity that our economy will need, whether that is for transport, heat or our wider electricity needs.

John Mason: In the electricity section of the plan, policy outcome 1 states:

"Scotland's electricity grid intensity is below 50g CO_2 per kilowatt hour".

One of the related policy development milestones is that the

"UK Government delivers a viable route to market for a wide range of renewable technologies".

Some witnesses have pointed out how reliant we are on the UK or the EU to make some things happen. I am interested in your views on how dependent we are and how much is under our control.

11:45

Paul Wheelhouse: Electricity generation is probably the easiest example to use in that respect, because the key financial instruments that influence the deployment of renewables are very much within the Westminster Parliament's control.

For the large-scale deployment of offshore wind, for example, the contracts for difference auction process allocates funding to projects, and the Scottish Government has no direct input into that process. We are therefore at the mercy of UK ministers on the financial instruments to support the sector.

A key area in which we have had fundamental change in the environment in recent years is onshore wind. There is currently no subsidised route to market for new onshore wind projects that are coming on stream. It is worth putting that in context. More than 11GW of renewables projects have been going through the consenting process in Scotland, so there is a strong interest in investing in Scotland, but there is no route to market—there is no guaranteed price to underpin a long-term investment decision. That is destabilising for the industry.

There is also no route to market for pumped storage hydro. There are agreements with National Grid, which are regulated by the Office of Gas and Electricity Markets, on providing energy from existing pumped storage facilities such as Foyers and Cruachan. Such facilities help to balance the grid and are heavily used to ensure that the electricity that comes through the network to consumers is of good quality, is reliable and does not create fluctuations—members might sometimes notice fluctuations in lighting, where they are more obvious, because the lights flicker. To avoid such fluctuations and ensure that there is quality supply and sufficient black start capability in the event of a power outage, pumped storage hydro is important.

We have massive investment projects lined up—in Coire Glas, above Loch Ness, and in Dumfries and Galloway at Glenmuckloch—which will go ahead if there is a route to market. Each project is worth hundreds of millions of pounds, but we need a route to market.

We have encouraged the UK Government to think about a cap and floor mechanism that is similar to the one for interconnectors, so that developers have some certainty that the price will be within a range—it might not be guaranteed, but there are upper and lower levels, so developers know that their investment is relatively secure. That is what the industry is looking for. We need UK ministers to be expansive on that front.

We recognise that the UK Government has, in its view, an electoral mandate not to subsidise new onshore wind energy projects. We think that there is strong support for projects in Scotland from communities that want them, and the solution is to encourage the UK Government to allow a zero-subsidy CFD auction process to take place. That would involve no public subsidy whatever, but there would be a guaranteed supply of electricity at a guaranteed price, to allow sufficient certainty for developments to take place.

We have some influence over how we support community-led schemes. We are doing work through the renewable energy investment fund and the community and renewable energy scheme, which is a fund that we use to support communities to develop the feasibility of projects. We provide support to the planning system in relation to community projects, to enable renewable energy sources to be deployed, but it is unfortunate that the financial instruments are under the UK Parliament's control.

John Mason: You are saying that on the community side of things we have a lot more influence, but on other areas you put arguments to the UK Government, which it might not accept. I am not taking issue with your arguments but, if the UK Government does not accept some or all of them, will our targets and aims be put at risk?

Paul Wheelhouse: I can say explicitly that there is no doubt that it is becoming more challenging to meet our 100 per cent target for 2020, but we are still pursuing that aim and pushing for it. We have invited the industry to feed back to us—through the consultation on the draft energy strategy, which sits alongside the climate change plan—its thoughts on how best we can deliver a zero-subsidy onshore wind industry, which would be a UK first.

We are inviting people to come forward with ideas on how we can deliver projects. That is about the Government working with industry to identify ways of eliminating costs. There are exceptional costs that affect sites around the UK—for example, some relate to the Ministry of Defence and NATS, which is national air traffic control services.

When we can have a direct influence—for example, in relation to the planning system—we try to be supportive. We also encourage the industry to consider the potential for repowering existing sites and extending the life of sites. An extension to life might help by proving that the cost of the asset can be recovered over a longer period, which reduces the requirement for subsidy.

We are working with the industry and asking what else we can do if the UK Government does not come forward with a more supportive environment. We have invited comment on the potential role and remit of a Government-owned energy company and of renewable energy bonds to see whether we can finance projects in other ways. We are always open to constructive input from the industry about how the Scottish Government can influence that.

We continue to press the UK Government to come forward with more positive policies that accept that there is a stronger case in Scotland for supporting renewables projects. We are in the fortunate position that, by virtue of having a higher-than-average wind speed in Scotland—particularly around our remote islands—than in many other parts of the UK mainland, we have efficient sites that are very competitive. If there were a zero-subsidy CFD auction, we are confident that Scottish projects would do well, because they are economically strong projects from an efficiency point of view.

Another area in which we need a more supportive environment is transmission charging. As we have seen—not just with the premature closure of Longannet but with the renewables industry—an unfair charging regime for projects in Scotland has a profound impact on their ability to compete in an auction process. The higher price that they pay perhaps reflects an older model of electricity generation that was about big thermal plants providing power and exporting it to England and other parts of Great Britain.

John Mason: You have listed quite a number of areas in which we need the UK Government to change policy or whatever. Do you hope to get results for all of them? Do you feel that there is an open door for some areas, while others have a closed door?

Paul Wheelhouse: I could go on to discuss other areas, such as tidal energy, but I am conscious that I am eating into the committee's time. There is indeed a long list of areas for which we have asked for a more supportive position from UK ministers.

It was helpful to have the recent debate to get strong support for renewable energy from political parties in the Scottish Parliament and to put forward the message that we need UK ministers to listen to and support the industry more when they can. We do not expect a free lunch; we know that, ultimately, consumers pay for their electricity. However, the context is of a strong and long-term commitment being given to a new nuclear power station—Hinkley Point C—for electricity at a price that is higher than the price at which onshore wind is already providing electricity to the grid. There is already a differential of at least £10 between the power that will be purchased until 2025 from Hinkley Point C power station and onshore wind, which came in at £82.50 per megawatt hour in the most recent CFD auction in which it competed.

Onshore wind is already cost competitive and we are making a commonsense argument to UK ministers to support those industries and to support their development in areas where they are supported by communities—that applies in many parts of the UK and not just in Scotland. If UK ministers allow that to happen, they will diversify the risk of higher prices. They have a nuclear commitment with a stronger electricity strike price, and that should be mixed with technologies such as onshore wind and solar. I am confident that offshore wind will also come down significantly in price, as will tidal and wave slightly further down the line.

