

ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 4 November 2009

Session 3

£5.00

© Parliamentary copyright. Scottish Parliamentary Corporate Body 2009.

Applications for reproduction should be made in writing to the Information Policy Team, Office of the Queen's Printer for Scotland, Admail ADM4058, Edinburgh, EH1 1NG, or by email to:
licensing@oqps.gov.uk.

OQPS administers the copyright on behalf of the Scottish Parliamentary Corporate Body.

Printed and published in Scotland on behalf of the Scottish Parliamentary Corporate Body by
RR Donnelley.

CONTENTS

Wednesday 4 November 2009

Col.

DECISION ON TAKING BUSINESS IN PRIVATE	2595
FINANCIAL SERVICES INQUIRY	2596

ECONOMY, ENERGY AND TOURISM COMMITTEE

28th Meeting 2009, Session 3

CONVENER

*Iain Smith (North East Fife) (LD)

DEPUTY CONVENER

*Rob Gibson (Highlands and Islands) (SNP)

COMMITTEE MEMBERS

*Ms Wendy Alexander (Paisley North) (Lab)

*Gavin Brown (Lothians) (Con)

*Christopher Harvie (Mid Scotland and Fife) (SNP)

*Marilyn Livingstone (Kirkcaldy) (Lab)

*Lewis Macdonald (Aberdeen Central) (Lab)

*Stuart McMillan (West of Scotland) (SNP)

COMMITTEE SUBSTITUTES

Nigel Don (North East Scotland) (SNP)

Alex Johnstone (North East Scotland) (Con)

Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)

David Whitton (Strathkelvin and Bearsden) (Lab)

*attended

THE FOLLOWING GAVE EVIDENCE:

Clive Maxwell (Office of Fair Trading)

Alastair Mordaunt (Office of Fair Trading)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 6

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 4 November 2009

[THE CONVENER *opened the meeting at 10:31*]

Decision on Taking Business in Private

The Convener (Iain Smith): Welcome to the 28th meeting this year of the Economy, Energy and Tourism Committee.

Under the first item of business, I seek the committee's agreement to take item 3 in private. It concerns our draft budget report. The normal practice is that committees make their reports to the Finance Committee, and the discussions and reports become public only when the Finance Committee publishes its report. Do we agree to take item 3, and all future items relating to our draft budget report, in private?

Members *indicated agreement.*

Financial Services Inquiry

10:32

The Convener: The main item of business today is the continuation of our financial services inquiry. We had a break from the inquiry while we were considering the budget, and we are pleased to be able to return to it now.

I welcome Philip Augar, who is our adviser for the inquiry. We look forward to working with him over the coming months.

Last week, we published details of most of the witnesses who have been scheduled to appear before us in phase 2 of our inquiry. Today, we will hear from an organisation that is important to our inquiry, the Office of Fair Trading. I welcome our witnesses to the meeting and invite them to introduce themselves and make brief opening remarks.

Clive Maxwell (Office of Fair Trading): I am the senior director for the services sector at the OFT. We welcome the opportunity to meet the committee in Scotland today, and I hope that we can provide some evidence that will be useful to your on-going investigation. I am accompanied by Alastair Mordaunt, who is the director of mergers at the OFT.

As many of you know, the OFT has a permanent representative in Scotland, Kyla Brand, who is sitting behind me, and our chief executive, John Fingleton, was here last week to speak to Consumer Focus Scotland. I know that members of the board of the OFT met members of this committee last autumn. We are keen to contribute to these discussions.

There has been considerable and rapid change in financial markets in the past couple of years—that is, perhaps, an understatement. Although markets are much improved in some areas, they remain in a state of upheaval. A lot of change is still under way, and the announcements that were in the news yesterday are examples of that sort of change.

A few months ago, we sent the committee a letter about the work and priorities of the OFT. Drawing on what was in that letter, I would stress the importance of considering some of the longer-term developments that affect the banking market. As our chief executive, John Fingleton, has said, it is important to examine the causes of the events that we have witnessed over the past couple of years and consider the regulatory responses to those events. It is particularly important to ensure that, in designing new regulatory frameworks, we do not stifle innovation and change that can bring benefits to consumers.

The Convener: Thank you. I start by reflecting that almost exactly a year ago, on Halloween night, Lord Mandelson—sometimes known as the prince of darkness, which is appropriate for Halloween—said of the proposed merger between Lloyds TSB and HBOS that the deal was “in the public interest” and that

“preserving the stability of the financial system”

outweighed any potential anti-competitive effects. On the other hand, the Office of Fair Trading stated clearly that the merger would result in a “substantial lessening of competition”.

Given yesterday’s announcements about Lloyds to bring it in line with the European Union competition commissioner’s views, does the OFT believe that the advice that it gave to Lord Mandelson last year was right at the time? In light of the demerger plan that has been announced, was he right to waive the normal competition rules at that time?

Alastair Mordaunt (Office of Fair Trading):

Perhaps it is best if I answer that because I was director of the mergers group at the time. We did indeed look at the anticipated merger almost a year ago, as you rightly say. By way of background and to provide the context of the OFT’s role in looking at mergers, I say that typically the OFT is the first-phase reviewer of mergers that fall under the jurisdiction of UK merger control. We look at mergers and we are the decision maker when it comes to determining whether to send a merger for further review by the Competition Commission. We are not the ultimate decision maker. Any ultimate decision to block a merger, for example, falls to the Competition Commission. We can accept remedies as a way of avoiding a Competition Commission reference, but the commission is the ultimate arbiter.

