



OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit Committee

Wednesday 28 May 2025

Session 6



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Pàrlamaid na h-Alba

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PUBLIC AUDIT COMMITTEE

17th Meeting 2025, Session 6

CONVENER

*Richard Leonard (Central Scotland) (Lab)

DEPUTY CONVENER

*Jamie Greene (West Scotland) (LD)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)

*Stuart McMillan (Greenock and Inverclyde) (SNP)

*Graham Simpson (Central Scotland) (Con)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Stephen Boyle (Auditor General for Scotland)

Cornilius Chikwama (Audit Scotland)

Kirsty Ridd (Audit Scotland)

Catherine Young (Audit Scotland)

CLERK TO THE COMMITTEE

Katrina Venters

LOCATION

The Sir Alexander Fleming Room (CR3)

Scottish Parliament

Public Audit Committee

Wednesday 28 May 2025

[The Convener opened the meeting at 09:30]

Decision on Taking Business in Private

The Convener (Richard Leonard): Good morning. I welcome everyone to the 17th meeting in 2025 of the Public Audit Committee. Under agenda item 1, does the committee agree to take agenda items 3 and 4 in private?

Members *indicated agreement.*

“Scottish National Investment Bank”

09:30

The Convener: Agenda item 2 is consideration of the Auditor General for Scotland’s performance audit of the Scottish National Investment Bank. I am pleased to welcome our witnesses. We are joined by the Auditor General for Scotland, Stephen Boyle—good morning. Alongside the Auditor General, from Audit Scotland, are Cornilius Chikwama, audit director; Catherine Young, a senior manager; and Kirsty Ridd, an audit manager.

Before we get to our questions, Auditor General, I invite you to make an opening statement.

Stephen Boyle (Auditor General for Scotland): Many thanks, convener, and good morning. I am pleased to bring to the committee my report on the Scottish National Investment Bank, which we published earlier this month. The bank was launched by the Scottish Government in November 2020. It provides long-term investment finance to businesses and projects with the aim of supporting sustained economic, social and environmental improvements across Scotland. The Scottish Government is the sole shareholder of the bank, and the bank’s missions are to address climate change, transform communities and scale up innovation and technology.

The bank has worked hard to establish its position in the Scottish investment finance landscape and it has a clear understanding of its purpose. It has made good progress with its operational, governance and reporting arrangements. That progress includes establishing robust risk management arrangements to mitigate the inherent risks of investment financing. The governance arrangements that were put in place by the Scottish Government effectively balance oversight with maintaining the bank’s operational independence.

The Scottish Government’s ambition is for the bank to become what is known as a perpetual investment fund that is therefore not dependent on on-going public funding for its capital investment requirements. However, His Majesty’s Treasury financial management rules present barriers to achieving that, and action will be needed to set the way forward. The bank has delivered against its objective to self-fund its operating costs by 2024-25, helping to reduce its dependence on the Scottish budget, but single-year capital allocations from the Scottish Government can be difficult to align with the bank’s long-term investment activity and make maintaining the position a challenge.

It is perhaps too early to make a full judgment on the impact of the bank's long-term investment, but, from our audit, we have seen that it has established good monitoring arrangements, and it reports that it is on track against its 2030 impact ambitions.

As ever, we look forward to answering the committee's questions between the four of us.

The Convener: Thank you for your opening statement. We will move straight to questions from the deputy convener. This morning, rather than asking questions at the end of the meeting, Jamie Greene will ask them at the beginning.

Jamie Greene (West Scotland) (LD): Thank you for your opening statement, Auditor General. This is probably the first time since I joined the committee that you have given an opening statement that did not criticise the organisation concerned in any way, shape or form. I know that you always criticise respectfully and with an intensely academic view of the world, but is there a particular reason why the report did not pick up any governance, performance or operational issues at all?

Stephen Boyle: As with all our reports, we are evidence led. In our audit, we looked at the bank's operational arrangements; how it was managing some of the inherent risk that comes with investing, which we have talked about—the bank's position means that it is adopting a place where it has to engage in some higher-risk investment activity; and how it structured itself to manage some of those risks. We also looked forward to what the bank wants to achieve and how it is performing against its impact ambitions. The scope of our work and the consideration of the evidence that we encountered over the many months in which we undertook our audit have led us to the conclusions in our report.

Not to disagree with your comment, deputy convener, but we point out that there are still challenges to be overcome if the bank is to be successful in delivering its ambitions for itself and its sole shareholder, the Scottish Government. In particular, we are looking at how it will manage the finances of its funding, and, although it has not yet reached the position where it has had to exit from some of the investments, how it will manage what happens to that flow of funding, because, at the moment, it cannot retain the money when it comes back.

Other factors that we point out in the report include the fact that the bank needs to make more progress on its impact reporting. We have seen a recent impact report from the bank, but it perhaps needs to more clearly explain some of its investments. Building on the feedback that the bank received from its shareholder that, although it

has made more progress—there is significantly improved awareness of the bank and its responsibilities—given the nature of some of the stakeholders that the bank deals with, we see that there is perhaps an appetite for more pace from the bank so that it can take decisions more quickly.

You make a fair assessment that this is one of our more positive reports, but we are absolutely evidence led in our judgments.

Jamie Greene: Thank you for that explanation. It is refreshing and nice to see a positive report that identifies good governance and operational practice. I am sure that other committee members will cover some of the areas that you raised, particularly around potential improvements to impact reporting and awareness of the bank's activities.

It is interesting that, in your answer to me and in your opening statement, the areas of risk to the investment bank's long-term success that you mentioned are external factors. The first area of risk relates to the bank's mission to be a perpetual investment fund. You mentioned that the barriers to that are Treasury rules, as opposed to the bank's own operations. The other external factor relates to the annual capital allocation of funds from the Scottish Government, which, again, is outside the bank's control, albeit that the bank is owned by the Scottish Government. How will it be able to address those external factors?

Stephen Boyle: That is as much a question for the Scottish Government as it is for the bank. The point about the annual funding arrangements is linked to the Treasury rules point, but the issue was identified as far back as the implementation plan. It is coming up to 10 years since the project was first mooted and arrangements were undertaken to explore the possibility of a Scottish national investment bank, what its responsibilities might be and the perpetual investment fund requirement.

As you know, deputy convener, the Scottish budget is set on an annual basis, and public bodies receive resource and capital funding following the Scottish Parliament's consideration and scrutiny of the budget. Unlike other parts of the public sector, particularly local government, central Government bodies do not have the ability to hold reserves or, typically, to carry funding over from one year to the next. As we mentioned in the report and as has been covered elsewhere, the Scottish Government has said that it is exploring with the bank the ability to deploy end-year flexibility that might address the first point about the annual funding arrangements. However, like others, we await the detail of what that would actually mean in practice.

Linked to your question about the perpetual investment fund scenario, the question of HM Treasury rules will have to be addressed—I think that the language that is used is that a dispensation would be required—to allow resources to be channelled back to the Scottish National Investment Bank when an investment comes to an end, and then redeployed.

The United Kingdom Government and HM Treasury are reviewing the application of financial transactions, which is a milestone that may be worth looking out for. Financial transactions have been the primary source of funding for the Scottish National Investment Bank, and the committee will be aware that that source has significantly reduced in recent years. That will pose important questions for the Scottish Government, depending on the outcome of the UK Government's review. The UK Government has signalled that that will be announced very soon—potentially, it will be settled as soon as next month, in alignment with the UK spending review. We know that the Scottish Government is planning for its own medium-term financial strategy, which has been delayed from this month to next month.

Those are the important factors that we identified in our report. Those two elements must be addressed if the bank is to deliver on its overriding ambition to invest in a planned way that is consistent with the market's expectations. What happens when investments come to an end is also important.

Jamie Greene: Before the meeting started, we had a discussion to get our heads around some of the numbers in your report. Perhaps you could help to clarify our understanding of some of the top-level numbers.

One of the key facts on page 3 is that £785 million in capital has been committed for investment by the bank since it launched. However, exhibit 1 shows £1.1 billion in capital allocation from the Government over the course of the bank's existence, much of which is made up of financial transactions, as you have said, and a smaller amount of resource allocation, of which there was zero in this year's budget. Can you talk me through how the two numbers correlate? My reading of that is that the Scottish Government has allocated more than £1 billion to the bank but that, in total, the bank has invested around three quarters of a billion. Is there money that is sitting in a pot somewhere, waiting to be invested?

