ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 6 January 2010

Session 3

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ECONOMY, ENERGY AND TOURISM COMMITTEE
1st Meeting 2010, 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)

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*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:

Right hon John McFall MP (House of Commons)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 2

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 6 January 2010

[THE CONVENER *opened the meeting at 10:35*]

Financial Services Inquiry

The Convener (Iain Smith): Good morning, ladies and gentlemen, and welcome to the Economy, Energy and Tourism Committee's first meeting in 2010. I wish all members and members of the public who are present a happy and prosperous 2010, and I hope that you all had a pleasant holiday period. We have received apologies from Stuart McMillan, who unfortunately slipped and broke his elbow during the Christmas period. He will be off this week at least. We wish him a speedy recovery. We also have apologies from Marilyn Livingstone, who is a little unwell. We hope that she makes an early recovery. Unfortunately, Christopher Harvie is stuck somewhere in the snowdrifts in the Borders and is unlikely to make it either, although we hope that he finds his way through. Nigel Don is here as a substitute member for Stuart McMillan and we expect Dave Whitton to join us at some point as a substitute for Marilyn Livingstone.

Today's only agenda item is the continuation of our evidence on the banking and financial services inquiry. It is a great pleasure to welcome as a witness the right hon John McFall MP, chairman of the House of Commons Treasury Committee. With him is the clerk to that committee, Eve Samson. I ask John McFall whether he wishes to make any opening remarks.

Right hon John McFall MP (House of Commons): Thank you for inviting us. The banking crisis is still in progress and is not yet over. The Treasury Committee has produced nine reports on the issue—two on Europe and the rest on banking. In the next few weeks, we will continue our inquiry on the issue of too big to fail. That issue seemed to be buried last March when Lord Turner's report was produced, but it has been revived, not least by the Treasury Committee, as it goes to the heart of the problem. Are we willing to continue with a system in which we kid on that a free market exists and in which it is logical for banks to take excessive risk because, at the end of the day, the taxpayer bails them out? It is with that in mind that the Treasury Committee is continuing its inquiry.

The Convener: Thank you for those opening remarks. I am sure that we will be keen to explore some of those issues further this morning. You have perhaps had a unique position, given the amount of evidence that you have taken and the number of interviews that you have carried out with regulators, civil servants, central bankers and bankers. It is not our intention to duplicate your committee's work; we want to consider the implications of the crisis for the financial sector in Scotland, the way forward and competition in the banking sector. However, given the work that your committee has done in its inquiries, will you give us an overview of your views on the causes of the financial crisis?

John McFall: The Treasury Committee has had a threefold focus. We have considered how we got into the situation, how we get ourselves through it and what the financial architecture will be like in future. It is obvious that we have had "the Great Moderation" that Ben Bernanke talked about. Low inflation rates and the search for yield resulted in ever-increasing financial innovation and complex products that nobody understood. That lack of understanding was taken by investors to mean security—they felt that their investments were safe, but it turned out that they were not.

We had, if you like, a brave new world of securitisation. The banks came to the Treasury Committee over the years and said that risk had been dispersed. They said that securitisation meant that the risk was no longer on their books; it was off their books. The question is, where was it? We have seen that it was shared in the banking community. As a result, we have had a global recession; 75 per cent of countries are in recession, which is unprecedented. In a normal recession, 50 per cent of countries are affected, so the crisis has had a huge impact. If we do not sort out the product complexity and understand what risk is, another crisis will come along shortly.

Only a couple of weeks ago, I attended a lecture by Dr Jon Danielsson of the London School of Economics and Political Science, who is an adviser to our committee. He made the point that none of us really understands risk. It is a fundamental issue. The core issue is that economists had the view that the market was self-correcting. They have now been disabused of that. Governments have stepped in and ensured the safety and stability of the banking sector.

In the words of monetary policy committee member David Miles, the banking community is "on life support" for the next few years and Government has a big role to play. There is an opportunity for the state to fashion a new system, but it will not be fashioned in the next five or six months; it will take years for that to happen. The worry is that the banking community thinks that what happened in the past couple of years was a normal recession—a blip—and that it can go on doing business as usual. However, voices such as those of the governor of the Bank of England, Paul Volcker, who is a former chairman of the Federal Reserve, and Nicholas Brady, who was US Secretary of the Treasury under Ronald Reagan and who had an article in the *Financial Times* yesterday, are saying that the financial system is volatile and unstable and that we need to tackle that issue.

That is how the crisis arose. We have muddled through because Governments stood behind banks 100 per cent. In the future architecture, we need to tackle the issue of banks being too big to fail.

The Convener: In some of the reports that it has produced on the banking crisis, your committee has been critical not only of governance arrangements in the banks but of the regulatory framework. In fact, in your 14th report of 2008-09, which was published on 31 July 2009, you say:

"By any measure the FSA has failed dreadfully in its supervision of the banking sector".

Are you surprised that there have been no significant changes in the leadership of the Financial Services Authority and in the tripartite arrangement in the United Kingdom, despite the regulatory failures?

John McFall: Actually, there have been changes in the leadership of the FSA. It was hopeless at prudential regulation. In fact, it put its hands up on that and came out with a good, self-critical report in 2008. Lord Turner then examined the FSA in his report in March last year. The authority had not examined institutions' business models because it felt that that was not part of its remit, but it now realises that it has to consider them. It has made changes by increasing capital and liquidity requirements for banks, but it has not gone far enough yet. There is a national issue, but we also need to tackle global regulation.

Rob Gibson (Highlands and Islands) (SNP): Good morning. The Treasury Committee heard apologies from many of the people who were involved in the crisis, including the bankers themselves, but many of those individuals have now left the industry. What is your perception of the people who have replaced them at the top of the banks? Do they really get the need for change?

10:45

John McFall: If we consider bank bonuses and the Chancellor of the Exchequer's proposals for taxing them, we get the feeling that the banks still do not get it. They are still living in their own little world and have yet to come out into the real world.

The banking crisis highlighted two major areas of deficiency: corporate governance and attitude to risk. In the Treasury Committee's opinion, the Royal Bank of Scotland was an example of a failure of corporate governance. When RBS's then chairman, Sir Tom McKillop, appeared before our committee, he was very clear that the demise of RBS commenced with its acquisition of ABN AMRO. After carrying out due diligence in May 2007, RBS acquired ABN AMRO on 15 October, which was after the credit crisis had started with the default of BNP Paribas on 9 August. RBS continued with the acquisition despite due diligence having been done six months previously. The acquisition also had the unanimous approval of the RBS board.