We are encouraging UK ministers to ensure that they are taking full account of the cost-reduction trajectory of those technologies. If they back those industries and get economies of scale, there will be significant reductions in cost. We see that with offshore wind now; some sites in the Netherlands and other places are coming in at well below the target prices that the UK Government has set in its CFD auction process. The UK Government needs to back those industries and reap the supply-chain benefits that come from that.

Nuclear facilities have been commissioned. We have nothing against using technology from abroad but, when we have the ability to support domestic industries—whether that is tidal energy or offshore wind—why are we not doing that? That is a gilt-edged opportunity to generate jobs in fabrication, as well as to generate electricity from a sustainable source.

Jackie Baillie: I am curious about energy efficiency measures. The goal for residential energy efficiency is a 6 per cent reduction in heat demand. That is a smaller and slower goal than getting all homes to an energy performance certificate C rating by 2025, which was what the fuel poverty forum recommended. Do you not accept the forum's recommendation?

Paul Wheelhouse: We are very supportive of improving the energy efficiency of our stock—let me make no bones about that. However, we are trying to deliver a pathway that is cost effective and deliverable. In recent years, we have had challenges in trying to convince house builders—in, to be fair, a very tough economic climate—to make a leap of faith and start moving towards higher energy efficiency standards for new builds. We can, nevertheless, work with industry to achieve that.

As you will know, we face a big challenge with the existing building stock, but we have done very well in rolling out energy efficiency measures such as cavity wall insulation as well as more traditional insulation products to more difficult-to-treat properties such as rural properties with solid wall construction. If we were to focus purely on making all the building stock energy efficient to a certain standard, we might eliminate options that could be more attractive or cost effective for particular buildings. In places such as Inverclyde, I have seen the impact that a district heating project can have in reducing the cost of energy for residents and tenants in a large high-rise block. Our approach needs to be sophisticated enough to take account of the context in which we are trying to achieve energy efficiency.

Therefore, I am not resistant to the improvements that are being pushed for, but, as we have set out in the energy strategy, we have been making steady progress on the average energy efficiency rating of our building stock over time and we need to take a more balanced approach.

Jackie Baillie: It sounds as though you are not going to go for that recommendation. Not resisting it is slightly different from being whole-heartedly in favour of it.

Paul Wheelhouse: I would not want to shut off any option. This is a draft energy strategy and we are genuinely listening. If the committee and the industry feel that the energy rating is achievable and are able to convince us, we will be keen to listen to that argument.

Jackie Baillie: Do you think that the 6 per cent energy efficiency target that you have gone for is sufficient to end the poor energy performance of homes?

Paul Wheelhouse: It is not sufficient in and of itself. We still need to invest in the roll-out of energy efficiency measures. Targets in themselves are just a means of measuring progress; we need to back them with investment, which is why Scotland's energy efficiency programme is a national infrastructure project. If the budget is passed this week, more than £0.5 billion will be committed in the period up to 2020 to the roll-out of provisions in the SEEP process.

Beyond that, we are looking at a multibillion-pound programme over more than a decade to achieve the quality of building stock that we think the people of Scotland deserve. We also want to work not just with domestic properties but with non-domestic properties, which can be challenging. In new towns such as East Kilbride and at other locations where a lot of buildings have been built at roughly the same time, we know that a huge number of non-domestic properties are in need of investment to make them energy efficient. That is both a problem for local authorities and an opportunity, in that they might be able to roll out a programme with relative efficiency over a larger number of building units. Because the buildings are all of the same type, they might learn a lot from working on the first one and be able to make efficiencies and economies of scale in working on subsequent buildings.

We have a live consultation on SEEP and we are looking for input from the industry and from stakeholders such as the Poverty Alliance on how we can achieve our goals. I ask Kathie Robertson to say something about the technical parameters of the target and the deliverability of the energy rating.

Kathie Robertson (Scottish Government): About two thirds of our residential properties have achieved the EPC standard. As the minister has said, the next tranche of properties to be addressed will be the harder-to-treat properties, which are often in rural and more remote areas. Alongside the challenge of energy demand reduction, there is a big challenge in ensuring that people—particularly more vulnerable people—have the best energy prices and are paying a fair price for their energy. We are therefore looking at how we can make the best use of smart technology and at the roll-out of smart meters. People in Scotland are also not very good at switching energy providers, so, alongside trying to reduce demand, we are trying to encourage more switching so that people get the best energy prices.

Jackie Baillie: The real test will be whether we actually improve the energy performance of homes. We could take all those measures and people might still remain in fuel poverty.

I have one small final question. Although a lot of the problem is in rural areas, there are also problems with private sector stock, and private sector rented stock in particular. Do you intend to introduce regulations on that? The proposals are a bit vague with respect to private sector tenants and owners, so could you expand on your plans for that?

12:00

Paul Wheelhouse: We certainly recognise the problem. Like many members round the table, I represent a rural area and I know that the issues there can be challenging. In some urban contexts, it might be easy—or easier—to roll out a large-scale programme, working with large-scale landlords such as registered social landlords and councils, although we have the issues of owner-occupiers and private rented properties among that estate, so it is more complicated than I am presenting. However, in the rural context, private rented accommodation is much more dominant, as you rightly say.

We have to look at a mixture of approaches. Where possible, regulation is perhaps a way of driving that. Obviously, we would have to be proportionate about that and bear in mind affordability. The benefit of taking a long-term strategic approach is that we can take a very long telescope, if you like, to look at where we are trying to get to. That means that we can bring people with us over a longer transitional period so that there is no overnight change and people do not have to do things straight away. People will upgrade and invest in their properties annually or at longer intervals. If we tell them that they have to get to an energy efficiency standard by a certain time, they will know that they have a long deadline to achieve that. We hope that they will be able to develop an approach that gets them to the destination in a cost-effective way.

There is a mixture of approaches, and we are considering regulation. We are also working with local authorities on the development of local heat and energy efficiency strategies. There is a separate consultation on that issue, which invites the Convention of Scottish Local Authorities, individual local authorities and wider stakeholders to give us their thoughts on what impact that might have by, for example, helping to support the development of district heating or perhaps connecting large industrial sources of heat to provide local district heating opportunities. Clearly, we will also encourage owner-occupiers and private sector landlords to get involved in that. In a mixed-tenure block, it certainly makes sense for everybody to be involved in and benefit from any efficiencies in procurement at that point, rather than having to do something separately, which might be a bespoke solution and which might be much more costly for them. We will also try to work with energy suppliers to encourage them to be involved.