As I am sure the committee knows, the exceptional circumstances of both HBOS at the time of the proposed merger and the financial conditions in the marketplace meant that the Government intervened exceptionally, which meant that the decision-making authority moved from the UK competition authorities to the secretary of state. In a sense, we were making recommendations. It is worth highlighting that our recommendations must be viewed in the light that we were the first-phase authority. It is not that we identified on the balance of probabilities, for example, that competition concerns would definitely arise from the merger; we were highlighting potential concerns and it would have been up to the Competition Commission to determine whether they were actual concerns.

We hold to the views that we put in our report on public interest considerations, and financial stability was the particular public interest

consideration in that instance. Public interest considerations go beyond our remit as a merger control authority, as our remit falls squarely on competition.

I am not sure that it is for us to say whether we think that Lord Mandelson got it right, but we respect that, in exceptional circumstances, it is appropriate for the Government to consider public interest considerations alongside competition concerns. That is exactly what happened. It is worth making the point that it happened in a democratic and transparent way. The UK legislation provides explicitly for public interest considerations to be looked at in that way. Our system compares favourably with other jurisdictions, where perhaps the process is not so transparent.

Now that people are realising that competition is important in the banking sector, they are referring with increasing frequency to the report that we wrote this time a year ago, in which we identified numerous concerns. We will have to see how those concerns are mitigated in the context of disposals that are being undertaken by the Government, perhaps as a result of the state aid process that the European Commission is undertaking.

The Convener: In Lord Mandelson’s response, he asked the OFT to

“keep the relevant markets under review in order to protect the interests of UK consumers.”

Given that you raised concerns in the report on the merger in three particular areas—personal current accounts, mortgages and the situation in Scotland regarding small and medium-sized enterprises banking services—have you been keeping those markets under review and what is your current assessment of the situation?

Clive Maxwell: We do keep markets under review. There is an awful lot of upheaval in the markets at the moment. For example, in the UK banking market, we have seen the merger to which the convener referred, a number of developments involving other banks and the withdrawal of some foreign lenders. There is another wave of possible change following yesterday’s announcements. We need to be wary about making conclusions when there is so much change going on.

In the case of a couple of the markets that you mentioned, I can tell you a bit more about what the OFT is doing. The OFT has a number of work streams under way relating to the personal current account market. Two or three weeks ago, the OFT published a follow-up to a market study that it carried out looking at ways to improve competition and consumer protection in the personal current account market. It looked at two particular areas

where banks agreed to make a series of changes to the way in which they carry out their business. They were to do with transparency of accounts and providing information to customers so that they understand properly some of the charges that they pay; and improving the switching arrangements for accounts to give consumers greater confidence that, when they want to switch between different bank accounts, there is the capacity for them to do so and that it will work smoothly. We think that those sorts of changes will bring benefits to the market across the UK as they are delivered by the banks. I give that as an example of a market that we are looking at and have been working on.

Rob Gibson (Highlands and Islands) (SNP): I am interested to explore your approach to regulation for national, regional and local competition. Could you give us a little more information about how you consider that in terms of banking?

Clive Maxwell: I will say something about regulation in the narrow sense and then my colleague will talk about competition policy and how that works. Most aspects of financial regulation in the UK are the responsibility of the Financial Services Authority. I know that it will appear before the committee at a later date. Many of the policies that the FSA pursues are informed by European legislation and, indeed, global standards in the case of some markets. The OFT has particular responsibilities for regulating certain types of credit market across the UK. It works with other organisations where it needs to do that more effectively. Alastair Mordaunt will deal with competition.

Alastair Mordaunt: I can probably speak best about how we look at regional and local issues from a mergers perspective, but I think that it applies across all the different competition tools that we have in our toolbox, for want of a better word. On mergers, you will know that in the report on Lloyds TSB and HBOS we identified Scotland as a particular area of concern in relation to SME banking. That reflects the fact that, when we review mergers, we will often look at national effects, but we will also look at the extent to which competition may be impacted at a regional level or, in fact, at a local level—by local I mean really very local indeed. We are talking about, for example, an area that may be a handful of miles from a local branch, or from a supermarket, if we are looking at groceries and so on. We will look at that level of granularity, if we think that competition is important at that level.

I can give you some examples in the banking sector in addition to the SME issue in Scotland. In 2005, the OFT referred the Northern Ireland personal current account banking market to the

Competition Commission. There were also the recent acquisitions by Nationwide, including of the Dunfermline Building Society. We looked at the impact at a local level, so we assessed whether there would be sufficient choice for consumers in a 1 mile or 1.5 mile radius around individual bank branches. That just goes to show that we look at very local issues, irrespective of where they are in the UK.

Rob Gibson: What happens now in, for example, the case of SMEs in Scotland? What is your attitude? What do you think will happen now that there are proposals to change the structures of the big banks through demergers?

Clive Maxwell: Some proposals have come out and we will have to see how the market develops. I have seen the Scottish Government's report on lending, which presents a picture that, broadly speaking, seems quite similar to that in the rest of the UK. It is important to consider that, and I am sure that you will receive evidence from other witnesses who understand the credit markets and how those connect to the real economy.

10:45

Ms Wendy Alexander (Paisley North) (Lab): It would be helpful if we could get some data on the table. In the three markets that you highlighted—personal current accounts, banking services for small and medium-sized businesses and mortgages—what is the level of concentration among the largest two, three or four major players in the UK at present? What were the figures behind the anxiety that you expressed? It would be helpful if you could provide the data for both the UK market and the Scottish market.

Clive Maxwell: We have that information in the report that the OFT compiled on HBOS—we will dig it out now if you like, or we can write to you with those numbers if that is more convenient.

Ms Alexander: Other members may have questions, but I would really like to explore the issue further in today's evidence session. Perhaps we can move on to other questions and then come back to that issue.