Stephen Boyle: I will bring in Cornilius Chikwama, who might want to say more. Effectively, you are right: that is the rationale for why there is a difference between the numbers. Exhibit 1 on page 16 sets out the total allocations. In some respects, this goes back to the discussion that we have just had. The bank cannot carry

forward funding from one year to the next. During the course of our audit, we heard very clearly from the bank that it is led by its missions and its risk management and investment risk management arrangements, so it does not rush to spend an allocation. In some respects, if that means that there is a underspend, the attitude is "So be it". The investment must be right—the purpose is not to deliver an allocated budget.

Cornilius Chikwama can say a little bit more about the difference between the two numbers that you have referred to. Exhibit 1 also includes the 2025-26 capital allocation, but we do not yet know what has been spent in that period. A fairer comparison might be to look at the £785 million relative to the £918 million—that is, stripping out the funding that has been allocated for 2025-26.

Jamie Greene: During 2024-25, £174 million was allocated—I use that example as the financial year has ended already. I presume that that money was made available, as opposed to it being moved physically into the bank's coffers. We are trying to get our heads around whether the money has been allocated to investments. The bank cannot underspend or roll over cash, so I presume that the money is either not drawn down at all by the bank or it is sent back to the Government. Of the £174 million, a percentage of that may not have been invested. The money that has been allocated is a made-up number—you can say that £1 billion has been allocated, but if the bank cannot spend that amount of money during the financial year, it would, effectively, not have been allocated to it. That is the sort of transaction that I am trying to get my head around.

Stephen Boyle: You are right. There will always be a difference between what is spent and what is allocated until the points about year-end flexibility are resolved. The nature of investment opportunities means that they do not fit neatly into a financial year end or budget allocation process. I will bring in Catherine Young.

09:45

Catherine Young (Audit Scotland): Paragraph 46 says:

"In each year to date the Bank has not invested its full capital allocation."

I do not have the figures to hand for each year, but the challenge, particularly when bringing in private investors, is that the approach does not work alongside the annual budget timeline. The bank has been clear that it will not just invest to spend money in a particular year. It has strict investment criteria, and it would pause at that point to allow it to make all the correct decisions on investing. However, as you say, there will be a percentage of

capital returned or not drawn down across those years.

Jamie Greene: The other big selling point of the bank is its so-called ability to unlock private investment. My understanding is that the bank would not regularly invest at the start-up stage of a business but, rather, at the so-called growth stage, although there is some ambiguity about what that means. In your report, you talk about £1.4 billion of funding

“attracted from other investors as a result of investment by the Bank”.

That is a bold statement to make. How do you quantify the idea of unlocking private capital? It is a bit like saying that you switch on a light bulb and mosquitoes come to it. Did you instigate that by switching the light on? It is easy to put that figure down as a metric of success because it is such a big number, but it must be very hard to pin down in real terms.

Stephen Boyle: I will bring in Cornilius Chikwama in a moment to talk about the methodology that the bank uses to arrive at that assessment.

The principle that the bank is citing is that its investment of circa £800 million—or perhaps slightly less than that—will have generated £1.4 billion across the individual projects that the bank has provided with debt, equity or pooled investment arrangements.

You are right about the nature of some of the Scottish National Investment Bank’s investments. They tend not to be immediate start-ups but growth-stage businesses. We know that the Scottish National Investment Bank is not the only player in Scotland in that environment. I am happy to say a bit more about how the bank’s work and its position relate to those of the enterprise agencies in Scotland. We are clear from our work that the bank is investing in growth-stage businesses, which tend to be those that are higher risk and that have not been able to secure funding from the enterprise agencies—because that is not appropriate—or private finance.

It is a factor that the bank’s investment will be seen as offering some certainty to other investors. The quantum of private investment in the projects that we have looked at, relative to the investment that the bank has made, gives some credence to that.

Cornilius Chikwama (Audit Scotland): The starting point is to look at the bank’s mandate, which is to invest in those high-risk businesses and projects that other lenders would not normally invest in. That is the test. If we start from that position, most of those projects would not have happened without the bank putting in some

money. As the Auditor General said, once the bank has invested, it lowers the risk level for other investors. That is how the crowding in is generally happening. It means that the bank ends up carrying more risk in its portfolio than would be expected of other investing institutions. However, that reflects the purpose for which the bank has been set up: to invest in high-risk, potentially high-return projects that the private market would not normally support.

Jamie Greene: Is there any evidence that the Scottish National Investment Bank is, in a sense, distorting the investment market by competing with private venture capitalists, private banks and other such forms of investment, or is it working well alongside—again, not competing with—other publicly funded organisations such as the British Business Bank and the National Wealth Fund, which are available UK-wide?

Cornilius Chikwama: In the report, we look at how the bank is working with other institutions. In some of the examples that we have highlighted in the report, the bank is co-investing with private investors. It is exploiting those synergies. In some cases, the bank has gone on to support businesses that have received early support from the enterprise agencies. It is engaging with other public investors. That is a core part of what the bank has done while finding its place in the investment market to see where it can work with others. As we highlight in the report, the bank might just need to continue working in that area. However, there is evidence in the report that some of that is already happening. I am sure that the Auditor General will want to say something.

Stephen Boyle: I agree with Cornilius’s point. Effectively, we set out some of the arrangements and judgments that we have made in that area on pages 9 to 11 of the report.

Your direct question, deputy convener, was about whether the bank is distorting the market. To an extent, yes, it is. It was broadly the intention behind its creation that it would find its place around some of the higher-risk growth-stage businesses. I will say a bit more about Cornilius’s point about engagement with the enterprise agencies but the report gives the example of Ardersier port, whereby the bank’s joint investment was with the National Wealth Fund, which was previously the UK Infrastructure Bank. There is sufficient evidence so far that the bank is working in a complementary way with other relevant agencies to support the delivery of its missions and theirs.

Some of the typical structures that we would expect to see are in place around that. The bank has a memorandum of understanding with the National Wealth Fund. We have also seen the Scottish Government mirroring a UK Government

approach to putting some governance infrastructure around what is known as the business investment group, which involves the Scottish Government supporting the work of enterprise agencies and the bank. The word that we use in the report that perhaps best sums that up is that there is an “alignment” between the work of the bank and that of the enterprise agencies, as opposed to a disconnect or excessive duplication.

Jamie Greene: Thank you for that. Obviously, you can see my questions from afar, because you have pre-empted my next one, which was about the business investment group. That is very positive feedback. Thank you both.

The Public Audit Committee’s job is to scrutinise the spending of public money. Is there any sense or feeling in any of the work that you did that people are concerned that, due to the high-risk nature of the bank’s activities, it is playing fast and loose with huge sums of public money? By their nature, some of those businesses will fail. I presume that a percentage for that is factored into the business model. Given that public finances are extremely tight and that cuts are being made in many areas of public service, including vital lifeline services, people will be looking at a quasi-private bank with 80-odd people in it, spending billions of pounds of public money. Do you think that that is a concern?

Stephen Boyle: I think that it is a trade-off. I will invite Catherine Young to talk about this in a moment, but a key part of our audit was to look at the investment risk management arrangements that the bank has in place. Some of the activity that the bank will undertake is inherently risky, and that is by design, because the bank has sought to position itself to fund higher-risk activity. If the opposite were true, we would be equally concerned. If there were no investment losses for the organisation, we might ask why not. Would that suggest that the bank has not engaged with the more opportunistic growth-opportunity organisations?

However, the bank must do that style of investment with the right internal infrastructure, and we found that it has done so. I will perhaps say a bit more about some of the examples and the evolution of that, but I am keen to bring in Catherine to set out the bank’s overall arrangements to put the right safeguards in place.

Catherine Young: As we highlight in the report, one focus was to look at the investment process. We did some case studies to test that process and how it works in practice and we felt assured that there is a robust process in place for decision making on approving investments. The strategy is clear about where the bank will invest. As Jamie Greene said, one aspect is not crowding out the private market as well as leveraging in private

capital. There is a focus on impact and aligning to the missions.

In 2023-24, the bank refined the criteria to tighten up some of the expectations around investment financing. For example, an organisation should have a revenue-generating aspect, enough cash to operate—there should be a bit of a cash runway—and a proven management team. There are various checks such as those. It was clear from our look at the case studies that there is good documentation on decisions, from the initial consideration of something right through to the final stage of investment approval. There is a strong culture of due diligence. Various aspects of financial impact and risks are considered, and lead opinion statements are given on each of those. There is a multilayered due diligence process at various stages.

On risk management, we found strong evidence of a culture of risk awareness. There is a robust risk management framework, with risk registers and key performance indicators, and strong reporting on those. As the Auditor General highlighted, we wanted to look at the foundations and whether those match up to a gold standard. We took assurance and tested that through the case studies that we did.