As I said at the time, any examination of RBS's corporate governance needs to ask whether the non-executive directors were stupid or whether the problem was systemic. Given the track record of the non-execs on the RBS board, who had a distinguished pedigree in the financial services industry, the problem must be systemic. We felt that that was coupled with the issue of risk and product complexity. As I mentioned, I do not think that anyone now has a handle on risk, so the methodology of risk needs to be looked at again. However, the RBS case highlights a deficiency in the job that non-executives do. We need to work on corporate governance as well as on attitude to risk.

On the question about those who have replaced the people at the top of the banks, our committee has heard from the new chief executive of Lloyds Banking Group, Eric Daniels, and the new chief executive of RBS. We feel that lessons have been learned, although not in total as yet. As I mentioned, we have a long way to go on that.

Rob Gibson: Further on corporate governance, do the new people understand risk any better than their predecessors did?

John McFall: No, they do not understand risk. I asked the FSA's then chairman, Callum McCarthy, whether it could supervise institutions only when it understood the products that were being sold. In a way, that remains an unanswerable question. However, I think that we need to probe so that we get an answer to that question, because if we do not understand risk and the non-executives do not understand risk, we are heading for another fall pretty soon.

Rob Gibson: Does the Walker review of corporate governance go far enough in its recommendations on how non-execs should be geared up to do their job?

John McFall: Sir David Walker's review was a good start in one way, although I was a bit critical of the review in saying that I was a bit underwhelmed by it. I still stick by that view. At the core of the Walker recommendations is the concept of comply and explain. Over the next number of months, I think that we will get an awful lot of explanation but very little compliance. I think that we need to take that a bit further.

Rob Gibson: Let me ask about that in a little more detail. Do you think that the gene pool of non-execs has been extended in terms of the way in which the banks are now being managed?

John McFall: Do you mean whether different non-executives are now coming on to boards—

Rob Gibson: Yes. Are more people coming on to boards with different experiences from those whom they are replacing?

John McFall: Not yet. For example, our committee is undertaking an inquiry into the role of women in the City, who are vastly underrepresented on these boards. When we took evidence from a distinguished former member of the monetary policy committee, Professor Charles Goodhart, he was very clear that failing to use 50 per cent of the available talent means that we are not firing on six cylinders. That is still an issue, so we still have quite a way to go in terms of getting diversity on boards.

The culture and diversity of boards are an issue. There is a feeling that the boards were part of an old boys' network—although I do not want to go into that too much—with their membership drawn largely from people with the same background, so the simple or dumb questions were perhaps not asked. The former chief executive of JP Morgan—I think that it was Dennis Weatherstone, but Professor Augar will keep me right on that—used to take people into his office and say, "Look, you've got 15 minutes to explain this to me. If you cannot do it in 15 minutes, you're out of the door and we are not doing it." However, that maxim seems to have been thrown out the window.

Rob Gibson: That is a telling remark. On the current tripartite arrangement, is the FSA now taking an enforcement-led rather than a light-touch approach? Has its approach changed since the report was published?

John McFall: The problem is that I do not think that the approach was ever light touch; it was soft touch. I am all for light-touch regulation if people take their responsibilities seriously. There is a big issue in respect of risk and the FSA's approach. What I hear from some people in the industry is that it is up to the FSA. They are a bit like naughty schoolboys—I speak as an ex-schoolteacher—who cause problems in the schoolyard but hide round the corner when the headteacher comes and say that if the headteacher does not catch them, it is the headteacher's fault. Wait a minute, guys: you are being paid handsomely, you have a corporate governance responsibility and your business model is your responsibility—you cannot dodge it. The issue of regulation by the FSA and responsibility on the part of the corporation is one for politicians to probe.

Rob Gibson: I used to be a guidance teacher and I often looked at the parents as part of the problem. In that respect, has the Treasury, which was the architect of Britain's market-based, non-interventionist economy, changed its apparent belief that the market knows best?

John McFall: Everyone succumbed to the idea that the market was self-correcting, that it knew best and that politicians had to put distance between themselves and companies for the free market to work, but the issue is that we do not have a free market. If it had not been for Governments around the world, the recession would have turned into a depression. The Treasury Committee visited Japan in, I think, October 2007, to have a look at the situation. It was a pertinent time to visit. The Japanese had what they called their lost decade—in fact, it was 20 years. They suffered from deflation, which was the issue that was facing us.

Two points were put to me when I visited the policymakers, the politicians and others in Japan. First, we must recapitalise our banks and do it early—Japan prevaricated. We have done that here. Secondly, we must have a strategy to deal with public anger and resentment, because when public services are tightening over the next few years, when people have been made unemployed—a million more people are unemployed this Christmas than were last Christmas—people will say, "What did it have to do with me?" As politicians, we must take that seriously. On a recent visit to Germany, I was told by the regulators there that the public will not tolerate a second bank bailout. The same is true in quite a lot of countries around the world. If we do not get that right and if we do not have political stability accompanying the economic stability, the social consequences for us could be dire.

Rob Gibson: Have the Treasury civil servants and ministers changed the way in which they look at these matters? Are they taking a different approach?

John McFall: I think that they have; I think that this has been a wake-up call for them.

A point that we highlighted in our report was that the financial services department in the Treasury was understaffed, because the Treasury did not think that there was a need for it, although it does now. One area in which the Treasury and the civil service have to come up to scratch is the quality of personnel in these departments, because an increase is needed not only in size but in quality. It is necessary to be more incisive and not to take people at their word. As President Reagan said, "Trust, but verify." We trusted, but we did not verify.

Rob Gibson: The relationship between the Treasury and the Bank of England perhaps has a degree of ambiguity. What do you make of the Bank of England's approach? The governor appears to disagree with the chancellor and some of his own officials about, for example, the need to separate utility and investment banking.

John McFall: That is the very reason why the Treasury Committee is conducting an inquiry over the next few weeks. It is one of the reasons why we were keen not to let the issue be swept under the carpet, so I applaud what the governor of the Bank of England is doing. I have to say that any time that the chancellor and others have been invited to the committee—he has been invited on a host of occasions, as has the governor of the Bank of England and the chairman of the FSA—they have come along to engage in the debate. We also want to engage the Treasury and others in the debate, because the issue has a social dimension. The governor has been joined by Paul Volcker, Nicholas Brady and others, so there are now a lot of distinguished people behind the argument. We have made progress during the past six to nine months. I would like to think that, before the general election, the Treasury Committee will put down a marker on the issue, which will contribute to efforts to ensure that the financial architecture of the system is changed.

Rob Gibson: Are you surprised, then, that the Bank of England will not send someone to give evidence to a committee of the Scottish Parliament?