Clive Maxwell: While my colleague digs out the numbers for you—he will do his best—I will make a general point. Given the degree of change that is going on in the markets at present, it is important to consider, for example, the stock of certain types of business and the flow of new business. It is also important to think ahead in relation to how some of those markets are changing. My colleague is still looking for the numbers, but I will put those broader comments out there for the time being.

Ms Alexander: I will pursue one specific issue while we wait for you to provide the data. In the

context of small business banking, the uninformed view in the media, which has been widely commented on, is that there is a 75 per cent concentration between two players in the provision of banking services to small businesses in Scotland. Has the OFT, having raised concerns about that concentration, which is higher than that which exists in the rest of the UK, initiated any work in the past 12 months to examine the consequences of such a situation?

Clive Maxwell: Those figures sound like the numbers that are in our document, but we will check. The OFT addressed those issues in its report on the merger between Lloyds TSB and HBOS, which was approved by the Secretary of State for Business, Enterprise and Regulatory Reform under the legislation that my colleague Alastair Mordaunt has set out.

It is clear that it is not the OFT's role to undo a decision that was taken by the secretary of state. However, with regard to the type of changes that we would like to happen in the markets—I pointed to the cross-market issues that we are examining in relation to personal current accounts, for example—it is important to look ahead to changes that might take place in that particular market as a result of the opening up to competition that will follow some of the divestments from those two banks, and the involvement of any new players.

Ms Alexander: I will push a bit harder on that, because last year the secretary of state said:

"I am asking the Office of Fair Trading to continue to keep the relevant markets under review in order to protect the interests of UK consumers and the British economy."

In the intervening 12 months, have you at your own hand initiated any work at all in response to that injunction to examine the concentration level in relation to small business banking services, which in a Scottish context involves three quarters of the market being shared between two players?

Clive Maxwell: The secretary of state referred to the need to keep the situation in the market under review; he did not specifically mention the concentration. To answer your question more directly, we are examining cross-market issues, and considering different elements such as personal current accounts. The OFT is not carrying out a new inquiry into small business banking in Scotland, if that is what you are asking.

Ms Alexander: I am aware of that, but it is important to get it on the record. What worries me is that your own financial services plan, which was published in July and lays out your work programme in that area, makes no reference of any kind to SMEs or to Scotland. It is difficult to reconcile that with the fact that there has been a specific injunction

"to keep the relevant markets under review in order to protect ... UK consumers".

Why are SMEs not included in the work plan?

Clive Maxwell: Many of the generic things that I talked about have potential benefits for microbusinesses as well as for personal customers. For example, easier account switching and more transparency in account charges can bring benefits to the smallest of businesses. Also, given the upheavals and changes in the market, we are not looking at a static position. It makes sense for us to focus a lot of our energies on the systemic things and on ensuring that we have the right regulatory structures in place to support the right incentives in the system. That will help to support all sorts of customers, including SMEs.

Ms Alexander: Obviously, the SME market is distinct from the PCA market, given the range of services that SMEs require. You will understand my concern that your forward work plan for financial services does not flag up the issue, but I will leave it there. Perhaps other members will return to the matter.

If we can get the data for the UK market and the Scottish market, that will be great but, whether we can have the figures or not, can we have some qualitative assessment of where you think we are in the three markets that you flagged up as areas of potential concern in relation to competition? Where are we, qualitatively, in the PCA market, the SME market and the mortgage market? I note that the work that you have done on PCAs is not about the level of concentration in the market but about other important things such as switching. Where are we with the levels of competition in the three markets that you flagged up as concerns a year ago?

Alastair Mordaunt: I now have the data that you requested. I think that they were given in the SME paper that the Government produced. You are right about the levels of concentration and the number that you mentioned. I have before me the public version of the decision, which does not contain the specific market shares but, broadly speaking, Lloyds TSB and HBOS combined have some 30 to 40 per cent, and the Royal Bank of Scotland has some 30 to 40 per cent as well. As I said, I do not have the specific shares. Those are the market shares in start-up SMEs, or new businesses, with a turnover of up to £15 million. In terms of stock, we looked at the market shares in SMEs with a turnover of between £1 million and £25 million. For those businesses, the combined entity's share is slightly larger, at 40 to 50 per cent, and the RBS's share is 30 to 40 per cent.

It is worth making a couple of points as background to that. First, the point is not necessarily about concentration. It is true that the

OFT's concerns were triggered by an increase in concentration in that market, but we should bear it in mind that the two main players did not change as a result of the merger. Before the merger, the two main players in that market were HBOS and the RBS group, and they remain the main players. Lloyds TSB was not a major player in Scotland. It was big enough for us to be concerned as a first phase merger authority—I am not denying that—but it is important to remember that the two main players have remained the same.

Secondly, when the Competition Commission looked at SME banking some time ago, it considered what remedies should be put in place because of the potential concerns. Interestingly, even though the Scottish market was more concentrated at the time of the Competition Commission's review, it did not find that firms were making excess profits, whereas it did find that in England and Wales. That was reflected in the remedies that were subsequently imposed. Although behavioural remedies were imposed throughout the UK, those on pricing, which the Competition Commission called transitional remedies, were imposed only in England and Wales. That reinforces the point that it is not necessarily concentration that causes bad outcomes in the market.

Ms Alexander: The figures that you gave us for Scotland are 60 to 80 per cent for new businesses and 70 to 90 per cent for stock. What were the equivalent figures for the UK market?

Alastair Mordaunt: Let me pull them out.

Ms Alexander: Thank you.

Alastair Mordaunt: If you like, we can provide a copy of the information, but it is in our public report on Lloyds TSB and HBOS, which is freely available.

Ms Alexander: It is just that you singled out the SME market in Scotland in your report last year, which implies a differential level of concern, so I wanted to get an order of magnitude.

Alastair Mordaunt: I do not have the precise numbers to hand, but the concentration levels were lower in England and Wales.