In parallel with that, we have the roll-out of smart meters, which will certainly accelerate once we have SMETS 2—smart metering equipment technical specifications, version 2—meters, which are more technically advanced. Those are more attractive to the industry—and to consumers, in terms of switching.

Lots of things are happening, but you are right that we might need to provide a mixture of carrot and stick. However, we have to be mindful of affordability and of the need to give people as much notice as possible.

Kathie Robertson: There is a plan to consult on the domestic private rented sector, which we hope will happen next month. That will give us an idea about timescales for consulting on the owner-occupied sector.

Gillian Martin: The climate change plan places quite a lot of reliance on carbon capture and storage and bioenergy. Carbon capture and storage is a core technology for delivering decarbonisation. You will know that Peterhead, which is in my area, was leading the way in developing that technology, but that the funding was pulled by the UK Government. If we were unable to rely on that, what would the implications be?

Paul Wheelhouse: That is a very significant point. Peterhead is extremely important for energy supply in Scotland more generally. As I am sure that you are aware, we are steadily moving towards a decarbonised electricity system in Scotland, but at the moment Peterhead provides a very important function. It provides baseload power, which is important in its own right, but it also has black-start capability, which provides resilience in the energy system. Therefore, it is an important part of our infrastructure. We are trying to find a future for Peterhead that is genuinely sustainable and which fits with the low-carbon vision for our energy system.

I appreciate that CCS is not universally supported, but we believe that it is potentially a very important technology that would allow Peterhead to continue to provide power to the grid through sequestering carbon emissions from the plant. That might lead to a valuable industry that would use—not prematurely, I hope—decommissioned oil and gas infrastructure for storing carbon dioxide; indeed, there are in the central North Sea largely depleted oil reservoirs that might be suitable for storing carbon dioxide.

In section 7.2 of the draft climate change plan, we state:

> "The United Nations Inter-Governmental Panel on Climate Change (IPCC), the International Energy Agency ... and the Committee on Climate Change have all identified Carbon Capture Storage as an essential lowest cost climate mitigation technology."

Essentially, the IPCC and other parties are saying that

"it would cost 138% more to achieve a 2°C scenario without CCS."

We think that that is a commonsense point of view.

Suspending my own political beliefs for a second, I think that, at the UK level, people should be saying, "This is an asset that can be used; the infrastructure is there to be used; and there is a power station that can not only provide power but do so while trialling CCS technology." I certainly share the disappointment of local people in Peterhead—indeed, your own disappointment—at the plug being well and truly pulled from the plughole by the UK Government. Of course, that came after Longannet's hopes were raised that it would be a site for CCS.

The constant chopping and changing of the UK policy position is destabilising. I do not think it appropriate for us simply to sit and expect the world to develop a technology that we can exploit, given that we have a gilt-edged opportunity at Peterhead to do it. If we do not do it, there is a risk that some of the offshore infrastructure arising from the decommissioning of mature fields will be lost to us. There is therefore also a timing issue to take into account, and there is an imperative to get the technology up and running and to ensure that it contributes in the way that the Intergovernmental Panel on Climate Change and the International Energy Agency believes that it will in helping the world keep to a 2°C or less scenario. It will also reduce the cost to the economy of achieving that trajectory.

For all sorts of reasons, therefore, I think that the UK policy position has been extremely short-sighted. When research funding was pulled from wind energy, we saw Germany and Denmark exploit the technology—and good on them for doing so, because we have definitely needed it. However, CCS should have been a UK-based industry. In CCS, we have an opportunity to develop a technology that can help the world deal with the issue and to reap the economic opportunity that will come from that. I just hope that the UK Government sees sense.

Gillian Martin: Will the Brexit situation have an impact in terms of the university research that could be carried out to make up for UK research funding being pulled from carbon capture and storage?

Paul Wheelhouse: Ultimately, we need demonstration projects. There are different scales of project that can be undertaken. With the convener's permission, I might bring in Chris Stark to talk about this, because I know that we have looked at what has been done elsewhere.

The fact is that we have to demonstrate the technology and, as with the renewable technologies that I referred to earlier, demonstrate how costs can be brought down and how the technology itself can be made cost effective. I accept that it will not be cheap to start with, but it is a worthwhile commitment that will ultimately help not only the UK and Europe but the wider world community achieve the reduction in climate emissions that we need to achieve.

I stress that we are very much supportive of renewable energy. We are pushing renewables in a big way in Scotland, and we are encouraging the UK Government to do more than it is doing on the matter, but I think that not only the whole of the UK but Europe and the wider world need CCS to be deployable. What will be the solution for the many countries around the world that do not have the renewable energy opportunities that the UK and Scotland have? How will they lower their climate emissions if they are reliant on fossil fuels for energy generation? We need to help, and we can play a vital role in that respect. At the same time, we can generate export earnings from the knowledge, expertise and technology that we build up.

You are right that access to European funding is important across all areas of energy research and development. We perform very well in attracting funding from horizon 2020 and other European funding sources. Our universities are foremost among the academic community in Europe, and they lead in areas such as marine energy and CCS, in relation to which academics at the University of Edinburgh and other institutions are very proactive.

I would like to bring in Chris Stark to add to that.

Chris Stark (Scottish Government): I do not have much to add, except to say that I think that it is credible that carbon capture and storage can play a part in the future. We were all stung by the decision to pull the funding for the competition, which we were very hopeful that Peterhead would benefit from. The energy strategy, in particular, reflects that. We are looking at small-scale demonstration, at least in the interim, but with a clear view that it should grow in the 2020s and 2030s to become something that plays an equal part in the energy system. It is essential that we work with the UK Government on that.

There is real stuff going on at the moment—we have put real funding into real projects in Scotland for CCS. We will contribute to the consultation that the UK Government is running on its industrial strategy to make the point that carbon capture and storage should be an equal part of that strategy in the future.

Gillian Martin: You are involved in the TIMES modelling. If CCS were taken out of the equation, what effect would that have?

Chris Stark: We can manage without CCS; it is just that it will cost us more. The primary issue for the model is to achieve the targets at the lowest system cost, which might be thought of as the lowest cost to the whole economy in Scotland. It is perfectly possible to achieve those targets without CCS, but with CCS, we have the ability to achieve them with a cheaper system cost overall, so it makes sense to include it. The modelling that underpins that finding is the same modelling that my colleagues in the UK Government will use when they think about the future, so we would expect the same arguments to apply.