Jamie Greene: That sounds very positive. Maybe some private banks could learn lessons from the risk investment strategy.

I have spoken to a few organisations that have dealt with SNIB over the years. In your stakeholder engagement, did you speak to any organisations or companies that were denied investment to find out what feedback they were given? Has Audit Scotland identified any gaps in the Scottish Government’s approach to making high-risk investments?

Limited options are available to folk when the private market says no. Auditor General, you might have watched the session that we had last week with the strategic commercial assets division, in which we unearthed the fact that the division has made zero interventions, other than those that it inherited when it was set up. I have had feedback that organisations such as Business Gateway can make small grants to people, which SNIB does not do, but that there are limits to how much money is available to it. SNIB does not offer small or medium-sized amounts of capital funding to start-ups or small businesses. Is there a gap in the market that SNIB is not filling or that it could fill?

Stephen Boyle: There are a number of points there. I will try to address them all, and I will bring in colleagues on various points.

In paragraph 7 of the report, we set out who we engaged with in our audit work, just for completeness. Clearly, we engaged with the bank, the Government and the enterprise agencies, as well as representatives from sector bodies. We wanted to try to triangulate and find out how the organisation is performing, which I think is the point that you are raising. We also drew on evidence from the survey activity on awareness of the bank's offer.

10:00

We say in our report that we think that the bank has found its place within what can seem from the outside to be a cluttered landscape with a number of different enterprise organisations. The committee is familiar with the role that the strategic commercial assets division plays and, outside the Scottish context, there is also UK Government activity. As we have touched on, we think that there is broad alignment, but that can never be taken for granted. It is appropriate for the Scottish Government to have some convening infrastructure, if I can put it in those terms, to ensure that everything is working in practice as it ought to.

As you rightly say, the bank is clear that its role is not to be a grant-giving body or a business development institution, as we might expect Scotland's enterprise agencies to be. The bank is also clear about its range of capital and financing support, which is between £1 million and £50 million for each individual investment. There has been some flexibility and the report touches on an example—my colleagues will keep me right, but I think it was for affordable housing in Shetland—that went below that threshold. We will have to keep the arrangements under close review as the bank evolves.

The report says that the bank has remaining ambitions, one of which is to address the extent to which it is reactive or proactive in its offer. Its current arrangements are generally reactive, but we have recently seen the bank, through one of its subsidiaries, acquiring Financial Conduct Authority authorisation to move into a more proactive space so that it can advise potential clients of its offer.

Any increase in the bank's activities, its alignment and how it works with other organisations will all have to be kept under close review.

My colleagues can say more to address your question about the feedback that we got.

Catherine Young: In paragraph 23, we highlight the fact that we spoke to representatives from financial sector services. The bank has been on a journey in building its reputation and a wider understanding and awareness of its role in that

market. We also reflect on the positive feedback that the bank got through its own stakeholder survey and on the operational improvements that it made on the back of that.

I will highlight some feedback from the financial services sector that said that the bank could sometimes take more risks to support scalable businesses, particularly in the tech sector, to improve Scotland's productivity. There will always be feedback from various businesses that have tried to tap into that. We spoke to the financial services sector as a representative of business and reflected on the feedback, because we were looking to find out what the bank has done with feedback, how it has learned from that and whether it has made changes or improvements.

The Convener: We have some questions about the financial basis on which the bank was established and operates. Those will be put by Colin Beattie.

Colin Beattie (Midlothian North and Musselburgh) (SNP): I will begin with a simple question about paragraph 35, which says:

"The Bank's ambitions extend to taking on a more active role in the private investment market."

You write about "engagement" and "advice", which I presume means giving advice, and about "investment arrangement activity" and "management of third-party capital". Fairly wide-ranging skills are necessary to be able to do that. I have worked in investment banking and each of those areas is highly specialised. How will the bank bring together all the expertise to be able to support that ambition and how will that be balanced with its key role, as agreed with the Scottish Government?

Stephen Boyle: I am sure that you are right, Mr Beattie. The affordability of some skills in a public sector context will be central to the next phase of the Scottish National Investment Bank. Can it undertake the next phase of its ambition in a way that manages risk? We have seen that it has broadly managed risks and it has, to an extent, evolved its risk management arrangements, as Catherine Young mentioned.

As I mentioned to the deputy convener, Scottish Investments Ltd, which is part of the bank's group structure, has received Financial Conduct Authority permissions

"to carry out enhanced arrangement and introduction activity within the private market."

It has to strike a balance between proactive and reactive opportunities, but the next steps will have to be carefully managed. In our audit report, we have not said whether the bank is now ready to do that work. That will depend on the bank's management arrangements and governance as

well as the Scottish Government's oversight, because it must ensure that the new avenues remain consistent with the bank's overall purpose.

Colin Beattie: Elements such as giving advice, presumably on how to invest capital, are highly-specialised, highly-paid areas in which people get mega bonuses and so on. How is that compatible with SNIB and, to be blunt, how can it afford that?

Stephen Boyle: Fundamentally, those are questions for the bank, which it can reconcile at the next stage of its ambition by setting out a clear path that is deliverable and that manages the risks. Such activities are newly regulated, so the bank is not unsighted on the risks. In our work so far, we have seen that the bank is engaging in higher-risk investments, and it has put the right level of investment risk management infrastructure around them. However, if the bank moves into a new level of activity, it will have to be absolutely satisfied that it has the right challenge and the right processes, board and people in place to deliver those skills.

I am sure that the committee will want to touch on some of the wider staffing arrangements. However, we mention in the report—this was, perhaps not unreasonably, anticipated—that the more traditional public sector pay and reward arrangements might not be compatible with delivering an investment bank. We have seen that to be the case. The bank reports transparently in its annual report and accounts that it operates an incentive programme. It pays more than we see in other parts of the public sector, but its pay and reward arrangements perhaps do not align with what you would expect to see in the financial services industry.

Given your expertise, I am sure that you know that acquiring some of the skills that are necessary to deliver on the bank's next stage of ambition will take a different level of pay and reward than we would typically expect in a Scottish public body.

Colin Beattie: It is an extremely competitive area that has some really big players. There are a lot of questions about where in the existing market SNIB might fit—or, indeed, whether there is a place that it can fit or find a niche to take on.

Stephen Boyle: Cornilius Chikwama might want to say a bit more about that, but it is the next phase for the bank. In our audit work, we have seen that the bank has gone through levels of consideration and development of its strategy and business plans in order to support its ambition to address and deliver on its missions. We have no evidence or reason to doubt that at the moment, but we have not yet audited how it is actually going to deliver that level of evolution in its approach. I will pause there because Cornilius Chikwama wants to come in on that point.

Cornilius Chikwama: I reiterate your point, Mr Beattie, that the cost of providing that service involves very high-cost skills. However, the fundamental question is what the gap in the market is that the bank is trying to fill. You are absolutely right that it is a highly competitive market and that many businesses are providing that service. It is on that point that the bank could be challenged and asked what gap it is trying to address and whether that justifies taking on the additional cost and risk that comes with a public body giving commercial advice.

Colin Beattie: I can see that there are some questions for the bank.

I will move on. The bank has made pretty good progress on covering its operational costs from its own income, but the ability to continue to generate that income to cover its costs is pretty closely tied to the continuing supply of capital from the Scottish Government. How confident are you that that funding will be sustained? What would be the impact on the bank if the capital allocations were to fall short?

Stephen Boyle: To start to address that question, I signpost the committee to exhibit 2 on page 17 of the report, which sets out the progress that the bank has made in covering its day-to-day or operational costs relative to the income that it generates. In the most recent year of audited accounts, which are for 2023-24, we see that the bank's income now exceeds its operating costs, which is real progress. Income from the bank will be generated from investment income, arrangement fees and so forth.

However, as we touched on in response to the deputy convener's questions, the change or the uncertainty around the volume of financial transactions, which have been the primary source of the bank's capitalisation—

Colin Beattie: That was the subject of my next question.

Stephen Boyle: Are you happy for me to continue?

Colin Beattie: Yes. It all hangs together.

Stephen Boyle: The volume of financial transactions and the bank's capitalisation are intrinsically related. If the bank's capitalisation does not continue as its financial strategy assumes, and if that is based on financial transactions, the question for the bank—and, really, for the Scottish Government—will be whether it can find an alternative way to continue capitalising the bank, reduce its allocations or find some other approach. Those are the key decisions that now await the Government, the bank and its board.