Ms Alexander: You have dwelt on the dynamic nature of the market. I suggest that we have not seen any changes in the intervening 12 months—until yesterday. As a result of what happened yesterday, the EU has suggested a number of disposals. Will you be involved in assessing them and, if so, to what timescale? Does that still leave the consideration of our anxiety about SMEs in Scotland? The disposal of Williams and Glyn's branches in England, six NatWest branches in Scotland and TSB branches in Scotland does not, on the face of it, appear to address our concern

about the SME sector. Will you look at that prior to the disposals taking place? Is any work in prospect to look at the SME sector in Scotland in light of disposals? Will you be involved in those discussions, given that there are issues about potential acquirers and a move to even further concentration?

Alastair Mordaunt: The OFT would have a role, as it does in any merger review context, in looking at any disposals, as long as they fall within our jurisdiction and are big enough to meet our test to determine whether a merger is reviewable. If the merger, and the merging parties, had sufficient international operations, it is possible that Brussels would look at it. However, let us assume that we are talking about the UK. We would look at the merger, as we would look at any merger, to determine whether concerns are raised. We would look at those disposals in our ordinary course of business.

We have no role in advising Government on what the disposals should be and so on. We know as much as you do from the announcements that were made yesterday. I suspect that it is too early to make any comment. In fact, we would never comment before a merger came to us on whether we thought that it would be problematic, because that would prejudice our review.

I think that your question is more about what we are going to do in the meantime in relation to the SME market. I echo the points that my colleague Clive Maxwell made: our efforts are being made—our calories are being burnt—in the advocacy role that we play in ensuring that Government does not trip itself up unintentionally in relation to the regulation that is being set in the marketplace. Because of the flux in the market and the changes that have happened in the past 12 months, which are continuing to happen, we do not think that it is worth investing our efforts in looking at the market now, as Clive Maxwell articulated.

Ms Alexander: It will puzzle small businesses in Scotland that there is absolutely no work of any kind under way to look at the potential competition concerns in the market, given that that is an area that you flagged up last year and which the secretary of state asked you to continue to keep under review. How can you perform an advocacy role if you have no work of any kind under way, even on a dynamic basis, to look at what is going on? The widespread concern among small businesses is that they are having difficulty accessing credit.

Clive Maxwell: It is worth looking a bit more at your last point about accessing credit. The report from the Government sets out a number of interesting facts—they are quite useful data to get into. The first question is whether the situation here is significantly different from that in the rest of

the UK. The concentration might be slightly different.

Ms Alexander: Could we have the figure?

Clive Maxwell: However, that does not mean that the level of competition is necessarily different. When you look at the lending data, you need to be able to compare that with what is going on in the rest of the UK. You have businesses saying that they are unable to access credit. The report from the Scottish Government is quite open in saying that there is always unmet demand for credit. The question is how to assess how much of that unmet demand is coming from businesses that are sustainable and which would expect to get credit in normal circumstances. If they have problems in accessing credit, you need to understand how much of that is a normal function of a normal recession and how much is due to the particularities of what is going on now and, if particular things are going on, how much they are down to competition. I think that you will get evidence from other people that will help you to work through some of those macroeconomic questions.

11:00

Ms Alexander: It would be helpful to clarify the concentration in the UK market in comparison with the Scottish market. I take your point, however, that that is not the only criterion; another appropriate criterion lies in lending data. I am simply asking whether, given the injunction that you were given last year, you have any work of any kind under way at your own hand that compares access-to-credit data or access-to-lending data in the UK market with the data for the Scottish market. You might wish to reflect on that and come back to us.

Clive Maxwell: My colleague has the data here, and he can give them to you now. We are always interested in the views that are expressed to us by business or—especially—by committees such as yours. If your work identifies particular problems, we will consider those very carefully.

Ms Alexander: The absence of small business lending from your financial services work plan was a surprise to many of us.

Alastair Mordaunt: I do not have all the data, but our report gave the merged entity's combined market share for start-ups as somewhere below 20 to 30 per cent. As I said, I do not have the precise number from the public version of the document. We are talking about a level that is roughly 10 basis points lower than the level in Scotland. As I suggested, the concentration levels are slightly lower. I do not have the Royal Bank of Scotland market share figure, but that is the figure for the combined Lloyds TSB-HBOS entity.

Ms Alexander: It would be helpful if you could write to us about that, given that those banks are the two major players. I suspect that the difference is not slight but is significant. We cannot adjudicate on the basis of what you have described, in the absence of the data.

Clive Maxwell: I am happy to write to you with those numbers.

Gavin Brown (Lothians) (Con): On the point about SME banking, when you write to us will you be able to give us slightly more exact figures for market share in Scotland? If I heard correctly, on SMEs—that is, businesses with a turnover of up to £15 million—Lloyds Banking Group had a 30 to 40 per cent share and the RBS had a 30 to 40 per cent share. Surely there is an enormous difference between a market where the top two players have 60 per cent and one where they have 80 per cent. When you write to us, will you be able to give us slightly more exact figures? A difference of 20 per cent is enormous.

Alastair Mordaunt: As you can imagine, a lot of the information that was provided by Lloyds TSB and HBOS at the time of our merger review was highly confidential. As is normal with such documents, certain information that is provided by the parties is redacted if it is considered to be a business secret. I am sure that we can give you some public data that will give you a better idea of the situation.

I take your point that 60 to 80 per cent is a large range. I am quoting from the public source, because I would not feel comfortable—and I suspect I would be breaking the law—giving you the specific numbers that were provided by the parties concerned. That said, I am sure that there will be data in the public domain that will give you a better idea of the numbers.