The Convener: Minister, before we move on, Schleswig-Holstein, where much of the German renewable wind energy is from, is not looking for independence from Germany, although it has not always been a part of Germany. Do you agree that a stable political system is also helpful in this area?

Paul Wheelhouse: A supportive political system is very helpful too, is how I would put it, convener. I bow to your superior knowledge about the location of the technology in Germany, but I believe that support is what we have to have, and I have believed that since before I took this post. I met a number of key industry players when I was at my first climate change conference, in Doha in 2012. They all said that what was attractive about Scotland was having a long-term commitment and stable policy position on the issue. There was certainty about the Government's commitment to the growth of renewables—the well-known 100 per cent target for 2020 and a very supportive environment around it.

Whether Schleswig-Holstein will become independent or not, I am not sure, but I am sure that as long as supportive policies and the right fiscal and regulatory regime are in place, we will continue to see investment. International players recognise that Scotland is among the most progressive administrations anywhere in the world in terms of support for renewable energy and I think that that is what they are most attracted to.

The Convener: My point was that Schleswig-Holstein is not looking to be independent, but we will move on.

Bill Bowman: Getting back to Scotland, minister, you touched briefly on the thermal generation of electricity. I think that the Scottish Government has expressed a desire to see new thermal capacity, to provide

"base-load capacity and support the resilience of the electricity system".

We have heard evidence that suggests that investment is unlikely to come in the near future, due to transmission and infrastructure costs. We have also heard from National Grid that it could meet the peak demand from the UK grid through the interconnections that either are, or shortly will be in place. Given that, why is new thermal capacity considered to be strategically important? Under what scenario do you consider that Scotland would need the new thermal capacity?

12:15

Paul Wheelhouse: The first thing to say is that we have thermal capacity, at Peterhead. There was a capacity auction, which was unsuccessful from the point of view of the operators, who have been unable to secure a contract. Our first priority is to ensure that there is a long-term sustainable future for Peterhead.

As you know, a number of sites in Scotland, such as Longannet and Cockenzie, have been vacated. In the case of Cockenzie, there is planning consent for a new thermal plant. It is right that transmission charges have been cited as a key reason why new thermal capacity will not come forward at the moment.

For the reasons that I gave earlier, whether we are talking about pumped hydro storage or thermal capacity, we will see a growth in the requirement for electricity in the Scottish economy as we decarbonise the vehicle fleet and our heating systems. We need to provide reliable, secure sources of electricity. Thermal has a role in that mix. We have never been of the view that we should have a one-technology energy supply, and we have always pushed a range of technologies.

Peterhead has a particularly important role from the black start capability point of view. We need a range of thermal plant around the GB system, to kick-start the system and get the grid back up and running in the—I hope—unlikely event of a black start. Thermal is an important part of the mix, and the loss of Longannet has been significant in that respect.

We support the establishment of new thermal capacity in Scotland. We put in place measures that would require such generation to be capable of deploying CCS, to ensure that it does not become a net addition to climate change emissions. In response to Gillian Martin, Chris Stark talked about the impact of CCS and bio-energy and made the point that they help to get the electricity generation sector into negative emissions. That is where our mix has to be if we are to deliver on the pathway in the climate change plan, so it is important that thermal capacity is capable of being adapted, to reduce the risk of it adding to emissions.

We face the barrier of unhelpful transmission charges at this time. National Grid and Ofgem are looking at the transmission charging regime, reflecting that we have moved to a more distributed electricity generation model and that the current regime perhaps reflects the old system, in which a number of large plants largely exported electricity to the rest of the GB grid.

Bill Bowman: National Grid made the point that it is unlikely that every generational asset in Scotland would go down at the same time, so there would be some residual power. It also said that it has enough energy, through interconnectors, to get the grid started again. Do you take a different view of the technology?

Paul Wheelhouse: No, no. I was not disagreeing with National Grid. On a day-to-day basis there is enough power in the grid and we have interconnection to Europe, which tops up the energy supply in the UK from time to time.

In relation to offshore wind, we are seeing a lot of development off the coast of England. I am not objecting to that in principle; the sites are good and cost competitive, so it is a good thing. However, we would argue that all our eggs are in one basket and we need a more diverse range of sites, including offshore wind sites in Scotland. We are pushing floating offshore wind for the same reason. The wind will always be blowing somewhere in the British Isles—I am sad to say, although it is a strength in this context—and we need to be able to benefit from that.

We saw that there was a problem with capacity in France when a large number of nuclear plants were lost simultaneously because of a common safety issue—in most cases the loss was precautionary but the issue hit supply and there was a shortfall. Severe weather events can take out interconnectors and grid infrastructure. The picture is complex. I agree with National Grid that there is enough power in the grid on a day-to-day basis, but as electricity demand grows we need to future proof the supply and provide appropriate back-up.

Bill Bowman: I think that National Grid was saying that there is enough power not just on a day-to-day basis but for a black start, as I think that you called it. Do you disagree with National Grid on a technical basis, or is it just that you want to have a thermal plant here?

Paul Wheelhouse: We are doing a lot of work on grid resilience with National Grid, Scottish Power and Scottish Hydro Electric Transmission.

A report that has been commissioned and which will, I hope, be published in the near future will lay out the position with regard to security of supply at GB level and Scotland's place within that. I do not want to prejudge that report, but I believe that we need, first, to invest in maintaining Peterhead and ensuring that it is not lost to the GB grid and, secondly, to consider the options for establishing CCS-enabled thermal capacity.

Obviously, for that to happen, we need the UK Government to continue to pursue a CCS agenda, but it is important that we consider what we need for the long term. The situation might be okay at the moment, but with the electrification of transport and heat, we will need more, not less, electricity, and this will become an important issue.

Bill Bowman: Did you say that you were going to invest in Peterhead?

Paul Wheelhouse: As you know, this is a reserved area, but we are looking to work with SSE to see whether there are any ways in which we can help. Clearly we want to secure a long-term future for that plant and to work with the company and, indeed, National Grid and Ofgem to ensure that that happens. There is a desire to work together on this issue, and we will work with UK ministers on it, too. There is genuine partnership, and I hope that UK ministers see that, no matter whether we are talking about Scotland or other parts of the UK, they need to ensure that the electricity supply network is resilient for the future and that we do not have to rely overly on one form of technology—whether it be that used at Hinkley point, offshore wind or whatever—in one part of the country. We need capability to ensure that we have a resilient electricity grid for the long haul, and we will work with the industry and our counterparts in the UK Government to achieve that.

Gil Paterson: You have said that you are aware that the present transmission charging mechanism is detrimental to Scotland. In a wider context, the UK is obviously looking at thermal installations for strategic reasons, because if we look at what is coming into the UK from abroad, we could ask whether we need any thermal capacity.