There is a risk to the bank's ability to become a perpetual investment fund. The outcomes of the UK Government's consideration, the spending review, the Scottish Government's medium-term financial strategy and the 2026-27 Scottish budget will provide the real evidence—not just for next year, but for the years to come—as regards the direction of travel and whether the bank will be capitalised as intended, cover its running costs from its income and, ultimately, become the perpetual investment fund that it was envisaged to be.

Colin Beattie: If I recall correctly, financial transactions have already been reduced somewhat over the past few years. I think that most of them now go to the bank, do they not?

Stephen Boyle: Cornilius Chikwama can say more on that, but that is correct. The essence of financial transactions is that it is capital that goes outside Scottish or UK public sector bodies, typically to support Government activities or interests that are not delivered directly by public bodies. That is consistent with what we see in the bank.

Financial transactions have reduced, but it is also the case that, in the provision of financial transactions, the bank has been more protected than other parts of the Scottish budget. For example, we mention in paragraph 39 that the position of the affordable housing supply programme in the Scottish budget has not been protected as much as the bank. However, we are clearly at a real decision point now.

10:15

Colin Beattie: Financial transactions are not part of the block grant. They have to be repaid, and the obligation to make the repayments is on the Scottish Government. Is there a back-to-back agreement with SNIB in connection with that?

Stephen Boyle: Cornilius Chikwama might want to say how the process works, but what you describe is the fact that, as investments end or are repaid, the money is not held by SNIB. It will ultimately be returned to the Scottish Government and then the UK Government. Until that situation is resolved and there is a dispensation from HM Treasury—this is the fundamental point that the bank is making and that we set out in our report—it will not be in a position to have that level of clarity around its perpetual investment fund, cover its operating costs and invest at a different pace than we have seen thus far.

Colin Beattie: What are the implications of that? Financial transactions have to be repaid, and that obligation is on the Scottish Government and not necessarily on SNIB, unless there is a back-to-back agreement on that. It is likely that, as those

transactions come to maturity, that will, in effect, reduce SNIB's capital, because it will have to return the money to the Scottish Government, which will have an impact on future investment. Given that it has been receiving financial transactions for a number of years, the cumulative effect of those payments down the line could be quite significant.

Cornilius Chikwama: Yes. The way that we understand it is that, as the Auditor General said, the financial transactions that the Scottish Government receives are normally invested in a body that is outside the Government, and that investment transaction creates a financial asset that sits outside the Government. The Scottish Government has spent the money, but there is a financial asset, which the Scottish Government owns, that sits outside the bank. In the case of the bank, when that asset matures in the sense that it is disposed of, the bank gets its capital back and the settlement with the Treasury then happens, with the money flowing back to the Scottish Government and then to the Treasury.

Before that happens, there is an asset that sits outside the Government that we can associate with that spend. We could almost say that there is not a net change in the Government's debt position in that case because, although the Government has spent money, it is also holding an asset against that spend. It is a complex technical point, but the use of financial transactions basically gives the Government greater flexibility in how it manages its debt, because the financial assets can be quickly disposed of, if needed, and the money can then be returned to the Treasury to cover the Government debt.

Colin Beattie: What happens if the asset becomes impaired?

Cornilius Chikwama: That is the big risk, and we have already seen that happen to an extent. If the asset becomes impaired, the bank has to cover the losses from its income. If it is unable to do that, there will be a call on the Scottish Government's budget, so the risk will extend to the Scottish Government. In that regard, how the bank manages the risk and return trade-off is critical. If it is to carry a lot of risk that results in more assets becoming impaired and it is unable to cover the cost from the income that it generates, there will be a call on the Scottish Government, which is where it becomes a real liability for the Scottish Government to cover those losses.

Colin Beattie: Given that the whole purpose of the Scottish National Investment Bank is to take on higher-risk assets, the risk that it will end up with impaired assets will be higher. That is part of its job.

Cornilius Chikwama: That is absolutely right. The Auditor General highlighted earlier that we have to recognise that accepting an institution such as the Scottish National Investment Bank means that we have accepted that the public sector carries a level of risk. How much risk we are willing to accept becomes a policy question, so we would not want to make a judgment on that, but the bank needs to be working on those challenges with investment and decision-making. We were assured that it has the right systems to deal with that, but those are the real-life challenges with having such an institution sitting in the public sector.

Colin Beattie: Based on what you have said, it seems that the bank is aware of those risks and is managing them, to the extent that it can.

Stephen Boyle: That is a fair assessment. It is aware of the risks and is engaging with its sole shareholder, which is the Scottish Government, to try to find a resolution. However, while I do not wish to temper any enthusiasm on that, Mr Beattie, those issues were known about when the bank was established. Clearly, they are complicated, and the bank will require support and dispensation from HM Treasury to find a resolution. We make that clear in the recommendation in the report.

Colin Beattie: I will move on to my final question, the subject of which has been touched on already. Because annual budget rules affect the bank's ability to plan long term, any investments that are made are not for the long term; I note, however, that part of the bank's responsibility is to provide patient capital. Can you tell us a little bit more about how the accounting rules impact on the bank's ability to plan long term? Are you aware of engagement between the bank's leaders and Scottish ministers on providing increased flexibility? After all, it is difficult for a bank to operate within such rigid rules.

Stephen Boyle: It is clear that it is challenging for the bank to function as a public body while trying to operate as a lender. As we mention in the report, and as has been touched on this morning, the Scottish Government has acknowledged the bank's ambition to have year-end flexibility and to find an appropriate mechanism that can help it manage its capital allocations and investment in a more open-ended way than public sector accounting rules allow for. However, we do not yet know what that means, what the detail is or what timescale is being operated to. Finding that out is key.

The Government should provide clarity. If the issue can be overcome, it should set that out, but if it cannot, it should make it clear that, under the arrangement within which the bank has to operate, it will be bound by annual capital allocations. It can

spend what it deems appropriate, and other amounts in future years will be dependent on what the Scottish budget dictates.

The lack of clarity is unhelpful. It probably feels like this has been going on for a while, but the issue has now been acknowledged by the Government—and not only by ministers. The question of how funding might work has also been a feature of some of the discussions in the relatively recently established ministerial advisory group, which forms part of the Scottish Government's arrangements. It is clear that the matter has to be resolved, but I do not know how or when that will happen.

Colin Beattie: I have one final point, on which you might be able to provide clarity. The bank receives an allocation for year 1, but drawdowns happen over a period that crosses the annual budgeting period. Therefore, I presume that there are mechanisms in place to ensure that any unallocated capital issued in year 1 can roll over to year 2.

Stephen Boyle: The bank depends on the Scottish budget for the allocation of capital funding—that is at the root of the issue. There is no reserve that it can draw down and then hold; it has to draw down and invest as required.

That raises the issue of the totality of the capital allocations. As exhibit 1 on page 16 illustrates quite well, total capital allocations, if we include 2025-26, amount to £1,118 million, relative to committed capital of £785 million. Those two figures will never align exactly. In the feedback that we got from the bank, it indicated that it very much wishes to address the issue of not having flexibility between financial years.

Cornilius Chikwama: I want to illustrate the practical implications of the arrangement. It impacts on capital utilisation; indeed, the discrepancy between the £1.1 billion and the nearly £800 million that the bank has committed is an illustration of that. Two things are happening in that respect. For a start, the bank cannot anticipate with confidence how much capital it will have going forward, which limits its ability to develop a pipeline of investable projects.

However, as you have said, there are also multiyear disbursements for projects that have already been committed to. It means that the capital that the bank will receive next year has already been drawn down for projects that it has committed to in previous years, which leaves the bank with very limited headroom to invest in new projects. It is a huge handicap in the bank's ability to fully utilise the capital that it is being allocated. That is the implication of that issue, and it is a fundamental constraint on how the bank operates at the moment.

The Convener: Before I bring in Stuart McMillan to ask about governance and accountability, I want to go back to something that you mentioned a few minutes ago: the newly established Scottish Government ministerial advisory group. In the report, you refer to another body that was established in January under the international trade and investment directorate—a business investment group that comprises Scottish Government policy advisers as well as representatives from the Scottish National Investment Bank and the three enterprise agencies. Is there a danger of overgovernance—a cluttering of lines of accountability—that will make it more difficult to understand where decisions are being made and where direction is coming from?

Stephen Boyle: It is a real risk to be managed. A number of public bodies active in the Scottish context and more widely across the UK are investing in or giving out grants to support economic growth, and I do not think that we can ever take it for granted that such an approach is operating well. Some infrastructure has been newly established; for example, the business investment group under the international trade and investment directorate is bringing together partners to ensure that alignment is working properly.