Clive Maxwell: The Government's report on lending in Scotland has some more detailed numbers, based on its own survey. That is not marketwide, but it provides some slightly more detailed numbers than the ones that have just been read out.

Gavin Brown: Anything that you could give us would be helpful. I totally accept the point about confidentiality, but I cannot imagine any business saying that it has a 30 to 40 per cent share of the market, for instance; I am sure that businesses use more exact figures, even publicly.

Alastair Mordaunt: I am sure that that is right. The banks did not tell us that they had 30 to 40 per cent; they told us their precise market share. The ranges were put into the public version of the document.

Gavin Brown: I will move on to personal current accounts, which Mr Maxwell spoke about earlier.

The OFT produced a report in July 2008, a couple of months before the meltdown in September to October last year. You reached the conclusion:

“The market in personal current accounts is not working well for consumers.”

Two issues that you mentioned in your report jumped out at me. One was about the transparency of charges; the other was about the difficulty of switching between accounts.

I have not had the opportunity to read the report that you produced two to three weeks ago, but you mention the things that you want to do about transparency and switching. Can you give us a bit more detail? On the broad-brush point, what you have said does not sound all that different from what was said in your report of July 2008.

Clive Maxwell: I am happy to ensure that we send the committee a copy of the follow-up report, so that you can see all of it. The important point is that the follow-up report of two or three weeks ago included specific commitments from the banks that serve the UK personal current account market to change their behaviour by providing more transparent information to consumers and to change how the payment system interface works, so that people's confidence about switching is improved. The OFT did not just make a set of proposals in the hope that the market would improve; banks have made commitments to deliver changes within particular timescales.

Some of the proposals are detailed, so I will not go into them all now, but they are about the information that customers should expect to see on their statements regularly, to allow them to understand the charges that they face and to compare products from different banks, just as they can more easily compare products such as utilities when they have more information.

Banks have made particular commitments to provide more transparent information for consumers, and the operators of payment systems and other businesses that interact with those systems have made commitments to improve people's confidence in switching arrangements. The result is that when people want to move their bank accounts, they will have a tool—transparency—that will allow them to understand whether an account with a different bank offers them a better deal. If they choose to follow that up and switch accounts, they will have more confidence that that will take place in a more efficient and straightforward way without worry.

Gavin Brown: It is obvious that you cannot control everything directly. However, if you produced a follow-up report in October 2010 to the report of a couple of weeks ago, would you be strongly or extremely hopeful—

Clive Maxwell: By this time next year, we expect the banks to have made significant progress on several items. It is inevitable that some changes to information technology systems are involved. We have examined that and we know that big firms cannot make such changes in a week or two—they take a bit of time. However, we want them to make progress and to have milestones. We are working with the banks to ensure that a group is driving that work forward and ensuring that the deadlines are kept to. That will be publicly transparent, so people will be able to see the speed of progress.

Gavin Brown: I return to Peter Mandelson's statement of a year ago that the OFT would “continue to keep the relevant markets under review”.

Several committee members have touched on that. The phrase “under review” has different meanings for different people. Some would say that they have kept something under review by reading the newspapers, but sometimes the phrase can have a far stronger meaning. Given the comments of various committee members, can the OFT take stronger action than it has taken so far to keep under review the Scottish SME market situation?

Clive Maxwell: We listen with interest to views or concerns that are expressed and we consider them carefully. If the committee has views on that market, we will consider what it says.

Christopher Harvie (Mid Scotland and Fife) (SNP): The SME lending issue is to an extent a red herring. The Prime Minister was definitely in the driving seat when Lloyds TSB took over HBOS last October. Was he aware of the size of HBOS's loan book and particularly its loans to very large businesses—not SMEs—that had invested heavily in housing at the top of the market and whose investments, as you will agree, have collapsed? Companies such as Crest Nicholson and McCarthy & Stone are involved. Can we have anything like a market when it has a hole in it of the size of the hole that existed in HBOS after October?

The Convener: The witnesses might not find that those questions fall within their remit, but they are free to answer.

Clive Maxwell: I am not sure that the subject is in our remit.

Christopher Harvie: The situation is like trying to refloat the Titanic. Was the Prime Minister—who, with Sir Victor Blank, took an important role in carrying through the merger and who knew people such as James Crosby and Lord Stevenson—fully aware of what the situation entailed? It seems to me that all sorts of other factors followed the making of the decision. The

effect has been that people whose interests in the bank were comparatively tiny have been crushed.

Alastair Mordaunt: One of the arguments put to us in the merger review was that the merger should be allowed because HBOS would not be a viable entity going forward. That reflects some of the points that you have made. We did not buy the argument, because we thought that the Government would not have allowed the bank to fail and would have propped it up. You raised the issue of the bank's future competitiveness. In our report, we made the point that in the immediate future HBOS would not compete to the same degree as it competed immediately before the crisis, for many of the reasons that you have highlighted.

Lewis Macdonald (Aberdeen Central) (Lab): I am interested in your last point. I recognise that you are not the Prime Minister's personal adviser, but I am interested in your comment that the point was made to you that HBOS needed the merger in order to continue and that, during your decision-making process, you set that argument aside on the basis of a judgment about what would happen were the merger not to go ahead. That suggests to me a lesser degree of pessimism about HBOS's position than we have heard from other witnesses. Have I understood the background to your reasoning properly?

Alastair Mordaunt: I do not think that you can read that into our decision making. The counterfactual position—what would happen in the absence of a merger—is the hardest bit of analysis that we must do in merger review. Essentially, it is a probability assessment. It is extremely difficult to determine what would happen in the absence of a merger. Often the most cautious approach for a competition authority is to consider that the prevailing conditions of competition before the merger will continue. In this case, by the prevailing conditions I mean the conditions prior to the crisis. We took the position that we could not rule out the possibility of HBOS not failing, because it would be propped up by the Government and might be able to turn itself around in the short to medium term. That was the cautious approach. If we accept the counterfactual position that I have outlined, there is more likely to be a competition problem. As a first-phase competition authority, we think that that is the most appropriate way to go.