Given that London and thereabouts are presently paid to connect to the system and that those areas that are further away from London are charged to connect, if the wooing that you are currently engaged in to get a fairer charging system in the national grid fails, will the Scottish Government consider taking over Peterhead for strategic reasons? There has been chat about the Scottish Government being involved in the energy business and, in any case, we should be looking at putting in place a strategic supply, given that, as I understand it, we are not on a UK basis able to maintain levels of supply with any surety.

Paul Wheelhouse: I have to say that we are not there yet. I understand the point that is being made, and the importance of Peterhead to Scotland's needs, certainly for the near future, cannot be overstated. We need a plant such as Peterhead to provide both power for the network and that black start capability. Pumped hydro and other such areas are very important in kick-starting thermal plants and getting them up and running, but it is those thermal plants that really carry the weight of getting the grid up and running again once things have been fired up. It is very important to us.

As for the transmission charging regime, you are quite right to say that in certain parts of England new projects are being paid to connect to the grid. Such are the peculiarities of the regime. We, on the other hand, see substantial costs for plants; for example, I am sure that members are aware that Longannet faced an annual bill of about £40 million to connect to the grid and that that played a big part in its premature closure. Although in the longer term we are trying to decarbonise our energy mix, as set out in the energy strategy and the climate change plan, I have to say that that was an unhelpful development in its own right and it happened so precipitately because of the financial pressures caused by the transmission charging regime. The Scottish Government has made those points very strongly to UK ministers in the past, and we will certainly consider what we can do to support Peterhead. I do not want to prejudge anything, but I will say that we have a strong strategic interest in ensuring that Peterhead is kept up and running.

It is a real issue that the regulatory regime and transmission charging mechanisms are purely cost driven, rather than taking into account the socioeconomic aspects of what the electricity infrastructure—the grid—provides. In Scotland, we have 32 per cent of the UK's landmass but projects that are in that area are faced with an unacceptably high barrier in connecting to the grid. To go beyond thermal into areas such as offshore and onshore wind, those technologies have to start from a position where they have a higher cost than their competitors in the auction process—if there ever is a zero-subsidy CFD auction process for onshore wind—before they even start to put anything in the ground.

The transmission charges are unhelpful because they do not allow sites in Scotland to compete on a level playing field with sites elsewhere. As I said, fortunately, wind sites in Scotland are particularly good in terms of their efficiency—the capacity and load factors are higher than in many other parts of the country—which to an extent counteracts those higher charges. However, for thermal, we do not have that advantage. If a site is burning coal, oil or gas, that is the same coal, oil or gas that is being burned elsewhere, so there is no efficiency advantage in that respect to overcome the unhelpfully high transmission charges in Scotland.

I can assure the member that we will do whatever we can within our powers to help to maintain the resilience of the electricity system in Scotland.

Gil Paterson: I think that you dodged the bullet there a wee bit, and that was my real question, so I will ask it again. From my point of view, there is no UK grid—that is clear given that those mechanisms are in place. Is there any legal impediment to the Government investing in energy? Is there anything that prevents you from doing that?

Paul Wheelhouse: I will defer to colleagues on the legal aspects. I certainly did not mean to dodge the point that I think that you are referring to, so I will just answer that while I have the chance. At the moment, I believe that there is a 5 to 6 per cent capacity margin in the GB electricity grid. In other words, on balance, we produce about 5 or 6 per cent more than we need. Therefore, National Grid is right that, at peak, we can usually cope, and that has not been a problem to date. In the last year for which we have figures, Scotland exported 29 per cent of the electricity that we generated, so we play a particularly important role in maintaining that capacity or safety margin at GB level. The loss of plants such as Longannet, which has come off the grid since those figures were produced, chips away at the safety margin at GB level and not just in Scotland. We obviously need to address that concern and we have raised it with UK ministers and National Grid. Clearly, we want to support the maintenance of such facilities in Scotland.

On the legal aspects of whether we could intervene to shore up a particular plant such as Peterhead, I will now carefully give a hospital pass to Chris Stark, who might be aware of the legal aspects.

Chris Stark: There are barriers to any form of state ownership in any market, most of which are presented in the state aid framework. The other barrier or hurdle—which is probably a better way of considering it—is the regulatory one. In the scenario that Mr Paterson has presented, we would have to have a licence to generate and be part of that market. It is worth noting that Ofgem has made an offer to us to consider some of those things. There is a commitment in the energy strategy to consult on what we have called a Government-owned energy company, which could take many forms. It is good to have it on record that there is a good record of partnership working with the regulator, and we will explore that issue with it. It has offered what it calls a regulatory sandbox, which is a good term, to consider some of the regulatory aspects. The short answer to your question is that it is possible.

Gil Paterson: Thanks very much for that.

The Convener: We will move on from the sandbox to questions from Andy Wightman.

12:30

Andy Wightman: I have three questions on the residential sector and heat. The target for the residential sector is a 76 per cent reduction in emissions by 2032. Areas including transport and agriculture are taking much less strain, but by 2032 they will account for 33 per cent and 26 per cent of emissions, respectively. Given that the emissions figures for transport and agriculture have been predicated on inputs to the TIMES model, and that constraints have been placed on expectations about, for example, demand reduction in transport, to what extent are we placing unreasonable expectations on the residential sector to reduce carbon emissions?

Paul Wheelhouse: I recognise the issue. I may ask Chris Stark or Mike King to comment on the TIMES model. I think that emissions from agriculture are not picked up by the TIMES model; that analysis has had to be separate from the TIMES model, which is focused primarily on energy aspects. Emissions from agriculture are difficult to model, in that respect. However, if Fergus Ewing were here, he would tell you that the emissions from agriculture have been on a steady downward trajectory; we are saying that we need to see that continuing over the period of the climate change plan.

I hope that we can deliver emissions reductions in the residential sector in a way that helps to save people money and makes people less exposed to fuel poverty, through SEEP—which Jackie Baillie touched on—and through tackling the energy efficiency of our housing stock. I also hope that we can, beyond the residential sector, help businesses to improve the energy efficiency of their buildings by making them more fuel efficient, which will save them money. Another very important aspect is that improved health and other benefits will come from people having warm, dry and well-heated homes.