John McFall: One thing that I have learned is not to stick my nose in places where it would get chopped off. The issue is for you and for the governor of the Bank of England. I read the correspondence that the convener sent to me, and I think that a private meeting with the bank agent has been offered. The bank agent is an official of the bank who is there not to convey policy issues—that is for members of the monetary policy committee to do—but to pick up information throughout the country and feed it back to the bank when it is undertaking its quarterly reports. I have been privileged to sit in on some of the sessions and I know how extensive the information gathering is.

It would be good if the committee took up the bank's offer; you can see where you go from there. Engagement is important, and it is important for the committee. If I leave the committee with one message, it is that the issue is global and therefore we need to work together in the United Kingdom. Westminster and the Scottish Parliament need to work together.

Rob Gibson: You demonstrate that by being here; engagement is precisely what we are trying to have. Other members want to ask questions, but I will ask a final question. The bankers say that they were under pressure from institutional shareholders to grow profits as fast as possible in the lead-up to the crash. Have the institutions adopted a more responsible approach to the companies that they own?

John McFall: Absolutely not. In a report we described institutional investors as supine and ineffective—that was just as a starter. We have also described the institutions as "ownerless corporations". We need to do something about that, because it is all about short-term rewards, and the long-term health and stability of the institution go by the board as a result. There is a great debate to be had about the issue and a number of institutional investors have come along to speak to me about it.

I give an illustration of the supine and ineffective approach. A representative of Legal & General Investment Management, which is an institutional investor, came along to the Treasury Committee and told us that he had petitioned the Royal Bank of Scotland on 14 or 15 occasions but to no effect.

Rob Gibson: Ultimately, if we consider the social usefulness of investment by the banks at the urging of corporate investors, it is probable that very little investment came in the direction of the real economy in Scotland.

John McFall: Paul Volcker made that point at a conference in the UK a few weeks ago, when he said that someone would have to give him sound evidence that financial innovation has led to economic gains. He said that, as far as he was concerned, the only decent innovation in the past 20 or 30 years was the ATM.

The Convener: The taxpayer is now by far the largest institutional investor in RBS, with an 85 per cent stake. The taxpayer is also the largest institutional investor in Lloyds Banking Group—I think that it currently has a 43 per cent stake in the bank. Is the shareholding company that the Government has set up to hold those shares in the interests of the taxpayer sufficiently engaged with the banks on their direction of travel?

11:00

John McFall: The Treasury Committee has heard from UK Financial Investments on a number of occasions and I think that UKFI is scheduled to appear before us again before the general election. I think that it would agree that its first meeting with the committee was a spectacular failure. I asked questions that we had e-mailed to the company a few days previously but was told that the questions had not been received. We did not start off in the best frame, but I think that as a result UKFI has become increasingly engaged.

UKFI was before the committee about six weeks ago, when John Kingman—the then chief executive, who has now departed—focused on corporate governance and said that RBS was one of the worst-run companies for corporate governance that he had seen. UKFI is now focusing on corporate governance, so things are being done, but my response to earlier questions is that such changes cannot be made all of a sudden.

Powerful forces are also against us—we can see that in the bankers' attitude. In this morning's *Financial Times*, John Kay talks about the powerful forces that are still working against us, which are one reason why I recommended the establishment of a future of banking commission, which the consumer body has taken up. As I said to Mr Gibson, engagement with the public has not been sufficient. What are banks about? Fundamental questions must be asked about the purpose that banks serve in society, what they are about, whom they should serve and how they should go about their business. That debate has been missing so far.

We have much to feed in, but I would like to think that the public angle can put pressure on UKFI and others to ensure that the reforms are achieved. We are up against a major challenge.

The Convener: I asked my previous question because the impression that I gained—I do not know whether other committee members gained it—from some of the evidence that we took from RBS and Lloyds was that their interest in institutional shareholders is very much in the minority private shareholders rather than the taxpayer shareholders. Have you formed that impression, or is that approach beginning to change?

John McFall: We will see Lloyds next week, so I will take that question direct to Westminster—okay? I will ask the representatives why they gave that dumb impression.

The Convener: I will ask about two other corporate governance issues before bringing in Lewis Macdonald. Your report on corporate governance refers to credit rating agencies and to the role of auditors. Has enough been done to examine the role of credit rating agencies and the reliance that bankers place on them? You also said that

"the fact that the audit process failed to highlight developing problems in the banking sector does cause us to question exactly how useful audit currently is."

That suggests that the role of audit in the banking sector needs to change. Do you have comments on those issues?

John McFall: The committee has prompted some soul-searching among auditors, which is good. In our Northern Rock report, we highlighted the fact that the auditor received more for non-audit work than for auditing the company. The charge per letter that the auditor wrote worked out at about £700,000. A few basic questions arose from that. The Institute of Chartered Accountants in England and Wales is examining the issue, as are Anton Colella and others in Scotland, so perhaps it would be good for the Economy, Energy and Tourism Committee to contact the Institute of Chartered Accountants of Scotland, if it has not done so already. The Financial Reporting Council is also considering the issue.

We cannot hold auditors responsible for a company's business model—absolutely not. However, auditors have the privileged position of being able to crawl all over a company and understand what a company is about. When the Treasury Committee produced its Northern Rock report, people in the City told me anecdotally, "Well, John, if you'd come along to us, we could've told you that Northern Rock was an outlier and that its business model was a bit wonky—lots of people knew that." If lots of people knew that, why did the FSA and the Bank of England not know that? Auditors are in there, so we want to ensure more dialogue and more information exchange between auditors and the FSA, so that the FSA can undertake its prudential supervision properly and ensure that it understands the business model.

Europe is producing legislation on credit rating agencies. A conflict of interest arises with those agencies. Just as I would like to see more banks in the market, I would like to see more credit rating agencies so that we have more competition. Indeed, I would like to see more audit companies. We rely on three major audit companies since the demise of Arthur Andersen. When Howard Davies, the former chief executive of the FSA, came before our committee many years ago, he said that he feared the lack of competition in that area—in some specialist areas there was only one auditor to go to. We need competition in this market. Adam Smith spoke about the invisible hand, but there is also a visible hand, and we need to get that visible hand in the market.

The Convener: I meant to say for the record that the committee has taken the offer of a private meeting with the Scottish agent of the Bank of England. I intend to arrange a meeting with the new agent in the near future.

Lewis Macdonald (Aberdeen Central) (Lab): Good morning, John. I want to ask you about the

Scottish aspects of the financial crisis and the way forward. As you said, we all recognise that the crisis is a global phenomenon that has a global impact, but in the context of the British financial services sector the biggest institutions to fail have been the Royal Bank of Scotland, HBOS and Northern Rock, all of which had in common the fact that they were based outwith the City of London. Do you regard that as coincidental or does it reflect in some way a disadvantage for financial institutions that are based away from the City of London, which is the centre of the financial services industry in Britain?