As was required under the founding legislation, the ministerial advisory group was established to support ministers and advise them on the bank's work. There is always a balance to be struck between overreach, ensuring sufficient interest and exercising understanding of how governance is performing. Our audit work has satisfied us that that balance is in place: the bank is well governed and has appropriate internal governance arrangements, and its sole shareholder, the Scottish Government, is able to observe board meetings and discussions. Again, we see no evidence of either a lack of interest or overreach.

I agree with your point. I do not think that you can ever take this sort of thing for granted, especially when you are dealing with such a complicated environment in which multiple organisations are present. Constant triangulation is required to keep the arrangements operating well.

10:30

The Convener: In the interests of transparency, do we know whether the newly established groups publish the agendas or minutes of their meetings that are in the public domain? Do we know exactly what their terms of reference are?

Stephen Boyle: I will ask colleagues to talk about the business investment group, but that is certainly the case for the ministerial advisory

group. Since it was established, the list of its members has been in the public domain, as are its terms of reference and its minutes. I think that the minutes of two meetings have been published and are available on the Scottish Government's website.

Catherine Young: The business investment group is an internal working group, and it was very much welcomed by representatives of the enterprise agencies when we spoke to them. It is more of a forum to discuss collective market analysis and to ensure that each agency is working and adding value as best it can in the market, although there are formal engagement routes, too. It is an internal group, and the minutes are not published.

The Convener: Thanks for clearing that up. I invite Stuart McMillan to put some questions to you.

Stuart McMillan (Greenock and Inverclyde) (SNP): I just want to echo the comments of the deputy convener, and note that bullet point 2 in paragraph 20 of the report says:

“Overall positivity about the Bank increased from 68 per cent to 83 per cent.”

Furthermore, paragraph 27 says that the bank

“demonstrates a culture of continuous improvement”;

paragraph 72 talks about its “sound oversight arrangements”; paragraph 89 mentions

“improvements in ... content and presentation”;

and there are other paragraphs in the report that say that the organisation appears to be doing well on governance.

I come back to a point made by my colleague Colin Beattie. I note that paragraphs 21 and 47 are about the issue of risk, and it strikes me that the organisation is very cautious, notwithstanding the financial straitjacket that it has to work within. It appears that it is focused on risk, that it is trying to provide certainty for business investment and that it is not prepared to go out on a limb. Is that an accurate assessment?

Stephen Boyle: On those points, we are, as I mentioned to the deputy convener, evidence led, and our judgments are, in our view, supported by the material, evidence and sources that we came across during our audit.

The nature of the organisation is that, inevitably, it will encounter risk, and it has to strike a balance. It is an organisation that invests in higher-risk activities, such as scaling up phases of business growth, and it must ensure that it has the right internal infrastructure to make those decisions and to monitor them as the investments progress through to maturity and, in due course, to exit arrangements.

I would highlight to the committee exhibit 4 on page 25 in which we set out the existing investment decision-making framework, and our view on whether that is as it ought to be. I am not sure that I entirely share your characterisation of that as being cautious. If anything, I think that it has to strike the right balance and that such an approach is appropriate for the type of organisation that SNIB is.

Kirsty Ridd can tell you how all of that is operating when it comes to the making and communicating of investment decisions. The stakeholder feedback suggested that the pace of some investment decisions could be faster, but that should be set against a backdrop of generally positive feedback from stakeholders.

Kirsty Ridd (Audit Scotland): On the point about the communication of investment decisions, Catherine Young has already talked about the investment structure and our work on the case studies. We found that there was a really clear rationale for, a lot of information about and a lot of consideration given to why an investment would be taken forward and the decision in that respect, both on the more commercial aspects with regard to the finances and on the impact expected as a result of that investment.

In the report, we recommend that the bank could go further in explaining such things when making its investments public. Although we absolutely recognise that it needs to balance any business or commercial sensitivities, it could provide a little bit more explanation to make it clearer why certain investments are taken forward and what the expected impact will be. In other words, it could tell its story a bit more to the public and help people understand why certain investments are made. If it explained the process publicly, people would be more assured about the process that it goes through and the things that it considers in making decisions.

Stuart McMillan: That is helpful. Obviously, that is a recommendation in the report, but has the point been put to SNIB in discussions between you and its representatives? If so, has it been receptive to it?

Kirsty Ridd: Yes, SNIB has seen the report and has talked to us about it, and I think that it is receptive to it. In fact, there are now some good examples of SNIB communicating publicly, and it has, for example, put out short videos to explain and contextualise decisions on investments, including information on the local context for why decisions have been made. In the report, we highlight the decision to invest in mid-market housing in Shetland and the fact that it is a little outwith SNIB's normal range of investments, so it has given a little bit more explanation about that. Our recommendation seeks to encourage the

bank to consider, across its range of investments, where it can follow its existing good examples in providing more information, and it seems to have been receptive to that.

Stuart McMillan: On the advisory group, which the convener has touched on, has there been any indication of its impact on SNIB's future direction?

Stephen Boyle: I do not think that we have that detail yet. It is still early days for the ministerial advisory group; as I said to the convener, it has had only two meetings for which the minutes have been published. Looking at the forward work programme in the most recent set of minutes, I see that the group will consider our report, which is welcome, and the bank's relatively recently published impact report.

I am not taking a view on the group's work—I think that its impact remains to be seen. It is perhaps for ministers or the Government to give a view on whether they think that the advisory group is working as intended. We will consider that as we move forward with our own work.

Stuart McMillan: Do you have any indication as to why it took a fairly lengthy period of time before the group met?

Stephen Boyle: From the materials available on the Scottish Government's website, it seems that a view was taken to wait until the bank was established and beginning to show its own impact before forming the ministerial advisory group, as was required by the legislation. Could that have been done sooner? Probably. It is perhaps too early to take a definitive view, but the material that the group has put in the public domain about its interests and activity look to be consistent with what you might expect an advisory group to undertake. I suspect that it is more a question for the Government as to why it took as long as it did to set it up.

Stuart McMillan: You have already touched on exhibit 4, on page 25, which outlines the process for the bank's investment decisions. Those are taken without the Scottish Government's involvement. How robust are the safeguards that are in place to maintain independence?

Stephen Boyle: You are right. The bank is very clear that it operates independently from Government, which is its sole shareholder. That can be true even though—this point was discussed with the convener earlier—the Government is represented at or observes the bank's board meetings. Colleagues can say a bit more about how it operates, but we have seen the safeguards that the bank has put in place to satisfy the need to guard against any ethical challenges and to ensure that its independence operates as intended. Even in evidence to parliamentary committees, the chief executive and

the chair of the bank have been very clear in asserting its independence. It is the bank, its investment committee and its board that will take decisions, rather than the Scottish Government as a shareholder. I will pause and bring in Catherine Young to set that out in a bit more detail.

Catherine Young: In the report, we highlight that the selection process is based on the bank's criteria. Throughout our case studies, we found no evidence of any involvement of the Government in that process. Of course, the bank's missions align to Government policy, but there is a clear distinction between those and the management of the bank. As we said, there is the shareholder team, and reporting arrangements for that are sound. Overall, there is no evidence of political consideration in any of the documents that we looked at in our case studies.

A key point for the bank is that private sector confidence is an important part of the process. It is keen to be transparent about that and about leveraging in other private sector capital.

Stuart McMillan: The target rate of return is between 3 and 4 per cent across the bank's portfolio. Can you provide further information on the mechanism for that and how it will be measured and reported on?

Stephen Boyle: Certainly. I will start with a bit of background and I will bring in colleagues to say how it is performing. Effectively, it is the financial return that the bank generates from its investments, alongside the achievement of its missions. From looking at some of the material, including the implementation plan for the bank, it was clear that, in setting a target rate of return with reference to international comparators, 3 to 4 per cent of gross domestic product investment was anticipated as being appropriate.

On whether the bank is achieving that, there is a distance to go yet, which probably reflects the evolution of its maturity as an organisation. It will probably be a number of years—perhaps the first 10 years of its operation—before it can be satisfied that its investments are delivering both financially and in wider impacts. I turn to colleagues, who might want to say more on that point.

Cornilius Chikwama: That is probably the main issue. It is too early to judge whether the bank is on course for hitting that target. The portfolio is still very small, at 47 projects, with investment of less than half the capital that the Scottish Government has committed to providing. Five years since the bank was established feels like a long time, but it is too early to make a judgment on how the bank is performing on that long-term target for the rate of return.