We are trying to find ways to encourage people to be part of the process. We have had some successes in recent years, through the work that has been done around "Low-carbon Scotland: A Behaviours Framework" by the "greener together" team in the Scottish Government. That work has considered how we can, through good practice, incentivise and encourage people to do the right thing. In the residential sector, we are dealing not only with properties but with the transport side of things, so we have to encourage people to change their vehicles to lower-emissions vehicles. We do not have at our disposal direct fiscal tools for that, so we must provide other incentives and we must provide the infrastructure of a network of charging points to support that change.

We are going to have to be positive in encouraging and helping individual householders to lower their emissions. We recognise that that is a pretty hefty challenge, but we always knew that it would get more difficult as time went by. The importance of achieving the target cannot be overstated, though. If we do not achieve it, the impact on our environment and the global community could be devastating. We are trying to encourage people to do the right thing, but we must provide a cost-effective way of doing it and we must help private householders. The consultation that Kathie Robertson referred to will try to unpick how we can incentivise people in the private rented sector and make it easy for them to take part in the roll-out of energy efficiency programmes.

Andy Wightman: I am conscious of the time, so I will move on to my second question, which is on heat. Policy outcome 1 for the residential sector seeks improvements in the fabric of Scotland's domestic buildings resulting in a 6 per cent reduction in their heat demand by 2032. I understand that that 6 per cent reduction is a reduction in forecast demand in 2032 as opposed to a reduction from any baseline demand figure. Can you clarify what that means?

Paul Wheelhouse: Kathie Robertson will address that because she will have studied the figures more carefully.

Kathie Robertson: I will pass the question over to Mike King. I think that the target is based on where we are now, moving forward to 2032.

Mike King (Scottish Government): The target is a 6 per cent reduction from the starting period to 2032. It takes account of the demand drivers in the residential sector going forward, as well.

Andy Wightman: So, if the demand today is 100 per cent, in 2032 demand will be 94 per cent.

Mike King: Fabric measures will reduce overall demand by 6 per cent on forecast 2032 levels.

Andy Wightman: What is the forecast demand for 2032?

Mike King: I do not have the figures with me, but we can write to you with them.

Andy Wightman: Thank you. It would be extremely helpful if you could do that.

I will move on to my final question. The reduction in carbon emissions from the residential sector towards the end of the period relies heavily on technological solutions. On low-carbon heat technology, RPP2 said:

"We intend to produce a detailed proposal on how we may realise this potential in RPP3."

Table 8-7 in the draft climate change plan—which is, in effect, RPP3—says:

"We will look to put forward a more detailed proposal on how we will realise this potential in subsequent Climate Change Plans".

Are you ever going to do that, given that you made a commitment that you would do it in RPP3?

Paul Wheelhouse: I acknowledge the point, because I was involved in RPP2. At that time, we faced the challenge that the technology was not available, but we knew that research was being done. A lot of work is being done to pilot technologies through the low-carbon infrastructure transition programme and SEEP. I visited a project covering Edinburgh, East Lothian and Midlothian that involves Sunamp, which is an East Lothian based business that is providing heat-battery storage. Big steps forward are being taken. Many properties these days have combi boilers and therefore do not have the capacity to store hot water, so it is necessary to be able to store heat in another, space-efficient way. We are supporting companies to develop new technology in that area. I reassure Mr Wightman that significant funding is being put into that research and development. I hope that we can develop technological solutions, but we will reflect on the point that he has made. If I or Ms Cunningham can provide any further detail, that might be helpful. Kathie Robertson might be able to say more.

Kathie Robertson: As well as the climate change plan and the energy strategy, we are consulting on SEEP. In particular, we are looking at two aspects of heat. It is not a case of setting one technology against another. We are considering regulation for district heating and local heat, and we are considering energy efficiency strategies. Local authorities understand supply and demand in their areas, so they might be able to zone particular areas for particular heat technologies.

In the context of the climate change plan, as I mentioned earlier the focus between now and the mid-2020s is on demand reduction and no-regret or low-regret heat solutions. We are talking about solutions such as heat pumps for individual buildings in off-gas-grid areas. District heating could be used in areas of high heat density, where that makes commercial sense. Until we reach that point, we will not be sure what will happen with the gas grid and whether there will be any options in respect of repurposing or greening the gas grid. We want to be very sure that we understand what will happen across the UK before we push people or businesses into taking up particular technologies, with the possible result that they end up with a stranded asset or regret making that choice.

It is fair to say that we made it clear in "The Heat Policy Statement: Towards Decarbonising Heat: Maximising the Opportunities for Scotland" that we will need to use all the available heat technologies to meet our targets. When it comes to a specific focus on district heating, heat pumps and one or two of the other tested technologies, 2025 is as far as we can look at this point in time.

Andy Wightman: I will leave it there.

The Convener: Gordon MacDonald will ask a short supplementary, after which we will move on to Ash Denham for further questions.

In the light of the pressure on time, I ask that answers be kept a bit more focused. There will, of course, be an opportunity to write to the committee on any issues that the minister or his officials have not been able to cover as fully as they might have liked to, and the committee might write to the Government for clarification of one or two matters.

Gordon MacDonald: How realistic is the target of achieving a reduction of 31 per cent in transport emissions between 2017 and 2032, bearing it in mind that, according to the latest figures from the Department for Transport, sales of ultra-low-emissions vehicles made up only 1.2 per cent of total sales in 2016, and that much of the responsibility for regulation in the area lies with the UK Government or the EU?

Paul Wheelhouse: That will be a challenging target to meet, as I acknowledged earlier. Mr MacDonald is right to identify that different Governments are involved, and that the EU has a distinct role on oversight of emissions standards.

Around Europe, there are significant moves being made, including by individual cities within countries: for example, Paris has set a target to ban fossil-fuel cars from its environment by about 2020. I will check that and get back to the committee. In Norway, nearly 25 per cent of new-vehicle sales are of electric hybrid vehicles. Significant steps forward are being made.

I admit that the UK figures for take-up of electric vehicles, and those for Scotland within the UK, are lower than I would like. We want a significant step forward to be made on that, over time. For that, we need a supportive UK policy environment in terms of fiscal incentives. Thankfully, there is a fiscal incentive. We top it up—I will check the exact margin with colleagues because I cannot recall the figure. There is a loan of, I think, up to £35,000—I will check with colleagues about that—with a very attractive rate of interest, to help people with the cost of an electric vehicle. On top of that, there is support from the UK Government through a reduction in the overall price.

We are trying to support an increase in sales and we have an aspiration for electric vehicles to account for more than 40 per cent of sales by the end of 2030. That is not unrealistic, given that Norway is already into the 20 per cents. We just need UK and Scottish policy to work in concert to achieve it.