John McFall: In the nine inquiries that we have held, that issue did not arise. I mentioned the Financial Services Authority earlier. From an impressionistic viewpoint, I felt that the FSA put its best personnel with the largest banks and the less experienced people with the smaller banks on the basis that the smaller banks would pose less of a risk. We know now that that was not the case. Also, the better personnel did not understand those large corporations—indeed, large companies such as RBS and HBOS could probably have told the FSA personnel about the issues rather than the other way round. There is an imbalance in the market. People employed by the FSA who are doing a decent job could probably walk out of Canary Wharf on a Friday and get about six to 10 times their salary in the private sector on Monday.

What I am saying to the industry is this: if it wants to ensure that self-regulation works, that there will be no heavy-handed regulation and that the state is not going to intervene regularly, it has to create a level playing field for itself. What does that mean? It means that there has to be secondment from private industry to the FSA, not just at junior level and for six months, but right up through the chain so that the poacher turns gamekeeper and understands the issues. If that were the case—and going back to your question about Northern Rock being an outlier in the business model—any issue would be known about and acted on straight away. That is the fundamental issue: the FSA was deficient in prudential regulation and we need to sort that out.

Lewis Macdonald: You proposed secondments from the industry to the regulators. That would bring expertise and might level the playing field in terms of the rewards that different people in different sectors receive, but is there a risk that some of the cultural weaknesses that you described as existing in the industry could be imported into the regulators through that mechanism? In other words, what could you do to ensure that such an arrangement does not infect the public sector with the same cultural mistakes or weaknesses that the private sector showed?

John McFall: We are alive to that issue, which we describe as regulatory capture. The point was made earlier about the governor of the Bank of England making noises offstage and the chairman of the FSA talking about socially useless activities. I said that I welcome them, and I do so very much.

We have to ask the question: who takes away the punch bowl when the party is in full swing? William McChesney Martin, the first chairman of the FSA, says that the job of a good regulator is to take away that punch bowl. All that we did was add more punch to the table, and we have ended up with a massive hangover as a result.

We need to ensure that the FSA and the Bank of England have authority and independence. At the time of the Northern Rock problems, they came to the Treasury Committee and said, "Look, we sent out warnings to the industry, but nobody took heed of them." If that is the case, we need to beef them up. In the debate in which Mervyn King, Adair Turner and others are involved, they are marking out their ground so that they are seen to be independent and separate from any prevailing political philosophy, to use Adair Turner's words. As I say, we need to beef up those bodies.

Lewis Macdonald: Nonetheless, Adair Turner and Hector Sants come from a banking culture and have a banking background.

John McFall: I do not think that there was a consumer representative on the FSA until a number of months ago. I banged on about that, and I think that there is now one such representative on its board, but that is still insufficient. A range of cultures must be represented.

Lewis Macdonald: So the essential point that you are making is that such diversity is the best protection against regulatory capture.

I return to the Scottish financial services sector. Some witnesses have at least implied—if they have not directly stated—that the Scottish financial services sector was a bit inward looking and perhaps even a bit smug in its inclination to believe that everything was going swimmingly and that nothing could possibly go wrong. Have you picked up that idea in the evidence that you have taken in your various inquiries? Was that a distinct characteristic of the leaderships of the Royal Bank of Scotland and HBOS or simply a reflection of wider weaknesses in the sector as a whole?

John McFall: I think that it was a reflection of wider weaknesses. As I mentioned earlier, we saw deficiencies in the Royal Bank of Scotland's corporate governance and deficiencies in HBOS's attitude to excessive risk. The chairmen of both organisations agreed on that when they appeared before the Treasury Committee. We have to consider why the Royal Bank of Scotland and

HBOS failed while Santander, HSBC and Standard Chartered Bank, for example, are still standing. I think that the corporate governance and attitudes to risk that prevailed in those organisations ensured that. Therefore, I do not see the aspect that you mention as specifically Scottish. Indeed, the Royal Bank of Scotland promoted itself—rightly at the time—as a global enterprise and the fifth biggest bank in the world. I think that it was almost the second biggest bank in the world at one stage.

Lewis Macdonald: From this committee's point of view, one concern is that, although the weaknesses were not confined to institutions based in Scotland, the impact of institutions collapsing so spectacularly and coming close to going out of business altogether has been particularly marked in Scotland. Do you perceive that any injury or damage has been inflicted on Scotland's reputation as a financial services sector that is distinct from the wider hit that the City and other British regional centres have taken?

John McFall: I do not think so. I was asked that question at the time of the Northern Rock problems. At that time, I visited Brussels to make a speech and detected a certain schadenfreude in some representatives in Europe in their thinking that the phenomenon was British. They had seen queues in the streets outside branches of Northern Rock but no such queues in Europe. However, as members know, such things happened with a bang in Europe and affected it as well. At the time, I was asked whether what had happened would be a hammer blow for the City, but financial services are resilient and can sweep such problems aside if we ensure the proper mechanisms.

Financial services in Scotland have a future—Scotland is still strong in areas such as asset management, for example, and we can play that up. We should not beat ourselves up; rather, we should remember that the issue is global, as I have mentioned. Some 75 per cent of countries have gone into recession, and banks throughout the world have gone down as a result.

In December 2007, I visited Washington and spoke to representatives of the Federal Reserve and the Federal Deposit Insurance Corporation and others. Those bodies take banks in and out of receivership almost on a weekly basis. For example, in 1987, Continental Illinois National Bank had to be taken in by the Federal Deposit Insurance Corporation, although it was reprivatised five years later. That example happened under the presidency of Ronald Reagan, the great free marketer.

There are mechanisms for dealing with the situation—Continental Illinois is now a private enterprise and doing well. We should not beat ourselves up about the situation but ensure that we work together more closely in future, given the globalised nature of the market, its interconnectedness and the resulting effect on confidence if things go down, as we saw with Lehman Brothers.

11:15

Lewis Macdonald: I was encouraged by the submission that we received from the Treasury the other day. It said explicitly that it recognises that Scotland has a particularly important financial sector and sees that part of its responsibility is to work with the Scottish financial sector and look after its interests. Do you recognise that approach from the evidence that the Treasury has given to your committee? Does the Treasury recognise that its remit extends not simply to the City of London but more widely? Is there a role for the relationship between your committee and this committee in strengthening Treasury connectedness to and awareness of the Scottish sector?

John McFall: Yes. The Treasury has realised that there is a wider world out there. The situation has caused as much of a shock to the Treasury as it has to anyone else—that was evident in the remarks of the permanent secretary and others when they appeared before the committee.