The Competition Commission, which reviews mergers against a higher standard of proof, might have reached a different decision. As we know, the commission did not have the opportunity to review the merger in this instance. I am not sure that you can read into my comments the suggestion that we had some insight into whether

HBOS would be able to get back on to its feet quickly. We simply took the cautious approach.

Lewis Macdonald: You are making a point about the test that was applied to the merger.

Alastair Mordaunt: That is right.

Lewis Macdonald: I would like to understand better the way in which you analyse markets and market failures or difficulties. We have heard that, when looking at the merger between Lloyds TSB and HBOS, you considered the mortgage market, the PCA market and the SME lending market. Do you look across markets? For example, there is a school of thought in banking that the retail side and the investment side are two distinct businesses and that some of the problems that have arisen have resulted from the same institutions operating in both areas. Do such considerations come into your work on mergers or assessment of future markets?

Alastair Mordaunt: I will answer in respect of mergers; my colleague Clive Maxwell will give the more general picture. We certainly look across markets where they are related. In a two-sided market, we look at the impacts of competition on both sides. A typical example would be the newspaper market, in which one set of customers are the readers and the other set are the advertisers. The more readers a newspaper has, the more interested advertisers will be in advertising in it.

In one sense, we are looking at the impact of connected markets in the banking sector, as we see that the PCA market is a gateway to other banking products. However, we have not gone so far as to consider the link between the retail side and the investment banking side to which you refer. From a merger perspective, we do not see those links as sufficient to impact on competition.

11:15

Clive Maxwell: I reinforce Alastair Mordaunt's comments that there might be issues around bundled products or the way in which people use one form of business proposition, such as a personal current account, as a gateway into selling other services. The FSA as the financial regulator is considering the debates around whether, for financial stability, it is better to split investment banks from retail banks.

Lewis Macdonald: Much in yesterday's announcements concerned the disaggregation of not only different bits of retail but—certainly in the case of the RBS—some investment activities from the retail side. From previous answers, I have picked up that you had no role or input at all in the discussions between the European Commission and the Government on that. Is that correct?

Clive Maxwell: Yes. The decisions were made by the European Commission and the Government.

Lewis Macdonald: Were you involved in them in any way?

Clive Maxwell: We have no formal role in such things. However, we talk to Government departments and the European Commission to provide background information all the time.

Lewis Macdonald: I want to understand how far the announcements that we heard yesterday reflect any of your concerns about competition within the UK market. Is there a link between the concerns that you raised last year and those announcements?

Clive Maxwell: To the extent that they deal with market share and the potential concerns that the OFT registered, there is a link.

Lewis Macdonald: But not a causal link.

Clive Maxwell: I do not know.

Lewis Macdonald: There is none that you are aware of.

You said that, if mergers arose out of that disposal, you would have a role. If, for example, new entrants are not already significant players in the market, will that mean that any such disposal falls entirely outwith your purview?

Alastair Mordaunt: It does not mean that we would not consider such a merger. We would have a role to play but, if a new entrant comes in, it is unlikely to raise competition issues from the merger perspective.

Lewis Macdonald: That is helpful. On the way forward for the institutions concerned, do you expect to be consulted by the secretary of state or the tripartite authorities on the terms of disposals if the college of commissioners at the European level approves them?

Alastair Mordaunt: We certainly have not been consulted to date and I am not aware that we would have any formal consultation role to play.

Rob Gibson: I will put the point the other way round: did the European Commissioner for Competition consult you at all about the specific conditions that you understood existed in Scotland and Britain with regard to the decisions that were announced yesterday?

Alastair Mordaunt: I can only reiterate the points that Clive Maxwell made. The OFT plays no formal, official role in that; we are not even an interested third party. To the extent that there are people negotiating the matter, the decisions are made by the European Commission, the Government and the banks.

However, as Clive Maxwell said, we speak all the time to sister regulators and often provide background information about markets. We talk to the European Commission regularly about markets but the straight answer to your point is that we have not been formally or informally consulted on what the state aid process hopes to achieve.

Stuart McMillan (West of Scotland) (SNP): I seek clarification following Lewis Macdonald's question. In his decision last year, the secretary of state said that he

"considers that the merger will result in significant benefits to the public interest".

What does the OFT think about that statement now, one year down the line?

Alastair Mordaunt: Sorry, can you repeat the question?

Stuart McMillan: Sure. The document detailing the secretary of state's decision last year states:

"the Secretary of State considers that the merger will result in significant benefits to the public interest".

I am curious to find out and to clarify what the OFT's position is now.

Alastair Mordaunt: As I stated earlier, our remit in merger control is purely a competition-based assessment. That did not use to be the case—the secretary of state used to be able to decide mergers on a public interest test—but for the past few years decisions have been made on a competition-based test. As I said, the UK competition authorities are usually the ultimate arbiter of mergers.

In exceptional circumstances, the secretary of state may intervene on public interest grounds. The OFT's position is that we respect the fact that, in certain circumstances, the public interest needs to be weighed against other interests. The decision on the merger was precisely one of those occasions. The secretary of state decided that the importance of financial stability—I think that he referred to the systemic risk of bank failure—meant that those considerations outweighed the potentially adverse effect on competition. As we have no remit in public interest considerations, we can only respect the secretary of state's decision, given that all the facts were put in front of him. Our report was made public, as were the reports from the FSA, the Bank of England and the Treasury. The secretary of state took the decision on the basis of those reports.