The roll-out of the rapid-charging infrastructure is going well. I hope that the infrastructure will provide people with the confidence that they need to use that fleet, so that they do not have range anxiety about being unable to complete their journeys. With improvements in battery technology, that problem is largely becoming a thing of the past. Over the time to 2030, we will see steps forward in the technology such that people will be able to drive similar ranges as they do now with fossil-fuel cars. I anticipate big strides forward in battery technology, but we will also have infrastructure where people need it in order to charge their vehicles, as well as support for the cost of buying or leasing a vehicle.

Ash Denham: The objective is that by 2032, 80 per cent of domestic heat will come from low-carbon sources. However, at the moment, 80 per cent of households are using gas for heating and only about 2 per cent are getting their heat from low-carbon sources. Therefore, in effect, the objective is to reverse that position by 2032. That is really ambitious. What do you envisage the mix being? How much will come from electricity, how much from hydrogen in the gas supply and how much from zero-heat homes?

Paul Wheelhouse: That is an important question—it is probably one of the most important ones. The general thrust of the draft energy strategy is to try to achieve, on heat, an ambition of the scale of the one that we have achieved on electricity. More than half our energy consumption—54 per cent—is for heat, so it is a huge issue for us.

We recognise that we need to deploy different technologies and different solutions in different areas of the country. At the convention of the Highlands and Islands yesterday, stakeholders said that it is necessary to have the flexibility to provide solutions that match circumstances including building stock, rurality of location and access to infrastructure. To start with, not everywhere is on the gas grid. Those are all inhibiting factors for which we have to come up with solutions. In cases where it is not already happening, the solution may be to move away from solid fuel to electrification of heat. In other cases, the solution will be a district heating system.

Kathie Robertson and I have referred to the consultation on potential regulation of the district heating market. I should say for the record that investors are, if I judge by my interaction with the industry, showing extremely strong interest in district heating in Scotland: they see London and Scotland as the two places in the UK to which to go to invest in district heating. There is the right combination of Government support. The regulatory environment is emerging, so investors have confidence that there is an appropriate mechanism to help district heating to happen.

In Scotland's case at least, there is potentially also a strong partnership with local government to make district heating happen. I am sure that there is in COSLA a strong interest in the agenda, but I want to put on the record that there is also strong investor interest. There will probably be substantial investment in district heating but that will not cater for the majority of properties. We need to be realistic about that.

12:45

In the longer term, hydrogen has the potential to replace domestic natural gas, and there is an opportunity for the oil and gas industry and other players to get involved in that. That is one of the reasons why we have such a firm commitment in the energy strategy. The oil and gas industry has a role in the low-carbon transition because it has the skill sets, the infrastructure and—in some cases—the technology and the expertise in natural gas to support that. Before coming into this role, I had not appreciated that before I was born—I do not want to overstate my youth, because I am clearly not as young as I used to be—we used to have town gas with hydrogen in it. Hydrogen has been used before in Scotland in the domestic context and could have a rebirth through providing an alternative to natural gas as a heating fuel.

We are encouraging people to take part in the SEEP consultation on aspects of energy efficiency, as well as in the consultation that Kathie Robertson referred to on district heating and local heat and energy efficiency strategies. It is really important for us to get industry engagement on the sort of supportive environment that we need to make it all happen.

Ash Denham: You mentioned district heating. One of the policies on that is the district heating loan fund, from which local authorities and housing associations can apply for money. Is that mainly for retrofitting or for new builds, or for a combination of those?

Paul Wheelhouse: I am open to suggestions. Until now the fund has largely been for retrofitting, but I am aware of some proposed projects that are a mixture, for example where there is a new development adjacent to an existing development. I met one potential developer who was looking at an existing development where the roll-out of a district heating package could also benefit other households. I have encouraged industry to look at opportunities to design that in for new builds and to think about how they can benefit the existing community, so that it is positive for an existing community when a development is happening in the area and, rather than a new housing estate being plonked next to it with no benefit for it. There are a lot of upsides to that approach and we are certainly not against it in any way—we encourage it.

Ash Denham: We heard that the take-up of the loan fund has been a bit lower than expected. Why is that, and is it a concern?

Paul Wheelhouse: We are certainly funding innovative projects in that area under a number of different headings and LCITP, SEEP and the district heating loan funds all contribute to that. It might be that there is more activity than is visible through one particular fund. Perhaps Sue Kearns or Kathie Robertson want to comment on the other funds that are being used to promote energy efficiency projects and, specifically, district heating projects.

Sue Kearns (Scottish Government): Innovative district heating is being funded under the low-carbon infrastructure transition programme, as the minister said. There are some innovative schemes coming out of that, as well as wider local energy systems, and funds are going in. The way for the future is that, when we look for innovation, we will not look for standard loans. Instead, we will look largely towards grant programmes in the first instance and work towards commercial projects in the longer term.

Paul Wheelhouse: I think that the River Clyde Homes project that I referred to earlier was funded under that route. Tenants I spoke to had had a very modest bill of, from memory, around £50 to £70 for their entire heating bill for the period of three months prior to my visit, which was just before Christmas. They were very happy tenants—put it that way.

Dean Lockhart: I want to follow up on the point that the energy strategy should be seen as part of a wider business and industrial strategy, which I agree with. Given that, why is the Scottish Government proposing significant rate increases for renewables projects and companies around Scotland? I understand that Scottish Renewables has written to the Scottish Government highlighting concerns about the proposed increase to business rates. In some cases, the increase is fivefold and puts into jeopardy the commercial viability of projects. Does the minister agree with and share the concerns that were expressed by Scottish Renewables?

Paul Wheelhouse: I am not denying that that is an important issue—I will come on to it—but the valuations that Mr Lockhart referred to are set by the assessors. It is with relief schemes and in setting the poundage that the Government comes in, as I am sure Mr Lockhart knows. Projects with a significant community component benefit from a relief scheme on business rates, so they should not be affected in the way in which Mr Lockhart describes, and very small projects with a low rateable value benefit from the small business bonus, too.

However, I appreciate that, in the draft valuations that the assessor has put forward, there have been some significantly higher valuations. We have been engaging with Scottish Renewables and the industry on that, and we have also been feeding that into Mr Mackay. I know that he is listening carefully to those concerns, and I hope that we will be able to address them in due course.

We are encouraging any business, regardless of whether it is in renewables or in the wider economy, to take advantage of the appeal process that will be available to it between the issuing of the finalised valuations in the middle of March and September. We encourage any business that believes that it has been treated unfairly in the valuation to take advantage of the ability to appeal to the assessor. Where the assessor has used estimates to reach a valuation, we encourage businesses to use actual data for their project, perhaps to demonstrate that there has been an overvaluation of the asset.