There is a role for continuing the relationship between our committees. That is why I was keen to accept your invitation, convener. It would be good for our committees to keep in contact, perhaps even informally. We could meet once or twice a year and exchange information on the issue. I would welcome that. If you have any ideas on the subject, convener, I will be delighted to take them up. Our clerks are already in touch with each other.

The Convener: Thank you for the offer, John, which I am sure the committee will want to consider. Perhaps we can discuss it informally later today.

Lewis Macdonald: Much of the focus of what you have said, John, and what your committee has considered is the tripartite structure of financial regulation. Will the proposed developments take us in the right direction? Should there be a Scottish aspect to the way in which the regulatory system develops in future?

John McFall: There is no specific Scottish aspect. It would not do justice to yourselves or Scottish industry if we were to say, "This is just Scottish." We want to ensure a strong Scottish dimension and presence, but we can do that only by ensuring that Scotland works closely with London, which is a large financial centre.

My committee needs to find out what is going on. As I said earlier, we visited the ECB headquarters in Frankfurt a few weeks ago and spoke to Jean-Claude Trichet. We also visited Vienna, Hungary and Brussels. Europe is a big market—indeed, it is bigger than the United States. Europe does not have the same growth prospects for the next 10 years as the US, but it is a big market nonetheless and we need to understand and engage with it. Indeed, we also need to engage with Washington and New York if we are to understand the legislative changes that are being made there.

The big issue that lies behind everything in fixing the system is the global regulatory system. We need to ask: how did all of this come about? In many ways, it came about because of a savings glut: China was saving while the UK, the US and other western countries were spending. We need to rebalance and, until we do so and until we ensure that the International Monetary Fund and other institutions perform their mandates—which were set up under the Bretton Woods system in the 1940s—we will have neither financial stability nor a lack of volatility in the markets. Scotland has a proud contribution to make, but we are part of a wider world.

Ms Wendy Alexander (Paisley North) (Lab): My questions are on the theme of where we go next. Obviously the clean-up will not be instant but, that said, we need to keep moving. In your opinion, are Governments, central banks and regulators taking the right action to prevent a recurrence of the difficulties that we have seen?

John McFall: No, we are not there yet by any means. That is why we are holding the too big to fail inquiry.

There are many questions for politicians to ponder, and they are as much for your committee as for our committee to consider. With regard to direct Government involvement in exit strategies, for example, we should remind ourselves of—and put on the record—the Treasury's support for the financial services industry.

First, the Treasury purchased £37 billion of shares in RBS and Lloyds Banking Group. It then gave indemnity for the Bank of England of £200 billion for quantitative easing. It agreed to guarantee up to £250 billion of wholesale borrowing by banks, provided approximately £40 billion of loans and other funding to Bradford & Bingley in financial services compensation and insured about £280 billion of assets. The National Audit Office suggests that the net cash outlay for purchases of shares in banks and lending to Northern Rock and others will be about £117 billion. That all translates to a commitment to banks by the UK Government of 60 per cent of the gross domestic product of the country, which equates to 8 billion working days. That should make a great impression on us as politicians.

I have learned during the crisis that economics ain't a science—it is an art that some people have fouled up at. We have the brightest and the best working in the financial services industry, and they have given us the most spectacular cock-up. We should keep that in mind when we seek to change the system.

Ms Alexander: Do you therefore still believe that banks should be broken up into casino and utility banks? Do we need a split between narrow and broader banking?

John McFall: That is what the inquiry is about. Do we go back to the Glass-Steagall Act and the 1990s? I do not think that we can transpose and go back on things like that, but how do we eliminate the volatility and financial instability in the system? The issues are tied up with that question: if we do not address it, we will not get to the core of the issue, and we will fail again.

Ms Alexander: I note that in your 14th report of session 2008-09, "Banking Crisis: regulation and supervision"—which is presumably an area that you will consider in your next inquiry—you state that we must

> "ensure that there are no banks which are 'too big to save'"

and that we therefore need to

> "review the wisdom of allowing a banking market to be dominated by firms whose balance sheets are larger than the national economy."

We have had evidence from the Treasury that it is seeking to reduce the Lloyds balance sheet by 27 per cent and that of RBS by 41 per cent. However, that would still leave RBS many multiples the size of the Scottish economy—indeed, at its peak, it was a couple of multiples the size of the British economy. Is there sufficient urgency around tackling that issue?

John McFall: Competition is the fundamental issue, and Neelie Kroes, the European Commissioner for Competition, has started the process. Adam Posen, a newly appointed member of the monetary policy committee, said when he appeared before the Treasury Committee that the UK economy does not have "a spare tyre"—in other words, it does not have enough non-financial avenues for lending. That is the issue that we as politicians must get our teeth into.

We have had the sterile debate about banks lending, and we have had lending agreements, but there is still not enough competition. If we rely on only five or six big institutions for lending, we do not have enough channels. That is an issue that your committee can take up, as we are doing, to ensure that there is competition in the industry.

I attended the Confederation of British Industry's annual dinner a number of weeks ago. Its members told me that 50 per cent of all lending is to financial institutions, 40-odd per cent is to the retail and commercial sectors, and only about 5 per cent is to manufacturing. We must ensure that we have sufficient avenues of lending—that spare tyre—so that we can stimulate our economy.

As has been mentioned, there are opportunities for us in the current recession in areas such as the green economy, transport infrastructure, health, law, advertising and cultural issues. Something that is not well known is that the culture industry in London employs more people than the financial services industry does. We have certain strengths in that regard—certainly in Edinburgh, with its festival. We should consider that issue and grab that agenda.

The concept of the self-correcting market has gone and the Chicago school is buried. The state is back, and we must use the state wisely.

Ms Alexander: Earlier, you said that whatever solutions we come up with must be global. Do you think that the US is up for the necessary reform?

John McFall: In a few weeks, I will be visiting the US to get some real-time information on that, but at this point I would say that I do not think that sufficient progress is being made in the US. The political process there is rather slow. As John Kay mentions in his article in today's *Financial Times*, we must confront powerful forces in that regard.

We need to work with the US, but we also need to work with the developing economies in China and the rest of Asia, whose GDPs are already bouncing back. That gives us an opportunity with regard to the creation of a new industrial policy.

Ms Alexander: Given the slow pace of reform in the US, one strategy that is being advocated is for banks to be required simply to set aside more capital if they engage in risky activities. Do you think that that will be enough to deter the sort of extremely high-risk behaviour that we have seen in recent years? You talked about the risk of a second bank failure. Will setting aside more capital be sufficient to prevent a recurrence?

John McFall: I do not think that it will be. We have to focus on proprietary trading and ensure that deposit-taking institutions are just that. There are a number of areas that must be considered.

Politicians have a big issue on their plates. The Turner review conference discussion paper, which was released following Lord Turner's speech last March, said that there is a trade-off

"between the benefits of reduced financial instability and the costs which may arise from a higher price, or reduced volume, of credit extension and maturity transformation".