The Convener: I want to pursue issues arising from yesterday's announcements to clarify whether the OFT will have any future role in these matters. Given the concerns that the OFT raised last year about the impact on competition resulting from the merger between HBOS and Lloyds TSB,

do yesterday's announcements by the European Commission, the RBS, Lloyds Banking Group and the Treasury address those competition issues? It seems to me that yesterday's moves are more to do with the overall size of the organisations than with the competition in specific markets—in particular, I refer to the SME market in Scotland—that the OFT raised last year.

Clive Maxwell: It is worth noting that the European Commission's role relates to state aid. The Commission looks not at a particular merger but at the amount of state assistance that banks and other firms have received. The Commission then requires either changes in the behaviour of those firms or, as in this case, divestments of their business to compensate, in a sense, for the state aid that has been received. The Commission comes to its own decisions on such matters. That is an important point.

To the extent that the proposals when put in place will lead to competition, they might have some bearing on the potential concerns that we raised about the merger. However, the proposals do not take away the OFT's ability to exercise its existing tools and functions, which include the carrying out of cross-market studies and our role in examining the specific possible mergers or acquisitions that might take place as part of those divestments. The role of the OFT will remain. For the reasons that Alastair Mordaunt mentioned, it is quite difficult for us to comment too much on the individual possibilities that might arise.

The Convener: Does the OFT have no role in looking at whether the proposed divestments will improve existing competition within markets?

Alastair Mordaunt: Clearly, the state aid process has slightly different objectives, in that it is not designed to remedy competition concerns that are raised about a particular merger. The state aid process might have some impact—after all, we are talking about the same relevant markets—but it is designed with different objectives. To the extent that mergers result from the selling off of branches or businesses, the UK's competition authorities might well have a continuing role to play.

The Convener: Stephen Hester of the RBS is critical of the EU rulings as he does not consider that they improve competition or the RBS's ability to repay the taxpayer, which is you and me. In particular, he refers to the fact that the banks are being required to sell off insurance businesses, and it is difficult to see how that does anything to improve competition in the insurance market or the banking market. Have you any comment on that?

Clive Maxwell: I do not think that we will be drawn on what we think of different aspects of the European Commission's announcement. That is its decision and it is outside our remit. As Alastair

Mordaunt explained, we must also avoid commenting on specific disposals, acquisitions or anything else.

The Convener: I will make one final attempt to look at the question in a different way. It appears to me that the proposed divestment of the Lloyds TSB branch network in Scotland will not have any significant impact on the SME market. During the merger last year, you raised concerns about competition in that market. Would it be appropriate for you to look at the impact of the proposed divestment on the SME market? In a sense, we are asking you to do a negative thing because you usually look at mergers. The divestments that are being proposed for the RBS and Lloyds TSB in Scotland do not appear to address those concerns, so will the OFT look at that issue?

Clive Maxwell: We do not have a role in saying whether any particular state aid proposals or remedies are right, so in a sense we do not have that negative role that we are talking about.

The Convener: But you raised concerns last year about the SME market in general. If the proposed divestments do not address the issues that you raised last year, would your office be willing to look again at competition in the SME sector in Scotland?

Clive Maxwell: We are certainly willing to consider proposals, including from this committee, if people believe that we need to examine particular markets. That would include the SME market, if there was evidence that would merit us looking at it. I cannot make any more commitment than to say that of course we consider things that are proposed to us.

Ms Alexander: At its most basic, this comes down to who decides the OFT's work programme.

Clive Maxwell: The OFT is independent. It has a board that endorses its work programme and its objectives are set out in legislation.

Ms Alexander: Was it inappropriate, therefore, for the secretary of state to ask the OFT to keep the relevant markets under review last year? That was an injunction from the secretary of state. Does that conflict with the OFT's deciding on its objectives and what merits investigation? I am trying to get a handle on this.

Clive Maxwell: No. We also listen to people's suggestions on what we should look at, whether that be particular markets or keeping things under review. As I said, if the committee thinks that there is something we should look at, we will consider what the committee says.

Ms Alexander: Last year, the secretary of state asked the OFT to keep three markets under review. Is any work being done on either small

businesses or mortgages, which are two of those markets? You have covered PCAs.

Clive Maxwell: There is a lot going on in those markets at the moment and of course we want to keep them under review and see how things develop.

Ms Alexander: Okay. You have been very clear about your position and role with regard to the EU and you have said that there is a different process around state aid. I want to ask specifically about your relationship with the Scottish Government. Have you received any representations from the Scottish Government following the publication of its "SME Access to Finance 2009" survey?

11:30

Clive Maxwell: The short answer is that I am not aware of any such request or correspondence. As I said, discussions go on between the OFT and many parts of Government, including the Scottish Government.

Ms Alexander: My understanding from officials is that the Scottish Government has made no representations to the OFT following publication of the survey. If the Scottish Government had written to the OFT, would its representations have been considered?

Clive Maxwell: That is a hypothetical question, so it is difficult to answer it.

Ms Alexander: Sure. Is it possible for a third party such as the Scottish Government to make such representations?

Clive Maxwell: As I said, if bodies such as the Scottish Government make sensible points to us, we will of course consider them and decide whether it is appropriate for us to take action.

Ms Alexander: Of course, under the terms of the Enterprise Act 2002, the Scottish Government would have been at liberty to invite the OFT to undertake an inquiry into small business banking in Scotland. Any third party that has concerns about competition may make such representations.

Clive Maxwell: As far as I know, that is the case, but I will check.