I hope that there is a positive option in the pre-existing appeal process, but I also hope that we are demonstrating that we are a listening Government that is listening to the industry, and that that will help to alleviate concerns in the area.

Dean Lockhart: As these projects tend to cover large areas and have a large footprint, they are more likely to be covered by the large business supplement. Is it fair for renewables companies to be subject to a tax that is, in effect, double the tax elsewhere in the UK?

Paul Wheelhouse: We should bear it in mind that the process that we are going through is exactly the same as in the rest of the UK. The assessor's role is to come up with a valuation and, as I said, there is a mechanism by which valuations can be challenged. Obviously, larger projects have larger sites, and I accept that there are likely to be higher rateable values in that situation. However, I think that, at the upper end, on the larger sites, there is a smaller increase in the draft valuations than exists at the lower end of the spectrum.

As we set out in the energy strategy, we are trying over time to encourage developers to consider shared revenue models with the community, to engage with the community and to take a genuine look at community ownership options and shared investment. The Government helps communities to take those opportunities forward through the renewable energy investment fund and the community and renewable energy scheme. Where that is possible, the community projects become eligible for rates relief.

There are different ways for developers to attack the problem, but we certainly encourage them to engage with the assessor. I know that, quite often, assessors are willing to meet businesses informally to discuss their concerns about valuation and, I hope, address them without the need to go to a formal appeal, which is more expensive for businesses. I know from having been up in Aberdeenshire recently that the assessor there is keen to engage with businesses informally and see whether there is a way in which they can tackle the issue. If not, the business always has the right to go to appeal anyway.

We are looking seriously at how rates interact with renewables. I have been encouraging the industry to feed into Ken Barclay's review during the consultation to ensure that any such issues are taken into account, because the objective of that exercise is to have a rates regime that is supportive of economic growth.

Richard Leonard: I have two quick questions on the supply side. I go back to Ash Denham's question about the switch in heating sources from 80 per cent non-renewables to 80 per cent renewables, which is a fairly phenomenal change. The depiction that has been presented to us by witnesses in previous evidence-taking sessions is that you seem to be jogging between now and 2025 and sprinting flat out between 2025 and 2032. How on earth do you expect the low-carbon technologies industries to build the capacity and have the skill sets to deal with that kind of schedule? Would it not be better to maintain a reasonably average speed throughout the period?

Paul Wheelhouse: There is always a challenge when we are making a long-term shift in something as significant as this, but we have to give a signal and allow the industry's capacity to build up. We cannot expect it—to use Mr Leonard's analogy—to go immediately into sprint mode from day 1, or at least into a canter, if I can mix my modes of transport. We need to build up the capacity of the construction industry and the skilled trades. We had a huge contraction in many aspects of the skilled trades during the housing recession from 2008 onwards, and the industry is taking time to recover and invest in apprenticeships and in building up the skills that are required to roll out the technology.

If we were to rush at the fences—to return to the cantering analogy—we would end up having inflationary pressures, given the industry's limited ability to respond to growth. That might make it less cost effective for us to roll out the technology that we talked about with Mr Wightman, which is still being developed, to a degree. We are demonstrating the technology, through LCITP and SEEP-funded projects, which will help us to understand which technologies work best, are most cost effective and have the biggest impact on household savings and climate emissions.

It is not unrealistic to expect that it will take a few years for us to get to the position of having a steady-state industry that can go on at a pace, scale the walls and get us to the target. However, we have to give a strong signal, for reasons to do with aspects of society, which I touched on in response to Jackie Baillie. We need to give private landlords and private occupiers time to prepare and a long timescale in which to achieve the objective.

Richard Leonard: Is there a forum at which you can sit down with the industry and its trade unions to plan the implementation of such transformational change?

Paul Wheelhouse: We engage with trade unions and the industry, although probably not in the way that you described—albeit that we are open to doing that. We certainly need to understand the skills aspect from the perspective of not just the college sector but trade unions and the workforce.

I have said in the Parliament that we want to honour the commitment that we made during the passage of the Climate Change (Scotland) Act 2009—you and I were not members of the Parliament at the time—to take society with us on the journey and not to break the economy in the process of making the transition to low carbon.

We have to help employees in the high-carbon areas of the economy to transition to low carbon. Through the likes of the transition training fund in the oil and gas industry, we are providing opportunities for people to retrain in fitting smart meters for the electricity system and opportunities to get apprenticeships and new skills, so that they can be employed in the area.

I appreciate your point. In an ideal world, it would be nice to have a smoother trajectory. However, we must first overcome the capacity issue, and we cannot expect industry to respond quickly and immediately. We must also allow time for the regulation and other aspects to emerge and be put in place to help to drive the market, and we must allow time for COSLA and other partners to develop strategies at local level.

Richard Leonard: On a different issue, at the weekend CS Wind UK announced that it is planning to make 60 people redundant from its plant at Machrihanish. Have you spoken to the company? Do you intend to take action?

Paul Wheelhouse: Yes, I have spoken with the company on a number of occasions, including in my office in the Parliament building last week, when we were trying to identify ways to prevent job losses. I think that the company has a sustainable future; it is sad that there is a short-term issue as a result of the sudden changes in policy position on onshore wind, which have dried up the onshore wind market to some extent. Also, the emerging offshore wind market is such that it is proving challenging for supply-chain companies to be cost competitive in the context of the CFD auction process, when a developer can lose a bid on the basis of 1p per megawatt hour. In my view, that is a crazy way of doing it; more account should be taken of the supply-chain impact on the economy. We are encouraging UK ministers to be more expansive in the area.

I assure you that we will work closely with CS Wind to identify anything that the Government in Scotland can do to help it. That includes looking at how we can support the supply chain and support innovation, to help the company to become more cost competitive with yards in Spain, for example, where there are significantly fewer state-aid considerations. The very high level of unemployment in Spain is such that there is a stronger market argument for intervention there than we can make in the context of our relatively tight labour market in Scotland—I stress that that is not my view; it is just the state-aid environment.

I assure you that we are working closely with the company, as we speak, to try to help it and that we will support the workforce, which is important to the Argyll economy.

The Convener: I thank you and our other guests very much for coming to the committee today.

Paul Wheelhouse: Thank you.

12:59

Meeting continued in private until 13:03.

This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

Published in Edinburgh by the Scottish Parliamentary Corporate Body, the Scottish Parliament, Edinburgh, EH99 1SP

The Scottish Parliament
Pàrlamaid na h-Alba