The paper went on to say:

"Part of this trade-off is about social choice—consumers might value stability sufficiently highly to prefer prudential standards set above the level implied by an attempt at pure maximisation of long term output".

In other words, there is a trade-off between growth and stability. As politicians, we have to accept that.

Ms Alexander: How can we pursue the agenda that Lord Turner laid out of encouraging banking to live up to its social responsibilities?

John McFall: There is an awful long way to go, as you can see if you look at the front page of today's *Financial Times*. The Treasury estimated that, as a result of the bank bonus scheme, it would get £500 million in tax receipts, but we are now talking about a figure of up to £4 billion. Why? Because the banks have said, "Irrespective of what you say, we are paying this out, so we are going to pay the tax on it." There has been no change there.

I have said to banks—although my view has not been accepted—that they are in the last-chance saloon. We have to change the system because this country cannot afford a second bail-out—no country can. The IMF has pointed out that there are still a lot of bad and toxic debts that must be written off.

Some months ago, our committee had a welcome evidence-taking session with Professor Amartya Sen, who said that the link between effort and reward, in terms of fairness, is out of synch in the banking community. People talk about Adam Smith and his works but, as you and I know, he was a professor of moral philosophy at the University of Glasgow, and he said:

"Humanity, justice, generosity, and public spirit, are the qualities most useful to others."

An economy needs values such as mutual trust and confidence if it is to work efficiently. We have not considered that in sufficient detail. I hope that the banking commission that has been established will consider those qualities when it takes evidence from the public.

11:30

Ms Alexander: In that context, do you think that the size of bonus payments to bankers is an on-going concern? Is it a meaningful issue, rather than simply a side issue, as some bankers would have us believe?

John McFall: It is a meaningful issue. When the governor of the Bank of England came before the committee in the past year or so he said that remuneration was at the heart of the problem because for bankers it is a one-way bet—they win irrespective of what happens. If their company does well, they win handsomely, and if their company goes down, they still win handsomely.

The remuneration issue is about the long-term interests and health of the company and society, and it is therefore hugely important. As I said, we are still at the foothills on it. If we want companies that exist for the benefit of their employees and society and for the long-term interests of the economy, we have to look at the issue.

Ms Alexander: My final question relates to the theme that we have just been discussing. One issue that has concerned the Economy, Energy and Tourism Committee is the attitude that Lloyds Banking Group is taking towards its charitable foundations, which were set up under covenant. One per cent of Lloyds Banking Group's profits goes to charitable foundations in the nations and regions of Britain, and one proposal from Lloyds is to reduce that share from 1 per cent to 0.5 per cent. The committee thought that, given that Lloyds Banking Group has benefited from literally hundreds of billions of pounds of public guarantees over the past year, it should reconsider its threat to the payment of tens of millions of pounds to charities in the current economic climate. That is obviously a UK-wide issue. Might your committee be able to look at it?

John McFall: I just want to add something in response to your previous question about bankers' bonuses. At the moment, those bonuses are going out the door—they are not rebuilding capital, which is essential to those companies. That is folly from the banks.

You and I have spoken about the Lloyds TSB Foundation before. I have spoken to the foundation and to Lloyds, and I believe that Lloyds intends to cut its contribution from 1 per cent to 0.5 per cent of its profits. That is complicated by the fact that the foundations in Northern Ireland and Wales and England have signed up to that. My view is that Lloyds and the Lloyds TSB Foundation should get round the table to discuss the issue, so that we get a decent outcome. It is important that the social contribution that Lloyds makes is maintained, and we do not want charities in Scotland to lose out as a result. As I mentioned earlier, Eric Daniels is coming along to our committee next week, and I will certainly ask him about that, given what you have asked me.

Ms Alexander: There seems to be a wider public interest issue. When we had leading members of Lloyds Banking Group before us, they justified halving the charitable contributions by talking about stakeholder interests. In circumstances in which the taxpayer has stood behind the banks more than any other stakeholder, it would be folly for Lloyds to pray in aid stakeholder interest to justify the change to the covenant that was agreed by Parliament in the 1980s.

John McFall: I watched Archie Kane's contribution—perhaps you had him in chains—and I thought that he was shifting in his seat a little as a result of your questioning on that. Let us hope that Lloyds shifts even further.

Gavin Brown (Lothians) (Con): In advance of your appearance today, I picked up two key messages from what you said in the Sunday press. One was that we ought to stop beating ourselves up—I think that you dealt with that in response to Lewis Macdonald's questions. The other big message that I picked up was about the divestments that are being thrust upon the banks by the European Commission and in particular, from a Scottish perspective, the one that is being forced on Lloyds, with the divestment of about 185 Lloyds TSB branches. I think that you described that as a once-in-a-generation opportunity to change the landscape. If you could wave a magic wand, how would you like the position to develop in Scotland?

John McFall: One of my engagements—it is in March, I think—is to address the annual dinner of the Airdrie Savings Bank. When I got that invitation last year, I was delighted to accept it because I thought that it was fantastic that we had a small institution that had lasted 100 years and had not been nationalised by Government. It is nice to see small institutions doing well. Alternative, non-profit organisations such as mutuals have survived because they are more financially stable than larger corporations. They have weathered the storm more effectively than other organisations because legislation has meant that there have been restrictions on what they have done. They have served their communities. I would like that situation to be replicated for consumers.

The bankers will probably not like me saying so, but I feel that, culturally speaking, the banks generally do not understand consumers as well as, say, retailers such as Tesco, which understand the consumer and what the consumer wants. To a large extent, the consumer has been missing from the debate. Consumer representation in the UK is pretty weak, but it is even worse in Europe. We have an opportunity to build a consumer agenda to ensure that we get the necessary competition and that we attract new people into the field so that it is not just the traditional people—the five or six big banks—to whom the public can go. Do not let me give the impression that quite a number of those banks, such as HSBC and Banco Santander, are not doing a good job, but we need diversity if consumer interest is to be served. I would like the opportunity that exists in Scotland to be taken; I would also like the committee to look at the issue and to probe what the banks are for and what services they should provide to communities to ensure that we keep our manufacturing base, build ourselves out of the recession and have a stable system. I think that the committee has a role to play in that.

Gavin Brown: You mentioned the smaller institutions. Does your committee intend to look at the financial services compensation scheme, or has it already done so? Representations have been made to me by credit unions and smaller institutions in particular, which feel that the present set-up of the system is pretty unfair. Their argument was that the more stable and the safer the institution in question was, the larger the slice of the pie that they have had to contribute to the scheme. I know that your committee has touched on that, but do you see that work continuing?