Christopher Harvie: It is interesting to hear that you always come back to competition. You must be about the only people in Britain now who actually believe in more perfect markets. That seems odd when contrasted with the various more-or-less insider accounts of the financial system. What emerges from accounts such as those of Gillian Tett and Paul Mason—or even the evil Geraint Anderson—is the limited vision of the people within those sectors. Indeed, when I looked up the Scottish banks in the index of Philip Augar's

book, I remember not finding much there. There seems to be a notion that the overarching view that one expects from an organisation such as the OFT is incredibly difficult to reach because of the complexity of the subject that we are dealing with. For instance, think of the contrast between the virtual money in circulation among the world's stock exchanges and banking centres and how that relates—the inflation is of a factor of about 13—to the world's gross domestic product.

Let us also consider how the OFT comes down to trying to impose its notions of competition. For example, in its intervention of about three weeks ago on corporate contracts that had sought to fix the market in public works, it was generally considered that the companies involved—with turnovers of billions of pounds—were given the mildest of slaps on the wrist. Ultimately, those companies had to fork out only a few million. Does not the attempt to reach more perfect markets simply mean that the OFT gets sand kicked in its face by the big concerns, which carry on behaving as before because they operate in a different international market and because they can clean up with their bonuses and clear out if they feel offended?

The Convener: I suppose that, if there were such a thing as a perfect market, the OFT would not exist.

Clive Maxwell: In what our chief executive, John Fingleton, has said and written during the financial crisis, he has made much of the need to retain competition as an important principle even during recession. I think that that remains the case.

As I commented in my opening remarks, one of the important roles for us now is to examine to what extent the changing regulatory system will have an impact on competition. It is perfectly understandable that the FSA and its counterparts around the world are looking at changing financial regulation to remove or reduce risks to financial sustainability, but it is also right that people should understand the consequences that any such changes will have on competition. Indeed, in the FSA's most recent report, Lord Turner notes those issues and identifies the need to understand the competition aspects. It will be important to ensure that we are involved in that issue going forward.

Lewis Macdonald: We have heard described an on-going process of significant change, of which the European Commission's requirements are one part and the FSA's changes to regulation are another chapter. We have also heard described how the OFT seeks to keep markets under review and to consider the effect of those changes. Does the OFT anticipate arriving at a point in that process—this might be another difficult hypothetical question—at which it can say

that it now understands what the substantial changes are and it should now consider the impact that, taken together, all those changes will have on the concerns that others raised and that the OFT registered at earlier stages in the process?

Clive Maxwell: In particular, as markets improve and change, it will be worth going back to some of the fundamental market issues that have arisen during this period. One important issue that has affected the lending markets has been the drying up of liquidity and funding for banks and non-bank lenders, which have played an important role in the past. We must see how the market changes bed down and what the new normal in the markets will be. That will be an important factor in understanding the shape of where we are going.

Lewis Macdonald: So an overall assessment may be a bit of time away simply because of the time that it may take to return to normality.

Clive Maxwell: That is certainly one factor.

Stuart McMillan: Does the OFT regularly work with similar bodies throughout the world?

Clive Maxwell: It does. There is an international competition network. I invite Alastair Mordaunt to say a bit more about that.

Alastair Mordaunt: There are various networks at the European and global or more international levels. There is the European competition network and the international competition network, which is currently chaired by the chief executive of the OFT, John Fingleton. There is a tendency towards quite a lot of convergence in competition policy throughout Europe underneath the European Commission umbrella and more internationally.

The Convener: That almost raises the question why there is only one competition commission. That is an old joke.

I thank Alastair Mordaunt and Clive Maxwell very much for appearing before the committee. Their evidence has been very helpful. If they could provide us with slightly more detailed information on market shares, particularly for SMEs in Scotland and the UK, that would be helpful.

Next week, we will hear further evidence in the banking inquiry from the Nationwide Building Society and Jeremy Peat from the David Hume Institute.

That concludes the public part of the meeting.

11:37

Meeting continued in private until 12:33.

Members who would like a printed copy of the *Official Report* to be forwarded to them should give notice at the Document Supply Centre.

Members who wish to suggest corrections for the archive edition should mark them clearly in the report or send it to the Official Report, Scottish Parliament, Edinburgh EH99 1SP.

The deadline for corrections to this edition is:

Friday 13 November 2009

PRICES AND SUBSCRIPTION RATES

OFFICIAL REPORT daily editions

Single copies: £5.00

Meetings of the Parliament annual subscriptions: £350.00

WRITTEN ANSWERS TO PARLIAMENTARY QUESTIONS weekly compilation

Single copies: £3.75

Annual subscriptions: £150.00

Published in Edinburgh by RR Donnelley and available from:

Blackwell's Bookshop

**53 South Bridge
Edinburgh EH1 1YS
0131 622 8222**

Blackwell's Bookshops:
243-244 High Holborn
London WC1 7DZ
Tel 020 7831 9501

All trade orders for Scottish Parliament documents should be placed through Blackwell's Edinburgh.

And through other good booksellers

Blackwell's Scottish Parliament Documentation

Helpline may be able to assist with additional information on publications of or about the Scottish Parliament, their availability and cost:

**Telephone orders and inquiries
0131 622 8283 or
0131 622 8258**

**Fax orders
0131 557 8149**

**E-mail orders, Subscriptions and standing orders
business.edinburgh@blackwell.co.uk**

Scottish Parliament

**All documents are available on the
Scottish Parliament website at:**

www.scottish.parliament.co.uk

For more information on the Parliament, or if you have an inquiry about information in languages other than English or in alternative formats (for example, Braille; large print or audio), please contact:

Public Information Service

The Scottish Parliament
Edinburgh EH99 1SP

Telephone: 0131 348 5000

Fòn: 0131 348 5395 (Gàidhlig)

Textphone users may contact us on
0800 092 7100

We also welcome calls using the RNID
Typetalk service.

Fax: 0131 348 5601

E-mail: sp.info@scottish.parliament.uk

We welcome written correspondence in any language.