Stuart McMillan: When it comes to comparisons internationally and within the UK—with, for example, the British Business Bank—how is the bank faring? Is it too early to say?

Stephen Boyle: I am reluctant to give you an assurance on that at this stage. It will be for the bank to evidence its impact, and it is doing so through its impact reporting. As I have alluded to, in the past couple of weeks, the bank has published its latest impact report, which sets out its progress towards delivering on its missions and the extent of capitalisation. Some of its wider objectives involve job creation, carbon reduction and so forth. The extent to which that progress is where the bank needs it to be, relative to international comparators, is more for the bank itself to address, where appropriate.

10:45

To an extent, we have seen from our own work that there is quite a wide, varied picture—not just in Scotland but across the UK—as to what these different public sector financial institutions are doing. The Scottish Government has set up a plan to take stock of how the connections are working as appropriate, but the UK Government is working more fundamentally to satisfy itself as to how all the arrangements are working in totality.

Fundamentally, it is a matter for the bank itself to satisfy stakeholders and Parliament that it is operating as intended, and that its operation is consistent, where appropriate, with international comparators.

Stuart McMillan: How content are you with the Scottish Government's sponsorship role? That has come up at the committee's previous meetings.

Stephen Boyle: It has been a feature of much of my own reporting with regard to the adequacy of sponsorship and the committee's investigations about how that role has, fundamentally, not been working as intended in some organisations. That view is welcome, but it is not what we have seen. We have seen, in the feedback that we got from both the bank and Scottish Government teams to whom we spoke during the audit, that the sponsorship role is being discharged appropriately by the Scottish Government.

That is at the heart of how such an organisation operates. It has one shareholder—the Scottish Government—but it is aligned with a bank that is very protective of its independence. The bank asserts clearly—and has provided appropriate evidence—that the bank itself that is making the investment decisions, but it is engaging with the sponsorship team as appropriate. As I have mentioned once or twice, the sponsor team is observing board meetings and it engages appropriately with executives and non-executives,

where there has been a ministerial advisory group in place. The arrangement is complicated, but it seems to be working.

Stuart McMillan: In exhibit 7, on page 33, 27 local authority areas are covered, and five are not. Which are those five?

Stephen Boyle: I know this. [*Laughter.*] That is set out in detail—if the committee is interested to see it—not in our own report, but in the bank’s impact report. East Dunbartonshire, East Renfrewshire, Falkirk, Clackmannanshire and Comhairle nan Eilean Siar—Western Isles Council—are the five local authority areas that have not been identified as locations that have received investment from the bank.

Stuart McMillan: That is helpful—thank you.

The Convener: Can I follow on from that? At paragraph 91 of the report, you give a very precise figure. You say that

“92.3 per cent of ... direct investees”

are small and medium-sized enterprises. Whose figure is that, and how is it derived?

Stephen Boyle: That will be a figure that the bank has produced. Catherine Young may have the detail of the nature of that calculation.

Catherine Young: Yes—it is from the bank’s annual report. I do not have it to hand, but it sets out the criteria for an SME—for example, its cash runway and that sort of thing. The figure is directly from the bank.

The Convener: It is a very precise figure—92.3 per cent. When I look at the quantum of investments that have been awarded since the bank was established, I note the three biggest investments, at the maximum of £50 million. One went to North Star Shipping Renewables, which is based in Aberdeen—that is fair enough. However, £50 million went to the Ardersier port—to which you have referred already—which is owned by a venture capital company that is based in Houston, Texas. The third investment, in Gresham House Forestry Fund, has been quite controversial and has been raised in Parliament before. The fund is now owned by a private equity company that is based in 5th Avenue, New York.

Maybe this is just a fact of life, but it seems to me that quite a large amount of investment through decisions by the Scottish National Investment Bank has gone to big, private equity-owned international funds rather than to SMEs that are trying to grow their business in the terrain of the Scottish economy.

Stephen Boyle: The examples that you gave are all accurate. We have seen some of the detail of those investments, and there has—as you

mentioned—been parliamentary interest in some of them.

In the audit, we sought to be clear about whether the bank was delivering on its purpose, and we looked at whether there were any exclusions regarding the extent to which, and where, it could or could not invest and how that was structured. We have not found that to be the case. I note that some of the events that you mentioned occurred after the original investment took place. You mentioned the Gresham House ownership change, which took place after the bank’s original investment.

That perhaps goes back to a point that we have not yet touched on in all that much detail this morning, which concerns the impact that the bank wants to achieve, rather than the initial investment arrangements. We are looking in particular about what the bank is getting and how it is delivering on its missions. A key part of that involves looking at whether it is delivering the side benefits that we would expect, such as the creation of high-value jobs, and at where those jobs are being delivered, as opposed to looking at ownership in the context of large organisations relative to SMEs.

We are conscious of the circumstances that you mention, and we note the bank’s reporting of investment in SMEs as opposed to some of the larger-scale investments. However, I echo Cornilius Chikwama’s point more generally: it feels like early days to make a definitive judgment on some of these investments, whether the bank is looking to invest in an SME or undertake a larger-scale investment.

The Convener: The starting point is that, in your report, you quote a figure that you say is an echo of a Scottish National Investment Bank figure, which shows that 92.3 per cent of investees are SMEs. I am challenging that as a likely reliable figure.

There is another point with regard to the Gresham House Forestry Fund. When the investment was first announced in August 2021, I went on to the fund’s website to look at how it positioned itself as a business and saw that it was, largely, selling forestry investment as a way of avoiding paying inheritance tax and capital gains tax. Is any kind of ethical filter applied to these investment decisions?

Stephen Boyle: I will bring in Catherine Young again to say a bit about some of the ethical aspects, as I mentioned to Mr McMillan, primarily around avoiding conflicts of interest in the bank’s investments. Fundamentally, the bank has set out and asserted that it is there to deliver on its objectives and the overarching three missions of investment in technology and impact on climate and place. On the barriers to that, with regard to

whether it will invest in particular industries and organisations, it has criteria for that. For example, it has said that it will not be investing in tobacco or armaments organisations.

There is something of a framework, but I will pass over to Catherine on the question whether that translates directly to saying that the bank will not be investing in a particular ownership structure, or what it means if there is a change of ownership during the course of an investment. If we do not know the detail, we can certainly look at that further; it may be that the bank itself can provide that detail to the committee.

Catherine Young: I do not have too much further to add, other than to highlight that ethical considerations are part of the due diligence that is carried out in the early stages.

With regard to conflict issues, we found strong evidence that there was a recognition of perceived and real conflicts of interest, in particular with many non-executive directors having either current or previous employment in private sector financing. The bank has in place policies relating to conflicts, including a code of conduct on conflicts of interest and that sort of thing.

With regard to individual investments, we would have to look at categorisation and what is categorised as an SME. I just had a quick look to see whether I had any further information on how the bank has categorised businesses, but we can maybe come back to the committee to clarify that. We checked the definition of an SME when we quoted the figure in the report.

The Convener: I think that probably quite a number of us might feel that an organisation whose *raison d'être* seems to be to help its clients to avoid paying tax should not necessarily be benefiting from public funding to aid its venture. I am not talking about individual directors' conflicts of interest—I am talking about a conflict of interest between the organisation and its purpose and its resorting to the use of public funds.

Before I move on to something else, another point about the Gresham House Forestry Fund—which is of note, is it not?—is that the bank says that 60 per cent of its investments will be in Scotland. Presumably, therefore, I would deduce that at least 40 per cent are going to be investments elsewhere. I think that that means investments elsewhere in the UK, to be fair, but they are not going to be in Scotland. Is that not subject to some kind of evaluation when decisions have been made about where investments are being placed?

Stephen Boyle: Yes, indeed. Ultimately, that will be framed by the bank's investment policy. I have mentioned one or two aspects of that with regard to the clarity with which it sets out the types

of industries in which it will not invest, such as arms manufacturing and tobacco.

We can step back for a second and think about what the bank is trying to achieve from its investments. Yes, it is trying to deliver on its missions, but it is also trying to achieve a financial return. It is looking to recover its income and produce growth in the economy.

I would perhaps use the analogy of other public-style institutions that also invest. Local government pension schemes, for example, will also be investing not just in Scotland or the UK but internationally to derive return and benefit. It is about understanding the bank's clarity on its decision making and its framework for those decisions, and that is really clear.

Cornilius Chikwama wants to come in on some of the detail.