John McFall: Yes. I have spoken to Graham Beale, who is the chief executive of Nationwide, and others on the issue, and I accept that the smaller societies have been unfairly treated. That goes back to the issue of a depositor protection scheme that involves prepayment. I mentioned that I visited Washington a year or so ago, when I spoke to the Federal Deposit Insurance Corporation and the American Bankers Association. Before I met them, I thought that everything that they said would be red in tooth and claw, but their message to me was that a prefunded scheme was hugely important. Such a scheme would involve the banks putting money aside in the good times so that the system could be fixed during the bad times, when things go wrong. If we do not have a prepayment scheme—a cash pot—we will end up relying on Government. That is the core issue.

The banks are not too keen on such a system at the moment, which is understandable. However, it needs to be impressed on them that they must make efforts in the medium to longer term, when financial stability has returned, to ensure that we have a prepayment scheme, so that the institutions that have the biggest contribution to make do so when they have the money in the pot, which would avoid the smaller institutions that have been more prudent facing a financial penalty.

Gavin Brown: Do you have any personal preference with regard to the divestment of 185 Lloyds TSB branches in Scotland? Should they be taken over by one new institution or divided among two or even three institutions? If you were in control of the landscape, how would you like it to develop?

John McFall: I have no particular preference in that respect. I have no objection to a takeover by one institution, as long as we can be satisfied that it has the right intentions and consumer focus. Indeed, size is still an important issue; one of the perverse consequences of the current situation is that larger corporations are able to borrow money much more cheaply. Just the other day, I read in the paper that the Clydesdale Bank was interested in Northern Rock. Of course, that is pure newspaper speculation but, from my discussions with its management and others, I feel that that particular bank has served the country's interests well, and it would be good if it could develop. As I say, I am not against a takeover by one large institution.

Gavin Brown: When the Lloyds takeover happened, the Office of Fair Trading's report on various competition aspects flagged up a couple of issues around personal accounts, mortgages and, in particular, business accounts in Scotland. Those concerns were overridden for quite important reasons but, at the time, the then Secretary of State for Business, Enterprise and Regulatory Reform said that the matter should be kept under review as things moved forward. Perhaps I am being harsh, but when the OFT gave evidence I did not get the impression that that review was being undertaken, apart from an occasional check of the newspapers to see what was happening. It certainly did not strike me as being anything more official than that. Does your committee intend to consider that matter, particularly with regard to the business competition issue in Scotland?

John McFall: As you know, this UK Parliament has only a few more months to go, but I feel that the issue should be on the Treasury Committee's agenda after the next election and should certainly be kept under review. I have to say that although I admire the management of institutions such as the OFT I have been hugely frustrated in my dealings with them. I remember that in 2004 the Treasury Committee pointed up the issue of unfair charges and reported it to the Competition Commission; the matter then went to the OFT and subsequently to the Supreme Court a couple of months ago for a decision that, five or six years after we first highlighted the issue, has put us all on our backsides. I, too, feel a certain amount of frustration in that respect and sympathise with your feelings. However, the issue that you have highlighted is on our agenda.

Going back to the Clydesdale Bank, I should make it clear that I am very much aware that it is now an Australian bank. However, there is a Scottish concept involved, which I believe reinforces the element of globalisation.

David Whitton (Strathkelvin and Bearsden) (Lab): First of all, I apologise for arriving late with my substitute's jersey on. It is very nice to see John McFall here.

With regard to interest rates, I believe that you said that you were told by the CBI about where all the investment is going. Not that long ago, at a meeting of construction industry people that I attended, two RBS representatives told the assembled gathering that the days of interest rates of 0.5 per cent above base rate were over. You will not be surprised to learn that the assembled gathering was somewhat hostile to that suggestion. I asked the RBS representatives why that should be the case, given that their bank was basically owned by the public and that even with 0.5 per cent it would still be making a profit. In desperately trying to repay all this money as quickly as it can, is the bank actually hindering interest rate policy? Is it as a result—and as you have suggested—not focusing on its consumers or catering for customers by offering them low-price interest instead of rates at 5, 6 or 7 per cent above base rate?

John McFall: When RBS and Lloyds come before our committee next week, I will certainly raise that point. I think, however, that the issue is more complex than you suggest. RBS is now such a global entity that, in order to get to grips with its many lines of investment, its management is having to disinvest. From reading yesterday's papers, I think that there might be problems with disinvesting in Pakistan as a result of that. The question that has to be asked is why there were so many different businesses in RBS. Stephen Hester still has to work out the consequences of that.

We cannot forget the issue of RBS and Lloyds eventually going back into the private sector. We want the taxpayer's interests to be preserved, so those banks and others should behave commercially. We must recognise that they have to exist as commercial entities. It is too simple to say that the days of interest rates of 0.5 per cent above base rate are over. We will certainly be asking Stephen Hester about that next week.

11:45

David Whitton: Of course, it is not just RBS; the other banks are at the same game.

John McFall: The interest rate is above the latest London interbank offered rate. At the moment, trust and confidence in the banking sector are missing outwith and within the sector, and that is reflected in the LIBORs that are being paid. That is why the banks are saying that money is more expensive, and why we need to ensure that we get back that trust and confidence. It is a wide agenda.

David Whitton: Would it be better to say to the banks that, instead of their working as hard as they can to divest themselves of the Government's shareholding, they should set a timescale of, say, 10 years so that they can get their houses in order before they even think about paying back the money?

John McFall: They should get their houses in order, and it should be done over a longer timescale; a period of five or seven years is being spoken about at the moment. However, I do not want the banks to undertake that if the taxpayer is going to be short-changed as a result. The IMF has estimated that the total exposure of the UK economy as a result of the banking crisis is £1.23 trillion, which is an enormous amount of money, and we must ensure that we get it back. However, we also want healthy companies to go back into the private sector. Therefore, the Government, which wanted separation, brought in UKFI so that it did not wholly own the shareholdings. That aspect is quite good: as RBS improves, as I hope it will—I think that the share price went up by about 10 per cent yesterday—that will give investors confidence and they will come back into the market. We must have a window on the markets in the outside world.

David Whitton: You are here to give evidence today, the FSA has also given evidence to the committee, and we have received written evidence from the Treasury. The one missing link is the Bank of England, which seems to think that it is only accountable to your good self and the House of Commons. Given that the Bank of England has a person based in Scotland, do you think that they should be willing to come before the committee as well?

John McFall: Mr Gibson tried that one on me.

David Whitton: I missed that because I was not here; I will ask him later.

Nigel Don (North East Scotland) (SNP): Good morning, Mr McFall, and thank you for coming through the snow to join us this morning.