Cornilius Chikwama: You are right, convener, that the figure of 60 per cent is what was expected—or rather, targeted—to be invested in Scotland, but we need to look at what that means. It is 60 per cent, but of what? Our reading was that the bank was investing in the forest growth and sustainability fund, which was supposed to be £300 million, so it is actually 60 per cent of the £300 million that was going to be invested in Scotland. The bank put only £50 million into that, so when we look at the equation, it has actually leveraged more investment into Scotland.

We have not looked at whether that has actually transpired in order to form a judgment, but when we look at the detail more closely, we see that more funds could have come into Scotland than the bank has actually put into the £300 million fund.

Another thing to emphasise is what the Auditor General has said. The bank has invested in a fund—it pooled funds with other investors. The nature of the fund means that it has no control over what happens to the overall fund; that may be one of the risks that the bank, and Government, has taken in accepting that the bank can put money into these funds. Is that right or wrong? That is really a policy question for the Scottish Government and the bank to consider.

The Convener: I will move on to what is, in my view, a more positive investment—it has been referred to a couple of times already—which is the investment in a construction company that was building housing in Shetland. In the report, you mention the fact that one of the attractions of that investment, albeit that it was below the normal threshold for investments, was that the company was converting to being an employee-owned business. Again, is the ownership structure and the way in which a business is put together a factor in determining where investment is placed?

Stephen Boyle: You are referring to the fact that there is discretion in the bank with regard to the range of factors on which it will base an investment decision, along with the overarching nature of the missions and organisational objectives. I will bring in Kirsty Ridd, if she wants to add anything about the Shetland investment in particular.

Kirsty Ridd: In the Shetland investment example that we have given, the bank specifically set out some rationale to communicate why it went outwith the normal range of investment that it set out in its investment strategy—between £1 million and £50 million. That is why we saw some more evidencing and explanation of the rationale for making that decision. That links back to one of our recommendations about explaining decisions more. Even when it is within the core structure of its investment strategy, setting out some of the things that the bank considers could help to tell that story more clearly, where it has thought about other aspects of the business.

11:00

As the Auditor General said, there is a range of factors, and that is what we have seen in the case study review. The bank has options to look at different things and balance them across impact considerations, risk considerations and financial considerations. Those will be slightly different for each investment, depending on the context, but it is helpful when the bank explains that a little further so that people can understand the thinking.

The Convener: That goes to one of your recommendations about transparency, does it not?

Stephen Boyle: It is trying to do all those things—to invest successfully and to give itself a degree of discretion and leeway. The risk of that is, of course, that it rubs up against transparency and clarity about why it invests in a particular area. As Kirsty Ridd rightly mentioned, it became apparent during the audit that stakeholders were not always immediately clear about why an investment was made. Although the bank does not report which investments it does not engage in, there will obviously be a market understanding—indeed, perhaps an understanding among members of the committee—of where an organisation has sought investment but did not get it.

Although we say in the report that the bank has found its place, that will not satisfy everybody if they have not been successful in getting an investment and they think that an organisation similar to them has.

The Convener: I have a final question before I bring Graham Simpson in. One of the vehicles for

investment is taking out an equity stake—I think that that is one of the options that the bank has, is it not? Are there examples of that? When equity stakes have been taken out, is a nominated person from the investment bank on the board of that organisation?

Stephen Boyle: I will bring in colleagues to say a bit more about how that works. You are right that the bank has three main ways in which it will structure its investment finance. The first is debt: it lends money to an organisation and generates a return with agreed interest. The second is equity, which is a not uncommon approach to investing. The third, as Cornilius Chikwama mentioned when he spoke about the Gresham House Forestry Fund example, is a pooled investment in a particular fund. I will turn to colleagues to set out the arrangements for equity investment in a bit of detail for the committee.

Cornilius Chikwama: We might need to come back to you on that, convener, given that we did not do a detailed follow-up on individual investments to look at arrangements. I do not think that that comes out in the report, but it is important to understand who represents the bank where it is holding equity. Unless my colleagues have something to say, we can come back to you on that in writing.

Stephen Boyle: I am sorry about that, convener. We did not anticipate that line of questioning, but we can certainly check our records and come back to you in detail.

The Convener: Thanks a lot. That is absolutely fine. I am conscious of the time, but we have one final line of questioning, which is going to be prosecuted by Graham Simpson.

Graham Simpson (Central Scotland) (Con): I want to follow on from the convener's line of questioning. I do not know whether you are a fan of the TV programme "Dragon's Den", but I am. One of the questions that the investors often ask is, "How will I get a return on my money if I invest in you?" They are thinking of an exit strategy. Does the investment bank ask that kind of question when it is making these investments? Ultimately, it needs to get a return.

Stephen Boyle: First of all, Mr Simpson, I am familiar with the programme and I am absolutely aware of the nature of that type of investment. There are parallels that can be drawn with the Scottish National Investment Bank, but I think that it was clear from the material that—and Mr Beattie used this phrase earlier—this is patient finance. It is not investment that is made for a quick flip of return; it is more aligned with consistency with the missions and the overall objectives.

It may be of interest to the committee to see that, in exhibit 4, we have set out a flow chart of

how all this operates. Stage 1 of the process involves the new business forum, where, every week, the relevant people in the bank will say, “Here’s a particular opportunity that we’re aware of.” We have touched on this to an extent this morning, but that tends to happen on a reactive basis in the bank, and for the process to feel more rounded, and in order to strike the balance between reactive opportunities arising from people approaching the bank and opportunities arising from the bank proactively proffering its services to potential investees, it has had to get Financial Conduct Authority authorisation for the additional part of its offer.

What we are seeing, therefore, is that the bank has an investment strategy and approach and the right governance around that, but it is trying to evolve where it wants to go next so that it gets a return that is of its choosing and which is in line with its expectations when it makes the initial investment.

Graham Simpson: But when it makes that investment, has it got an exit strategy? If you put in, say, £10 million, A, you are not going to want to lose that money and, B, you will want to make a profit. Do you think that it has such a plan for its various investments?

Stephen Boyle: The team can say more about whether there is an example either in the case studies or in the round, but I am clear that that is absolutely inherent in how a national investment bank will operate. This is not some open-ended investment—if it were, it would be a grant. The sort of activity in which you did not get your investment back would be more aligned with the style of business support that you might see in some aspects of the work of the enterprise agencies.

Again, I am happy to pause to let colleagues give a bit more detail about how that operates.

Kirsty Ridd: I just want to echo what the Auditor General has said. We saw consideration of the financial case for the investment as an inherent part of, and built into, the entire investment process. The issue is considered from the start right to the end, with clear reporting at each stage and clear consideration of the financial considerations of, essentially, the commercial viability of that investment.

Of course, that will look different for each investment, as things are balanced at portfolio level across the bank’s full investment range to support its target rate of return and its achievement in that space, but it is absolutely a consideration from start to finish throughout the investment decision-making process.

Stephen Boyle: Perhaps I can just add, as an example, that investments evolve and change. In

the appendix to the report that we are discussing today—it is on page 38—we set out an innovation case study involving Orbex, a satellite launch company. In 2022, the bank made an initial equity investment of £17.8 million, but, as the organisation has changed—and with satellites being able to be launched in different parts of Scotland—it has received further investment from the bank to support its business strategy.

That probably illustrates that it is all a bit horses for courses when it comes to whether the timescales for investments maturing are likely to change from when people might have thought that they would initially, relative to the investment that would subsequently take place. Kirsty Ridd is right; it is clear that the initial investment would have had an expected return and an investment exit date, along with a consideration of what it would achieve during the course of it with regard to wider mission objectives.

Graham Simpson: As we have discussed, there are inherent risks when investing—if there is investment in companies that are deemed to be high risk, there will be winners and losers. Probably the biggest loser among SNIB’s investments so far was its investment in Circularity Scotland. You have said repeatedly that the bank sees itself as independent and that it does not like political interference—it would say that there is no political interference—but Circularity Scotland was set up in the wake of Government proposals for a deposit return scheme, so could there at least be the perception that there was an element of politics in the decision to invest a lot of money in Circularity Scotland?

Stephen Boyle: I recognise that point. The chair of the board was subject to parliamentary scrutiny when the Economy and Fair Work Committee and the Net Zero, Energy and Transport Committee looked at whether pressure was brought to bear on the bank to make that investment. Our report includes a case study on the bank’s investment in Circularity Scotland and the arrangements leading up to it. You are right that the failure of Circularity Scotland following the delay to the deposit return scheme’s implementation in Scotland is the only loss that the bank has declared to date, but the bank has been absolutely clear in asserting its independence. It has said that the decision to make that investment was not subject to political interference and was taken by the bank itself.