I was looking at the Treasury Committee's 16th report, on European regulation, which was published on 16 November. Why on earth do we need European regulation if banks are regulated at the national level anyway? If the issue is a global one, why do we need someone to draw a boundary around Europe and say that they are going to do something in Europe? Is there any sense in that at all?

John McFall: Again, I refer you to this morning's newspapers and the President of Iceland's decision to veto the repayment of about £4 billion to the UK and others, and to stall on the IMF loan. We are part of the European Union, in which the concept of passporting prevails. It is important for us to consider Europe. RBS and others had substantial investments, not least in Spain with Banco Santander and others, so there is a European dimension to the issue, and we need to get Europe right. The report on macroprudential and microprudential regulation pointed to problems with the proposed European systemic risk board and with the lack of involvement of the Bank of England in certain committees in Europe, as well as to issues around cross-border banks and institutions.

The Treasury Committee visited Sweden a couple of years ago to examine the solutions that the Swedes implemented following the liquidity problem there in the 1990s, which resulted in the nationalisation of many banks. When we were there, we were told that Sweden had extensive interests in the Baltic states. The Baltic states' fiscal position is not very good at the moment, and the Swedish taxpayer could be on the hook as a result.

The issues do not concern just the UK; if we consider passporting, a Europe-wide community is involved, and we need to get the European issues right. I recommend to the committee the view that European involvement and understanding will help all of us.

Nigel Don: So you view Europe simply as a practical necessity. My question was about whether the boundaries of Europe are arbitrary in the context of a global industry. Perhaps the reality is that Europe is one of the areas within which we have to work.

John McFall: It is about globalisation. A system in Europe that works well is a force in globalisation, and it helps. It is an entity within the global entity.

Nigel Don: That takes me to another issue, which I picked up on in several of the reports on the matter. The institutions concerned are "too big to fail", but how do we operate in an environment where the opportunities are global, but where things must be picked up nationally, at the home of the bank, when they go wrong?

In one report, your committee expressed the desire for subsidiary banks or parts of banks to be domiciled and capitalised in specific national areas, with their capital protected within those national areas. Can you give me some clues as to the practicability of that?

John McFall: That is a controversial point, but if we want to prevent the sort of problems that were experienced in Iceland, the Isle of Man and Guernsey from appearing in future, and if we want to prevent UK citizens from banking elsewhere, with their money not protected, we must consider such issues, so they are very much on the agenda.

Nigel Don: That idea might be on the agenda, but do you really see it as a practical solution? If you believe in freedom of capital, how can you have non-freedom of capital and capitalisation in a nation state when we are dealing with global banks, which may move their money around?

John McFall: That goes back to the core issue of financial stability and volatility. We have an unsafe banking system at the moment. Do not take my word for it—Nicholas Brady, former US Treasury secretary, wrote about the issue in his article yesterday in the *Financial Times*. We need to consider such issues if we want to fix the system.

Why should the UK, Spanish or Swedish taxpayer be put on the hook for something that happens in another country? We have to sort that out, and that must be on the European agenda. There might be a reluctance to consider the matter at the moment, but that does not mean that politicians should not attack it with vigour.

The Convener: I have a question about the devolved model. Under the Scottish devolution settlement, financial regulation is clearly reserved to the UK Parliament and Government. However, the Treasury has acknowledged that Scotland has a particularly important financial sector. The Treasury, the Bank of England and the Financial Services Authority say that they take account of the interests of all countries and regions, including Scotland, in their deliberations. Do you think that the particular interests of Scotland are taken account of adequately when regulation is considered?

John McFall: It is perhaps for others to judge, but I am sure that such considerations can be developed. I encourage you to take up the offer from the Bank of England's agent.

In the next couple of weeks, we will go to other parts of the United Kingdom that may feel the same as you—actually, I do not know whether that has been announced officially, so we are going somewhere that I cannot announce. [*Laughter.*] You will know about it. Given the global context, we must ensure that a foot is placed firmly in every part of the country.

The Convener: As we all have an interest in the area, should we be redefining the relationship between the devolved Administrations and the regulatory authorities, the Treasury and the House of Commons to ensure that we can all engage in the process? I am not talking about accountability; I am talking just about engagement.

John McFall: Why don't your clerks communicate and we will have a meeting before the general election? After that, I may not be here.

The Convener: Okay—fair point.

My final question relates to the issue of competition, which has been touched on. The divestments that the European Commission is requiring of RBS and Lloyds effectively leave the competition situation in Scotland as it was before the Lloyds TSB takeover of HBOS. Do you think that that is adequate to deal with the problems around the lack of competition in the Scottish market?

John McFall: No, I do not think that it is adequate. There are areas that we must look at. I mentioned mutuals. One of the sad things about the situation is the fact that all the mutual building societies that went plc have gone down the tubes as a result. We need to look at the not-for-profit model. As I said earlier, if you want an advocate for that model, you have Adam Smith. We need to look at the issue of mutuals and the different types of credit providers. The Government must also make it easier for non-financial entities to enter the market. That is an issue for politicians to consider, as Governments have perhaps not been alert enough to it. For example, I would like to see Northern Rock mutualised but I know that if I went to see the chancellor about it, he would say, "Right, John. You give me £15 billion and you can take it." There is an issue there, but we need that kind of diversification on the agenda. What could Governments do about reduced competition? Could they cap rates and charges? That is another issue to put on the agenda. I am not advocating that that should happen, but there is a lively debate to be had on the subject.

The Convener: The EU has said that it is looking for new entrants to take over, for example, the Lloyds TSB branches in Scotland. Where do you see those new entrants to the market coming from, given the capitalisation requirements that they would have to satisfy? How could a new entrant—a new mutual, for example—possibly get involved? As the committee's convener, I have been asking witnesses how new entrants can come into the market. Are we just going to see a takeover of the divestments by large banks from outwith the UK? The Brazilian banks are sniffing around, for example.

John McFall: With mutuals, I have contributed to an Oxford University report on a way forward on that issue. We will leave a copy of that report for the committee to read.

The Convener: That would be very helpful.

That concludes our questions. It has been a long but interesting session. I thank you and Eve Samson for coming along to give evidence to the committee today. It has been extremely helpful. Let us hope that the co-operation between our committees can continue into the future and beyond the next general election, whoever takes over in your role. On behalf of the committee, I congratulate you on the work that you have done as the chairman of the Treasury Committee over the past two Parliaments. I am sure that you will be missed in that role.

John McFall: Thank you.

The Convener: Next week, we will continue our financial services inquiry but we will move away from banking and focus on the other parts of the financial services sector in Scotland. It will be a busy meeting, with other business before us concerning legislative consent motions and statutory instruments. I therefore ask members to be here and lively at 9.30 next Wednesday.

Meeting closed at 11:59.

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