I will point to a couple of factors. First, the Scottish National Investment Bank was not the only investor in Circularity Scotland that lost money. Other investors—notably, the Bank of Scotland—also lost money. Secondly, the Scottish National Investment Bank’s chief executive, who was not employed by the bank when the initial

investment in Circularity Scotland was made, undertook a review of the arrangements. He reported that the arrangements were robust but not perfect. It is reasonable to highlight that the bank had not adequately considered the risk of legislative change following its investment, but that is clearly what materialised.

I recognise your point, and the matter has already been subject to parliamentary scrutiny.

Graham Simpson: I was a member of the Economy and Fair Work Committee when we looked at the matter in June 2023. I put it to Willie Watt, the chair of the board, that the bank had demonstrated a lack of due diligence and had not thought things through. He told me:

“Sometimes people make mistakes, sometimes people get things wrong, and sometimes the facts turn out to be different from what we thought they would be.”

He also said that the bank

“will make losses on investments”.—[*Official Report, Economy and Fair Work Committee*, 21 June 2023; c 7.]

Well, we know that. Has the bank learned any lessons from that calamitous investment?

Stephen Boyle: I will say a few things and then Cornilius Chikwama can add a few details if he wishes to do so.

It was right for the bank to undertake a review by a senior leader in the organisation who was not present at the time, and it is welcome that the bank has identified improvements that it could make. In particular, as we have discussed, the risk of legislative or regulatory change was not adequately factored into the bank’s decision making when it made the investment, but the bank says that such risks are now considered, which is welcome.

Equally, you make the point that there will continue to be investments by the Scottish National Investment Bank that either do not generate a return or are lost completely. We just have to expect that. It feels uncomfortable, because it is public money and none of us wants to see public money being lost. Inevitably, given the scale of some of the investments that the bank makes, millions of pounds will be lost each time those investments are unsuccessful.

I think that we should hold off on making definitive judgments about the success of this until we are clearly through the initial patient investment approach that the bank will make before deriving a long-term view. That is what we have tried to do in today’s report. We have said that the bank has made a good start on its arrangements, but it needs to resolve these other somewhat external factors before it can do entirely what it is intended to do as part of its original purpose.

11:15

Cornilius Chikwama: On whether the bank has learned lessons, one change to decision making that we have observed is towards having a requirement that a business should be generating some revenue before it can access support from the bank. That would probably be a fundamental change, which might mitigate some of the circumstances around Circularity Scotland; as a business, it had not started generating revenue, there were all those regulatory uncertainties and, in effect, it was not operating. That change gives us added comfort that some lessons have been learned. Whether that change is linked to Circularity Scotland or to other cases, we are, at least, sure that the kinds of mishaps that happened there are unlikely to happen going forward.

Stephen Boyle: That is an important point, and I would signpost the committee to the other investment criteria in paragraph 65 of our report. In addition to the investment being in a revenue-generating business, the leadership team will need to have a demonstrable, proven track record, and there must be at least a 1:1 ratio of private sector to public sector investments. Those criteria feel like evidence of lessons being learned to guard against—I think that it is only that, unfortunately—potential future events where losses might transpire, bearing in mind that there will inevitably be some losses at a future date.

Graham Simpson: Okay. That is really useful.

Looking across the bank’s investment portfolio, I can see that it is made up of mostly small to medium-sized Scotland-based companies that need a helping hand to get to the next stage of their development. That is all great, but the case that the convener was asking about, the Gresham House Forestry Fund, is not in that category. It is an investment fund that certainly did not need Scottish Government money. Is that an appropriate investment for the bank to make?

Stephen Boyle: That is fundamentally a question for the bank to address. Notwithstanding what we have discussed already with the convener, we did not look at all the individual investments that the bank had made. We looked at whether investment was consistent with its investment strategy and with its missions to deliver its organisational purpose, rather than going through the individual detail of all the investments that it had made so far. The bank, in looking through that detail forensically, might be better placed to satisfy you on that point.

Graham Simpson: Maybe we will get a chance to ask it.

You mentioned in the report—and I think that it has come up already in the questioning—the

business of staff getting bonuses, which is not normal in the public sector, as you recognise. Given the nature of the business—let us call it that, because it is a bank—is it appropriate that bonuses are paid when they are generally not paid elsewhere in the public sector?

Stephen Boyle: It is not unique to the bank in the public sector context. We see bonuses in other organisations—for example, the committee recently took an interest in the water industry, and some public utilities pay bonuses. As we have discussed, it is a very common feature of financial institutions, and the bank is a public body that engages in financial-institution-like behaviour.

On the boundaries of my interests and responsibilities, it is not for me to say whether bonuses are appropriate. My interest is in whether they are consistent with the bank's framework document and its implementation plan—and, yes, they are consistent with those. Our interest is in whether the bonuses are being monitored properly and whether they are being discharged with the right level of scrutiny and governance around them, and that is what we have seen and what is being reported through the annual audit of the bank, Mr Simpson. It has a dedicated remuneration and nominations committee, which is overseen, as you would expect, by non-executive directors, who will take a view on whether the bonuses that are paid are consistent with the performance obligations of executives or investment-facing staff. That is a decision that the bank has taken.

In the report that we are discussing today, we say that the bank will want to continue to satisfy itself that it has those arrangements right—that they are appropriate for the organisation and based on its success in delivering its objectives. Through the remuneration and nomination committee and the board more generally, the bank will want those arrangements to remain part of its key focus, as opposed to their becoming a new norm or a routine set of arrangements.

Graham Simpson: I am thinking out loud here. You have said that it is too early to say whether many of those investments will pay off. Why are we paying bonuses if it is too early to say whether various investments have paid off?

Stephen Boyle: The pay-offs of investments are not the criterion that the bank judges executives on at the moment. The detail of the criteria in the long-term incentives plan that executives are measured against is set out in the bank's annual report and accounts, and there is another scheme for investment staff. That maps across to whether they are delivering the bank's missions and whether they are committing the investment funding that they have received already, and more detail goes alongside that. On

whether they get the required rate of return and whether investments are paying off, it would be for the bank and its remuneration committee to decide, in due course, whether to evolve the measurement criteria that lead to bonus payments.

Graham Simpson: This is my final question. You mention in the report the gender pay gap—the gap between what men and women are paid. That is an issue in the financial services industry and it is an issue in the bank. Is it a problem, and what is the bank doing to address it?

Stephen Boyle: It is an issue that we have disclosed. It is reported that there was a median gender pay gap of 30.9 per cent in 2023-24. As we say in the report, the bank recognises that that is not where it needs to be—nor is it, I am quite sure, where the bank as a public body would want to be in relation to delivering its equality outcomes. The bank is taking some action to address the gender balance that it has on its committees. It has established a gender equality networking group and is working with the Employers Network for Equality & Inclusion. The remuneration and nomination committee is also being reviewed by the organisation.

It is important that those steps make a difference. The bank has to deliver and clearly evidence its equality outcomes in order to satisfy its obligations as a public body, but it also has to operate in a financial services environment at the same time. It is important that the bank satisfies itself that the steps that it has planned are working. If they are not, it must amend and evolve its strategy.

The Convener: My final question is on the leadership of the Scottish National Investment Bank. Al Denholm recently announced that he plans to step down, and Eilidh Mactaggart was formerly the chief executive officer; so, in year 5 of the bank, it will have its third permanent chief executive. I think that there was also an interim chief executive—the finance officer stepped up for a period. That is a high turnover, is it not, in the leadership of what is a quite new institution. Do you have any comments on that?

Stephen Boyle: Factually, you are absolutely right, convener. Mr Denholm has announced publicly his intention to retire, and I understand that the bank is making arrangements to recruit a new chief executive and has stated that Mr Denholm will remain with the bank in an advisory capacity into 2026, to support transition handover arrangements. If that is consistent with a smooth handover and the transfer of knowledge, and if the bank has the financial resources to allow for those arrangements, that feels appropriate.

On the issue of the turnover, it is perhaps inevitable that there will be a change of leadership in a new organisation that is establishing itself. More generally in the public sector, change and turnover—recruiting and retaining people in senior leadership roles—is challenging for public bodies, as we have commented to the committee in relation to the NHS. I have no further insight into the specifics of the turnover and can refer only to the bank's public statements—which, I am sure, the committee has seen—about why there has been a change of leadership.

The Convener: I am sure that we will continue to keep a close eye on that.

Your evidence this morning has been very helpful for us. I thank Kirsty Ridd, Catherine Young and Cornilius Chikwama, and I thank you, Auditor General, for leading on the evidence this morning.

11:27

Meeting continued in private until 11:39.

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

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